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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 2

JULY 29, 30, AUGUST 6, AND 7, 1970

Serial No. 91–90

Printed for the use of the Committee on Commerce

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U.S. GOVERNMENT PRINTING OFFICE
50–934 WASHINGTON : 1971

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FAILING RAILROADS

WEDNESDAY, JULY 29, 1970

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

The committee met, pursuant to notice, at 10 a.m., in room 1318, New Senate Office Building, Hon. Vance Hartke, presiding.

Present: Senators Hartke and Cook.

Senator HARTKE. The committee will come to order.

OPENING STATEMENT BY THE CHAIRMAN

The Commerce Committee is in charge of communications and can't get the microphones to work. I am not too sure we can get the railroads running either.

Good morning, Mr. Perlman. We are gratified you are here as a witness. As I explained to you personally, I sincerely regret that your appearance, which was scheduled originally on July 15, was unavoidably and suddenly postponed. I want to thank you for your gracious cooperation, and I want to give you my apologies for the inconvenience that was caused to you personally by these rescheduling difficulties.

We are continuing our hearings on the rail loan guarantee bills. Since the bills were prompted by the problems of the Penn Central—although they did not get up here quick enough to prevent its filing for bankruptcy—we are very much concerned to learn what happened in the Penn Central to bring about its collapse. The Penn Central was created just 2 and a half years ago amidst glowing reports of great savings to be occasioned by the merger, of vastly improved service, and of rationalization of the rail system in the Northeast.

Today we have this huge carrier in reorganization: throughout the Nation people are injured because debts will not be paid. Employees' paychecks have been questioned in some instances at banks. Headlines raise questions about continuance of railroad services. The fate of other railroads—who are inextricably bound up with a system as large as the Penn Central—are also brought in question. Transportation service suffers throughout the East and the country.

The Penn Central has been involved in the conglomerate merger movement. We want to know if its railroad business suffered through diversion of assets; has management's attention been so concentrated on acquiring other businesses that it has not devoted enough time to the railroad business? These are some of the questions which have been in the mind of the committee and have been brought forward in the hearings.

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

The corporate structure of the Penn Central is so complex that we have not been able to get a clear picture of the company's condition. We can well wonder whether the Penn Central's own management was similarly bewildered.

Mr. Perlman, we are pleased that you could come down and we look forward to hearing your testimony.

STATEMENT OF ALFRED E. PERLMAN

Mr. PERLMAN. My name is Alfred E. Perlman. My railroad career started at age 15, 52 years ago during summer vacation from high school as a locomotive cleaner, known in the days of steam as an engine wiper. Subsequently in summers, I worked as a coach cleaner, when I got out of school, as a track laborer, and eventually became chief executive officer of the New York Central, a position held by me for a longer term than any other chief executive officer on that system. Upon merger of the New York Central and Pennsylvania, I became president and chief administrative officer of the merged railroad, with the real work of putting the two railroads together both physically and from the standpoint of the people in the organization.

The Reconstruction Finance Corporation borrowed me from the Northern Pacific Railroad in 1934. My assignment was to study and recommend programs to help the various then financially troubled railroads of the United States. By strange coincidence my first railroad study was of the New Haven which was then on the verge of bankruptcy, and later went into bankruptcy. The last was in 1935, on the Missouri Pacific who had had a $23 million RFC loan and applied for an additional $75 million. Unfortunately, the study made by me and two associates disclosed that the Missouri Pacific could not service that amount of debt in the foreseeable future and we very reluctantly saw the property placed in the hands of the court.

The RFC loaned many railroads large sums during that period and helped avert several bankruptcies. At the same time, it has a record of being repaid all the money it loaned to the railroads.

In 1936, I was again borrowed, this time from the Burlington Railroad by the Federal Court which had jurisdiction over the reorganization of the Denver & Rio Grande Western. That railroad had just gone bankrupt for the fourth time, and had not paid a dividend in the 76 years of its existence. The court asked me to make a study of the steps necessary to rehabilitate the railroad and make it a viable system. It had been in the hands of the same Federal judge in three reorganization proceedings, and he was determined that this time would be the last.

What started as a 2-year leave from the Burlington lengthened out to 18 years, and the Denver & Rio Grande Western, which competed on one side with the Union Pacific and on the other with the Santa Fe—two of the strongest systems in the country—became one of the most prosperous in the region. In the 5 years after its reorganization, the stock was split 1½ for 1, 3 for 1, and again 3 for 1. So even the bondholders of the defunct company were paid handsomely,

if they had the faith to hold onto their securities. In fact, the stock that came out after the reorganization at less than $5 a share, was worth $265 within 5 years.

In June, 1954, Robert Young invited me to become president and chief executive officer of the New York Central system. He took office as chairman at the same time, and after a week in office, discovered that the railroad was on the verge of bankruptcy. He asked me, "Aren't you terrified?"

Four months later he wrote me:

Dear Al: The preliminary October 15 man count on the Central is 74,700. This compares with 89,700 June 15 * * *. Miracles can still happen with an ownership board and a good all-around organization wrapped up in one man—the president.

Sincerely,

Bob.

October 18, 1954 marked a turning point in the fortunes of the Central. In 4 months, the payroll had been reduced by 15,000 people with no detriment to the service, and this would mean something like $165 million savings at this time, and we were on our way toward a 14-year plan of rehabilitation that would see the number of employees cut in half, better service to the customers, a reduction in debt, and a profit to the owners. 1967 was one of the most profitable years in the Central's history.

In 1968, just before merger, New York Central's income from ground rentals in New York and other real estate properties paid its fixed charges. Even if it had made no profit at all on the railroad, it still had a cash flow of $70 million a fear from depreciation, scrap sales and sales of unneeded operating properties.

At that point in time, the New York Central was in fine shape. We had prepaid over one quarter of a billion dollars in debt in the preceding 5 years, and with the exception of a small number of big four 4½'s which come due in 1977, we had no long-term debt coming due until 1992.

This hearing reminds me very much of a similar one in 1957 before the House Interstate and Foreign Commerce Committee, whose chairman was former Congressman, now Judge Oren Harris. The issue was identical—that committee had under consideration a bill which would have guaranteed loans totalling $500 million to ailing railroads.

At that hearing, my opening statement was to the effect that were I dying from an incurable disease and in severe pain, I would not ask for some kind of pill which would keep me living longer but in the same pain, just so the States and communities could be paid their taxes and other tribute.

My state of mind is exactly the same today. The Transportation Act of 1958 resulted from those hearings. It was clearly the intent of Congress in enacting that law that the railroads were to have greater freedom in making rates, and that rail rates were not to be kept artificially high in order to protect other competitive modes. Yet, thanks to Commission in the Ingot Molds case, and court decisions, we are virtually where we were 12 years ago in this regard.

Another section of the act in 1958 was clearly intended to permit the discontinuance of passenger trains, whose losses could be shown

to be a serious burden on interstate commerce. Many such trains were discontinued under that section, but many are still running. So many, in fact, that Penn Central lost $104 million in 1969 in passenger train service on the fully allocated system prescribed by the Interstate Commerce Commission.

Now, as I contemplate the fact that President Kennedy, in his first transportation message to the Congress, said the national transportation policy is "a chaotic patchwork of archaic regulation," and as I contemplate the fact that, since he made that statement nothing has been done to alleviate this—in fact, it has become more chaotic than at that time—I worry, as a taxpayer, about the Government loaning money to an industry which is not permitted to compete on equal terms with its peers.

When I see the billions poured out in building the Interstate Highway System which the newspapers on Tuesday said would cost twice the dollars first contemplated, huge sums spent by the Army Engineers dredging the canals and other waterways, and the tremendous Federal funds being poured out to expand airports and to pay the Federal controllers who land the planes for the airlines, and for research and development of new aircraft, I hesitate to say "me too" for the railroad industry.

However, when one considers that the steel wheel on the steel rail is still the most efficient method of conducting mass transportation, I think it is tragic to see this form of transportation relegated to the ash heap by the unequal burdens which are placed upon it.

I would like to put into the record two editorials in this morning's New York Times. One is headed "Too Much for Highways" and the second "Not Enough for Rails."

Senator HARTKE. Both of those will be included in the record, yes.

Mr. PERLMAN. Thank you.

(The editorials follow:)

[From the New York Times, July 28, 1970]

IN THE NATION: HOW TO HELP THE MOTORIST

(By Tom Wicker)

WASHINGTON, July 27—Many an American has recently been trapped in a crawling line of freeway traffic, awash in fumes and frustration, as he headed with his family for the seashore or the mountains. In the heat of that ordeal, his first impulse surely would be to egg on a Congress that is getting ready to increase the national investment in the Interstate Highway System to $75 billion. But maybe we all ought to think again about the implications of that investment.

The interstate system was authorized in 1956, with its total cost estimated at $41 billion. Any day now actual spending on the 70 per cent of it that is completed will pass that figure. Federal participation already is authorized for $50.6 billion, the Department of Transportation has requested $12 billion more and a House subcommittee is reported ready to add $5 billion to the request. The total cost (on the 90–10 Federal-state financing scheme) will thus rise past $75 billion when the system is completed, maybe in 1978, maybe not.

The 30,000 miles of the interstate system now in use form is no doubt as splendid a primary highway system as any nation can boast. Yet is it only a small part of the total freeway and toll-road system, to say nothing of all the other highways required for the 90 million automobiles on the roads in America, and the 3 million that join them every year.

In June, Senator Jennings Randolph, the chairman of the Public Works Committee's subcommittee on roads, reported the staggering fact that the Na-

tional Organization of State Highway Officials "estimate[s] that the national highway needs for the next fifteen years will cost $320 billion." That is just under the present national debt, which was about $375 billion at the end of the 1970 fiscal year; it is more than $21 billion a year, Federal, state and local, just for highways.

AGAINST DIVERTING FUNDS

Senator Randolph is well aware of this cost; he proposed to use part of the Highway Trust Fund to help develop bus transportation systems that would limit the need for more highways. But that would be a minor relief, at best, and the Senator left no doubt that he would stand firmly against diversion of any part of the trust fund to other transportation modes or programs. This has a surface validity because the trust fund, which puts $4 to $5 billion a year into highways, derives from highway user taxes.

ADVANTAGE OF AIDING RAILS

But compare, for instance, the annual outlay from the trust fund, not to mention the $21-billion total annual estimate of the state highway officials, to the proposed expenditures of the national rail corporation the Senate has approved. To operate the entire national railway passenger network, it would get loan guarantees of $135 million for buying new equipment and a Federal appropriation of $60 million—not annually, but one time only.

Yet, one railroad line can handle—without pollution—as many people in the same time span as ten to twenty lines of highway; the advent of the Metroliner increased rail passenger travel in the Northeast corridor by 50 per cent in eight months, easing by that huge amount the pressure on highways and airlines. In Japan, the new Tokaido line's "Bullet" trains are carrying over 200,000 passengers a day. Upgraded train service between major British cities has resulted in a 60 per cent increase in rail passengers.

Moreover, if the Federal Government would fundamentally alter national transportation priorities by buying up, refurbishing and then operating all the passenger and commuter rail lines in the country, the cost would not even approach $320 billion in fifteen years. Plenty would remain for reasonable and necessary highway expenditures.

Congress must certainly keep its commitments to the states for the interstate system, but the nation need not go on forever in its disastrous, near-total commitment to the one mode of transportation—the private auto—that is least efficient and most costly and destructive. When the Highway Trust Fund is renewed in 1972, some of its income could be diverted to mass transit and intercity rail systems; and by relieving the pressure on highways, that would serve the motorist better than any other single step.

[From the New York Times, July 29, 1970]

TOO MUCH FOR HIGHWAYS . . .

Congress and the American people are nearing a fundamental decision on transportation policy revolving about the Highway Trust Fund, which is scheduled to go out of existence on Sept. 30, 1972. The Nixon Administration has asked Congress to extend it for another four years, and House and Senate committees have begun hearings.

Established in 1956 to finance the Interstate Highway System, the fund is fed by the Federal tax of four cents a gallon on gasoline and by lesser excise taxes. Since this money can only be used to build new highways and since the Federal Government pays 90 per cent of the construction, the mere existence of the fund is a self-perpetuating engine which generates tremendous pressure on the states to go ahead with ever more ambitious road projects. The fund's annual revenue now approximates $5 billion and over the next several years will inexorably rise to $6.5 billion. Is it really necessary to spend this vast sum each year on new highways?

By contrast, only $156 million was spent in the last year in Federal aid for subways, buslines and other forms of urban mass transit. In the past dozen years, $50 billion has been spent to build highways, fifty times as much as the

Federal Government has devoted to mass transit. It is now expected that the Interstate Highway System will cost almost twice the original estimate—$75 billion instead of $41 billion.

It is not sound public policy for Congress to freeze such large tax revenues in any fund devoted to a single narrow purpose. But Congress has become wedded to the trust fund concept, and private interest group pressures make its abolition highly unlikely. This year a fund to finance airports was created.

As a practical matter, the issue before Congress is whether the highway and airport funds can be broadened into a single Transportation Trust Fund. Urban mass transit, railroad passenger service and other transport needs could then be considered and reconciled in accordance with a rational plan. The bankruptcy of the Penn Central, the inadequate service on the Long Island Rail Road and other commuter railroads, the headlong decline in railroad passenger service and its actual disappearance in many states, the ever-intensifying traffic jams in every city, and the shortage and undependability of bus service in both cities and suburban towns are the exhausting evidence of the lack of a coherent policy.

The nation's governors and mayors are urging Congress to introduce flexibility into the operations of the highway fund. They want each state to have the option to use part of its Federal highway funds for mass transit. Representative Edward I. Koch of Manhattan and other members of Congress are pushing bills to allocate the 7 per cent auto excise tax, which now goes into the Treasury's general revenues, to a new Urban Mass Transportation Trust Fund as a transitional step toward a merger of all the transportation funds. Senator Jennings Randolph of West Virginia has introduced a modest measure to permit the diversion of Federal highway funds for operation—but not construction—of mass transit in urban areas.

Secretary of Transportation John A. Volpe is well aware of these rising pressures. But he has been notably timid in offering any leadership for reform. In presenting the Administration recommendations for extension of the Highway Trust Fund, he recognized the desirability of balancing mass transit against the imperious demands of the truck and the private automobile but he ventured nothing more than a pious acknowledgement. He suggested no change except to make safety research and the pathetically starved program for removal of billboards eligible for comparatively small sums from the Highway Trust Fund.

Naturally this feeble proposal evoked ritualistic outcries from those well-known enemies of common sense, Representatives John C. Kluczynski, the Chicago Democrat who is chairman of the roads subcommittee, and William C. Cramer, the Florida Republican who is the ranking minority member. Messrs. Kluczynski and Cramer have been vocal and attentive servitors of the highway lobby for many years.

If Secretary Volpe defaults to the highway lobby, the nonpolicy of the last fifteen years will continue to prevail with increasingly disastrous consequences. The time of decision is rapidly approaching. Whenever it comes, the battle for a rational, balanced transportation policy is sure to be hard and bruising. The longer Secretary Volpe is timid and evasive the less likely is a victory for the public good.

. . . NOT ENOUGH FOR RAILS

"My God, my God, now I know what hell looks like," a dazed young woman gasped as she was led from a stalled train through the Penn Central Railroad's smoke-filled Park Avenue tunnel.

This commuter's vision of Hades was the result of what another Penn Central passenger grimly described as "our semimonthly Monday-morning fire," a blaze that flared up after a third-rail short circuit. It followed by just two weeks another fire on the Penn Central's tracks—at the Harlem River drawbridge—that also caused anguishing delays, though less discomfort and peril, for thousands of railroad patrons.

Rail commuters have been relatively lucky—so far. At least there have been no serious injuries in Penn Central's latest two major mishaps. Two weeks ago 37 subway passengers were injured in Brooklyn in an accident that also sent commuters groping their way through darkness in the Metropolitan Transportation Authority's own version of the netherworld. That was the second major subway accident in New York within two months, the fourth in seven months.

These ominous breakdowns in the metropolitan area's mass transit system have been met with bland assurances by transit authorities. "Believe it or not," a railway spokesman commented, "service on the Penn Central is getting a lot better." One thing is sure: it could hardly get worse. Dr. William J. Ronan, chairman of the MTA, boasted after the latest subway accident: "The New York subway system is still the safest in the world."

A New York Times survey of the record of other major subway systems in the world casts doubt on the validity of that claim. At any rate, commuters who have experienced the dark in the tunnels are not going to be satisfied with such evident complacency, nor will anyone else who has watched the mounting record of mishaps.

It is time transportation authorities owned up more frankly in public to the gross and dangerous inadequacies of the neglected facilities they have inherited and more vigorously led the fight for the massive public investment that is essential to give this city and the nation the safe and reliable mass transit systems they urgently need.

Mr. PERLMAN. I would also like to ask that an editorial which appeared July 8 in the New York Times be made a part of this record and I should like to read it to you because I think it is very important.

Senator HARTKE. All right.

Mr. PERLMAN. It is headed "Avoiding More Penn Centrals * * * "

In its last desperate efforts to avoid bankruptcy by seeking a $225-million short-term loan guarantee from the Department of Defense, the Penn Central submitted a confidential financial plan and forecast. This plan indicated that Penn Central's management expected to lose $271 million this year. Next year, however, it would have done better: management foresaw losses of only $221 million.

I would like to make this plain these are not my figures. This is after I had any responsibility for these figures. But I am just reading the New York Times.

It is distressing that it has taken this Penn Central catastrophe to focus national attention on the railroads. In working out a better national transportation policy, however, one must avoid overgeneralizing from the Penn Central case. Not every railroad is in trouble; some are doing quite well. Policies to reorganize and rebuild the Penn Central must not impose a rate structure or system of subsidies that will destroy what health is left among American railroads.

The Association of American Railroads is petitioning the Federal Government for more than $1 billion a year in subsidies, warning that if these are not forthcoming the nation will face "an ever increasing number of bankruptcies." Before the Government plunges down the subsidy route, it must take a probing look at the regulatory policies and practices that have done so much to produce the existing situation. A major reason why the old Pennsy diversified into real estate and other nontransportation ventures is that Government regulators would have blocked it if it had sought to move into trucking, barges, aviation or any other part of the transportation business.

Yet one of the basic solutions to the nation's rail and general transport problem may be to permit the development of horizontal integration among different modes of transportation. Unified transportation companies would be able to offer the public a range of services that could be produced by using the mode—whether freight cars, trucks, barges, or planes—that could do the best job with the least resources.

Instead, archaic forms of regulation have chopped up the supply of transportation into discrete categories. Rates are set with scant regard for the lowest costs and most efficient means of providing services. This sort of regulation is one reason for the low profitability and, to a considerable extent, the poor managerial practices of many railroads. By damaging profitability, it also accounts in large part for the poor record on technological innovation.

I might say the United States is the only country in the world that does not permit integrated transportation. And it is not by law, it is

by bureaucratic fiat of these various bureaus. And I think it is tragic.

Up in Canada, the Canadian Pacific has airlines that span the world, steamship lines that span the world, truck lines, and no one says that it is in anything but the public interest.

Without a thoroughgoing modernization not only of the technology of railroads but also of Government regulation and of the structure of the transportation industry, there will be an endlessly growing financial burden upon taxpayers—accompanied by a gradual worsening of services. In such a case, it might be better to nationalize the roads and have done with it, rather than pour billions into an allegedly private enterprise that is absolutely essential to the country and yet cannot keep its head above water.

I agree with everything except the last sentence.

I would like to talk for a moment about nationalization which I haven't in this record. But, I was head of the delegation to the International Railway Cybernetics Conference in Tokyo about 3 months ago. I have headed these conferences for the U.S. railways all over the world. And this is the computer and communications end of the railroad business. The Japanese national railroads had a bulletin there showing the financial situation of the Japanese railroads since the year 1960. The Japanese railroads have only about 20 percent freight, because most of their industry is on water, on the islands, and most of it is passenger business. The other 80 percent. They made a profit up until 1963, through 1963, on their railway, they made a good profit. The Tokaido line was cut in during the fall of 1964. In that year they lost, for the first time in that decade, money. And they lost about $90 million. The next year they had the line cut in for the whole year and they lost $340 million.

The next year they increased their rates 31 percent, passenger rates, for everything, commuter lines and everything, and they still lost about $170 million.

I am giving you rough figures, because this is in yen here.

The next year they increased the loss 50 percent over the year before and the next year they increased the loss 50 percent. They are now losing over $500 million a year.

I was in Tokyo 3 years ago and the Japanese railway officers weren't permitted to go out on the railroad with me because the Japanese Congress was holding an investigation of why the railroad was losing so much money at the time. So I don't think nationalization is any cure for the situation.

Dealing specifically with the Penn Central, the new system of interstate highways and the expansion of other forms of transportation in the Northeast quadrant, the flight of heavy industry to the West and South where labor and other costs, including taxation, appeared more favorable, caused the relative volume of business best handled by the railroads to steadily decline. New England, where I went to school had been the heart of the leather and textile industries, as well as heavy electrical and other machine manufacturing, now has a new type of light industry based on electronics and similar products. The traffic of these light industries does not offer high volume tonnage to the railroads.

The St. Lawrence Seaway was built on the promise of being self-sustaining, but it has not begun to live up to that promise. The re-

sult is that even the subsidized American Merchant Marine, paying wholly inadequate tolls, cannot compete with foreign flagships and have gone out of business in the St. Lawrence Seaway.

The foreign bottoms dump foreign goods into the Midwest in cut-throat competition to American producers. Moreover, their rates to the lake ports are generally the same as rates for east coast delivery, and preclude any profit on rail shipments made from Atlantic coast ports to inland receivers.

As a result, American steel mills have practically given up the production of certain products. For example, there is no longer any significant domestic production of barbed wire. Domestic production of steel reinforcing bars has virtually dried up. It is a disturbing sight to see thousands of foreign automobiles being unloaded in Detroit from foreign ships.

By the same token, the tremendous volume of interstate highways built in the Northeast section of the country and the rapid expansion of air facilities contributed to the declining volume of rail traffic. Rail capacity was seriously underutilized, and the cost of maintaining the excess capacity became an ever increasing burden. Reduction of the excess capacity was imperative, and mergers provided an obvious and perhaps the only solution.

I was schooled under Professor Ripley of Harvard, who was commissioned by the ICC under the Transportation Act of 1920 to study the possibility of achieving competitively balanced rail systems in the United States. Further, I had a keen interest in the formulation of the so-called Prince Plan for consolidation of the railroads. It was my belief that a system composed of the B. & O-C. & O.-New York Central to compete in the East with a system composed of the Pennsylvania and their controlled Norfolk & Western and other satellites would be the optimum competitively balanced solution. This would have divided between the two systems the profitable Pocahontas coal and likewise have distributed the passenger deficit burden equitably among the two systems.

Unfortunately, the Interstate Commerce Commission refused to recognize the need for regionally balanced systems. In the C. & O.-B. & O.-Central proceedings, the examiner in the case specifically excluded from the record, testimony looking toward the creation of competitive balance in the region.

Despite my earlier leanings toward a consolidation of Eastern railroads into two systems, the Penn Central can be made to work and the resulting system can be viable. We recognized almost from the beginning that we would have to pay certain penalties as a price for the merger, and that, for a time, these penalties would more than absorb any merger savings. We calculated that, during the first year after merger, these penalties would exceed the attained merger benefits by $82 million. This resulted from the fact that we were required to reinstate over 5,000 former employees who were no longer needed but had been on the payroll when the merger agreement was signed. These people could be removed only by normal retirement or death, unless they agreed to separation upon the payment of a certain amount of salary. It averages about 16 months.

There were other penalties prescribed by the ICC. One of these required us to indemnify other railroads for fluctuations in their busi-

ness caused by the merger. We were also required to take over, at a fantastic cost, the bankrupt New Haven, which had shown a $22 million deficit the previous year.

In the second year, 1969, the cash loss after merger savings was estimated to be $53 million, stemming from the same causes.

This year, because of merger savings and attrition, the cash loss was estimated to have been $3 million. Next year, when a substantial part of the merger savings were to have been realized, a cash savings of $31,000,000 was to accrue to the company, and in 1972, these savings were estimated to become $60 million. The full $81 million savings were expected to be achieved in 1973.

Therefore, we knew that we faced substantial losses in the first 2 years from these causes. On top of that, in order to achieve the merger savings, we had to spend a large amount of cash on the physical plant. For example, we had two passenger stations in Chicago. We had to construct a physical connection between the tracks so that one station could handle all the business previously handled by two. This was true of freight yards in 35 cities. Not only were connections required but, because one facility had to handle the business of both former railroads, very substantial increased capacity had to be added to 10 of the yards. The cost for this work at the end of 1969 amounted to $121 million and resulted in savings of $74 million annually. Where we had expected to get $81 million by 1975, we already had $74 million in 2 years of the merger. We have heard a lot of carping from some sidewalk superintendents about what happened in the last 2 years. But I think this is an amazing performance to have been able to speed up the merger of these two companies physically as quickly as has been done. Because the more quickly these changes could be made, the more quickly we could achieve the savings necessary to offset the tremendous penalties we accepted as a price for approval of the merger.

Despite these penalties, Penn Central would not, in my opinion, be in reorganization today had it not been for other circumstances. These circumstances include a recession in the industries which provide a large part of our profitable traffic, the inflationary spiral in wages and material costs, coupled with our chronic inability to keep pace by increasing rates, and the present extremely high cost of money. For example, Penn Central is the largest transporter of automobiles. Steel is more subject than any other industry to cyclical changes in the economy. You gentlemen are all aware of what has been happening in these areas.

Railroads have one of the highest ratios of labor to overall operating expenses of any industry. Inflationary trends, which have increased wages far beyond any possibility of meeting these increases with increased productivity, have put a profit crunch on the industry that cannot be met by the present system of rate increases.

It is historical that rate increases follow wage increases in our industry by about a year, and in many cases are not achieved even at that time. With the tremendous inflation in wages, taxes and material prices, railroad rates are still lagging at 1958 levels.

I am told that wage increases which the Penn Central is now paying, including fringe benefits, are running 10½ percent above last

year, and the rate increases which have so far been received, in the overall, will probably not be over 3 percent.

Since an average of two-thirds of railway costs are fixed and one-third variable, this has had an impact on many other railroads, and I note that despite an increase in revenues, the Santa Fe's net is down 41 percent for the second quarter of this year as contrasted with last and the merged Burlington Northern shows a net of 25 cents per share for the second quarter compared with 57 cents for last year. And the rich N. & W. has found it necessary by this morning's paper to reduce its dividend. Add to this the unavailability of money, even at rates which would have been thought usurious a couple of years ago. This alone has added enormously to the burden of even the more efficiently managed railroads, which had a high debt structure because it was not reduced through former reorganizations, as were many of the more marginal lines.

Further, the securities markets have felt the effect of the inflationary spiral so that the value of collateral used to secure loans has tumbled to prices which can no longer support the loans. This also greatly aggravated the Penn Central cash situation.

When we merged the N. & W. stock was around 130 and it is 60 today and this was collateral for a great many of the loans.

On top of all this, both the Pennsylvania and the New York Central were, prior to merger, the largest handlers of mail in the United States.

Just about the time of the merger the Post Office Department diverted mail from rail passenger trains to air and other means, causing a tremendous loss in revenue. Not only were we faced with the loss of revenues, but the thousands of employees on our payroll engaged in handling mail had to be kept on our payroll or paid off. The Government didn't pay off the mail handlers. Yet the passenger trains which had been handling the mail were not permitted to be discontinued under what amounted to a freeze on discontinuances by the ICC.

The combination of all these factors makes necessary some method by which cash can be made available to meet the falling working capital position of railroads and to make funds available to provide rolling stock, physical improvements and automation. These investments in plant will help to attain an increased productivity to meet in some part the spiraling wage costs.

I have with me the 1969 improvement budget which was not even submitted to the board of directors by the chairman because of lack of cash. And yet this contains items which would permit over 200 percent return on the investment if we had the money to do the work. This is a total budget. It is in three categories. One category is what has to be done for safety, the bridges that have to be rebuilt, track that has to be rebuilt, the ballast that has to be taken care of.

The second category is the items that have to be done for holding the business we have or getting new business. Liek new spur tracks for new industry coming in, or certain kinds of freight cars for the automobile industry, or the steel industry.

The third category is made up of what savings could be made through technology, if we had the money to do the work. And these

are three categories of the savings that could be made through technology. One is 35 percent to 50 percent, one is divided 50 percent to 75 percent, and these are savings over 75 percent in this third book.

Senator HARTKE. Those will all be included for reference in the committee files.

When was that submitted?

Mr. PERLMAN. That was submitted almost a year—let's see. It was submitted in the fall of 1968 to the chairman of the board.

Senator HARTKE. For implementation following that for your next budget year, right?

Mr. PERLMAN. That is right.

Senator HARTKE. What was the total amount of that budget request by division? Can you give us that? You have three divisions.

Mr. PERLMAN. Yes. I will have to take a little time to dig that all out here. I will submit it to you.

Senator HARTKE. The reason I asked that, Mr. Perlman, is simply to determine—an item I want to return to later—the availability of resources to make those improvements that you have designated there. In other words, you had a priority list of basically three groups as I understand it.

Mr. PERLMAN. That is right. We had to do the safety items.

Senator HARTKE. Yes, you had to do that. That is a requirement necessary for your operation. But that did not provide the biggest return, isn't that true?

Mr. PERLMAN. It didn't provide any return practically.

Senator HARTKE. Well, it provided a savings over failing to make the safety improvements——

Mr. PERLMAN. Well, if a bridge corrodes, if the steel corrodes and has to be replaced, that is no real saving. And the same way the rail wears out and you have to put new rail in, so there is really no saving there.

The second item, where you can get more business is an item that is very important, because your operating ratios depend on two things, your revenues and your expenses. You can cut expenses but if your revenues drop at the same time your operating ratio is just as badly off and the net income is just as badly off.

Senator HARTKE. Yes; I didn't want to interrupt you, but maybe I will at this point.

There was a basic division in concept of operation between the Penn and the B. & O.; is that correct?

Mr. PERLMAN. B. & O.?

Senator HARTKE. A basic difference between the New York Central and the Penn as to how they looked at what business they wanted? Let me put it in a question form.

Basically the Penn looked for big volume?

Mr. PERLMAN. Yes.

Senator HARTKE. And the New York Central did more of theirs on a selective basis, looking for profitable business rather than on massive volume?

Mr. PERLMAN. That is correct. The New York Central had a very intelligent and aggressive marketing department to work out which were the most profitable items and which should be solicited, what

time should be spent by salesmen and others in trying to get that business. And the Penn, which had been basically a railroad built around the steel industry, and a heavy volume of coal, ore, and steel, was more interested in getting volume and did not go into the profitability as much as the New York Central.

Senator HARTKE. When did the New York Central institute this new marketing concept?

Mr. PERLMAN. About 9 years ago. It was among the first railroads in the country to do that. The old traffic department was the sales department of the railroads. And we divided the traffic department into two departments, sales and marketing. The marketing people made studies of what traffic was available, competitive traffic, if it were priced properly, what traffic should be priced at, to be profitable, and what traffic the sales department should concentrate on in its solicitation.

Senator HARTKE. In reference to these budget items you referred to here, can they be made available to the committee?

Mr. PERLMAN. Oh, yes, certainly.

Senator HARTKE. Fine. We will include them by reference, not reproduce them in the record. They will be included as a part of the committee file.

Mr. PERLMAN. Yes; I just marked a few that are over 100 percent in return in here. I think you will find them very interesting.

Senator HARTKE. Let me proceed now on this basic conceptual difference as to operation in the field of marketing.

Was this concept which the New York Central used of going toward profitable business as contrasted with big volume (which was the concept used by the Penn Railroad prior to the merger), which concept was the prevailing one after the merger?

Mr. PERLMAN. Well, after the merger the man in charge of this department happened to be a Penn officer and I don't think he was too interested in the marketing situation. But he was later changed.

Senator HARTKE. How long did he stay?

Mr. PERLMAN. He stayed until I left.

Senator HARTKE. All right. Now I think this maybe puts in focus a little bit some of the problems as they appear at least on the surface.

Who did he report to?

Mr. PERLMAN. Ostensibly to me.

Senator HARTKE. Yes, but if you had had the really complete authority, you would have instituted the same type of marketing concept that was used effectively by the New York Central?

Mr. PERLMAN. That is correct.

Senator HARTKE. But because of the situation after the merger. you did have the Pennsylvania man who, although theoretically reported to you, in effect did not report to you; is that correct?

Mr. PERLMAN. That is correct. He wrote directly to the chairman.

Senator HARTKE. You may proceed.

Mr. PERLMAN. Early in my statement I told you I was reminded of my appearance before the House Interstate and Foreign Commerce Committee, 13 years ago, testifying on a loan program similar to that before you. I repeat what I said at that time—it is my con-

sidered judgment that any program of extending loans to railroads will be a temporary palliative, but in the long run will be ineffectual unless and until Congress addresses itself to curing the basic ills confronting the transportation industry and until Congress resolves to treat railroad equitably with their competitors.

I shall be glad to answer any questions members of the committee may have. And thank you for your courteous attention.

Senator HARTKE. Let me proceed on something that is not covered in your statement, but an item which is at least of collateral interest as far as the committee is concerned.

Since the reorganization has been filed of course, and the trustees have been named, four of them, Mr. Willard Wirtz of course, who has no railroad background that I know of—isn't that true?

Mr. PERLMAN. Yes.

Senator HARTKE. Jervis Langdon, Jr., is the president of the Rock Island?

Mr. PERLMAN. Yes, sir.

Senator HARTKE. Is he basically, although a railroad man, can you in general describe whether he is considered to be an operations man or not?

Mr. PERLMAN. Jervis Langdon is a professional lawyer who is a very well rounded in rates and regulatory practices. He is very much in favor of this marketing concept of which we have been speaking. He is a very intelligent man but he has had no operating experience.

Senator HARTKE. Now, as far as Mr. Baker, he is a former dean of Harvard Business School. He also has never been in the operation of railroads, isn't that true?

Mr. PERLMAN. He was professor of transportation at Harvard Business School before he was dean, and he is very well informed as to the policies and regulatory facets of the whole transportation industry. He is a very well rounded man in transportation. But he has had no operating experience in the railroads, that is true.

Senator HARTKE. Now Mr. Bond also is not a railroad man, isn't that true?

Mr. PERLMAN. That is true.

Senator HARTKE. He is president of Wanamaker's, he has headed Wanamaker's for some time. The Interstate Commerce Commission forwarded its approval of these trustees yesterday.

Now do you anticipate that under normal circumstances under a reorganization of this kind that they would seek to find somebody who has operating experience?

Mr. PERLMAN. Well, I think they should and I imagine they are. I would respectfully go back on my own experience on the Rio Grande. The two trustees were a lawyer and a banker, but they let the operating man run the railroad. I see nothing wrong with the group that is appointed as trustees now provided they do have a good man in the operations end, because Langdon is good in the marketing and traffic, and the other end, and he could balance out a good operating man.

Senator HARTKE. I understand that. But our primary concern is to keep the system moving, keep the railroad running.

Mr. PERLMAN. Yes.

Senator HARTKE. Now insofar as Mr. Bond is concerned, are you familiar with the law firm of Dechert, Price, and Rhoads?

Mr. PERLMAN. I have heard of it, but I am not familiar with it. I got a letter from them just the other day about something the court had said or something. But I have had no other dealings with them.

Senator HARTKE. You know they were the law firm that filed the petition for bankruptcy?

Mr. PERLMAN. Yes, sir.

Senator HARTKE. Did you know Mr. Bond's son is a member of that law firm?

Mr. PERLMAN. Mr. Bond's son? No.

Senator HARTKE. Did you know also Mr. Saunders' son is a member of that firm?

Mr. PERLMAN. No, sir.

Senator HARTKE. I thought that was rather interesting. I think it is something we should at least keep alert to. I want to return at this moment to this question concerning this marketing concept and this question of authority after the merger occurred.

As you said, the man in charge of the marketing generally speaking was a Pennsylvania man.

Mr. PERLMAN. That is right.

Senator HARTKE. As I gather it, you would have instituted, if you had had the authority to have done so, the same basic marketing concept that you used for the New York Central.

Mr. PERLMAN. Yes, sir.

Senator HARTKE. But could you not get that done; why not?

Mr. PERLMAN. If you notice the people at the heads of the departments of the merged company, everyone was from the Pennsylvania Railroad except myself. To me it was not a merger, it was a takeover, frankly.

Senator HARTKE. It was not a merger, it was a takeover. I think that is at the heart of this. I think this really is why to a great extent, going back into the merger from the very beginning, it has been one that required just a little more concern than has hertofore been given to this.

Now in this what you call takeover was it a requirement that you retain those people at the heads of the departments?

Mr. PERLMAN. Yes, sir; unless I got permission from the chairman to replace them.

Senator HARTKE. In your opinion, without being disrespectful to any of these people, was the best man put in the best job?

Mr. PERLMAN. No, sir.

Senator HARTKE. Now you see this is at the heart of what I am talking about. Mr. Saunders was here last week, and in his testimony, when I was questioning him about this policy as to what happened in regard to the line of authority, he made this statement:

> Mr. Perlman, when the merger occurred, was over 65 years of age. He had recognized as well as we did that he had a contract to stay on for three years, and we wanted him to stay on for a good period of time because he knew much more about the New York Central than any of our—I say our—my point is that Mr. Perman is not a New York Central man originally. He came from the Denver Rio Grande. I am not a Pennsylvania man originally. I came from

Norfolk Western Railroad. This has a lot to do with a lot of this talk about fighting between us.

But this is prelude.

But he says:

Mr. Perlman and I agreed at the outset of the merger that we would put the best man in every job that we thought was qualified for it regardless of whether he was a Penn Central or New York Central man.

Mr. PERLMAN. I would say this in mitigation of what Mr. Saunders said. The Pennsylvania men were the senior men. We had a young, aggressive team that was gathered from all over the country. The Pennsylvania men had risen through certain departments on the Pennsylvania and had been the older generation. I had hoped that they would welcome the younger men and help them, and use their know-how to make some changes in the methods. Because it has always been my feeling, and this was accentuated at the Harvard Business School, there is no one answer to a business problem.

I might have thought I had the right answer to this problem, and maybe Mr. Saunders knew better. I have tried to be openminded about these things and tried to go along with what he, as chairman, felt should be done, because my illustration that I always use to our people about this fact that there is no one answer is if you go to Woolworth's or J. C. Penney's or Macy's or any of those large chains of merchandisers and ask them what the secret of their success is, they say "low markup and a very high turnover, volume."

Just like the Pennsylvania believed in volume. And yet Gimbel's, their 34th Street store competes with all of these stores, also Saks Fifth Avenue, and Saks Fifth Avenue has a very low turnover and high markup, just the opposite, and probably makes more money than Gimbel's.

So I have always felt there are so many intangibles in a business problem that I didn't know all of the answers. I had hoped that these men that were put in there, because they were senior men, would welcome the younger men. Instead of that we lost quite a number of them. The younger men just wouldn't stay.

Senator HARTKE. Well in line with that, Mr. Saunders said in his testimony, that:

When Mr. Perlman was president, he was in charge of railroad operations and he had full authority. He may not agree completely with this, but he was given complete responsibility.

Now in line with that, when you testified before for the merger back in, before the Interstate Commerce Commission, dockets 21989 and 21990, on page 31 of your statement there you said—and this was before the merger—"I read the allegations that the size of the merged company would preclude manageability."

And your comment to your own statement was "This is nonsense."

Do you still agree?

Mr. PERLMAN. I still agree.

Senator HARTKE. Do you agree with the statement that Mr. Saunders presented to us, when he said the question was not the question of bad management, but unmanageability?

Mr. PERLMAN. Well, I tried to read over his statement and he, I suppose, used an unfortunate word. I think what he was trying to

say was it was the regulation of the industry which made it impossible to do the same kind of a job as an unregulated industry.

Now the New York Central, for instance, in part of the property above the Grand Central terminal, now has three hotels they run, and the fourth, Waldorf Astoria which they own but lease out. As the leases ran out, we took over the operation of the hotels and we made more money than the various hotel chains had made. Hotel Corp. of America had one, Hilton had one and others. And without any regulation of the hotels, where we could act independently, we could do better than those chains did. But running a railroad, with all of the regulation that you have, it would take Solomon or somebody else to try to do the job properly. I think this is what he tried to point out.

Senator HARTKE. Mr. Perlman, I think I understand what you are saying. I understand your criticism of the Interstate Commerce Commission in moving by bureaucractic fiat rather than by legislative procedures. We have attempted in the Congress, at least in the Senate, to correct some of those deficiencies. We have passed a railroad passenger bill, we have passed the antidiscrimination tax bill and at the same time we have begun hearings on the National Transportation Act to go ahead and proceed along other lines. But in spite of the fact, the New York Central was operating under the same handicaps to which you refer prior to the merger that occurred after the merger, isn't that true?

Mr. PEARLMAN. That is true; yes, sir.

Senator HARTKE. And those difficulties to which you refer existed in the 12-year period or 25-year period prior to that time as well as they did after the merger occurred.

Now in your statement you refer here to the fact that 1967 was one of the most profitable years in the Central's history.

Mr. PERLMAN. Yes, sir.

Senator HARTKE. Basically isn't this—correct me if I am wrong in this summary—the New York Central, in spite of all of its difficulties was not on the edge of bankruptcy at the time of the merger?

Mr. PERLMAN. We thought we were depressionproof at that time.

Senator HARTKE. You thought you were depressionproof. All right.

And you had moved effectively then from taking over at a time when Robert Young himself at that time thought you would have to go into bankruptcy, you had successfully taken that operation to the place where not alone was it manageable, but as far as the corporate structure was concerned, it was back in better shape. You had instituted a new system of marketing, your cash flow was in good shape, was it not?

Mr. PERLMAN. Yes, sir.

Senator HARTKE. You were not seriously jeopardized, although you needed more money.

Mr. PERLMAN. That is right.

Senator HARTKE. And you headed the New York Central into an operation that was moving forward.

Mr. PERLMAN. Yes, sir.

Senator HARTKE. That is in direct contradiction, however, to the statement Mr. Saunders presents to us. I am not trying to do any-

thing to extend this conflict of opinion, except to try to unravel what appears to be a very complicated operation.

In his questioning, he says: "Neither the New York Central nor the Penn Central had made any money of consequence in the last 10 years."

Mr. PERLMAN. We paid off a quarter of a billion dollars in debt in 5 years. We rebuilt the entire railroad. We used to have four tracks between Chicago and New York, we put in centralized traffic control and took out two tracks and had a more fluid railroad than before. We built five computer-controlled classification yards, one in or two in Indiana.

Senator HARTKE. I have been out there and seen them. It is a miracle to watch them.

Mr. PERLMAN. And they took the place of 60 of the old-fashioned yards, like many of which I found at merger on the Penn Railroad. So I don't think we did badly at all, sir.

Senator HARTKE. But basically then as far as the New York Central was concerned, it was a healthy operation as far as an industrial unit of the United States was concerned.

Mr. PERLMAN. Yes, sir.

Senator HARTKE. And even though you did appear before the Interstate Commerce Commission and asked for the merger as much as it was a takeover. Is that your conclusion?

Mr. PERLMAN. Yes, sir; and I would say this, actually had there been supervision by the ICC of balanced competitive systems in the East, I think this might have turned out differently, too.

Senator HARTKE. All right.

Mr. PERLMAN. I would say in defense of the ICC in this regard the Transportation Act of 1920 required the ICC to prescribe balanced competitive systems, but the Transportation Act of 1940 canceled that. So I can't put the blame on the ICC either. But it just seems to me a body charged with the public interest should have some direction of that kind, because they can prescribe all kinds of protection for one railroad, but if it is left alone among three strong merged companies, it is in trouble.

Senator HARTKE. Yes. Now was this question of the effect upon the region ever presented? Were hearings ever held before the Interstate Commerce Commission on that at all?

Mr. PERLMAN. Sir, the history of this merger started in 1957 when Mr. Young and Mr. Symes came to my office and said that Mr. Symes would like to present studies regarding a merger with the Pennsylvania.

I said to Mr. Symes: "Do you intend to include in that your control of the Norfolk and Western and their satellites?"

He said, "By all means."

And I said: "Well, do you think that it is in the public interest for the largest railroad, the second largest railroad, and the most profitable railroad in the United States to be merged into one system?"

He said "Well, any merger is a good merger when people are willing to merge."

"I said "I can't agree with that."

Then Mr. Young made some remark to me about, "This is the trouble, these railroad men don't want to lose their jobs, so they don't want to merge." He said "Aren't you openminded enough to make a study?"

I said "I will study anything."

So at the next meeting of the Eastern Railroad Presidents' Conference, I told the railroad presidents of the eastern region of the United States that I had been asked to make a study on the merger with the Pennsylvania. And I asked them to go back to their principals and see if we could all sit down and work out something along the lines of a balanced competitive system in the East.

At the next meeting they came in and none of them were interested.

So I started the study and I kept after Mr. Symes: "Are you willing to leave the N. & W. go to some other system?" And he was adamant that he would not.

Then Mr. Young passed away and this whole thing was left in my hands and I broke off the merger studies with the Pennsylvania.

Senator HARTKE. That broke off in what year? 1959?

Mr. PERLMAN. About 1958 or 1959, around that time. And I went to see the president of the C. & O. and said "Mr. Touhy, the Pennsylvania Railroad controls the N. & W. The only way that we can have any balanced competition in the East is for the C. & O. and B. & O. and Central to get together and let the Pennsylvania and N. & W. be together."

He said: "We are not willing to forgo our $4 dividend on C. & O. stock."

I said: "You can have pink paper, blue paper, you can have common stock or preferred stock or debentures, anything to protect your $4 dividend."

He said: "Well, I don't think Mr. Eaton would like it."

I said "Well, may I talk to Mr. Eaton, the chairman; I don't want to go over your head."

And I said to Mr. Eaton "I think you are an ostrich, sticking your head in the sand. Your $4 dividend is dependent on one commodity, coal, and that has three customers, the export market, and that can go out the window overnight, the utilities, and you have residual oil coming in more and more. You have atomic energy, you have this aluminum wire that can carry the electricity more cheaply than you can carry coal on the railroad, so you can make it at the mine mouth. And as far as the steel companies, with the new oxygenation process they will use less coal per ton of steel. You are just hiding your head in the sand. You have to diversify."

So he said to Mr. Touhy that he should start making studies. And the B. & O. and C. & O. and Central started making studies.

Suddenly I was made aware by the B. & O. and C. & O. that they had made a separate agreement among themselves, C. & O. was to control B. & O. and we were left out. So I made a competitive offer for 50 percent of the B. & O. stock. I made no offer for the 100 percent, I wanted C. & O. to have 50 percent and us. And then the N. & W. would be controlled by the Pennsylvania. But, the Pennsylvania moved to give the N. & W. entrance to the Great Lakes, it sold

them a line to the Great Lakes, which took away the Pocahontas coal from New York Central, they made arrangements to sell them the Wabash Railroad which put them into our markets in St. Louis and Detroit and other places.

We were faced with the Pennsylvania-N. & W. system versus us having joint control of the B. & O.

Our staff, after an exhaustive study, said to me "The only way that we can be competitive in the East is by accepting the Pennsylvania offer to merge, providing that they let go of the N. & W." They finally let go of the N. & W.

Senator HARTKE. All right. Let's return a moment. Did the Interstate Commerce Commission, during this interval, did they at any time give you any indication of their studies or concerns for what was happening in the balanced transportation system?

Mr. PERLMAN. When we were spending money to try to work out this control, joint control of the B. & O., which the C. & O. fought—there were lengthy proceedings before the ICC—the examiner expressly forbade any testimony of that kind in that hearing.

Senator HARTKE. That is right. In other words, it wasn't a question of whether they would cooperate in trying to develop a balanced system, but on the contrary, they went in the opposite direction and worked to what amounted to a program or an idea which really prevented us from coming up with a balanced transportation system. Isn't that true?

Mr. PERLMAN. That is my feeling.

Senator HARTKE. During the period of 1920 and 1940 when this legislative authority was there, was any action taken by the Interstate Commerce Commission?

Mr. PERLMAN. Well, they had this study made by Professor Ripley of Harvard, but nothing was ever done about it.

Senator HARTKE. And that was the extent of their utilization of this legislative authority in the 20-year period, they had the study made and filed it away?

Mr. PERLMAN. Yes.

Senator HARTKE. In other words, what you have here then is the Interstate Commerce Commission having authority, making a study, failing to use it, and then during the time in which there was a crisis developing in the Eastern railroad system, not alone were they not helpful in trying to solve the crisis, but really prevented any testimony and any study coming to the front of a sufficient nature which could have perhaps prevented some of the difficulties that later occurred?

Mr. PERLMAN. That is my honest opinion.

Senator HARTKE. I think that is very sad.

Let me come back again—excuse me, Senator Cook, I have taken enough time. Do you have any questions?

Senator COOK. Mr. Perlman, your testimony and your answers have been very enlightening, I think.

You envisioned, as I take it, when you sought discussions with the C. & O. and B. & O., you envisioned an end-to-end system?

Mr. PERLMAN. Yes, sir.

Senator COOK. It was your opinion as a sound railroad man, as a successful railroad man, that a parallel system was not going to be successful in the East?

Mr. PERLMAN. Well, it wasn't exactly that, sir. I think that certain economies came from cutting out certain parallel parts of the two railroads. But my idea was that the C. & O. and B. & O. and the Central, and the Pennsylvania-Norfolk Western would be more competitively balanced because each one would have about the same amount of the most valuable traffic in the country, which was the Pocahontas coal and each one would have about half of the share of the passenger loss.

Today the other group have all of the Pocahontas coal and the Penn Central has one hundred-some million dollars passenger losses and the others have an infinitesimal amount of passenger loss.

So the whole thing from the marketing angle, and from the viability of the two systems just can't compare, taking the C. & O.-B. & O.-Central and the Pennsylvania-Norfolk and Western traffic, the business, and all that the physical distances and all were not as important in how the railroads lived as the markets that they tapped.

Today the Penn Central taps all of the passenger market and the other taps all of the Pocahontas coal market.

Senator COOK. You started to disagree with my question about a parallel facility, but your answer agreed with the fact, that you really felt that an end-to-end system was what really would make a viable railroad system in the East. And that when the C. & O. and B. & O. merged, things really looked dark for the New York Central, didn't they?

Mr. PERLMAN. Well, and when the N. & W. was to be permitted to have a line into St. Louis and also to the Great Lakes, to take care of shipments of Pocahontas coal out of Columbus that we were getting before.

Senator COOK. In other words, when the discussions were broken off after the death of Mr. Young, and you went to C. & O. and B. & O. and made a proposal, it was at this stage of the game that the Pennsylvania proceeded to cut the market out from under the New York Central in its dealings with the B. & O. and C. & O. and the extensions of lines through the Wabash and St. Louis and Chicago market, that really made it almost mandatory in the long run that a merger of the two major railroads take place?

Mr. PERLMAN. That is correct. And our committee of vice presidents that made that study for me prefaced their report with "You are not going to like what we tell you." But this was a fact.

Senator COOK. Then really and truly, by reason of the hearings that precluded any testimony as to a viable end-to-end railroad system in the East before the ICC, and precluded apparently at least their knowledge on paper, because they must have had that knowledge anyway, but precluded a record of it before the ICC, you were forced into a merger that you really didn't like?

Mr. PERLMAN. Absolutely, yes, sir.

Senator COOK. At the same time the ICC, when they agreed to the merger of the parallel system, imposed on you 5,000 employees at an average salary of $200 a week, that is $1 million a week, or $52 million a year. They also imposed on you the New York-New Haven and Hartford. The Supreme Court the other day rather than agreeing with the $150 million cost to the Penn Central, imposed an additional $28 million onto that and make the judgment $178 million rather than $150 million.

Mr. PERLMAN. Yes, sir.

Senator COOK. Do you have any idea what the imposition of picking up the tariff loss to other railroads, what that will cost the Penn Central?

Mr. PERLMAN. Well, we haven't been able to figure that yet, sir.

Senator COOK. Is it going to be sizeable?

Mr. PERLMAN. I don't think it is going to be sizeable, no, sir.

Senator COOK. In other words, the first year of the merger, even though you were looking at the perfection of some $74 million in savings and the figure fluctuated between $74 million and $81 million, the ICC imposed a $52 million labor bill on you?

Mr. PERLMAN. Yes, sir.

Senator COOK. An ultimate $178 million cost to the Penn Central of the old bondholders of the New York, New Haven and Hartford, and a cost factor of any particular loss that might be suffered by intermediate railroads?

Mr. PERLMAN. Plus a $22 million loss annually of the New Haven Railroad.

Senator COOK. The $22 million annual loss of the railroad itself.

Mr. PERLMAN. Yes, sir.

Senator COOK. The ICC really did you a favor, didn't they?

Mr. PERLMAN. Well, if you can call it that.

Senator COOK. There is some talk, Mr. Perlman, that the merged New York Central-Pennsylvania is too large a corporation. Do you believe this?

Mr. PERLMAN. No, sir. With the third generation computer, I think that it would be easier to manage a company like that than it was in the old telegraph pounding days when I first started railroading. Much easier.

Senator COOK. Do you feel the Penn Central is too poorly balanced competitively?

Mr. PERLMAN. Should the N. & W. be allowed to merge with the C. & O. and B. & O., which they have asked to do in a proceeding before the Commission now, I think it would be horribly unbalanced.

Senator COOK. If the N. & W. were left out, then you believe that the Penn Central would constitute a competitively balanced corporation?

Mr. PERLMAN. Only, sir, if they could be relieved of this passenger loss and if they could do a few other things there and if in some way some credit were available to them to really modernize some of the old Pennsylvania facilities.

I do not think the Pennsylvania Railroad, Penn Central—I am talking about the Pennsylvania part between here and New York—can be really competitive with the other system until they fix the yard at Harrisburg, until certain of the yards are fixed at Philadelphia and certain other improvements are made.

The other thing that they must have is more freight cars. They have to turn away business because they are short of freight cars.

I think that in some way they have got to find some money to do those things.

Senator COOK. You said in your statement that you had gotten the New York Central into a position where it had nothing due until 1992.

Mr. PERLMAN. Except the big four, four and a halfs that come due in 1977, which is a small issue.

Senator COOK. How big is that issue?

Mr. PERLMAN. I don't know how much of it is prepaid, because we had been buying in some of that. But I doubt if it would be over $10 million.

Senator COOK. I see. What is your understanding of the present long-term debt that the Pennsylvania had that might come due shortly?

Mr. PERLMAN. Sir, I don't think the long-term debt is the trouble, it is the bank loans and the burden——

Senator COOK. I agree with that. What I am trying to do at this time is look at the overall railroad picture, rather than just the Penn Central.

The point I am making is isn't it a fact that in the late 1940's and up through the first of the 1950's, a great deal of long-term debt was incurred by the American railroad system by reason of the fact that it couldn't acquire equipment during the war, that it depreciated a great deal of its equipment and it deserved to redepreciate it because they needed to revitalize the lines?

Mr. PERLMAN. Yes.

Senator COOK. A great deal of these three and a quarter, four, and four and a halfs are now coming due, it is going to be refinanced at a horribly high interest rate. The entire American railroad system is going to have a real jolt when it starts picking up a multimillion-dollar refinancing program at the present 8, eight and a half and 9 percent market. Is this not true?

Mr. PERLMAN. That is very correct, yes, sir. Not only that, but the diesel locomotive came into being in the middle 1940's and the railroads took on quite an obligation there.

Senator COOK. And all of this, the American railroad system today at a 2.3 or 2.4 return is going to have to refinance this entire debt, aren't they?

Mr. PERLMAN. Yes, sir.

Senator COOK. If they can refinance it?

Mr. PERLMAN. Yes, sir.

Senator COOK. You were talking about the Japanese railroad.

I want to get into the record, Mr. Chairman, that since 1964 it has been estimated the Japanese Government has put into the railroad system a million dollars a day.

I might suggest to you that it is very interesting, because you really don't have to go to Japan to look at a governmentally-owned railroad. The United States owns a railroad, it owns the entire Alaskan railroad. It built it in the early 1920's, it has operated it first through Interior Department and it now operates it through the Department of Transportation.

And if anybody wants to take the time to look at the record of the operating factors of the Alaskan railroad, they will come to the conclusion that the Federal Government is not the one to be running the American railroad system.

Mr. Chairman, I will make a report for you on the Alaskan Railroad. It is very interesting. They tried to convince me in 3 days of hearings with them that they had made a profit 1 year. And the

only problem is, Mr. Perlman, during the year, the last year they said they made a $300,000 profit, they depreciated some $2,400,000 worth of equipment, but they are not a taxpayer, they don't pay taxes locally in Alaska, they don't pay taxes to the Federal Government and they set up no account for new equipment. So I couldn't understand how they were depreciating that until I realized it was to establish they made a $300,000 profit.

So I want to get that into the record, because I agree with what you are saying.

Mr. PERLMAN. Thank you, sir.

Senator COOK. Thank you, Mr. Chairman.

Mr. PERLMAN. I don't think you have to go to Alaska. You have the Canadian Pacific and the Canadian National. The Canadian National pays no taxes to the Government and loses about $40 million a year. The Canadian Pacific pays about $40 million in taxes and makes $30 million a year. Something around those figures. So right here on this continent you have the same thing, a Government-owned railroad and privately-owned railroad.

Thank you very much, sir.

Senator HARTKE. I am not interested really in getting into a theoretical debate on nationalization.

But the Pennsylvania and all the rest of them, and most airlines, are not paying Federal taxes and as far as operation is concerned, I don't think the Penn Central happens to be a very shining example of how to run a railroad either. I think maybe we have to find a better system.

Let me ask you a question in regard to that. I want to pursue this matter about the management of this operation.

Mr Saunders now was somewhat critical really, although being very polite, and in effect left the impression at least with this Senator that you had the complete authority to run the operation and you were given everything you needed to run it.

Is that true or not?

Mr. PERLMAN. It was not true.

Senator HARTKE. In other words, it was not true in personnel, was it?

Mr. PERLMAN. No, sir.

Senator HARTKE. Was it true in regard to money for these projects you were talking about?

Mr. PERLMAN. No, sir.

Senator HARTKE. Why not?

Mr. PERLMAN. Well, as an example, that budget never even was seen by the board of directors.

Senator HARTKE. Why not?

Mr. PERLMAN. Well, it was held on his desk.

Senator HARTKE. On Mr. Saunders' desk?

Mr. PERLMAN. Yes.

Senator HARTKE. Why did he hold it?

Mr. PERLMAN. He said we had no money to do it, so why show it to them.

Senator HARTKE. That was submitted in 1969?

Mr. PERLMAN. Yes, sir.

Senator HARTKE. Were you consulted at all?

Mr. PERLMAN. In the fall of 1968 sir. That is the 1969 budget.

Senator HARTKE. He told you in the fall of 1968 that they didn't have any money, yet they declared a $43 million dividend in the spring of 1969. Why?

Mr. PERLMAN. Sir. I can only tell you what my philosophy was on the Central.

When we made money, we never paid out more than 50 percent of our net income providing we had the cash to do it. And that has been the policy.

Unfortunately I am not the chief executive officer, never have been in the Penn Central, and I can't say why.

Senator HARTKE. Basically, in regard to this, who was making the decisions about where the money was going to go?

Mr. PERLMAN. Basically when you say the money, where the money was going to go——

Senator HARTKE. In other words, you had the Penn Central Co., the Penn Central Transportation Co. They were two separate operations. You were in charge of the operation of the railroad. The Penn Central Co. had a conglomerate and was acquiring other properties, including real estate, oil fields, things of that kind, various operations, hotels and laundries, everything else.

Who made the decision as to who was going to get the money?

Mr. PERLMAN. That was made between Mr. Bevan and Mr. Saunders. I think Mr. Bevan might have had more knowledge of where the money was going even than Mr. Saunders.

Senator HARTKE. Mr. Bevan will be with us hopefully before the hearings are complete and maybe we can get that story from him.

In your opinion were they diverting money from the railroad operations in order to utilize it for acquisitions and for movements of cash and of resources and the pledging of securities for the conglomerate rather than for the railroad?

Mr. PERLMAN. Well, it is very difficult to say. We did have a tremendous cash drain as far as the railroad is concerned in those first 2 years and we knew we were going to have it.

They did make some advances to the Great Southwest at the time, but I do not think that they spent a great deal of money acquiring real estate companies and other companies because outside of certain advances that they made to these companies that were already——

Senator HARTKE. The advances they made, was that in cash?

Mr. PERLMAN. Yes, sir.

Senator HARTKE. And that cash was needed for this program of modernization of the railroad system, which you said was necessary, and which was already anticipated prior to the merger? Was it not?

Mr. PERLMAN. Yes, sir, but again you get into that same business problem that I talked about.

My whole life has been taken up in railroading. And Mr. Bevan's life has been taken up in other things, and he has other interests. He was the man that really had to decide, he and Mr. Saunders, where that money was going. I only had really the supervision of the railroad and what was happening to the railroad and where they would put the money otherwise was really out of my jurisdiction.

I would hopefully have you ask that question of Mr. Saunders because when they made these advances, I had no prior knowledge of what they were doing.

Senator HARTKE. I understand that. This is the point that we tried to develop with Mr. Saunders the other day. But he left the impression at least in his statements here that as far as the railroad was concerned, they received all of the money they could receive and that they needed at that time.

See, the central issue involved in this was whether or not the Penn Central Co. was primarily diverting its efforts and resources and cash to diversification and to the conglomerate or whether they were directing their attention to the transportation company with which we are so vitally concerned here. That is the question I asked you.

In other words, did the merger place a priority upon the diversification and the conglomerate aspects, or did it place its primary emphasis on the transportation facilities?

Mr. PERLMAN. Well, may I explain it to you in this way, again comparing the Central and the Pennsylvania? On the New York Central we had these budgets once a year and we had people in from all over the railroad, the train masters, the division engineers, superintendents, we had the law department, we had the sales department, and it was a very educational thing to see what the requirements are on the railroad and every department has an interest and learns from it.

And the first thing that we did in the morning was have our chief financial officer give us a run-down of what estimates he had for the next year in operating expenses and revenues and cash flow. And from that, we knew how far we could go in spending the money.

One year anything that didn't save over 50 percent unfortunately had to be cut out of the budget. Some years we could go down to even 25 percent, when cash was a little more readily available.

And you might be interested in knowing that the first year we had this budget meeting I found that very few of the men knew the difference between capital expense and operating expense. We sent 400 people that first year to the American Management Association for 1 month to learn how to budget and what these things were all about.

When we merged all of those people were at these budget meetings except the financial people. And we didn't know what the cash flow was going to be.

Senator HARTKE. You were never kept informed of what the cash situation was or whether there was a positive cash flow or a negative one or whether you were headed for trouble?

Mr. PERLMAN. No, sir.

Senator HARTKE. Who made the decisions in this regard? Who made the central decision as to how they were going to use the finances? Did you have any part in it whatsoever or were they made by Mr. Saunders, Mr. Bevan, and other people?

Mr. PERLMAN. Well, these things were presented to the board piecemeal, because the safety items had to go immediately to the board, and certain of the things that we had to have in the way of freight cars and locomotives had to go to the board, because other-

wise some of the big shippers would have been right down there on our doorstep.

But actually those things went from Mr. Saunders to the board. And Mr. Bevan worked out the financing of them.

Senator HARTKE. But the end result was the failure to adopt these procedures in your opinion was one of the precipitating causes for the collapse of the Penn Central?

Mr. PERLMAN. I don't think so. I think that this tight money grabbed them and the fall of the collateral and things of that kind, that they were not prepared for at all.

I think a year and a half ago if one said this was going to happen, one would have been laughed at.

Senator HARTKE. In regard to the dividend, did you agree that the dividend should have been paid, the $43 million dividend?

Mr. PERLMAN. As I say, this was not my policy on the Central.

Senator HARTKE. Were you consulted?

Mr. PERLMAN. I was at the board meeting that declared these dividends, yes, sir.

Senator HARTKE. Did you agree or disagree?

Mr. PERLMAN. I didn't vote for it. I didn't vote against it. I think that that is something that the chief executive officer had to have a policy on and the board had to have a policy on.

Senator HARTKE. Let me ask you these factors you referred to, these extra factors, which are national in scope, the tight money, the recession, and the fallback in the economy, were those factors sufficient that they would have presented the same problems to the New York Central without the merger?

Mr. PERLMAN. Not bankruptcy. I think we were prepared——

Senator HARTKE. You were prepared for that?

Mr. PERLMAN. You see, the difference was, sir, that on the signing of the merger agreement we both agreed to a certain debt limit, until the merger was consummated.

Now we were far below that limit when we merged. For 2 years prior to merger the Pennsylvania had asked for permission each year to increase their debt $100 million. So they had increased it $200 million above the limit that we had set in the merger agreement. And our board agreed to it. But this was all short-term paper that they were putting out.

So this caught them short when this money market turned the way it did. I think that that is really the great contributing factor to this.

I think if the N. & W. stock had stayed anywhere around over 100, so their collateral was good, and they could have had any kind of a credit market, they would have gotten that $100 million they went for.

Again, what I say is not worth anything, because I didn't have the negotiations with the financial people, the bankers and all, that Mr. Bevan did. But I would have felt that way, that they could have gotten another $100 million if conditions had been normal.

Senator HARTKE. After the merger occurred, did the expectations which you had anticipated in regard to increased efficiency and better service, did they occur?

Mr. PERLMAN. No, sir, not the first 2 years and I didn't expect them to occur then.

When we rebuilt the yard, say at Albany before merger, put in the new electronic yard, we had to throw everything over to the Syracuse yard. Just that one thing disrupted the New York Central service for 6 months.

Now you take changing service at 35 yards within 1 year and you have got a heck of a mess.

Another thing that was a disturbing factor was the fact that the accounting and financial people on the Pennsylvania had designed their computer system and they were interested in getting figures for the financial department rather than for operating the railroad. It was designed on what we call a batch system, that turns out a lot of paper. But if you want to know where a locomotive is this second, you can't do it.

Now in the first generation computers you didn't have the memory capacity or the random access to the computer. But when the second generation came out, all the railroads that were interested in having the computer attuned to their operations, to automate and command and control their operations, went to the real time system, but the Pennsylvania stayed with that batch system.

Before the merger, we couldn't convince them to spend the money to reprogram it, because none of us knew when the merger would occur, this had been going on for years between the Interstate Commerce Commission and the Supreme Court and the rest, so they wouldn't spend the money.

So the day we merged, these computer programs were not compatible. They were the same IBM 360's, and all that, but the terminal hardware at the yards and all was entirely different and the programs were different. So cars that had come in from other railroads to these yards—we had two yards in Chicago for instance, and the bill from the Santa Fe said Penn Central. The train would come into the 59th Street yard and it would be going to Cleveland and it should have come into the New York Central yard to go to Cleveland. But the Santa Fe people just billed it to Chicago-Penn Central. Here were these computers that weren't working together. And the freight bills maybe would go over to 1 year because they were Penn Central and maybe the cars would go to another yard. It was a mess.

We couldn't train all of the yard clerks in the United States that if it was going to Cleveland it should go to the Central yard in Chicago and we couldn't train them if it was going to Pittsburgh, it should go to the Pennsylvania yard.

Until we got one yard in Chicago that had the capacity to take all of the cars, hell, we couldn't do anything. We had some sidewalk superintendents come around and say "Hell, I could have done it in a month, what is the matter with the darn fools?"

Well, God bless them.

Senator HARTKE. You were handicapped in spite of that—let me ask you this: Were you handicapped in spite of that by a lack of sufficient funds to proceed with some of the necessary items of modernization which you had proposed?

Mr. PERLMAN. Well, sir, I was handicapped because I drooled when I saw all of this. But from a practical standpoint, when you have $121 million that you have to pour in, just to get these things comparable, so you can run the railroad as an efficient railroad so you are not losing business because the freight cars are getting lost, because you have two yards, and these foreign railroads don't know where they should be sending it from their railroad to you, you have got to do something in a hurry.

As I say, in 2 years we did the physical work that was planned for 5 years and we got the savings, we got over $71 million out of the $81 million savings in 2 years. And we had to do it because as I said to you if a shipper has his car lost the way we had to lose them at first, he just ships some other way. And we lost a lot of business. And if it had continued another year, we would have never recovered it. We had to do it fast. It is hard to explain.

If I had been outside looking in, I would have felt the same way that some of the other people did. But the faster we did it, the quicker it was over.

And the following spring the shippers were very happy with the service. We started getting the business back, the competitive business. In fact, the Erie went to the ICC and said they were being put upon because we were taking the New England business away from them, they complained to the ICC. That is how fast we came back.

Then last winter killed us again on the Northern route because of the snow and cold, it was the worst winter in the century.

So these are things, of course, that are very hard to see. I mean you need a crystal ball. But I honestly think, sir, that now there is one of the finest young teams on the Penn Central that you will find on any railroad. I think the operating man we have is an excellent man. The man heading marketing now was educated on both the Frisco and the Penn Central, or I mean the Illinois Central. I brought a man down from the Canadian National whose father was a station agent and he started as a telegrapher, and he is a Rhodes Scholar, and he was vice president of the operations of the Canadian National, and he has had several other important jobs there. And it was a battle, and I don't mind all of the criticism and everything that has been heaped on me to date, there isn't a man heading one of those departments that I talked about, that was there 2 years ago. And I think I did my job.

Senator HARTKE. You mean if you had gotten those changes made sooner, maybe it wouldn't be in chapter 77?

Mr. PERLMAN. Well, I don't think I would have had the almost ulcers that I had either.

Senator HARTKE. You think you would have been in better shape.

Let me come to this question: The ultimate problem on the other side of the coin is that the Penn Central now is in a chapter 77 reorganization. It is still short of cash. There are other railroads which are short of cash.

In your statement which you presented originally you said that in your opinion it was not going to be sufficient to really just give this thing temporary treatment, that what was needed was something more substantial than that.

As of now, as far as I am concerned, there is not much we can do about two of the items, that is, with the Passenger Service bill, we have gone as far as we can with prodding the administration to get back into the 20th century with us on that one. Now Antidiscrimination is in the House, and we probably can do some more on the National Transportation Act. But taking all of these, as of now do you think that the legislation for a loan guaranty of $750 million will provide any substantial relief to the troubled waters of the railroad business? And if so, would it be a requirement that the Penn Central system should be included or should be excluded from such provisions of that type of loan authority?

Mr. PERLMAN. I think it should be included, if they can show items of which I talked, on which they could get a very good return, it would help them get back on their feet. If they could be permitted to use the technology we have today to do these kind of things, I think that would be very helpful.

As I say, it would be a temporary thing, but in the meantime I think they would have to go back to the Transportation Act of 1958 and say that the railroads should have the rate freedom they gave them in 1958 that was thrown out in this Ingot Moulds case.

Senator HARTKE. How much would the Penn Central need to get them out of this temporary bind?

Mr. PERLMAN. In the freight cars and in physical plant they have been spending about $250 to $300 million a year. Now they ought to be able to have some cash flow to take care of part of that. But I would say that for the next 3 or 4 years they ought to have about $150 million a year.

Senator HARTKE. $150 million a year that they would have to borrow for the next 2 or 3 years. That would be $450 million over a 3-year period, for one railroad out of a $750 million authorization.

Mr. PERLMAN. Yes, sir.

SENATOR HARTKE. In other words, that would be more than half of it going to one railroad system.

And we already have indications that there are 16 railroads which would qualify at the present time under the Interstate Commerce Commission's decision for assistance under this program.

Mr. PERLMAN. Well, maybe you would have to look at it on the basis of allocating it according to the needs of all the railroads, and I would not put any arbitrary figure for the Penn Central. I mean I think that that should be your judgment or the judgment of the Interstate Commerce Commission as to how that money is allocated, according to the needs.

Senator HARTKE. Do you feel that any part of it should go to alleviate the financial woes of those people who have loaned money to these railroads? That is, the bankers?

Mr. PERLMAN. If I were making the allocation, I would make it strictly on the basis that you do this, you do that, to improve the railroad.

Senator HARTKE. But how could you make sure though that they didn't use that money, earmark some of it for that, and use other of the money to continue their acquisitions and the pouring of money into operations which had no relevance nor relation to the transportation business?

Mr. PERLMAN. Well, sir, I think you probably have some inkling of my feelings when you say "they."

But in all justice, I don't think too much in these 2 years was diverted to outside acquisitions from the treasury of the Penn Central.

I do know of this money that was put into the great Southwest.

Senator HARTKE. How much was put in that, do you know? How much was diverted to that?

Mr. PERLMAN. Something around $25 million.

Senator HARTKE. You see, if you had had that $25 million, plus the $43 million of stock dividends, you would have had $68 million and that would have made a substantial difference in their cash situation, would it not?

Mr. PERLMAN. Yes; it would.

Senator HARTKE. In 1969 alone?

Mr. PERLMAN. Yes, sir.

Senator HARTKE. Would that not have been probably sufficient to have kept them in operation?

Mr. PERLMAN. That I couldn't say. They were pretty far extended in my opinion.

Senator HARTKE. Are the problems of the Penn Central basic ones for the industry as a whole, or are they unique to the Penn Central?

Mr. PERLMAN. No, sir; they are basic. There are railroads like the Southern Pacific who have outside incomes. All of these land grant railroads who had every other acre for 20 miles on each side of the railroad, the land grant, like the Union Pacific and Southern Pacific, they had tremendous tracts of timber land, oil, and coal, and I would say the Union Pacific and the Southern Pacific and many of those land grant roads could get along, with maybe 80 percent of their income being from outside. And you can't take them and say, like the Southern Pacific says, they are profitable. It isn't the road that is profitable, it is that outside income that they have.

The Northern Pacific is the same way. They are not too profitable, but I wish the Penn Central had their oil and coal lands and timber lands.

So if you take a railroad that is just in the railroad business, most of them are having troubles now. You can see it by their earnings; as I mentioned, even the Burlington Northern is down from 57 cents last year to 25 cents this year for the quarter, with all of their timber lands and everything else.

Here the rich Norfolk & Western had to cut their dividends. So I really think the industry is in trouble, sir, I really do.

Senator COOK. Excuse me, Mr. Chairman. Mr. Perlman you said in your statement that in 1968 just before the merger New York Central's income from ground rentals in New York and other real estate properties paid its fixed charges, and even if we made no profit at all, you say, the railroad would still have had a cash flow of $70 million a year.

Mr. PERLMAN. That is right. That is what I am trying to bring out. The railroad industry per se is in trouble. But the ones that were a little prudent to begin with and tried to trim their sails a long time ago—I went through the depression of the 1930's, and all of my experience has been with railroads that were in trouble.

Mr. Saunders came from one of the wealthiest railroads in the country and his outlook on these railroad problems may be entirely different from mine. A lot of people say "Well, here the two men have different philosophies." Well, sure, a man that comes from one side of the tracks may have a different philosophy than the other.

I have always had to help out, every time a railroad got into trouble. John Barriger on the Monon was in the red for 3 years and asked me to come down during my vacation and help him out, and we got him back in the black. This has been my whole experience.

Mr. Saunders had an entirely different experience, you see. So we looked at things from different ways.

Senator HARTKE. You mean he took an operation in the black and put it in the red?

Mr. PERLMAN. Well, I was in it too, I can't——

Senator COOK. Mr. Perlman, during your statement you digressed a little and said that prior to the merger, you had four main lines to Chicago and you cut it in two for an integrated system.

Now when you cut from four lines to two, what did this do to your operating picture from the standpoint of local taxes?

In other words, did you reduce your local tax effort along the way, so it reflected in your books?

What I am trying to figure out is what the local tax picture is. What are the entire local taxes paid by the Penn Central. Because it seems to me what we are really doing, we have two alternatives here, we are looking at a guaranty program which I am not sure is the way to do it at all, and I am not sure you think so either. This guaranty admits to begin with that we are going to ask nobody at any other level, other than this level, to share the responsibility of revitalizing the American railroad system.

In other words, the Federal Government through its tax dollars from all of the people is going to say we are going to guarantee three-quarters of a billion dollars. And yet every local tax agency is going to demand a share, and is going to get it. What I want to know is when you went from a four-line system to a two-line system, did you cut back so that it reflected in your budget? Was this part of your reorganization of the New York Central?

Mr. PERLMAN. In some States, yes, and in some States, no. Some States have formulas based on your revenues——

Senator COOK. In other words, when you cut it, you still paid as much taxes regardless?

Mr. PERLMAN. Yes; but in some States that is not true. In New York we were assessed $11 on every switch on the line, things of that kind. So in New York when you cut it, you really cut it. In certain other States it is based on a threefold formula that has something to do with your gross revenues, and it has something to do with your land values, so that is only part of it, you see.

And when you get all through, they can mix that formula so you pay just as much or a little more maybe.

For instance in New Jersey, the land tax on the railroads was just unconscionable. We paid three times the taxes on our right-of-way that the man right next to it paid. And we went into court, we have had many court battles on that. But you just can't arbitrarily say

you are going to cut taxes when you even take up a railroad, because you still have the right-of-way there and they find ways of taxing it, they have these formulas.

Senator HARTKE. Mr. Perlman, are you familiar with the bookkeeping operations?

Mr. PERLMAN. Well, I am familiar with——

Senator HARTKE. I mean any one of the three of them? I am not being facetious, but maybe I am.

Mr. PERLMAN. I am familiar with all three. We had to keep three, we had to keep one for the Interstate Commerce Commission, one for the Internal Revenue, which wants you to keep it in a different way, and to know what your costs were we had to have our own cost accounting system.

Senator HARTKE. You really did keep three sets of books?

Mr. PERLMAN. Well, we have to. If we want to know or to have any cost controls, we can't use either the ICC or—let me give you an illustration.

When I was roadmaster on the Northern Pacific and in charge of a certain district and maintenance of way, I got a certain allowance. If you cleaned out the stockyards, and we had a lot of stock shipments there, if I used a team and scraper to do it, hired a contractor with team and scraper, that was charged to transportation. If I put in the section men to clean it out, it was charged to my maintenance of way. If you got a snowstorm and you told the station agent to hire warehousemen to clear up the snow, that was charged to transportation. If I sent in my section men to do it, it was charged to me, to maintenance-of-way.

Well, you know how it was done. And yet it was absolutely according to the 1902 set of Bureau of Accounts of the ICC.

Senator HARTKE. They haven't changed since 1902? They have the same procedures?

Mr. PERLMAN. That is right.

Senator HARTKE. I am not really speaking about that. I would like to have permission of Senator Cook to include at the end of these hearings this morning the Fortune magazine article of August 1970 concerning the Penn Central.[1]

Senator COOK. No objection.

Senator HARTKE. This will be included.

Let me read just one item from it. This is at page 164. According to the author of this article, and this is the type of thing I am referring to:

> In 1968 the railroad also included in its profits a $11,700,000 dividend that was merely a property exchange. This represented Penn Central's interest in the Washington Union Station, which was transferred during the year from Washington Terminal Co. to the terminal's two owners, Penn Central and Baltimore & Ohio Railroad. Penn Central based the dividend on the price it expected to get for the station when it sold it to the Department of Interior for a visitor center. The sale has not even yet been consummated.

That is the type of bookkeeping I am talking about.

Are you familiar with that type of operation?

Mr. PERLMAN. Mr. Charles Hill, the vice president in charge of accounting, reports to Mr. Bevan and not to the president of the Penn Central.

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[1] See p. 402.

Senator COOK. Mr. Chairman, I can give you another example, at least last year. The Penn Central carried an item of $20 million of annual earnings of the Great Southwest Corp. as earnings of the Penn Central. Yet really the only thing the Penn Central received was a $2 million dividend. So unless they could absolutely call on the $20 million of earnings and utilize those earnings, which obviously would put the Great Southwest Corp. in a terrible bind, they were carrying a $20 million earnings item when really and truly their only earnings was $2 million in dividends. Is that not correct?

Mr. PERLMAN. That is right.

Senator HARTKE. I gather from what you are saying here today that in spite of Mr. Saunders' statements to the contrary, or at least appearance to the contrary, that the operation of the Penn Central Co. and basically the control of the Penn Central Transportation Co. and the policy decisions which were ultimately made were made by Mr. Saunders and Mr. Bevan and not by Mr. Perlman. Isn't that true?

Mr. PERLMAN. That is correct, sir.

Senator HARTKE. As a result of that, let me ask you, did they solely make the decisions? Were other members of the board consulted? Were other members of the board instructed as to what to do? Was this a two-man combine running an operation which originally was considered to be a holding company for the transportation company, but really the transportation company was the support for the holding company?

Who ultimately, who was really making the decisions?

Mr. PERLMAN. Well, the board had the authority to make the decisions. And I would say that these things were all presented to the board, that is, most of them were presented to the board.

Senator HARTKE. But was the action of the board basically predicated on the decisions of these two men?

Mr. PERLMAN. Well, I would say the recommendations; yes.

Senator HARTKE. And the rest of the board acquiesced in their decisions?

Mr. PERLMAN. Well, there were times when there were arguments about certain things. But by and large Mr. Saunders had an almost unimpeachable reputation.

Senator HARTKE. Yes; now in regard to the selling of stock during this period, did you own stock during this period of time?

Mr. PERLMAN. Yes, sir.

SENATOR HARTKE. Did you sell off your stock?

Mr. PERLMAN. No, I sold maybe about 500 shares out of 2,000. But this was sometime ago.

Senator HARTKE. Was there information presented in the board meetings or at any place whatsoever to indicate there was an impending financial crisis for the Penn Central which might have been available to other members of the board who sold and you did not?

Mr. PERLMAN. No, sir; I think this came as rather a surprise, this crisis. As a matter of fact, the man who took my place testified that 10 days before this happened he had no idea that we were in as bad financial shape as we were.

Senator HARTKE. I am sorry, I didn't hear your answer. I was trying to do two things at once and I didn't do either one very well.

Mr. PERLMAN. I said that Mr. Gorman, who took my place last December, I read in the paper that he said he didn't know 10 days before this occurred that we were in such a financial bind as we were.

Senator HARTKE. Does he get a pension for being president that short a period of time too?

Mr. PERLMAN. No.

SENATOR HARTKE. In other words, you don't think they knew this that Mr. Gorman didn't know this until 10 days before the actual proceeding?

Mr. PERLMAN. That is what I read in the paper.

Senator HARTKE. Well, that is what you read in the paper.

Mr. PERLMAN. Well, I mean I haven't talked much to Mr. Gorman since leaving office.

Senator HARTKE. Did you know Mr. Butcher?

Mr. PERLMAN. Yes, sir.

Senator HARTKE. What was his relationship to the company?

Mr. PERLMAN. Mr. Butcher was one of the most ardent advocates of merger of the Pennsylvania and New York Central. When I broke off with the Pennsylvania, he sent envoys to try to patch it up again.

Senator HARTKE. That was back in 1959?

Mr. PERLMAN. Yes, sir; and he was a very ardent promoter of the merger.

Senator HARTKE. Do you know whether or not he disposed of his stock while he was at the same time promoting it as being a good buy?

Mr. PERLMAN. I have no record of that. I haven't read any insiders reports about it.

Senator HARTKE. Mr. Perlman, I want to thank you for your testimony here today.

Senator COOK. I have one more question.

Mr. Perlman, I am not sure whether you heard Mr. Arthur Burns of the Federal Reserve Sunday on television——

Mr. PERLMAN. No; I did not.

Senator COOK. In substance he made the remark that one of the real problems we face has been the attitude of the Interstate Commerce Commission in regard to the entire American railway system, that it really has not been an advocate of the American railway system, but it has been an institution which has held them down rather than allow them to become viable.

Would you buy that in substance?

Mr. PERLMAN. That is what they were set up to do. The Interstate Commerce Act was set up when the railroads had a monopoly on inland transportation and they were set up to regulate them as a monopoly. And the world went by them. There were highways built, airways, seaways. And the monopoly has long since gone. Now a man can go out and buy a truck and carry his goods back and forth. Yet we are still regulated as a monopoly. Now the airlines, the authorities say they ought to ask for another raise this year. You never heard the Interstate Commerce Commission come in and say you ought to have another rate increase this year. They are not there to

promote the railroads; Mr. Burns doesn't understand their function.

Senator COOK. The point I am trying to make, I am not being critical of Mr. Burns, but I must confess to you I am being a little critical of the Interstate Commerce Commission because as a regulatory body it has regulated the industry on a rate basis to the point where it has made less than 3 cents on the dollar last year.

You and I can blame anybody we want to, and say somebody doesn't understand the function of the ICC. But the ICC has functioned so thoroughly in regard to regulating that it has almost regulated a business out of financial existence.

Is that not true?

Mr. PERLMAN. That is absolutely true, sir. But I must again say that is what they were set up for. And this is why I take issue with the national transportation policy as it is set up today. Just as the President said, it is a chaotic patchwork. The other three modes of transportation have these agencies to promote them. And when the Commerce Department had this function, that the Department of Transportation now has, a railroad man couldn't be seen with them, they were suspect if a railroad man were seen with them, because they had to promote, they had the Inland Waterway Corp. to promote the canals and inland waterways, they had the Bureau of Public Roads to promote the highways, and they had——

Senator COOK. The CAB for the airlines.

Mr. PERLMAN. Yes; and by gosh, they wouldn't be seen with a railroad man. I had hoped when the Department of Transportation was set up, at least you would have somebody as an advocate for the railroads. But that still hasn't happened.

Senator COOK. Let me ask you: Are you in essence saying to me that even if we come out with a bill that will guarantee $750 million worth of loans, or whatever it may take, that we are not going to have a viable transportation system in this country as long as the Congress allows the Interstate Commerce Commission to function under the present law?

Mr. PERLMAN. Yes, sir; yes, sir.

Senator COOK. Thank you.

Senator HARTKE. I don't want to belabor this other point, but were there directors who supported Mr. Bevan and Mr. Saunders? Did they just go along, I mean were they active in the participation in the board meetings, or was this a controlled operation?

Mr. PERLMAN. Well, you know most boards that I have been on will have maybe one or two real active men and sometimes they are thought of as gadflies really, and others aren't too active actually. I think this was no exception.

Senator HARTKE. Thank you, Mr. Perlman. Thank you for coming this morning.

Senator COOK. Mr. Perlman, I want to put one thing into the record because we were talking about the ICC. I want to read from the Interstate Commerce Act, the national transportation policy. I think this can be construed as a mandate on the Interstate Commerce Commission to do the opposite of what you and I are talking about, because I want to read from the act.

All to the end of developing, coordinating and preserving a national transportation system by water, highway, and rail as well as other means adequate to meet the needs of the commerce of the United States, of the Postal Service, and of the National Defense.

So I think we can read into this a mandate on the Part of the Interstate Commerce Commission to see to it and they should have seen to it that they had a viable rail industry rather than one that is in the condition it is in today.

Mr. PERLMAN. I agree with you, sir, on that score and I also think if you look at it, it was always assumed that the railroads make at least 5¾ of a percent on investment, and that has been a long time since that has happened.

Senator COOK. It sure has. Thank you.

Mr. PERLMAN. Thank you very much.

Senator HARTKE. Mr. Perlman, are you saying in effect that the railroad system today is in a condition which Prof. George Hilton alleges that it is, that it is a dying industry, it can not support itself?

Mr. PERLMAN. I say that under the present system of regulation, under the present system of subsidies to the other three forms of transportation, under the system where we are not allowed to make competitive rates with other modes, it is a dying system; yes, sir.

Senator HARTKE. He says we ought to let it die.

Mr. PERLMAN. I don't agree with him. I still say that the steel wheel on the steel rail is the most efficient form of transportation in the world. And it is being killed, we are not letting it die, it is being killed.

And, sir, I think that is the tragedy today, to see it being killed that way. All I say, as a taxpayer, is treat them all alike. Don't give any of them any subsidies—or subsidize them all. Why does it mean nationalization of the railroads if you are going to subsidize them like you subsidize every other form? There is no nationalization talked about with the airlines. I just read today they were giving them some more money, to a firm up in Bedford, Mass., to work out some research for the airlines.

What have they given the railroads? I mean compared to the billions that are poured out to these other forms of transportation?

Even the New York Times is all upset. I have three editorials here in the last week from the New York Times and this one today is certainly an example of that. If I were saying that as a railraod man—here is a whole editorial "Too Much for Highways," and they are saying what we are spending for highways is unconscionable and not enough for rails, and what is happening in the cities on mass transportation and all that.

SENATOR HARTKE. Do you know that some of the airlines are lined up so that if we pass a bill guaranteeing loans to the railroads, the airlines want to be included in that?

Mr. PERLMAN. Well I think we are fools that we are not lined up because you are giving money to the airlines, and highways, and waterways now.

I think the railroads are so far behind the times in not coming down here and knocking on your door that it isn't even funny.

Senator HARTKE. Let me ask you, you referred to the need for the Interstate Commerce Commission. What about the tight money policy? Should it go too?

Mr. PERLMAN. Sir, I have been out of step with both the Johnson administration and this administration as far as the money policy. When they repealed the 7 percent investment credit, I thought that was the greatest mistake that could be made.

Senator HARTKE. Let me say on the 7 percent credit, I wrote the minority opinion on that, I was in favor of continuing it too.

Mr. PERLMAN. I didn't know that, sir. But if you don't allow the industry to have the money to automate and improve its plant, how are you going to get increased productivity? You can't ask the men to work harder, you have to make it easier for them to work to increase productivity. The only way you can do it is to have the money to automate and improve your plant.

When they took the 7 percent away, because they said that it was increasing inflation, they are just out of step with the times. When they say tight money is going to do that, if you can't get money to automate, and if you can't get money to do these kind of things, how in the name of the Lord are you going to meet these wage increases? That is the only way you can meet them.

Now I don't understand—they are lying in their teeth about this tight money in my opinion. It is not going to help inflation, it is going to hurt it.

Senator HARTKE. It is adding to the inflation.

Mr. PERLMAN. If you don't have money to improve your operations and to improve your plant, and to put in automation and things like that, you can't meet these 6 and 7 and 15 and 20 percent wages increases. There is no way in the world, sir.

If a shoemaker takes 4 hours to make a pair of shoes and you pay him $2 an hour, you are going to pay $8 and a profit for that pair of shoes. If suddenly you are paying $4 an hour, it will cost you double that amount for the pair of shoes and your dollar is only worth 50 cents.

That, to me, is where we are going in inflation today. I think a grade school child can understand that. But not the politician.

Senator COOK. Mr. Perlman, I think I agree with you.

Senator HARTKE. Now that we all are agreed on that policy, I guess we will adjourn the hearings.

(Thereupon, at 12:15 p.m. the hearings were recessed, to reconvene at 10 a.m. the following day.)

[From Fortune magazine, August 1970]

THE PENN CENTRAL BANKRUPTCY EXPRESS

(By Rush Loving, Jr.)

History's biggest railroad merger was doomed from the start. Conflicting philosophies and feuding managements led to a breakdown in both operations and finances.

The long, heavy shadows had fallen across the gray archways of New York's Federal Reserve Bank. Inside, in a tenth-floor conference room, three officers of the Penn Central Co. and representatives from nine banks sat around the long table and waited impatiently. To stay solvent, the Penn Central Railroad had

to have a $50-million advance, which the nine banks were ready to make—as soon as Secretary of the Navy John H. Chafee signed a government guarantee to back a total loan of $200 million. Chafee was supposed to sign in Washington that afternoon, but now it was after five o'clock and these men were still waiting for his phone call. Some strayed out into the hall; the others chatted feebly at the table. The talk abruptly stopped as Thomas M. Timlen, a Federal Reserve vice president, came in and announced that instead of signing the guarantee, Chafee had sent word that the government was not going to back the loan after all.

The bankers were stunned. Timlen added that they were free to go ahead and make the loan anyway, but, as the shock wore off, the bankers replied that the loan had been pegged solely to a guarantee, and they started packing their briefcases.

Thus, on Friday, June 19, 1970, the Penn Central Transportation Co. rolled toward bankruptcy with the finality of an express train thundering through the night. The railroad had run out of cash. Virtually every asset it owned was either mortgaged or pledged, and the banking community was not making any more loans—not without a government guarantee. In terms of assets ($4.6 billion) it was the biggest bankruptcy in history.

The bankruptcy followed by nearly two weeks the firing of Penn Central's chairman and chief executive officer, Stuart T. Saunders, pillar of Philadelphia's Main Line and one of the most powerful men in American railroading. It also followed months of secret negotiations between Saunders and top government officials, talks that were aimed at saving the railroad from insolvency.

The underlying causes of the failure can be traced back to the 1968 merger of the Pennsylvania and the New York Central railroads, the biggest corporate marriage in business history. The merger should not have happened, for the personalities of the two roads were so far apart they were incompatible. And the men who ran them found it impossible to work in harmony. The merger was badly executed, and management since has been just as bad. There was chaos out on the road, aggravated by infighting between some of the company's top managers.

Worse yet, complex and sometimes hazy financial reporting had cloaked the great losses and the steady hemorrhaging of cash that the chaos had wrought. The blame for all this falls on many men, not the least of them the directors who went along blandly—until it was too late.

THE UNCONVENTIONAL RAILROADER

"It wasn't a merger, it was a corporate take-over," grumbles one former Central man. For ten years, while the merger proposal dragged through study committees, the Interstate Commerce Commission, and a maze of federal courts, Alfred E. Perlman, the Central's president, threatened repeatedly to call off the deal. Independent and proud of the line he had streamlined and glamorized, Perlman scorned the stodginess of the Pennsy and its banker-like management. But a merger would cut rising costs, and the Pennsylvania was the only partner the Central could find.

The Pennsy and the Central were unrelenting competitors, and they were the two dominant railroads of the Northeast. Their combination created the world's longest privately owned rail system. Their fleets of cars and locomotives could be stretched from New York to Laramie.

But they were opposites, and this was a problem when their differing operating styles were brought together. The Pennsylvania got much of its business from hauling steel, ore, and coal, while the Central was primarily a mover of merchandise from the factories of the Midwest to the consumers of the Northeast. Thus one emphasized volume while the other offered speed and service. The Pennsylvania was traditional in both organization and thinking. It maintained a massive bureaucracy that worked on a strict military chain of command. The Central was known for the imaginative and highly unconventional team of informal young men that Perlman had collected. They were like the Central itself, lean and hungry, and they contrasted mightily with the comfortable, staid, and conventional men whose tenure had slowly lifted them to positions of command in the Pennsylvania.

The personalities of Saunders and Perlman, the two men who were to dominate the merged system, are equally constrasting. Perlman, lean with piercing eyes of cobalt blue, had been a railroader almost all his life, holding a rising suc-

cession of operating posts at the Northern Pacific, the Burlington, and the Rio Grande before heading the Central. He had an engineering degree from M.I.T., and was known as one of the best operations and maintenance men in the business. Perlman is an intellectual in spirit, always seeking better ideas, constantly reminding himself that there might be a better way of doing things if a person kept an open mind. Perlman, like most operations-oriented presidents, toured his road constantly, demanding something new wherever he went. He would dig out the places where his line could economize, handing his lieutenants specific directives for savings.

If jobs weren't done right, if a man was inept, Perlman raged. He is fairly short, but his vice presidents were giants, all above six feet. "When he came to town, it looked like a mobster and his bodyguards," recalls a former Central man. And when Perlman raged, he was a fearsome antagonist, for he could cut down a man with a sarcasm that sliced like a frozen scalpel.

COURTLY, COLD, AND UNCARING

By contrast, Saunders was a lawyer and a politician, a man whose sharp mind sorted facts and neatly laid alternative decisions side by side, ready for selection. But Saunders often preferred mediation and compromise to the more testing task of selecting the best of those decisions. As a politician, Saunders saw the advantages to himself and his railroad in building political bridges, and once he even talked of runnning for governor of Virginia. A mover inside the Democratic party, he held influential government advisory posts and was a confidant of such leaders as Lyndon Johnson.

Bald-domed, shackled with a watch chain of gold, neatly incased in a convex vest, Saunders gave off an air of supreme self-confidence. Unlike Perlman, he has few close friends, and to some of the people he meets he comes off as outwardly warm and even courtly in his southern way, but underneath he seems cold and uncaring. To those who have known him the closest, he's always been a man trying to prove something. In the mountains of Bedford County, Virginia, a man who grew up with Saunders once recalled him as "the fat little boy we used to chase home from school."

After a spell in Washington law offices, Saunders had risen through the legal department of the Norfolk & Western Railway until, after nineteen years, he was elected president and chief executive. Shortly after taking office, he brought in a bright young Virginia public-relations man named William A. Lashley, who made Stuart Saunders his personal project, by molding him in the image of a transportation innovator and a king of industry.

At the Norfolk, and when he took over the Pennsylvania from James M. Symes in 1963, Saunders made it quite plain that he was unconcerned with the details of daily operation. (And there was no cause to be concerned at the N. & W., where a heavy coal business guaranteed a steady flow of profits.) "I'm only interested in that operating ratio," he once growled at a vice president. Symes had been an operating man, as had Saunders' predecessor at the Norfolk, "Race Horse" Bob Smith, who had used his lanky legs to walk almost as much of his right-of-way as he rode, and he rode it all. But Saunders rarely visited any of the properties of his railroads, and when he traveled he usually forsook the trains for private jets.

He ran his railroads by giving broad orders for cost cuts and revenue hikes, telling his lieutenants that either they would find ways to carry out his directives or they'd be fired. And he punctuated his threats with a growling temper that started with a crimson tide that swept up over his face and across his round dome.

Early in the game, Saunders distinguished himself for his good stockholder relations. While per-share profits always rose under his regime, so did the dividends. In his first three years at the Pennsylvania he hiked annual dividend payments from $6,800,000 to nearly $32 million.

The Penn Central's troubles began even before the merger. To combine two such mammoth rail lines is a costly and involved task. There were different operating rules, different types of locomotive controls, even different language. To establish a uniform method of operation after the merger, a planning committee, manned by staff members of the two roads, met off and on for ten years before the merger. The merger had been proposed so that the two roads might eliminate thousands of miles of duplicating tracks and scores of surplus yards, at a total estimated annual saving of more than $80 million.

The committee failed to agree on some key issues, most notably what type of computer would control the operation of the merged system. The two roads had different computers that wouldn't mesh, and neither line's computer people would yield. Even today the two systems still operate side by side; replacing them with an effective realtime system will cost the Penn Central as much as $20 million. Since he was to become chairman and chief executive of the merged line, Saunders had the role of arbiter for these disputes, but, being a mediator by nature as well as training, he often failed to hand down final, resolving decisions. (The computer is a case in point.) Not long ago he confided to an associate that he had been afraid of antagonizing Perlman, who had been threatening periodically to call off the merger.

Probably the most controversial miscalculation of all was the agreement that Saunders engineered with all the operating and shop craft unions in the spring of 1964. To avoid long and paralyzing negotiations each time a shop or a yard was shut down or consolidated, the railroads promised the unions that, once merged, they would rehire all workers with five years' seniority who were furloughed between the time of the agreements and the day of the merger. This promise cost $38 million in the first two years of merger. In addition, the Penn Central agreed to pay one year's severance for each five years of seniority to any workers laid off after the merger. This would cost nearly $100 million for every 10,000 unneeded workers. Normally workers are merely furloughed with no severance.

"WHERE THE HELL IS HARRISBURG?"

With the merger, Perlman became president and chief operating officer, with full responsibility for the new railroad's marketing, traffic, and operations divisions. Perlman reported to Saunders, as did David C. Bevan, the Pennsylvania's former chief financial officer, who retained that title in the merged road and headed the finance committee. Thus the company's finances were outside Perlman's control, a matter that was to have repercussions later.

As soon as the two roads were legally joined they began operating as one. Saunders' friends say that Perlman should have merged the operations in bits and pieces. But Perlman's supporters say this was not possible—because Saunders' labor agreements cost so much the Penn Central had to grab what economies it could by consolidating everything as quickly as possible.

The merger came at 12:01 A.M., Thursday, February 1, 1968, and the chaos came right on its heels. "It was just a goddamned operating mess," says one railroader. Routes were changed immediately for some types of traffic, but since none of the classification clerks had been taught the 5,000 new combinations of routings, cars started flowing by the thousands into the wrong yards. Recalls a former Central worker at the yard in Albany: "They'd get a car for Harrisburg, which wasn't on the old Central, and they'd say, 'Where the hell is Harrisburg? I know where Pittsburgh is. Shit! I'll send it to Pittsburgh.'" Worse yet, many cars had no waybills—the papers that accompany each car and show its routing and destination—and yard superintendents were sending out entire trains of no-waybill cars, just to get rid of them, thereby making more confusion at the next yards down the line. The yards were jammed, and trains were unable to get in. And because of this their engines weren't available to haul fresh trains out of the yards and relieve the congestion. Many times crewmen had to leave entire trains on sidings along the main lines, and the Penn Central suddenly began losing trains. In one case, at the close of 1968, a coal train of more than 100 cars was lost for ten days outside Syracuse.

The real trouble lay at the top of the Penn Central. The merger had created a strange management pattern. Layered through the top ranks were all the former executives of the Pennsylvania and the Central. Perlman, of course, was loyal to his old Central team, and, quite naturally, Saunders was not going to allow this love to jeopardize any of the old Pennsy crowd. Generally a department was headed by a former Pennsylvania man, followed by a Central man, followed by a Pennsylvania man, and on down the line. If a subordinate was unhappy with his immediate boss, he could always feel free to vent his feelings to an old colleague further up the ladder. The results were catastrophic.

Saunders' edicts of do-or-be-fired ran up against Perlman's technique of leading men by encouraging them. At the same time, Perlman, who was used to exercising complete control over his railroad, was frustrated by his lack of authority over finances.

Although Perlman made up his budgets, the outlays and other key financial data were controlled by Bevan, who was suspected of favoring land investments

over the railroad. Perlman wanted more money for car repairs and modernization, but Bevan offered too little to suit him. Saunders presided over all this like the mediator he was, trying to bring the two to an accommodation and only frustrating Perlman's love for decisions that were hard and binding.

"WHO DOESN'T LIKE SANTA CLAUS?"

Perlman was unhappy with his executive vice president for operations, a former Pennsylvania man named David E. Smucker. A rough and tough old railroader who cursed with an eloquence that was awesome even to steam veterans, Smucker ruled in the old autocratic Pennsy style, a leadership trait that won him his men's endearing appellation of "Mother Smucker." More than that, Smucker did not get out on the road very often and he failed to show enough enthusiasm for Perlman's attempts to streamline the company. On the other side, Perlman's open disdain of the Pennsy's stodginess hadn't endeared him to Smucker. "You run a wooden-wheeled railroad," he had told Smucker before the merger, thus adding a few more lightning bolts to their relationship.

Time after time, as the railroad's operations descended into an ever gooier mire, Perlman pleaded with Saunders to let him dump Smucker, but each time Saunders refused. Finally, early last year, Perlman asked one last time, and, when Saunders turned him down, Perlman announced that he was through. A day or so later Saunders gave in, and Smucker was replaced by Robert G. "Mike" Flannery, who now has the thankless job of operations.

Another thorn in Perlman's side was Henry W. Large, his executive vice president for marketing, a big-boned and usually affable Pennsy alumnus. Large was as disdainful of the Central marketing people—Perlman's pride—as Perlman was of Smucker. The Central people had made their money by selling service to shippers, at a good price. Large and the Pennsy marketing department, on the other hand, had always worked on the principle that volume counted, no matter how bare the profit. Thanks to this difference, the Central had made an average per-mile operating profit nearly equal to that of the Pennsylvania, which had taken in nearly twice the Central's operating revenues. The department's ranking Central man, James R. Sullivan (who is still vice president for marketing), tried in vain to hold his old marketing team together while he and Henry Large battled over a policy that the Central people insisted was costing the railroad blood. "If we lose this battle, and they prevail," Sullivan told his men before one crucial showdown, "then we'll paint this thing nationalization green."

Meanwhile, Perlman was asking Saunders to let him dump Large too, but to no avail. Finally, last August, over lunch at the Sky Club in New York's Pan Am Building, Perlman is said to have presented Saunders with statistics proving that Large's policies were costing the railroad money.

"You just don't like Henry Large," snapped Saunders.

"I do like Henry Large," said Perlman. "He's a great big lovable St. Bernard. No one can help but like him. But he's giving away the railroad."

"But the shippers like him," countered Saunders.

"Well, who doesn't like Santa Claus?" Perlman replied, and Saunders proceeded to tell Perlman that he was being negative, a verdict Saunders is said to have rendered on Perlman before.

A WINTER OF DISCONTENT

This was the final straw, Perlman was frustrated already by his dealings with Bevan, particularly by his inability to get $25 million to refurbish 12,000 unserviceable freight cars. Saying that he no longer wanted to have his hands tied while taking the blame for the railroad's collapse, Perlman told Saunders he was quitting the presidency. Saunders, who had long felt that the place would be quieter without Perlman, accepted the resignation forthwith. Perlman took the meaningless job of railroad vice chairman. Saunders told someone later that he regretted not getting rid of Perlman earlier.

Although Saunders tried to get a veteran railroader for the presidency, those whom he approached could be their own bosses elsewhere. A member of the board recommended Paul A. Gorman, sixty-two, then president of Western Electric Co., a neat and orderly administrator and, most important, a cost cutter. Saunders hired him at $250,000 a year.

Gorman reorganized top management, trimming the number of vice presidents who reported directly to him, and in March of this year, Gorman replaced Large

in the marketing department with Edward G. Kreyling Jr., a vice president of the Illinois Central. With Large went the Pennsy philosophy of volume over price. "We're killing Santa Claus," said Kreyling. "They won't be giving things away any more around here."

Meanwhile, Mike Flannery was trying to turn around the road's operations. A forty-five-year-old Indianian, Flannery had been one of Perlman's operating officers at the Central, and he had learned well under the master. With shirttail hanging out, black Irish locks dangling in his eyes, Flannery was highballing his way up and down the system, freeing bottlenecks, demanding more of his men. And, more important, he was instilling into the Penn Central a much-needed morale. Motivation by fear was out; motivation by pride was the new order of the day. "Flannery can really chew you out, but he always has time to listen to you," one operations man said last spring. "I think the son of a bitch is going to bring this thing off like Gang Busters."

Actually, Flannery was well on his way to bringing things back by late last fall. Then the worst winter in the railroad's history swooped in, tearing up miles of roadbed, freezing up locomotives by the scores. For days the Penn Central came to a near halt. By early this summer Flannery had operations back to their pre-winter level. But he still faces almost insurmountable problems. Derailments still plague the road, and up and down the main line there are slow orders, or reduced speed zones, largely because years of deferred maintenance have finally taken their toll. There is congestion around the yards in Cleveland; there is need for a new yard at Philadelphia and automation in the yard at Harrisburg. Failure to spend money on maintenance has left the railroad in a ramshackle state.

108 CADILLACS BITE THE DUST

At Albany's Selkirk yard, for instance, Herb Schwartse, a crew-cut, square-jawed engineer from New Jersey, rolls out onto the main line southbound to Weehawken; this is the old River Division that winds 140 miles along the west bank of the Hudson. It's midafternoon, and, with 102 cars of mixed freight behind him, Schwartse is rumbling down one of the most overworked stretches on the entire Penn Central, sections of single track that weren't meant to take the twelve trains a day that the re-routings of the merger have thrust upon them. The top speed here used to be seventy, but now it's only forty, and the two black diesels shake and pound even then. No sooner is he highballing than Schwartse has to cut to thirty because of a slow order, bad track from a derailment last winter. Just below the town of Alsen the afternoon sun glints on a blue car hood that still lies beside the road, a reminder of the day last winter when nine racks of new Cadillacs, 108 of them in all, flipped over here in one mangled heap.

Just above the high bridge at Catskill, Schwartse has to slow again, this time for a three-mile stretch where the limit on this, a main line, is a creeping ten miles per hour. That's because the track is still weak from a wreck in November. Four freight cars still lie on the wayside as remnants of that disaster. At Lake Katrine five boxcars await the cutters' torch; they were dumped in a derailment last winter. Just above West Park there are seven cars from another winter wreck, and below the town, lying along the roadbed like gravestones, are twenty-one torn and ripped cars from a wreck a year and a half ago. As Schwartse explains it, the maintenance and the wrecking men have to get a clear track if they are to make things right, and the River Division's single line is just too busy for that.

For that matter, it isn't easy for freight trains to get the track either. At Kingston, Schwartse and his firemen take a supper break while waiting in a siding for a northbound freight to get by, and above West Point, as the gray dusk of the Hudson slowly swallows Storm King Mountain, Schwartse puts his foot up on the cab window and lights a cigarette, while he waits for another northbound freight. An hour and a half later a big orange moon hangs over the tracks ahead as the engine roars on toward Weehauken. This night he'll be lucky and won't have to wait outside the oft-crowded Jersey yard.

On the other end of the system, out at the old Victorian station in Indianapolis, Charlie Barger bites into the stump of his cold cigar as he pulls back on the throttle of an old Covered Wagon, one of the Pennsy's earliest diesel locomotives, and takes No. 4 out for Richmond, Dayton, Columbus, and points east. Barger looks straight up the road, his eyes staring hard between the black tip of his cigar and the rounded brim of his green work hat. Charlie Barger sits up there

like a Buddha, his right hand on the brake handle, left on the throttle, and like the old steam man that he is he reaches up for long tugs on the whistle cord. Barger's been making this run for most of the forty-four years he's been a railroader, first firing, then driving, and he remembers the golden days when the speed limit here was seventy-five and the track clear. Now the top speed is sixty and this day No. 4 is late because of track work between Indianapolis and St. Louis, and before he reaches Richmond, Barger has to cut his speed three times, once to ten miles per hour. Beyond Richmond the track has been freshly repaired and the limit is seventy, and Charlie frets when he finds he isn't getting more than sixty-seven out of the old engine. By the time he ends his run at Columbus, he's running later yet, all because of those slow orders, and as he climbs down from his cab he gnaws unhappily on the final stubble of his half-eaten cigar. For to a proud old railroad man like Charlie Barger, trains like No. 4 just aren't supposed to be late.

A FATAL DOSE OF OPTIMISM

"I did not come to the Penn Central to liquidate it," Stuart Saunders declared one day last fall. But even at that moment the railroad was well on its way to bankruptcy. The Penn Central's troubles hang to some extent on this incurable optimism of Saunders. Just as he is said to have abhorred Perlman's negative thinking, Saunders apparently believed that if he kept saying he could do something he would inevitably succeed at it. This optimism sloshed over into his speeches and, at times, it carried into Penn Central's earnings statements as well. Saunders, for example, blamed much of last year's operating deficit on the road's passenger losses. But out-of-pocket passenger losses amounted to only half the railroad's true total deficit.

Thanks to some unique bookkeeping, the Parent Penn Central Co. was able to report remarkable profits, happy figures that lulled creditors, shareholders, directors, and managers. Many of the bookkeeping techniques conform to what the auditing fraternity calls accepted principles of accounting, and Peat, Marwick, Mitchel & Co., which received more than $600,000 from the railroad alone for accounting services last year, gave the books its certification of approval. More surprising yet, some of these practices were accepted by the Interstate Commerce Commission, which is supposed to keep an eye on the financial health of the nation's railroads.

Such normal operating expenses as wages and phase-out costs were taken out of capital rather than income, thus inflating Penn Central's reported profits by millions of dollars. Some bills for freight charges, which reportedly are uncollectable, were credited to income. Sales of real estate, which should have been designated as extraordinary items, were credited to normal income, as were the profits from securities sales. Assets were written off as extraordinary charges to avoid the annual depreciation, thereby enhancing earnings. When a large block of securities was exchanged, the paper profit from the transaction was credited to normal income in installments over the ensuing years, even though no cash had ever come in. In some transactions the railroad company sold assets to its financial subsidiary at many times their book value and credited the difference to its own income as profit. The railroad fed its own capital into affiliated companies and then took it back in the form of dividends—some of them exorbitant. Although these advances to affiliates were not charged against current revenues (they were charged as loans), the dividends were credited to income.

These accounting practices disguised the true state of affairs from even the most knowledgeable outsider. Although Penn Central told its shareholders that it earned $4,400,000 before extraordinary items in 1969, it actually suffered a normal loss of at least $95 million, and it may have lost as much as $120 million. Even aften an extraordinary gain of $18 million from security sales, the loss came to more than $75 million. The company recorded the profit from security sales as part of its normal income, even though such a transaction really was an extraordinary gain. Reported earnings also included $8 million in unpaid freight bills. According to one source, the railroad, in many cases, doesn't know whom to send the bills to. Earnings got another boost when the railroad took from its capital rather than from operating expenses the $22 million it spent refurbishing equipment of the acquired New Haven Railroad. The cost of rehiring furloughed workers, as required by the merger agreements, and the expense of removing surplus property—again brought on by the merger—were taken out of capital, and thus 1969 earnings were overstated by another $17,400,000.

Saunders was able to reap some hefty dividends last year from company-owned trucking lines, real-estate and coal companies, and rail lines. At the same time, however, Penn Central was making loans to some of these same affiliates from its own capital. The dividends boosted Penn Central's earnings by $35 million. Five affiliates, for example, posted heavy increases in dividends to Penn Central. The dividends totaled nearly $19 million, some in the form of stock, but both directly and through a web of subsidiaries Penn Central advanced the same five companies at least $17,300,000.

Furthermore, some of last year's dividends were quite extraordinary. For instance, the railroad showed a $14,500,000 dividend from its wholly owned truck line, New York Central Transport Co., which had a 1969 profit of only $4,200,000. To get the dividend, Penn Central virtually cleaned out all Transport's shareholders' equity, leaving a sparse $255,632. Meanwhile Transport's cash and cash investments plunged from $2,900,000 to $1,300,000, and its accounts receivable doubled to $13 million. Another trucking affiliate, Merchants Despatch Transportation Corp., showed a $2,800,000 profit for 1969, but paid Penn Central a $4,700,000 dividend. Manor Real Estate Co., which had a $714,000 loss last year, handed over a $2-million dividend, and Despatch Shops Inc., with a $252,000 profit (a decrease of nearly 40 percent from 1968), paid a $1-million dividend. In the fourth quarter of last year the Penn Central wrote off $126 million of passenger cars and stations on the ground that it would never recover any profit from them. While the cost of the write-off was listed as an extraordinary item and thereby did not hurt earnings, a former Penn Central director says the write-off actually was taken to reduce depreciation charges by $4,500,000. Even after its other paper gains, the company would have shown a slight loss last year, but, thanks to this write-off, it was able to report an operating profit of $4 million.

THROUGH A BALANCE SHEET, DARKLY

Last year's performance was nothing new for the Penn Central. In 1966 the Pennsylvania agreed to swap some Norfolk & Western common stock for N. & W. debentures. The company listed a $104-million profit from thet ransaction and had it allocated to profits over an eight-year period. Penn Central's 1969 earnings alone were inflated by $7,600,000 because of this paper gain.

The Penn Central reported a profit of $90 million for 1968 (later reduced to $88 million), but actually had a loss of better than $20 million. The company had a $54-million extraordinary gain from securities sales, but listed the profit as normal income. By capitalizing the merger costs, earnings were increased by $23,800,000. There was a credit of $1,600,000 for a tax refund that Penn Central claimed from the state of Ohio, and net advances to affiliates (whose dividends were credited to income) totaled $10 million. In 1968 the railroad also included in its profits an $11,700,000 dividend that was merely a property exchange. This represented Penn Central's interest in Washington's Union Station, which was transferred during the year from the Washington Terminal Co. to Terminal's two owners, Penn Central and the Baltimore & Ohio Railroad. The Penn Central based the dividend on the price it expected to get for the station when it sold it to the Department of the Interior for a visitors' center. The sale still has not been consummated.

This virtuoso bookkeeping was used to show that the company had an adequate cash flow. Nowhere is this technique more obvious than in the handling of Penn Central's real-estate operations. The 1969 earnings statement included $48 million from thee company's three major non-railroad subsidiaries, but Penn Central received little hard cash from those companies. Its biggest and most glamorous holding, Great Southwest Corp., had $34,400,000 in 1969 earnings, a hefty boost to Penn Central's consolidated statement. But this was offset by a $70-million gain in Great Southwest's accounts receivable, meaning that many of its sales had been made for IOU's rather than cash. Moreover, Great Southwest had raised money for its new land developments by borrowing; the railroad's supplementary pension fund still holds a $2,500,000 note from the land company. In 1968 and 1969, two years when cash was dearest to the railroad, Penn Central itself fed nearly $19 million in advances to Great Southwest. In return for all this, the land company contributed only $2,200,000 in dividends last year.

Although Great Southwest's great gains in earnings did much to prop up Penn Central's consolidated profit statements, the real-estate company has actually

been a costly drain on the railroad. Saunders and Bevan bought a controlling interest in the company for $16 million in 1964, and invested $9 million more in 1966, while other railroads were using what cash they had to modernize yards and tracks. One insider says that, if the same money had been invested in modernizations, it would have saved Penn Central as much as 300 percent on investment per year. Instead, Penn Central has received an average annual return from these two investments of less than 3 percent.

FOR THE STOCKHOLDERS, $100 MILLION

Despite the cash shortage, Saunders insisted that its dividend policy continue. For example, after deductions for the consolidated subsidiaries, Penn Central had about $100 million in 1968 for its $300-million capital-spending program. Nevertheless, the directors paid out $55 million in dividends to the stockholders.

Although some directors have told newsmen in recent months that they were not aware of the company's real financial position, the warning bells should have rung early in 1969, when Murray A. Harding, a Wall Street analyst, pointed out that Penn Central's 1968 earnings statement had been inflated by the Washington terminal "dividend." The directors, however, continued to bestow their confidence in Saunders, voting another dividend for the first quarter of 1969. By midyear, matters had deteriorated so badly that Bevan was urging that dividend payments be halted. But Saunders stuck to his philosophy of good stockholder relations, urging that the payout continue. He was trying to build Penn Central into a conglomerate, and the dividend payout would help hold up the company's price-earnings ratio. (Saunders now says he thinks the dividend was paid too long.) But by last fall the company was in such dire straits that the board finally chopped off the dividend. In those two years of negative cash flows, nearly $100 million had been paid out to Penn Central's stockholders.

Through this time, Bevan, as chief financial officer, had been borrowing to keep the company afloat. In 1968 he tapped the Eurodollar market, bringing back $50 million in short-term money. In 1969 he managed to raise the company's outstanding revolving credit from $100 million to $150 million, and he raised an additional $85 million from bond and debenture sales. At year-end 1969, with the squeeze tightening, he went back to Europe for another $59 million in one-year money, at an interest rate of 10.1 percent, or more than twice Penn Central's return on investment in good times.

As bad winter weather racked the road and the economic slowdown hurt business, it became obvious even to habitual optimists that Penn Central was headed for serious trouble. During 1970 the railroad had to meet $106 million in sinking-fund requirements. To get more leverage, Bevan mortgaged just about the last asset he had. He also sold $193,400,000 in unsecured commercial paper. But even more money was needed. The winter storms were costing the road a first-quarter loss of $80 million and, based on more conservative accounting methods than those practiced by the Penn Central, the loss was probably in excess of $100 million.

BRINGING BAD NEWS TO WASHINGTON

In the last week of February, Bevan went off to New York to negotiate another loan, while Saunders, Gorman, and Jonathan O'Herron—Bevan's assistant—paid a visit to the Interstate Commerce Commission. Saunders told the commission of the Penn Central's plight and urged that a proposed freight-rate hike for all the nation's railroads be granted immediately. In March, Saunders and O'Herron paid two vists to John A. Volpe, the Secretary of Transportation, and although Volpe now claims that he did not know until early this summer just how desperate things were, Saunders spelled out the situation to him then. In April and May, Volpe and Saunders jointly worked out a scheme for federal defense guarantees of Penn Central loans, and Volpe put Saunders in touch with the Defense Department.

While Saunders was pleading for help in Washington, Bevan was putting together a $100-million debenture offering, which was to be sold in late May or early June, just in time to allow the railroad to meet its sinking-fund requirements. The offering was to be sold by Pennsylvania Co., the railroad's financial subsidiary. Penn Central owns all Pennco's common shares, but the preferred stock is owned by the public. Because most of Pennco's assets were

pledged, and in order to transfer the debenture proceeds over to the railroad, Bevan planned for Pennco to buy three of the road's last nontransportation affiliates: Manor Real Estate Co., Clearfield Bituminous Coal Co., and Despatch Shops, Inc. Although Penn Central's total investment in the three came to only $29,300,000 (including a $24-million loan), Bevan proposed to sell the group to Pennco for $84,100,000, or nearly 150 times their combined 1969 earnings.

Initially, Wall Street appeared to be in a fairly favorable mood for the offering. But in late April, Penn Central anounced the first-quarter losses, and the commercial-paper market reacted immediately. Penn Central was unable to sell new paper to refinance the paper that was coming due. When an updated prospectus for the offering disclosed this squeeze, bond buyers turned thumbs down on the issue, even at a 10.5 percent yield.

A despairing Saunders hurried back to Washington on May 19 for a meeting with Secretary of the Treasury David M. Kennedy. He told Kennedy of the commercial paper redemptions and of the tightening bind on Penn Central's treasury. The debenture offering appeared doomed, said Saunders, and if he could not get guarantees for further loans, the railroad subsidiary, Penn Central Transportation Co., would have to consider filing for bankruptcy within the next few days.

Kennedy was stunned. With the stock market in its perilious decline, news of the bankruptcy of the Penn Central could trigger a chain reaction, if not an outright panic. Moreover, the Penn Central's collapse would bring heavy losses to many of the nation's big mutual funds. In the coming days Saunders made repeated calls to Volpe as Administration leaders hurriedly prepared a $200-million immediate Defense Department guarantee for Penn Central. And they drew up a bill to guarantee another $750 million in railroad loans, a large chunk of which would go to the Penn Central.

DIGGING AT THE TRUTH

For several months there had been growing signs of unhappiness among the members of Penn Central's finance committee. When the year-end and the first-quarter returns came in, committee members had begun asking questions. Although Bevan made all the financial data available, members complain that they had to thread their way through masses of detail to find the key points. "You'd have to dig for it," says one. One member, E. Clayton Gengras, chairman of Security Corp., a Hartford insurance firm, was an old hand at such digging. Gengras was elected a director late last year after Security acquired control of 220,900 Penn Central shares, and he joined the finance committee last March. Gengras began visiting the Department of Transportation, where he happened to have an old friend, John Volpe. Armed with advice from Transportation Department experts on what questions to ask of Bevan and Saunders, Gengras began boring in, and other members of the committee quickly joined him.

The forced cancellation of the debenture issue provoked sharp questioning at a May 27 meeting of the finance committee. Although no one suggested tossing Saunders out, the discussion swung around to the idea of giving Gorman the chief executive's powers, thereby giving him control over the financial operations. Until then the complaints and questions had been pretty well limited to the finance committee, but they spilled over into a meeting of the full board that same day. Again, though, there was no mention of any major change in management, although the New York bankers were getting restless.

The showdown came at 11:00 A.M., Monday, June 8, when Saunders convened a called session of the railroad's directors to brief them on his arrangements for the loan guarantees. He outlined the situation quickly, then, knowing the board's darkening mood, he moved that he, Bevan, Perlman, and Gorman—the inside directors—leave the room. Franklin J. Lunding, finance-committee chairman of Jewel Cos., Inc., and chairman of the railroad's executive committee, presided in Saunders' place. The remaining directors began reciting their own complaints and relaying the threats of the bankers, who had been demanding that Saunders be removed. For two hours the words flew, tempers flared, and before the directors realized the full import of what they were doing, they fired both Saunders and Bevan and voted to "relieve" Perlman of his duties, which were then virtually nonexistent. Lunding summoned Gorman from his office and offered him the post of chairman and chief executive. Then a committee of directors met with Bevan and Saunders and broke the news. Bevan, who had tried to retire in March but

had been dissuaded, seemed philosophical about the action. But to Saunders it came as a staggering and completely unexpected blow.

The next day Administration leaders and representatives of the railroad briefed congressional leaders and asked for support of the proposed bill to guarantee $750 million in railroad loans. As the Defense Department prepared the immediate loan guarantee, and nine banks proceeded to line up an interim loan of $200 million, Congressman Wright Patman of Texas, chairman of the House Banking and Currency Committee and an arch foe of big banks, suddenly opposed the guarantees. Patman also began questioning the legality of the interim $200-million guarantee. Other members of Congress surprised the Administration by their coolness to the two schemes, and by the following week the bill at least was considered as good as dead.

That left the Defense Department guarantee, which would provide only enough loans to get the railroad through the summer. Though not as disastrous as the first three months, the year's second quarter was producing a substantial loss, and at best Gorman hoped to see black ink again only in late summer. Even then there was both short- and long-term debt coming due, and more loans would be needed to refinance that. Thus the $200 million would run out around October 1, and if there were no more loans after that the company would go bankrupt. Despite this drawback, the Administration went ahead with its plans, but on Friday, June 19, just as Chafee was about to sign the guarantee, the Administration withdrew its support.

THE WHITE HOUSE BOWS OUT

Patman had obviously been the main cause of the Administration's change of mind. The next morning, Gorman, O'Herron, and three members of the executive committee flew to Washington in Penn Central's private plane for a meeting with Patman. But Patman would not budge. No sooner had the Penn Central men left than Patman issued a statement saying he had not been impressed by Gorman's pleas.

That night the executive committee, comprising Gorman and four outside directors, met in Philadelphia. The company had more than $30 million in loans coming due by the end of the month, nearly $2 million of them on Monday, and there was not enough cash in the till. Gorman recommended voluntary bankruptcy, and as quickly as possible, before the banks moved in and filed for involuntary bankruptcy. By going the voluntary route, Penn Central could ask for an orderly reorganization, while the other method meant chaos and possible liquidation.

Racing both clocks and creditors, Gorman met with his full board Sunday morning and asked for authority to file for bankruptcy. Penn Central's lawyers made arrangements with a local federal judge, C. William Kraft Jr., and a clerk was ordered to stand by at the court. Early in the board meeting, Gorman received a call from Volpe, who asked if there wasn't some other course. Gorman explained the situation while Volpe talked with the White House and tried to find some alternative remedy. They waited for hours, but finally, late that afternoon, the directors agreed they could delay no longer, and at 5:35 P.M., at his farm in Delaware County, Judge Kraft signed the bankruptcy order. The court clerk was notified by phone, and the order was filed five minutes later.

The bankruptcy has set off a multitude of hearings, investigations, and suits, and it has spurred Congress to more serious consideration of the railroad-loan-guarantee bill, which may turn out to be more necessary than anyone ever dreamed. There have been fears that the Penn Central's collapse will bring down other lines with it.

A FREEZE ON ASSETS

The railroad's bankruptcy placed both its parent, the Penn Central Co., and its subsidiary, the Pennsylvania Co., in unique and confusing positions. Many investors, who were not overly familiar with the web of Penn Central's organization, viewed Pennco as a subsidiary of the holding company and not the railroad. But within a few days after bankruptcy, the real relationship became apparent. Pennco was actually a subsidiary of the railroad, and all its common stock was pledged against railroad loans. The parent Penn Central Co.

itself was really left with only two small oil companies as assets, and their former owners have sued to get them back. On top of that, the holding company had guaranteed the railroad's $59-million Swiss loan. Thus Penn Central's investors were left with virtually nothing, and among the stockholders were more than 7,000 Penn Central employees, many of whom faced the added woe of going unpaid and even of losing their jobs. Stuart Saunders himself was reported to have borrowed heavily to acquire 45,000 shares, and payment of his $114,000 pension, voted by the directors after his dismissal, was held up by a federal court. To keep Gorman from feeding any more of Pennco's money into the railroad, New York's First National Bank and the other institutions that held the pledges on Pennco's common shares got the federal court to halt further dividend payments to the railroad. The court also froze further shiftings of the companys' assets.

The Directors' Debacle

The day after Bevan and Saunders were fired, a friend called Bevan and found him sunning himself by his Main Line pool. "What happened?" asked the friend. "Bad management," replied Bevan. "It had been management for a long time." But it also had ben bad supervision of management. The scores of men who were charged with the fiduciary responsibility of supervising the management of Penn Central had failed miserably. The accounting profession as a whole contributed to the debacle by making acceptable practices that are an open invitation to distortions and outright fraud. The Securities and Exchange Commission never raised a noticeable objection when Pennco tried to sell debentures after inflating the value of its assets. And the Interstate Commerce Commission, as musty as the old Pennsylvania, failed to notice a rapidly deteriorating treasury.

Most of the blame, however, falls on the directors of the Penn Central and its railroad subsidiary. The average shareholder could ask no knowledgeable questions, he could make no policy. Yet the directors, charged with that task, raised virtually no questions and blandly endorsed the practices of management. Although they had the power to demand that the books be restated in more realistic fashion, the directors did nothing. Even in the complex and often conflicting tables that Bevan and Saunders set before them, the directors had ample material for gaining an inkling of Penn Central's true health. But they accepted the financial statements at face value, and until this spring they made no demands for more information. Ten directors resigned within a month after Saunders was fired. Their performance was half-hearted, but their failure was absolute.

FAILING RAILROADS

THURSDAY, JULY 30, 1970

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

The committee met, pursuant to notice at 10 a.m., in room 1318, New Senate Office Building, Hon. Marlow W. Cook, presiding.

Present: Senator Cook.

Senator COOK. Good morning. We will bring this hearing to order.

This morning we have Mr. George W. Hilton, professor of economics at the University of California, and specialist in transportation at the university. We are delighted to have him here to express his views on this subject.

If you have a prepared statement, sir, you may go ahead and proceed.

STATEMENT OF GEORGE W. HILTON, PROFESSOR OF ECONOMICS, AND SPECIALIST IN TRANSPORTATION, UNIVERSITY OF CALIF.

Mr. HILTON. I do have a prepared statement that I deposited at the committee office 2 days ago. May I summarize it?

Senator COOK. Absolutely.

Mr. HILTON. I am the author of a book, "The Transportation Act of 1958: A Decade of Experience," which was published by Indiana University Press in 1969. It summarizes the first 10 years of experience under the Transportation Act of 1958, one of the major provisions of which was a loan guaranty program. That program is, I think, the best indicator of what a loan guaranty program if adopted at present could accomplish relative to the problems of the railroad industry and the transportation industry more generally.

The experience under that program indicates, I think, quite unambiguously, that this is not an appropriate form of public policy. The program, I think, has to be evalutated either as an outright failure or else as something which was very trivial with respect to the problems which the railroads had. I look upon it as an outright failure. The program ostensibly was designed to enable the railroads to make certain investments, notably cost-saving investments which were economic but which they were unable to make because of their weakness at that time. The country was in the most severe of the post war recessions, the recession of 1957–58, and the industry was in a particularly depressed condition, similar to its condition at the present time.

The loan guaranty program did not in any real sense have this effect. Some loans were used for this purpose: for example, enabling two relatively weak railroads to purchase diesel locomotives at a somewhat lower interest rate than they could otherwise have gotten. What it did mainly was to facilitate refinancing operations or to get working capital. It was possible to use the program for this purpose because the railroads could apply for loan guaranties, demonstrating that they had recently made investments. It was not necessary to point to future investment, past investment would serve the purpose. The largest single guaranty was given to the New York Central railroad on the basis of a recently-completed classification yard, for example. What the program really did was postpone some bankruptcies.

The act was inconsistently drafted. I point out the same inconsistency is in the bills currently under consideration. The Interstate Commerce Commission was directed to issue the guaranty only if the loan could not be made in the absence of the guaranty and only if there were adequate assurance of repayment. This is basically an inconsistency that resulted in the Commission's pursuing inconsistent policies, guaranteeing loans to the New Haven very readily and under very similar circumstances denying a loan guarantee to the Atlantic & Danville. Both of these were weak railroads immediately threatened with bankruptcy. The New Haven had a great deal of political pressure for its preservation, whereas the Atlantic & Danville did not, since it didn't carry passengers and it served a lightly populated area. So I am not particularly blaming the Commission for inconsistent behavior; the statute was drafted so as to make inconsistent behavior almost inevitable. I point out that the Commission was unable to prevent the bankruptcy of the New Haven.

In my book, I stated that the principal accomplishment of the program was preventing the bankruptcy of the Lehigh Valley until it could be integrated into the Pennsylvania Railroad system. But the Lehigh Valley went bankrupt last week, last Thursday or Friday. So I would have to modify my conclusions to say that that bankruptcy was only postponed by the loan guaranty provision. I think the same judgment is likely to be made of several other railroads. The recipient of the largest guaranty, the New York Central, went bankrupt as part of the Penn Central, as we know, recently. The recipient of the third largest volume of guarantees, the Missouri Kansas-Texas, is widely looked upon as one of the railroads most imminently threatened with bankruptcy at present.

To look at the program from another point of view, less than half the five hundred million provided by the statute for guaranties was ever issued. This, I think is a very clear indication that the program did not really serve the needs of the railroads. This was stated by several railroad presidents, notably, Mr. Heineman of the Chicago & North Western and Mr. Major of Lehigh Valley at the time the program was initiated in 1958.

Further, there are a priori reasons why one would not expect such a program to serve the needs of the railroads very well. Even by a priori evaluation, a guaranty is only a method of palliating the situation, postponing an evil day.

This I did not have in my prepared statement, but even if it is felt that the railroads' present distress situation is in part a consequence of public policy, and I think it is to the extent that they are subject to very severe limitations on giving up uneconomic services and disinvesting in redundant facilities—even if one accepts such an argument, a loan guarantee is not an appropriate way of dealing with the problem. Simply to let the railroads go farther into debt because they are carrying on a lot of uneconomic services is no way of dealing with the problem; it is simply postponing bankruptcies and making them worse when they occur.

I mentioned in the prepared statement that I wanted to take issue with a statement Secretary Volpe made in this connection. He stated that he thought guarantees were an alternative to nationalization, and with all respect to him I would argue that that judgment is the reverse of being correct; that loan guaranties are likely to make the Federal Government a principal creditor of railroads when they do go bankrupt, and as a result to make a solution such as the Canadian solution immediately after World War I look relatively attractive: That is, a selective nationalization of weaker railroads. This I think would be undesirable since State railways, like post offices, are much more prone to political pressures. The limitation that a regulatory body cannot confiscate the property of a privately-owned regulated firm through indefinite continuation of uneconomic service does not apply to a public enterprise. As a result, State railways are typically highly unprofitable, as they are in most European countries. Alternatively, in many British Commonwealth countries, they are organized as state monopolies and given extensive protection against rival forms of transportation. This is a policy which is open to all of the objections to monopoly more generally.

Consequently, I argue in my prepared statement that the loan guaranty program being considered is an inappropriate solution to the problem for which it is endeavoring to deal.

What is a more appropriate solution is a more difficult problem which requires more lengthy exposition, but, briefly, Congress should give this industry carte blanche to get out uneconomic activities. Society has gone from approximately 95 percent dependence on the passenger train for intercity movements to approximately 1 percent dependence. The activity is probably the most uneconomic ever carried on by private firms for a prolonged period. Many other parts of rail transportation activities, such as less-than-carload freight, and what is generically called "head-end activity" has long since ceased to be economic. So the minimum Congress should provide is carte blanche to get out of such activities and also to disinvest in branch lines and other redundant facilities.

As I pointed out, a drastically reduced network of freight-only main lines would be viable well into the future.

More basically, however, Congress should attempt to reorganize the industry, and the transportation industry more generally, in a competitive fashion; that is, the railroads should be reorganized as integrated transportation companies, allowed to provide transportation in any fashion they see fit, but subject to the Sherman Act. They should be given free entry and free exit to and from transpor-

tation activities and in fact other activities, but they ought to be prohibited from pricing collusively, and engaging in exclusionary or predatory practices in the same fashion as firms in other industries. The industry under these circumstances would at least in part be viable for a long period.

I presume that integrated transportation companies would provide the service mainly in containers, moving the containers by rail, truck, or water in the fashion of the White Pass and Yukon Route, the Alaskan-Canadian enterprise which is the principal transportation facility of the Yukon Territory, which mixes water, rail, and truck operation, providing extremely flexible transportation facilities based on a railroad of relatively low engineering standards. Free entry into truck and barge operation would be essentially perfect guarantee of freedom from monopoly conditions, in such an industry. This would be a very considerable reorganization of the industry, obviously, but is one to which I think public policy should go.

This, as I have stated, is not a radical proposal since it is arguing for organizing the transportation industry like any other industry under the antitrust laws. On the other hand, it is not a conservative solution. I would argue that loan guarantees are in the best sense of the term a conservative solution since they seek to perpetuate the present capital structures of the industry and what is possibly worse, they seek to perpetuate the present technology of the industry based on individual cars. The typical freight car operates under 3 hours a day, and spends more than 21 hours a day in the freight yard. During the period when it does operate, the slack action of its couplers is extremely detrimental to cargo. One of the worse curses of this industry is the high instance of damage claims relative to rival forms of transportation. To provide a loan guarantee program for investment in the industry tends to some extent to preserve present technology as it is likely to be used for present individual cars and present individual locomotives.

My guess is that integrated transportation companies would probably move toward a technology of integral trains without slack for moving containers which would very much work to the benefit of the industry in reducing damage claims. Consequently, both in the financial sense and the technological sense, it seems to me a loan guarantee system is conservative under the wrong circumstances.

Consequently, in closing, I would again urge the Congress to forms of policy other than a loan guarantee system.

Thank you.

Senator Cook. That is all very interesting purely and simply because I am not sure that this is the way to approach it, either. I think it is very interesting to note, for instance, that you stated in your remarks that under the act of 1958—and you reviewed that the railroads have been in a declining position since 1915 and 1916—a guarantee fund in 1958 of a half billion dollars was established to which only $244 million was utilized. I think this should allay some of the fears that many people have today, that the creation of a $750 million guarantee fund will immediately be inadequate and that we have to look further.

What bothers me about your remarks—and I want to discuss it with you and I hope you will discuss them pretty freely—is that you suggest that they immediately have that degree of freedom that you feel that a free enterprise operation should have. Also that they should have the option, curtailing or stopping completely, any nonprofitable phase of their business. If this is the case, what do we do with a half million people that have to pick up a train, pick up a train at this point to go to work, whether the service was good, bad, or indifferent? What do we do with these people, for instance, who represent possibly 65 or 70 percent of them or greater, who are represented in the eastern portion of the country?

Mr. HILTON. You are referring to the suburban commutation operations?

Senator COOK. Yes, let's talk about that first.

Mr. HILTON. Well, in all of the eastern seaboard cities, these services are operated under public subsidy, which I think is likely to continue. I am by no means convinced that this is an appropriate form of public policy because it is regressive with respect to income distribution. In addition, in certain respects it is also a conservative policy, in the wrong sense, in that it tends to perpetuate the disproportionate concentration of economic activity in the central business districts while most of the forces that work in the city are for diffusion. So I am not certain that this is an appropriate policy. However, I do think that most cities are going to continue such policies. I don't think that we are immediately threatened with discontinuance of such trains. It is the intercity passenger trains which would be swept away with relatively few exceptions, such as New York-Washington trains which remain barely profitable. They probably will continue for some years. The long-distance intercity trains would be swept away rather quickly. However, they, as I have stated, provide only approximately 1 percent of intercity trips. Most of the passengers would probably move immediately to intercity busses where they move at about half the cost or less to the carrier at approximately the same speeds.

I don't think you can argue that intercity passenger trains provide any considerable external benefits if only because their utilization is so trivial relative to automobiles and rival forms of public intercity transportation.

Senator COOK. You know, I am delighted you called for the abolition of the ICC, purely and simply because I can't imagine an agency of Government that would say to an apparent stock-held free enterprise system that you just absorb over a hundred million dollars worth of passenger losses in a year. I just can't for the life of me imagine how anybody can conceivably do this. What do you think of the ICC? What do you think their contribution has been, either to the system or to the detriment of the system? I think we are really not talking about a viable system anyway. And, I don't think we are talking about any phase of Government, including guarantee programs, that have in any way attempted to make them viable.

Mr. HILTON. I think you are quite correct. Unfortunately, I think these interrogations work out somewhat better when the questioner is much more hostile than you are.

I particularly identify myself with the position that the ICC should be abolished. In fact, I think it was a mistake ever to have set it up in 1887. It was established as an effort to stabilize railroad cartels which were inherently unstable with the means open to private parties under the common law in the 19th century. It has always been a cartelizing body. Up until 1920 it was a body designed to stabilize private cartels, rate bureaus. Thereafter it was an outright public cartelizing body under the Transportation Act of 1920, vested with minimum rate controls, and most of the normal accoutrements of a cartel. I think it is important to bear in mind that there is no possible effect of its being anything other than what it is; its statutory authority would not really permit this.

Further, the logic of such a body is such that there really isn't anything it can do other than generate monopoly gain in one activity and dissipate it in another. Unfortunately, the ICC doesn't work out very well because, given the fact that the railroads have been declining so long, they essentially have no monopoly gain left. Such monopoly gain as the ICC generates is mainly generated for major truck lines, and the railroads operate the principal unprofitable facility, passenger service. The usual cross-subsidization of regulatory activities doesn't work well; regulation is generating the monopoly gain in one activity, intercity trucking very largely, but then dissipating earnings in another industry.

I endeavor to point out that what is wrong with the Commission in this respect and a large number of other respects is intrinsic to its statutory delegation of authority. It is not a result of aberrations of members of the Commission; this is a very widely held view. I think Ralph Nader's recent report argues that the Commission could be something other than what it is if different people ran it. It really wouldn't. It suffers on the one hand from being a cartelizing body, as I have said. On the other hand, it suffers from being very poorly organized even as a cartelizing body. It has a very nebulous statutory delegation of authority. The people who set it up also wanted that. It mainly represents the ideas of Charles Francis Adams, Jr., who was the president of the Union Pacific Railroad. He was so eager for a highly discretionary commission that he stated he would prefer to have a commission without a law rather than a law without a commission. And the statutory delegation of authority is so nebulous that I think he approximately got what he wanted.

What I mentioned, that the delegation of authority in the loan guarantee provision was inconsistent, directing the Commission to do two inconsistent things, is quite characteristic of the Commission's statutory delegation of authority. Further, even where there are not explicit inconsistencies, the Commission very frequently pursues irreconcilable policies simultaneously: for example, in stating it will not indefinitely require the preservation of an unprofitable passenger train merely because the railroad as a whole is profitable, but, on the other hand, is saying that the passenger train as a national institution is a permanent part of the transportation system. There is no way to reconcile these two, short of getting subsidy for it which has, I think, inevitably driven the Commission to advocacy of subsidy in this case. I think that the railroads should have brought

some court actions arguing that the large passenger losses which they have suffered has amounted to confiscation without due process of law. There were such actions in connection with valuation in the 1920's, for example. There hasn't been such litigation concerning the ICC in the postwar period.

Until the California Zephyr was discontinued, the Western Pacific was dissipating more than 50 percent of its net receipts on the train, on the basis of which it seems to me it would have had a relatively strong case on such grounds in the Federal courts.

Senator COOK. You know, professor, I think one of the things that became so apparent yesterday was a part of the merger of the Penn Central. The ICC requested first of all, that 5,000 employees be maintained that had been furloughed; that as a part of the merger they had to take over the New York, New Haven & Hartford which had been running at a $22-million-a-year deficit; and that they had to, as a result of that merger and as a result of taking another problem off the ICC's hands, had to incur a long-term debt to the long-time controversy of the New York, New Haven at not less than $150 million, and we now find that the total is going to be $178 million. All they had to do was look at the Penn Central's record or at least look at the Pennsylvania record, see that today the combined railroad has a loss carryover of over $600 million, to know they were doing no more than merging two railroads and heaping a greater debt on them that they couldn't conceivably extinguish. If this is the role of the Government as performed by the ICC, then it has been of no value to anybody.

Mr. HILTON. I think you are perfectly right. But we have resorted to political resource allocation, instead of economic resource allocation in the sense of letting the price system deal with these matters. I think what you're inveighing against, quite properly, is the inevitable consequences of the present organization of this industry under the ICC.

The Commission is very responsive to political pressures. The railroads we have been talking about serve the most populous area of the country. As a result, they have given rise to greater political pressures for the perpetuation of uneconomic activity, also for the perpetuation of the debt of these companies different from companies in other parts of the country.

There is another matter, that the Commission has a very consistent pattern of tending to deal with any problem confronting it in such fashion as to perpetuate the problem. This has been true in the most basic things. It was established, as I said, to facilitate collusive ratemaking, which, in turn, had as its purpose establishment of discriminatory rate structures. This is a practice which the rise of trucks and barges would have eliminated by the 1930's. But the establishment of the Commission has perpetuated this problem to the present. But in the discontinuance of passenger trains and the preservation of debts of railways imminently threatened with bankruptcy, which is the matter at hand, the Commission behaves in this manner: When confronted with the Commission problem, perpetuates the problem, rather than adopting means through the use of market processes which would solve the problem.

Senator COOK. Well, as a matter of fact, doesn't the American railroad system face another tremendous danger right now with the long-term capital debt that it created in the late 1940's and early 1950's? All of this will shortly be coming due and all of this will become due at three and a half, 4 percent long-term rates and they are going to have to refinance this at eight and a half and nine and even more?

Mr. HILTON. It certainly appears to be true.

Senator COOK. So their position will only become worse.

Mr. HILTON. That's right. I think there is no question of that.

Senator COOK. In your statement you say that one of their inherent problems is that heavy volume of fixed capital to the industry invites the incursions of tax collectors and labor unions.

Mr. HILTON. That's right.

Senator COOK. Now, let's review this because you are saying, in essence turn them loose. In essence you're saying let's not have a loan guaranty program.

Now, as a part of the American railroad industry, the Sound Transportation Review Organization—I don't know whether you have seen it or had an opportunity to read it.

Mr. HILTON. This is the ASTRO program?

Senator COOK. That's right.

Mr. HILTON. I have seen reports of it in the trade press. I haven't read it in its entirety.

Senator COOK. What would you think if it became necessary on a, let's say on a phase out basis, to help the American railroad system for a period of time? What would you think of the wisdom—you may say there is a total lack of it, and I may be sorry I asked it in that vein—but what would you think of the proposal of the Federal Government picking up local taxation, in other words, to approximately the sum $400 million per year, that the railroad pays to communities throughout the United States?

Mr. HILTON. I think it is undesirable. Any tax remission is in the nature of a once-and-for-all benefit for the owners of the property at the time that the tax remission is made. The resources which are available in railroading have alternate uses; they would be taxed in their alternative uses. This is part of the technology. It may be a part of the technology that the proprietors would like to be free of, but I think it is something that they have to face up to. Rather, as I have argued, I think they ought to be free to get rid of these facilities which have become redundant, which are absolutely enormous in volume.

If you look at the facilities on the south side of the city of Chicago alone, you see a total investment in those facilities—you recognize they have properties which are worth hundreds of millions of dollars there alone which could be used for a wide variety of alternative uses, as Mayor Daley is well aware. So it seems to me even in such considerations it is disinvestment in facilities, using the facilities for other purposes, rather than tax remission on such facilities, that is the direction in which public policy ought to go.

SENATOR COOK. You may well be right. The reason I am expressing it to you in this way, if this Congress is going to do anything, I

think it ought to review all possibilities. For instance, a distribution by the Federal Government of the local tax bill seems to me to be conceivably a better immediate generation of cash to the railway system than the imposition of a major guarantee program that is merely going to add to the fixed interest costs of the railroads themselves. In other words, it is fine for us to sit here and say let's guarantee three quarters of a billion dollars a year, but we are imposing a fixed interest charge on the roads in the nature of 9 percent.

Now, is it better to look in the nature of totally relieving something and generating the cash than it is to in helping them win a battle but lose a war?

Mr. HILTON. Yes. I agree. This is consistent with what I said, that even if we feel that governments are in large measure responsible for their distress, which is a point I don't think one can avoid, that a loan guaranty program is not a second best solution. An outright subsidy is much more defensible and a tax remission is in the nature of a subsidy. I think you're quite right.

Senator COOK. You know, if there is anything that expresses the failure of action on the part of the ICC to even come to grips with the problem of the American railroad system, it is constituted in two paragraphs on page 16 of the ASTRO report:

> In 1969 the Interstate Commerce Commission issued one of the most dismal forecasts in its history. After 83 years of regulation it could only conclude of the railroads—and I quote from their year end report—given competitive presure, continued inflation and unsatisfactory rates of return, the general financial condition of railroads may be expected to remain poor, capital expenditures to remain minimal, and reduction in employment extended.

They admit that after 83 years of establishing a system to maintain a transportation program in this country that it is a total failure They admit it, and they even admit that there is an unsatisfactory rate of return, all this, though they could have done something about it.

Mr. HILTON. Well, to some extent I think they have to be defended. The present state of that industry is not entirely their responsibility. The typical foreign state railway is in worse shape financially than the American private railroad system. I don't question that the industry would have been declining for 50-odd years even had the framework of policy been somewhat different.

Senator COOK. Well, let me give you an example of what I consider to be a viable agency, and I think this is the CAB. The CAB without unnecessary hearings, without thousands of pages of records, without incurring on the airway industry hundreds of thousands of dollars of legal expenses grants rate increases. For example, the CAB automatically allowed the American airway systems on the first day of July, to round off every fare to the next dollar and generated $50 million worth of additional income to the air system, with no hearings, because they felt that it was to the best interest of the air service system, that they were responsible for. They regulate to the best of their ability to see that it remains healthy.

Mr. HILTON. Yes. Well, there are certain differences. In the first place, the CAB is regulating the most rapidly growing industry in the economy. On the other hand, CAB regulation does have certain very

real disadvantages. The policy, and, again, it is a result of a statutory framework and a very high degree of discretion which Congress invested within the CAB—results in semiempty airplanes flying around the skies. Almost everything in the policy is an incentive for airlines to expand their route networks, paralleling one another, flying minor routes, such as Anchorage to Honolulu, in the hopes that eventually there will be enough traffic there. There is a very considerable waste of resources in air regulation, also. But I think you're correct, it does work out somewhat better than ICC regulation.

Senator COOK. But you are telling me there is an emptiness and I can say to you that one of the problems that the railroads of this country have today is that the ICC is continuing to force the rail system to maintain passenger service between points when there is nobody on the trains. The rate of loss is phenomenal and yet the ICC insists it be maintained. While I agree that some of this service should be maintained, and improved— they are doing nothing about solving the problem. At least we are saying that the CAB is helping to alleviate that problem while it is promotionally helping the industry to advance its route and advance its capacity.

Mr. HILTON. Yes. That is a difference, but I do stick with my previous statement, that the fact that this is such a rapidly growing industry—airlines that is—makes it much easier for the CAB to deal with the problem, and also that it does have analagous consequence of idleness of resources. This is true in all cartels. Essentially this is why cartels are so unambiguously illegal under the Sherman Act; they generate excess capacity in any industry which is cartelized. Essentially, the Federal courts in their wisdom have recognized this by making it much more unambiguous that cartels are illegal than that monopoly is illegal.

Cartels are the worst possible organization of an industry. An incomplete cartel with a supervising body which doesn't in a literal sense know that it is running a cartel, which doesn't go at it with mathematical calculations or marginal calculations, but rather with an irrelevant framework of semijudicial behavior, a cartel consisting of all of railroading, a third of trucking and 10 percent of barge lines, is about as bad an organization of an industry as the human mind can conceive.

Senator COOK. Lets go back to this business of eliminating regulatory body and allowing the railways to seek that level of operation which becomes profitable and eliminate any level of operation which is unprofitable. You said that this lack of intracity transportation would be picked up by another means. Now, what is Congress going to do when the major bus lines in the United States become unprofitable? And I could only give you as the best example, the Washington transit system. All of a sudden we have a bus system that is supposed to be doing what the trains used to do years ago, and now the buses are no longer profitable. The buses are continuing to ask for increases and increases and still are running in the red. What do we do to solve this problem?

Mr. HILTON. I think the buses are likely to be with us for an awfully long time. Freedom of pricing there I think would keep the buses moderately profitable on major routes indefinitely.

Senator COOK. You insist, they must have freedom of pricing.

Mr. HILTON. I think they should have, yes. The bus is an awfully flexible device. It lends itself to declining demand conditions better than anything else. A given bus can be used for limited service or local service. It can serve small towns and large towns. There is a further matter, there is a major problem in the country of getting small shipments sent around. ICC-regulated carriers usually have little interest in this. The bus is an ideal means for dealing with this. Admittedly, Greyhound is not a very profitable enterprise, but its parcel service is one of its brightest features. Since it has to provide space for checking baggage, and it can carry parcels at a low additional cost, it builds buses with abundant parcel-carring capacity. A mixture of these two things, I think, is going to keep the bus industry around for the foreseeable future. You will have with respect to public transportation between cities something analagous to what you get for most of the economy, one technology for people with a high valuation of time and another for people with a low valuation of time. People who evaluate their time highly will fly. People who have a low valuation of time will travel by bus. Air will expand, bus will decline. Bus will hold its own best for short trips where the cost in time relative to air is minimal. I don't think we're confronted with the imminent extinction of the bus business by any means.

Senator COOK. Let's talk about that for a minute, because as I gather from your statement, you seek a limited major rail freight system in the country, the elimination of any side facilities, the elimination of many feet or arms to go to a particular plant, but a major market-to-market freight system, and the elimination of passenger service, and, conceivably, the upgrading of the bus service. Now, this interests me, because I want to know what effect these suggestions will have in the immediate future on a broadly based and balanced transportation system in this country. Because in viewing the congestion of our highways, our airports, our airways, particulary the Northeast portion again, and the resulting degradation of the environment, can this country really afford to drop so-called uneconomic intercity passenger service? I want to use the term freight service, but I think your statement envisions the continuation of this freight service. But can we really rid ourselves of this passenger service in view of, for instance in view of Mayor Lindsey's remark this morning, that it is conceivable that within today or tomorrow that he may ban all noncommercial automobile use in the city of New York. Are you not possibly using the term "uneconomic" in the most narrow sense. Shouldn't we speak of economics in the broad sense?

Mr. HILTON. Well, as I stated a few moments ago, the intercity passenger train as an institution carries such a trivial number of passengers relative to its rivals that it can't possibly generate any very significant external benefits. Such people as are left, as I said, will very largely convert to buses which may produce a visible exhaust but which are not bad for hydrocarbons; therefore they are not a source of pollution to the extent automobiles are. But the congestion you mentioned, the pollution you mentioned, are both in the main a consequence of inept pricing of public facilities. There is

no way in which private persons can collect for the use of roads. There is just too free access and egress. Similarly, there are no property rights in the air. As a consequence, it is a governmental duty to price road services and also to treat the ability of the atmosphere and the water system to dispose of wastes as a scarce resource, which it is. Unfortunately, the government does both these things very poorly. It charges for roads mainly on the basis of a flat excise tax on gasoline which raises funds for building additional roads. It does that very well, in fact, but it doesn't give people an incentive to economize on the use of existing roads. And you get exactly what you would expect. Roads are treated, not precisely as a free good, but since the user charges on them are not differentiated by hour of movement, place of movement, and direction of movement, the government is treating roads in a fashion similar to a free good. And you get exactly what you would expect, a queuing problem. You get this with essentially anything given away free. If it is the Library of Congress Chamber Music Concerts or the free highway accesses to New York City—you get queuing, usually called "congestion in rush hours."

In the case of pollution, there are no fees for polluting the atmosphere out of the tailpipes of one's automobile and you get exactly what you would expect: people use the cheapest form of automobile, that powered by the internal combustion engine, and they create a very serious problem with an enormous volume of pollution, which may prove to be harmful to a great deal of animal life. And they'll continue doing so unless the government taxes pollution in some comprehensive fashion so that it becomes so unbearably expensive to operate a polluting vehicle that any one of a wide variety of nonpolluting vehicles or more specifically, vehicles which pollute less, such as steam automobiles or automobiles run out of fuel cells possibly, become more economic to operate.

Senator Cook. Or another means of transportation.

Mr. Hilton. Unfortunately, I don't think there are very good prospects for that. Nothing else provides point-to-point transportation; as a result I think we have to face up to this form of transportation providing the majority of traps, intracity and intercity, in the indefinite future.

The sort of taxation devices as I have mentioned, variable user charges of roads by dealing with rush-hour congestion, making it very much more expensive, say five times as expensive to drive in rush hours as off-hours, will have the incidental consequences of speeding up buses, making them more adequate substitutes on the one hand for automobiles, and, on the other hand, for railway systems than they are. They can handle people much more cheaply than railway systems. I think that this is essentially the ultimate solution to the question that you raised previously, of a large number of people being dependent on rail transportation facilities in the major eastern seaboard cities.

Senator Cook. I want to go back a little bit. You make a point that interstate rail passenger service is not used and therefore is not needed. It seems like the chicken and egg riddle. Is the service not used because it is poorly run and poorly regulated, or is it not used because it is an uneconomical method of moving people?

Mr. HILTON. It is not used because is is an inherently uneconomical method of moving people. It can move people at best at 10 percent of the speed of aircraft for double the cost to the carrier.

The railroads, especially in the immediate postwar period, did all that anyone could do to make rail travel relatively attractive with the introduction of trains, such as the California Zephyr, the North Coast Limited, Sunset Limited, and so on. They endeavored to deal with the problem by making trains more attractive. Unfortunately, this isn't a solution which will work because people who have a low enough evaluation of time to be on the trains are consistent only if they want a low standard of service. The demand for high quality of service, pullman service, standard dining service, and other luxury aspects of railroading, fell off more rapidly than coach traffic. The rate I believe was approximately 7 to 4. This is what you would expect. People who evaluate their time low enough to take something which is comparable to bus in time are consistent if they want a level of service approximately equal to bus, with two exceptions: the affluent elderly who may have a high evaluation of time but still want a higher standard of luxury—and these are people likely to have more fear of flying and more tradition of traveling by rail than the rest of the population; and rail enthusiasts who look upon this as a form of consumption and so may want a degree of comfort while they are engaging in consumption. It is these two groups who produce most of the complaints against the standard of railroad passenger service. But most of the complaints, that the railroads have discouraged passenger traffic through low standards of service, I think are misapprehensions on this point.

Senator COOK. Now, you say in your statement that the low rate of return in the industry manifests a decision of society, a decision of society transmitted through the market process, that it wants this technology phased out. Mr. Perlman said that he didn't feel this at all. He feels that really this results from governmental policy rather than a decision by society. Now, I would agree with you maybe in regard to a logical rate of return. I will disagree with you in regard to passenger service because I think the industry itself has got to be blamed for the passenger service. I think it tried to rid itself of passenger service first and then when it found out that it couldn't, it decided to degrade the passenger service so it could substantiate its position to some extent. I honestly feel, with all due deference to the railroad systems themselves, that they have a real public relations problem to solve with the American people. I think the American people feel the railroad system let them down. And I think they tried to make them understand and realize that a system moving toward a freight system logically had to move away from passenger system. And through the degradation of the system, they made a lot of public enemies. But do you think it is a market process, for instance, that the railway systems will ultimately be phased out of the freight market?

Mr. HILTON. Well, to take the two points—I don't want to pursue the passenger matter because I did express my views on it. I disagree with you, that they made a conscious effort to get rid of something that could have been made viable.

Senator COOK. I don't think it could have been made viable. It is kind of an argumentative thing, but I think they had good trains; they had a degree of good service, at least they had a degree of cleanliness and all of a sudden they didn't have that. Obviously they had just as many employees on these trains, because even as a member of the State legislature, the one thing that we were bombarded with was legislation after legislation that had to maintain so many employees on a freight train, so many employees on a passenger train, and as long as the employees were there they should have at least kept it clean.

Mr. HILTON. Well, even railroads which maintain a quite high quality of service, such as the Burlington and the Santa Fe, had the same atrophy of patronage that the rest of them did. The eastern railroads have problems of cleanliness, and a great many other things, because of their low level of profitability. The Southern Pacific, which operates a very spartan standard of service, very widely criticized, is scrupulously clean, if only, I think, to protect itself against criticism before regulatory bodies. I don't think any railroad maintains a higher standard of cleanliness than that. But to get away from that to the more important question you raised, whether the decline of the railroad is a consequence of public policy or a consequence of a market decision, Mr. Perlman is very consistent with the attitude of American railroad men—I think virtually all of them will give you this response. He's an excellent operating man; I don't believe there is a better one. And as in the case of differing with Secretary Volpe, I differ with him in spite of the fact I have a great deal of respect for him. I think he is quite wrong in this: society has turned to something which is preferable, truck transportation. Railroad trains have slack in them, in their couplers, which results in a high instance of damage claims.

The size of damage claims in the industry is in the nature of a tax—the last time I saw it, something like 18 percent of their net receipts. And that's a small part of it. What is worse is what traffic never goes near the railroads because of the desire to avoid switching impacts and effect of slack action. On the other hand, trucks suffer from relatively high labor expense for long distances.

A recent Brookings Institution study by Prof. Ann Friedlaender of Boston College argues that the survival of the discriminatory rates, or value-of-service ratemaking, has diverted freight which ought to move for distances over 200 miles by rail to trucks. There is a waste of resources in this involving society in the welfare loss of $500 million a year. I am not convinced that she is right because I am not convinced that she has sufficiently considered the effect of the railroads' poor damage experience. However, I do think that a combination of rail and truck technology, using trucks for shorter movements and rail for longer movements, would result in some savings in the freight bill. The car service obligations of railroads, the limitations on all carriers in cutting rates, does result in some misallocation, whether it is of a character Professor Friedlaender mentions or not. What I have been arguing for is greater use of railroads for longer distance freight in containers, and use of trucks for shorter distance service, which would have the incidental ad-

vantage of permitting a really enormous disinvestment on one hand in urban facilities left over from the old LCL processing facilities, passenger facilities, and so on. Also in the classification yards, and especially in branch-line operation. The surviving branch lines could almost always be served more economically by truck, with the exception of a limited number of branch lines which serve mines and that sort of thing.

Senator Cook. I wanted to ask you some questions. Senator Baker of Tennessee introduced a bill to establish a commission. It would be the duty of this commission to consider the merger of the Interstate Commerce Commission, Civil Aeronautics Board, and Federal Maritime Commission. It seems rather useless to pursue this because you really think we ought to abolish the Interstate Commerce Commission to begin with. But one of the things he discusses in his remarks is that it might be conceivable that the Federal Government would take over the rights of the American railroad system and that in the future its utilization would be on a license basis. What would you think of this, even with the projection of your remarks, of a major point-to-point freight system without all the minor ramifications that you foresee as costing the railroads a great deal of money?

Mr. Hilton. I think it's a very undesirable organization of the industry. It would create some of the undesirable characteristics of the CAB regulation. You would have on the one hand a political problem of who is to run where. The railroad would have incentive to expand their networks, just as the airlines do at the present. I am afraid you would have identifiable Democratic versus Republican railroads, as you do airlines. You would have a further problem of what were equitable user charges for these facilities, as you do on roads, waterways, and airways. You are unnecessarily creating a problem of determining equitable pricing for publicly owned facilities in something that doesn't have to be publicly owned. Further, you would be taking away from the railroads what I think is really their best asset, the main-line rights-of-way between major cities which they can use with a modified technology jointly with trucks. It seems to me taking away from them their best asset and creating a lot of problems which almost all of the other forms of transportation have and which railroading has been mercifully free of. Railroading has plenty of other problems, you understand.

Senator Cook. I think I have just a couple of short questions, professor.

I take it from what you said that you feel that, first of all, a guaranty program would not be a proper thing to do for the industry. Secondly, that one of the real shortcomings that you found under the 1958 act was that somehow or other, more money was available to railroads that had already gone into bankruptcy, or railroads that were pending to go into bankruptcy, than to really lend funds to railroads that might have been in poor financial condition but really they didn't consider were in bad enough position to loan them any money. Is that correct?

Mr. Hilton. No, I wouldn't say that was correct. The funds were available for any railroad which was willing to take a pauper's oath.

Some of the weak railroads did. Some of the weak railroads such as the Pennsylvania, Baltimore & Ohio, and the Chicago & North Western, did not.

What I argued was that this was either investing in a declining industry in which the Government ought to be facilitating disinvestment rather than investment, or alternatively, it was postponing bankruptcies, which the experience since the expiration of the program in 1963 demonstrates pretty conclusively were inevitable in any case.

I wasn't arguing that the Government ought to be facilitating investment in any railroad, strong or weak. The stronger railroads are able to engage in cost-saving investment. So are the weaker ones, under lend-lease basis, with financial institutions, for example.

Senator COOK. The reason I express this to you is because we have discussed with other witnesses, that a loan guarantee program should be available to railroads that have already filed receivership.

The point I am trying to make is that in a loan guarantee program, in discussing whether one should extend loans to a not-yet chapter 77 railroad, or a chapter 77 railroad, I think it is immaterial.

Mr. HILTON. I think that's right.

Senator COOK. And I think this in essence is what you are saying.

Mr. HILTON. Well, not really. I am saying it is undesirable for either solvent or insolvent railroad—which is consistent with what you said.

Senator COOK. One of the things I felt was totally inconsistent about the 1958 act is that I just can't see how, on the one hand, you could ask the ICC to regulate the entire industry, and then on the other hand give the ICC the authority to loan up to a half million dollars to railroads that are in trouble.

Because I think they hold the viability to do something about it here and having done nothing about it here, extend credit to a railroad over here in the nature of a guarantee. And I think they are inconsistent functions within the framework of the Commission.

Mr. HILTON. I am not certain of that. On the one hand, as I said, the Commission, contrary to fairly universal popular opinion, was not established to restrain monopoly, but rather to stabilize cartels. So to that extent I am not sure that there is an inconsistency.

On the other hand, I don't honestly think it is within the Commission's power to make that industry prosperous.

In addition to what I said in connection with Mr. Perlman's testimony, again I call your attention to the experience of State railways—these foreign countries, virtually all of which have State railways, are not systematically trying to ruin their State railways. The forces for decline of this industry are in the technology of the industry. They are not exclusively a consequence of public policy.

Senator COOK. Now you bother me a little bit, because you just finished saying you didn't think it was the responsibility of the Interstate Commerce Commission to see to it that a railroad is comfortable.

Now I think to me this is an inconsistency with the operation of other agencies. For instance, at the Federal Power Commission, it is now being asked by sources throughout the country that they feel that—I have forgotten the figure—5 or six and a half or 7 percent is a fair return.

Most of the rate applications made by the industry have been made on the basis of establishing a profitable operation.

Mr. HILTON. Yes, Senator. There are two considerations here.

On the one hand, the national transportation policy, the preamble to the Interstate Commerce Act, imposed in 1940, does place the Commission under the obligation of engendering sound economic conditions, which the Commission generally interprets as keeping everyone prosperous.

Senator COOK. Let me read from that——

* * * receiving a national transportation position by water, highway and rail * * *.

If it isn't profitable, it is not going to be preserved.

Mr. HILTON. That is right. As I said, the Commission is under this obligation. A further one under the common law is to refrain from confiscating the properties of a regulated firm.

As I said, these are two rather different things. But I stick with my statement that I don't think it is within the powers of the Commission to keep this industry prosperous. No matter what the law may state, the economic forces operating on this industry are such that it can't be kept prosperous. The eastern coastal steamship lines could not have been. The interurbans could not have been.

Senator COOK. Let me refer back to just one point so that I might be able to clear it up.

When I talked about what I felt was an inconsistent authority of the ICC, I don't think you can be a regulator and banker at the same time. I feel they are inconsistent functions.

And I feel that in this instance, under the 1958 act, and I think this is why we have at least under this amendment given authority to the DOT, rather than the ICC, because I believe what we were doing under the 1958 act was to create a regulator and a lendor all in the same agency.

Mr. HILTON. Well, given the fact that the nature of the regulation is cartelization, I don't honestly think there is an inconsistency there. I think both these functions are undesirable, as a further matter.

Senator COOK. I understand.

Mr. HILTON. To that extent, I am probably biased, but I don't think there is any real difference between what you are saying and I am saying in this.

I think you are probably right that it would be preferable to vest it somewhere other than in the ICC, but I have been arguing that it would be undesirable to have the system of loan guaranties, no matter where it is vested.

Senator COOK. Are there any other questions?

Thank you very much, professor. I have enjoyed this, and I appreciate your statement, very, very much. And I think that this gives us another view, and I think it's badly needed.

Mr. HILTON. I greatly appreciate the opportunity to testify.

Senator COOK. I appreciate your being here. Thank you very much.

The hearings will be adjourned until next Thursday, or until the call of the Chair.

(The prepared statement follows:)

STATEMENT OF GEORGE W. HILTON, PROFESSOR OF ECONOMICS, UNIVERSITY OF CALIFORNIA, LOS ANGELES

My name is George W. Hilton. I am Professor of Economics at the University of California, Los Angeles, and the specialist in transportation in the UCLA economics department. I was chairman of President Johnson's Task Force on Transportation Policy in 1964, and more recently I am the author of a book, *The Transportation Act of 1958: A Decade of Experience*, published by Indiana University Press in 1969. Chapter III of that book is concerned with the experience under the program of guaranties of loans to railroads initiated by the Transportation Act of 1958, and allowed to expire in 1963. This experience is the most immediately relevant to the Committee's consideration of a new program of loan guaranties. Accordingly, I requested an opportunity to summarize the experience under the program and to present the implications for future policy. I greatly appreciate the opportunity to testify.

The Transportation Act of 1958 provided that the Interstate Commerce Act should be empowered to guarantee the repayment of principal of loans by private financial institutions to railroads under a variety of conditions. The Commission was directed to assure itself that the railroad could not make the loan in absence of the guaranty, that the rate of interest was not unreasonably high, that the terms of repayment of the loan should be no longer than 15 years, and that the prospective earning power of the railroad and the collateral gave reasonable assurance of repayment. Guaranties might be made for new investment or for reimbursement for expenditures in the recent past. The Commission was empowered to issue $500 million in guaranties. Originally, application had to be made by March 31, 1961, but Congress in 1961 extended the program, allowing application until June 30, 1963.

By the time the last of the guaranties had been issued in 1964, the Commission had guaranteed loans of slightly under $244 million, approximately 48.8 percent of the sum authorized, to 14 railroads. All recipients of guaranties were eastern railroads with the exception of the Georgia & Florida and Norfolk Southern in the South, the Monon and the Chicago & Eastern Illinois in the Midwest, and the Missouri-Kansas-Texas in the Southwest. The largest sum guaranteed was $40 million to the New York Central as reimbursement for expenditures on its Elkhart classification yard. Second largest was $35.6 million to the New Haven and its trustees after the company's bankruptcy. Third largest was a series of three loans to the Missouri-Kansas-Texas of $34 million.

In evaluating the success or failure of the guaranty program, it is well to bear in mind that the ostensible purpose of the program was to allow the weaker railroads to make investments which, in saving in cost or otherwise, were economic but impossible to make through the ordinary processes of the capital market because of the companies' weakness. This, it was hoped, would make the industry more competitive to the rivals relative to which, in 1958, the railroads were declining more rapidly than in most recent times. It can be stated quite flatly that the guaranty program did not accomplish this end, and in fact that most of the guaranties were not in any real sense made for this purpose. Rather, most were made to provide working capital, or to facilitate refunding operations, or otherwise to improve the financial positions of the weakest railroads. The fact that guaranties might be made for reimbursement of recent expenditures meant that a railroad which had made a major capital expenditure in the recent past—as most had done—could secure a guaranteed loan and use the proceeds for general purposes. Only a minority of the guaranties were made for loans such as those of the Reading and Monon for new locomotives. Accordingly, the program has to be evaluated mainly with respect to its effect on the financial operations of the railroads.

So viewed, the program must be considered at worst an outright failure, and at best a trivial force relative to the problems of the railroad industry. Quantitatively and in other senses, the principal activity of the Commission in the entire program was an unsuccessful effort to use loan guaranties to forestall the bankruptcy of the New Haven. In this effort, the Commission granted guaranties freely, even at the end without the usual collateral and in apparent disregard of the statute's directive that there be reasonable assurance of repayment. In this the Commission is not entirely to be blamed, since the political pressures on it to assist the New Haven were extensive, and the statute was inconsistent in its directives. That is to say, the Act of 1958 directed the Commission simultaneously to assure that the loan could not be made in absence of a

guaranty, and that there was reasonable assurance of repayment. Obviously, if there were reasonable assurance of repayment, the loan could be made. This gave the Commission authority to pursue inconsistent and irreconciliable policies simultaneously. To the New Haven the Commission acted as if it were directed to assist the railroad if loans could not be made in absence of the guaranty. To the Atlantic & Danville, a minor southern railroad without passenger service, the Commission refused a guaranty, driving the company bankrupt immediately, on the ground that there was inadequate assurance of repayment.

In my book, I characterized the program's most solid accomplishment as preventing the bankruptcy of the Lehigh Valley until the company could be integrated more thoroughly into the Pennsylvania system. I would point out that the Lehigh Valley went bankrupt last week, ending even that small show of accomplishment of the program. Similarly, the Jersey Central, one of the main recipients of guaranties, was bankrupt in 1967. The New York Central, recipient of the largest guaranty, went bankrupt as part of the successor Penn Central in 1970.

A further indication of the inappropriateness of the program was the small utilization made of it. Less than half the permissible volume of guaranties was ever issued. Upon passage of the Act of 1958, President Ben H. Heineman of the Chicago & North Western said, "The railroads' basic problem is not one of making loans. The real problem is to pay back the loans we've already made." President C. A. Major of the Lehigh accurately stated "The temporary loan guarantee scheme will do nothing whatever for the hard-pressed eastern railroads." Among the railroads worst off in the 1958-63 period, the Pennsylvania, Baltimore & Ohio and Chicago & North Western made no effort to secure guaranties, and the Rutland went out of business without any attempt to use the guaranty provision.

Consequently, Congress was well-advised in 1963 to let the guaranty program expire, and would be even better advised to refrain from establishing a similar but larger program at present. The conclusion that this is an inappropriate form of public policy follows from several considerations.

First, there is a question whether the federal government ought to be facilitating physical investment in this industry. As I have said, the ostensible purpose of the guaranty program was to facilitate investment in equipment or facilities which would be cost-saving or otherwise economic, but which the railroads were unable to finance. There is little question that an industry with chronic rates of return in the neighborhood of 2.5 percent has difficulty in investing. Such rates of return are biased by the heavy mileage of branch lines, the large volume of passenger-related facilities, and other properties of negligible or negative productivity. Main-line railroading remains a profitable enough activity that the railroads have been able to dieselize, adopt centralized traffic control, convert partially to piggy-back and container technology, and to make cost-saving investments quite generally. The loan guaranty program of 1958 presumably allowed the Monon and Reading make some small saving in interest on their diesel locomotives, but this investment was of the sort the railroads have most conspicuously been able to make.

Facilitating investment in a declining industry is an undesirable policy generally. The railroads have been declining since about 1915-16, either relatively or absolutely, dpendng on the activity and geographical area in consideration. They have declined for perfectly good reason. The technology of individual cars with slack action in couplers entails heavy incidence of damage to cargo and low speed in interchange operations: rails are inherently inflexible in destinations; the collusive pricing historically characteristic of the industry creates a pattern of rates which, being based on value of the service, stimulates costbased transportation, such as private trucking; the heavy volume of fixed capital in the industry invites the incursions of tax-collectors and labor unions. The low rates of return of the industry and such difficulty in investing as the industry has are manifestations of a decision of society, transmitted through the market processes, that it wants this technology phased out. The government should endeavor to implement this market decision by facilitating disinvestment in the industry, not to confute the decision by investing in it.

Similarly, if the guaranty program is viewed as a financial device for avoiding bankruptcies, it is also inappropriate for a declining industry.

Congress should expect bankruptcies in the industry, and in fact welcome them as parts of the process of disinvestment in it. Loan guaranties are advocated on the implicit presumption that the ills of the industry are transitory. Unfortunately, there is a bias in declining industries that the decline is continually about to be reversed; loyalty to one's superiors usually requires such an attitude. Thus, men in declining industries tend to treat their problems as transitory, often for decades, whereas the historical experience of declining industries indicates that virtually all—probably over 99 percent— of industries which enter secular declines do not stop short of extinction. The forces for decline of this industry are intrinsic to the technology of separate cars being pulled by a locomotive; it is extremely unlikely that the decline can be arrested as long as that technology persists.

Consequently, loan guaranties can only add to the debt of such railroads as do get into bankruptcy. Worse, they will result in the federal government's being a principal creditor of the bankrupt railroads. Secretary Volpe in testifying for loan guaranties was reported in the press to describe guaranties as the alternative to nationalization. With all respect to the learned Secretary, I submit that, rather, loan guaranties are the most obvious path to nationalization. If America nationalizes its railroads, it will probably do so as the Canadians did, selectively nationalizing the distressed railroads of the country. If the federal government is a principal creditor of a bankrupt railroad. the option of nationalizing it is particularly attractive. The pros and cons of railroad nationalization are a broader subject than I should attempt here, but the belief that the industry ought to be kept in private hands which seems to be accepted by most Americans seems to me perfectly correct. I am aware that countries such as Japan and Switzerland with at least as much philosophic commitment to private ownership of resources as we, have state railways. The fact remains that we are better off with privately-owned ones. However distressed our railroads, they are in better financial condition than the typical European state railway. American railroads are endeavoring to maximize net receipts, whereas state railways are typically under political pressure to provide a wide volume of uneconomic services, to maintain large labor forces, to preserve existing technology, and to subsidize various groups selectively. As a consequence, they are typically highly unprofitable. Alternatively, as in South Africa and several countries of the British Commonwealth, state railways are subjected to comprehensive protection against rival forms of transportation, essentially dealing with the forces for decline of railroads by establishing a state monopoly. Either of these options is an undesirable solution.

To revert to the point that appropriate policy toward the railroads is facilitating disinvestment in the industry, not investment, I would point out what, in my opinion, Congress ought to be doing instead of enacting a loan guaranty bill. At minimum, it should give the industry carte blanche to get rid of uneconomic services, notably passenger traffic, less-than-carload freight, and branch-line operations generally. The industry as a drastically reduced network of freight-only main lines would be viable well into the future.

More basically, Congress should attempt to organize the industry competitively, with the railroads converted into intermodal transportation companies, free to provide transportation in any manner, free of any compulsion to provide uneconomic services, free to set rates without regulation, but prohibited from pricing collusively or engaging in predatory or exclusionary tactics. That is to say, the industry should be organized in the fashion of any other industry, through abolition of the Interstate Commerce Commission and subjection of the industry to the Sherman Act. Free entry into trucking and barge operation would be an essentially perfect safeguard against monopoly problems. Integrated transportation companies would probably provide service mainly in containers, moving short distances by truck and longer distances by rail in some slack-free technology of integral trains.

Organizing the transportation industry like any other industry is not a radical proposal, but neither is it a conservative one. Loan guaranties are in a real sense a conservative solution, since they seek to perpetuate present technology and present economic organization. In so donng, they only postpone the inevitable, and make the inevitable worse when it occurs.

(Whereupon, at 11:20 a.m., the hearings were recessed, to be resumed at the call of the Chair.)

FAILING RAILROADS

THURSDAY, AUGUST 6, 1970

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

The committee met, pursuant to notice, at 10:10 a.m., in room 1318, New Senate Office Building, Hon. Vance Hartke, presiding.

Present: Senator Hartke.

Senator HARTKE. The committee will come to order.

We are continuing hearings on the Railroad Loan Guarantee Legislation, S.4011, S. 4014, and S. 4016.

The witness scheduled for this morning's hearing is Mr. David C. Bevan, former chairman of the Finance Committee of the Penn Central.

Good morning. You may proceed with your statement.

STATEMENT OF DAVID C. BEVAN, FORMER CHAIRMAN OF THE FINANCE COMMITTEE OF THE PENN CENTRAL

Mr. BEVAN. Thank you.

My name is David C. Bevan. I was born in Wayne, Pa., on August 5, 1906. I graduated from Lower Merion High School in 1925, from Haverford College with a major in economics in 1929, and Harvard Business School in 1931. I went directly from Harvard Business School to the Provident National Bank and during my stay there I operated in virtually every department of the bank.

In 1942 I resigned from the bank and went to the War Production Board and from there to the Lend Lease Administration. Early in 1943 I went to Australia as a member of the U.S. lend lease mission to Australia serving there until the end of 1944. During the latter part of this period I was acting head of the mission. In 1945 I was deputy head of the mission of economic affairs in London.

I returned to the Provident National Bank in January 1946, and remained there until October 1946, at which time I left to become an officer of the New York Life Insurance Co., where I remained until May 1951. At the time of my departure from New York Life I was the treasurer of the company. I left to become financial vice president and chief financial officer and director of the Pennsylvania Railroad Co. I remained in this capacity until October 1963, when I was elected chairman of the Finance Committee and chief financial officer. At the time of the merger, February 1, 1968, I retained my position as chairman of the Finance Committee but

was not elected to the new board of Directors nor to the Executive Committee.

Prior to merger, accounting, budget administration, and data processing were all under my supervision. However, as of February 1, 1968, the date of the consummation of the merger, these responsibilities were turned over to Mr. Perlman. I had responsibility for: (*a*) bank relations of the railroad; (*b*) raising the required funds for its operation; (*c*) supervising our diversification program; and (*d*) overall supervision of the companies newly acquired under this program.

In August of 1969, Mr. Saunders advised the board that Mr. Perlman was going to relinquish his duties as president as of November 30, 1969. At the August 27 meeting, I was elected a director of the board and also a director of the holding company. On September 24, Mr. Gorman was elected president as of December 1, Mr. Perlman, vice chairman as of December 1, and I was elected to the Executive Committee. At the same time, accounting and budget administration were again placed under my jurisdiction.

Immediately upon going to the railroad in 1951, I made a complete study of its financial operations and was impressed by the fact that the railroad was badly in need of a long-range debt management program. It had a large number of noncallable relatively medium-term issues in sizable amounts. The total debt was larger than I thought it should be. An increasing percentage of the debt was in the form of equipment obligations which would produce an increasing drain on the cash resources of the company because they were nonrefundable.

In 1952 I presented to the Finance Committee and the board a long-term program to meet this situation. Attached hereto is exhibit 1, which indicates what was accomplished under this long-range program during the years 1952 to 1964. Briefly, bonded and other debt was reduced from $765 to $531 million, a decrease of $234 million, or slightly over 30 percent. Equipment obligations were reduced from $350 to $230 million, a decrease of $120 million or approximately 35 percent. Total debt decreased from $1,116 to $761 million, a decrease of $355 million or about 32 percent. Interest charges decreased from $39 to $32 million, a decrease of $7 million or a little over 18 percent. Because of very careful attention to this program, decreases occurred in every category in every year during this period.

When I studied the railroad, I was also impressed with the complicated corporate structure and the fact that the debt structure seemed to have grown like Topsy. I therefore instituted a so-called simplification program under which we reduced the number of subsidiary and affiliated companies from 171 to a low of 89. By the time of merger this had gone back to 102 because of the new companies and their subsidiaries which we acquired through our diversification program. When we merged with the New York Central an additional 84 companies were added, bringing this back to a total of 186. Immediately after merger we started again working on the simplification program to the extent we had available help not occupied with merger problems. By June of 1970 we had the total down from 186 to 171.

By following this simplification program we had hoped by the end of 1969, to be in a position to issue one blanket mortgage which would be the senior vehicle for financing the needs of the railroad in the future. However, continuing tight money conditions, the insistence of many financial institutions for so-called kickers in the way of warrants or common stock, and the fact that the railroad was still operating on an unprofitable basis, made this plan impossible to achieve up to the time of filing of the petition for reorganization on June 21.

Another type of streamlining I developed was to bring the supervisory force in line with the reduced overall personnel. At the end of 1951, the total number of employes of Pennsylvania Railroad was 137,765. By the end of 1961, the figure had been reduced to 67,242.

This plan which I developed provided for early retirement of supervisory personnel between ages 60 and 65, at the option of the company. In certain cases retirement of employes was possible as early as the age of 55.

The thrust in back of all this, of course, was to bring the supervisory personnel in line with the overall reduction in the number of people employed.

This plan was successfully initiated in 1963. Up until the time of the merger, 603 people had been retired out of a possible 1,296, with estimated savings of approximately $12 million. The plan was continued after merger and, including retirements already authorized up to September 1, 1970, an additional 786 supervisory employes have been retired with an estimated savings of $25 million.

Having lived through the depression of the thirties, and having done a great deal of work on sick companies during that period, I developed a firm conviction that one of the basic reasons for railroad failures at that time was their lack of staying power stemming from the fact that they had never been able to build up adequate working capital. In my judgment, this has been and still is an outstanding weakness characteristic of the industry. I believe this is directly attributable to the large amount of money required for capital expenditures in the industry, coupled with an unreasonably low rate of return they have been allowed or have been able to earn. As a result, the industry has been practically unable to raise any equity capital for years.

Since I could see no quick way to remedy the fundamental situation as far as improving the working capital of the Pennsylvania Railroad was concerned, in 1954 I set up with a group of banks the first so-called standby revolving credit ever made in the railroad industry. This was in the amount of $50 million and was specifically used as insurance against an emergency to provide us with additional backup capital in the event of a major strike in the steel, automobile, or the railroad industry itself.

Fortunately we never had to call on this standby credit until near the end of 1967, when we did draw down $15 million. After the merger, in view of the increased size of the company, we were able to arrange a $100 million revolving credit. In 1969 this was expanded to $300 million. In the case of this $300 million revolving credit, we had the right to draw down any or all of it at any time

through December 1970, after which it would turn into a 5-year-term loan to the extent that we so desired, with minimum payments in each year thereafter.

In 1968, we also became the first railroad to use commercial paper in a substantial way. The ICC first approved the issuance of $100 million in July 1968, another $50 million in early 1969 and a final $50 million near the end of 1969, or a total of $200 million. With money conditions as tight as they were, we found it very difficult to back up the commercial paper to the extent I desired; namely, 100 percent. We were successful in backing it up with confirmed bank lines of $50 million. Since we were only able to get $50 million of confirmed lines, which I considered satisfactory, we withheld $50 million of our revolving credit as a backup to the commercial paper. We also tried to get confirmed Eurodollar bank lines, but were unsuccessful. As a result we had a 50 percent backup for our paper in the event the commercial paper market became weak. Under normal conditions we believed that if we were in a position to withdraw $100 million of our paper from the market at any given time, this would suffice. As it eventually turned out, this was not true, primarily because of the shock to the financial community of our 1970 first-quarter statement. Confidence eroded rapidly thereafter.

The demand for capital expenditures after merger had been enormous and since we were pushing very aggressively to expedite the merger, the timing became even more pressing. In 1968 and 1969, including lease agreements, the financial department under my supervision raised approximately $950 million in probably the tightest, most difficult money market of the century. Of this, about $560 million was used for capital expenditures, of which approximately $379 million was for equipment and $181 million for road expenditures. Of the balance, about $245 million was applied against debt maturities, with the remainder going for miscellaneous purposes including financing operation deficits.

In summary, I believe our financial management over the years has been good. Even with all the adverse circumstances I have outlined, we were able to produce the money necessary for the operating people to keep the railroad running in the face of deficits, and that was no small job.

I might add that it would not have been possible without the income made available through our new diversification program.

Our first acquisition was Buckeye Pipe Line in 1964, followed by Great Southwest, also in 1964, and Arvida and Macco in 1965. During this period, New York Central also acquired Strick Holding Co. which was later disposed of in December 1968. All in all, from the Pennsylvania Railroad side, we invested a total of approximately $144 million of cash in this diversification program, of which only about three-quarters of a million dollars came from the transportation company. The system realized a return of $146 million from these investments from the date of acquisition through 1969, approximately 5 years in all. Those dividends and income from other nonrailroading properties have served to blunt the losses from passenger service and have provided the margin necessary for continued opera-

tion of the railroad. In other words, our investment in nonrailroad companies yielded a much better return than the railroad itself, which would have been in much more serious trouble without the benefits of diversification.

Now, with respect to the merger itself, it seems to me that with the passage of time we tend to lose sight of the magnitude of that undertaking. Nothing similar to it had ever been done before. No one had ever merged a Pennsylvania Railroad and a New York Central and these two railroads had their special problems even before the merger.

Mr. Symes' testimony before the ICC in 1962 makes that clear. Briefly, he pointed out that although the Pennsylvania was first among all-American railroads with respect to gross revenues in the period 1952–61, and the Central was third, they ranked 10th and 18th, respectively, in net railway operating revenue; 17th and 18th, respectively, in rate of return on average net investment in railway operations; and 16th and 18th, respectively, in net income, for the same period.

The sheer size of the two railroads was staggering as indicated by the following figures as of December 31, 1967:

	Pennsylvania RR. Co. and Consolidated subsidiaries	New York Central RR. and consolidated subsidiaries
Total revenue	$1,163,000,000	$819,980,000
Earnings	60,344,000	10,995,000
Total assets	3,799,000,000	2,429,000,000
Total debt	1,264,000,000	863,000,000

The business of the two railroads was quite similar. In 1961, the Pennsylvania's freight revenue was 74.9 percent of its total; the Central's, 75 percent; the passenger revenue, 12.1 percent for the Pennsylvania, and 10 percent for the Central. And, as Mr. Symes pointed out to the ICC, the two roads' traffic patterns were similar and there were other similarities, not to forget duplication of services. This meant the opportunity for savings was there, but in view of the size and complexity of both railroads' operations, it also meant that the magnitude of the problems, initially, at least, would be tremendous. And I might say they were.

Since there was no precedent, there were really no guidelines which our operating personnel could use as standards in their operations. We did know that all past railroad mergers had run into problems and seemed to be difficult to effect. In the case of the Penn Central this seemed to be doubly true. Because of the complexity of putting the far-flung properties together operationally, the service disintegrated badly to start with and this cost us very substantial amounts in revenue. It is also true that you lose business faster than you get it back, because when your service returns to normal some of your customers have made other arrangements which they are loath to change.

We also had substantial nonrecurring expenditures; overtime soared, and so did per diem charges payable to other railroads; so that at the same time we had both inflated expenses and abnormal losses in revenue which affected our situation seriously.

In 1969 we saw some slight improvement in certain areas, such as a gradual reduction in per diem costs and a reduction of about 8,000 in personnel since the date of merger. For 1970, we budgeted a loss in the railroad of approximately the same amount as in 1969, about $55 million. We believed that as a result of improved operations in subsidiary companies we could show an overall improvement on a consolidated basis for 1970, and that there would be improvement in both areas in future years.

However, in January and February, 1970, as you gentlemen may well know, the Eastern and especially Northeastern United States had some of the worst weather the country had ever experienced. The railroad was virtually paralyzed for days at a time. Some of our freight classification yards were tied up for long periods of delays. Freight revenue plummeted. The expense of getting the trains back in service was tremendous but of course it had to be incurred. So once again in January and February we had both an abnormal loss in revenue and an increase in expenditures. We also had to accrue retroactively to January 1 what we estimated the final wage settlement would cost. This was without any offset in the form of increased rates in the first quarter.

As a result, the operating department missed the budget for the transportation company by a wide margin in the first quarter of 1970.

I think I should say at this point that in no way am I laying any blame on anyone. The circumstances here that we had to cope with I think speak for themselves, and the magnitude of the problems were such that I have no way of knowing whether anybody else or any other company could have coped with the situation any better. I am merely trying to state the facts as they actually occurred.

We had budgeted a $49 million loss in the first quarter, always our worst quarter. With this we could have coped and it would have been in line with the estimate of the budget for the year of a deficit of $55 million; but the actual loss was $79 million before a nonrecurring profit through the sale of a company. This was too wide a margin.

Shortly thereafter, it became apparent that in financial circles people were becoming skeptical as to the ability of our operating people to turn the railroad around. Many of them thought the railroad just could not be turned around by any management. As confidence evaporated, and as the result of the first quarter statement, we began late in April to see signs of the beginning of what you might call a "run on the bank" as far as our ability to turnover our commercial paper was concerned. I might say parenthetically that at this point we had already completed all of our equipment financing for the year 1970 as planned. We had floated one loan for other purposes, and on the basis of our budgeted requirements for 1970 all we needed was the proposed $100 million Pennsylvania Co. bond sale to complete our financing for the year. Since the company had failed to meet its first quarter budget, additional financing would no doubt have been required. We appeared to be in reasonably good shape to get through the year 1970 without serious trouble, however, until we

were confronted with serious problems in the commercial paper market. However, for reasons I have mentioned, it finally became apparent that in fairness to everyone involved, we should not attempt to sell any more commercial paper, that we should advise the underwriters that the transportation company was experiencing serious financial difficulties, and that the sale of Pennsylvania Co. bonds should therefore be withdrawn. Because of the gravity of the situation, we believed it was our duty to advise the Government promptly of the critical situation, and this was done. Immediately thereafter the banks were also advised as to the exact situation. Subsequent events are now a matter of history.

Before speaking about possible methods by which the Congress might assist the railroads in the future, I would like to briefly comment on a few factors bearing on the present situation.

First, much has been said about our so-called diversification program, when it started, what it encompassed, the reasons for it, and whether or not it drained off any assets of the transportation company. I believe I have already answered this question and have shown how successful the recent diversification program actually was.

As has already been pointed out, the Pennsylvania and the Central had been far more than railroad companies for many years and with beneficial results, as far as their outside activities were concerned. However, there had been some problems. For example, in 1963 the Pennsylvania Railroad was requested by the ICC in the public interest to agree voluntarily to divestment of Norfolk & Western stock. To this we reluctantly acceded. From the time that this agreement was reached, we assiduously and conscientiously attempted to work out the divestiture in the utmost good faith as far as the Government was concerned, and at the same time to do it in such a way as to protect the best interests of our stockholders. We could not justify distributing the stock of the Norfolk & Western to our stockholders because it was a valuable earning asset which the railroad needed. These earnings were required to support the operations of the railroad, and our creditors naturally would have had serious objections to such a course. It was also apparent that both we and the New York Central, with whom we anticipated merging, were heavily dedicated to the heavy goods industry, with violent cyclical fluctuations in earnings characteristic of this industry. A large part of our business came from the steel and automobile companies. Therefore, it seemed to be in the best interest of our stockholders to reserve the proceeds of this stock for acquisition of companies more nearly oriented to the ultimate consumer, with different patterns of fluctuation in earnings so that we could gradually eliminate some of the drastic fluctuations involved and at the same time establish a dynamic growth pattern in earnings.

Second, as I have indicated previously, lack of working capital is a problem that has for years plagued both the Pennsylvania and the New York Central, as well as the entire industry. Including debt due within 1 year, as a matter of fact, for most of the time in the sixties the two railroad companies showed working capital deficits. The combined working capital deficit as of the end of 1967 was approximately $34 million and on February 1, 1968, when the two railroads merged, the combined net cash for the two railroads was only $13 million.

I might say that at this point the industry itself has shown a corresponding trend which is very serious and indicates how critical the situation is. Going back to 1963, including debt due within a year, the class one railroads in the United States had working capital of $823 million. In 1964, it went down to $725 million. In 1965, $627 million. In 1966, $448 million. In 1967, $250 million. In 1968, it was down to $13.5 million, and at the end of 1969 there was a working capital deficit of $190 million.

This I think indicates that the whole industry has some very, very serious problems ahead of it.

Earlier in my statement I indicated that in 1954 we arranged the first standby credit in the railroad industry to bolster our working capital position. In 1957, in a presentation to the board of directors of the Association of American Railroads with respect to a plan for acquisition of new equipment and the financing of it, I made an extensive analysis of the weakness of the working capital position of the entire industry—this is discussed on pages 13 to 22 of exhibit No. 2—all of which indicated the seriousness of the working capital situation as far back as 1957.

There is no doubt that a stronger working capital position would have maintained the financial position of Penn Central somewhat longer. However, the real problem which proved insurmountable was the loss of confidence of the financial community in the ability of our operating people to stem the tide of increasing deficits in the railroad operations. When this occurred, we just did not have enough liquidity to meet the demands for cash brought on by the liquidation of our commerical paper.

Actually our working capital deficit was decreased in the year 1969 by $25 million. It was reduced from $136 million to $111 million. Also, from a practical standpoint, in all fairness I should say that the working capital deficit of $111 million was not as serious as it actually appeared on the surface. Of that, $84 million was in the form of commercial paper which, under normal circumstances, we planned to keep continuing to roll over for many years by industrial companies.

In addition, there was another $30 million from two of our banks which we anticipated would also be rolled over and constantly reduced. This loan had originally been $45 million and we had reduced it to $30 million and planned to obtain an extension. So that as far as working capital is concerned, althouth technically these two items had to be included in current liabilities, as a practical matter, we had plans for extending them.

Third, for a long time, we had recognized that we had very serious drains on our financial strength and that a merger with the New York Central, in itself, was certainly not going to answer either our problems or theirs. In my judgment, it was absolutely essential for us to diversify into other industries, in order to participate in their prosperity and thus enable us to support the railroad and to show some return to our stockholders.

Some of the drains on our system were extraordinary in nature, as compared to those of other railroads. For example, as far back as 1933, we had made an operating agreement with the Reading

Co. to operate jointly the so-called Pennsylvania-Reading Seashore Lines, basically a passenger operation. From that date up until the end of last year, we made up losses on the basis of one-third being borne by the Reading and two-thirds by the Pennsylvania. Our share alone has cost us $92 million in cash. This situation was not neglected; it was studied many times, and short of actual bankruptcy, we were unable to find any legal way to terminate this agreement. I hope and assume that under the present circumstances this now can be done.

Similarly, in 1962, the ICC authorized us to take over control of the Lehigh Valley. Up to that time we had owned 44 percent of the common stock, which was held in a trust and we were forbidden to control the actual operation of Lehigh Valley in any way. With the authorization of the ICC through an exchange of stock, we acquired approximately 97 percent of the Lehigh Valley. Prior to making this exchange, I personally had recommended from a financial standpoint, that rather than do this, we should let the Lehigh Valley go into bankruptcy, but on an overall basis, my recommendation was rejected by top management.

You gentlement will remember that in the ICC merger proceedings, perhaps, one of the conditions of merger was that we must hold the Lehigh Valley viable for a period of up to 10 years so that the Norfolk & Western or the C. & O. would have an opportunity to determine whether or not they wished to acquire control. From the time we took over actual control, it has been necessary for us to advance Lehigh about $18 million including the interline settlements not paid. At the present time, they owe us approximately $26 million. This is in addition to certain other securities of the company which are held in the Pennsylvania Co.

On top of this, in the merger proceedings, we were forced to take on the additional burden of the New Haven, which in the last year before we took over, had a deficit of almost $25 million. In my judgment, expressed at that time, this was wrong and the merger in itself was not going to provide a solution of the problems facing the two railroads. And they were not in a position to take on this burden.

We also had the heavy expense in the Northeast corridor, which is similar to the New Haven operation, of inaugurating the Metroliner service. Originally it was contemplated that our share of this experiment would cost us $10 to $15 million. The actual figure is approximately $55 million, with the Government putting up an additional 10, and some of this has not even been received—yet because of inability to meet some of the requirements of the Government test, primarily because the equipment manufacturers of the cars have not reached the specifications for performance that were required. This all came out of cash and was another big drain on our situation.

Finally, it must be remembered that the Penn Central Transportation Company has approximately 35 percent of all the railroad passenger business in the United States. This has placed a burden on us beyond that experienced by any other railroad in the country. Our passenger losses on a fully allocated basis have been running in

excess of $100 million a year. This alone has been a tremendous financial drain on us, even if we had none of the others previously cited.

I pointed out in my testimony before the ICC, when it was considering our merger, that the Pennsylvania rate of return had for years been not only less than that enjoyed by manufacturing companies and utilities, but "for many of the years, the return was actually below that obtainable on long-term governments, so-called riskless investments." At the same time, I observed that because of their failure to receive an adequate return, "the railroads' position as a whole has been severely damaged, possibly irreparably * * *." I also stated that, at that time, the railroads' debt structure was becoming unmanageable, their working capital position actually becoming negative, and their ability to attract equity capital had disappeared, so that these evidences have been with us for a long while.

I added:

> Many railroad companies are extremely worried at the present time as to how they are going to be able to finance equipment purchases in the magnitude required in the future. If the railroads cannot finance equipment acquisitions, it will become impossible for them not only to meet any expanded demand but to replace equipment which is wearing out year by year. If this is true, then in turn, they will be unable to provide the service necessary to industry in general and would obviously not have the ability to meet the demands of wartime. This sounds like a bleak picture, but factually, it is true.

With respect to the immediate post-merger period I noted:

> If the merger is consummated, it will, of necessity, involve a difficult shakedown period. Although the merged company will have combined revenues at 1961 levels of about $1.4 billion, it cannot look forward during this period to net earnings which are commensurate with the volume of business handled. On top of this, the combined working capital deficits of the two railroads, as of December 31, 1961, was about $10 million. Furthermore, it is estimated during the period immediately following the merger, the cost of employe protective conditions will substantially offset savings to be derived from the merger, and we will be faced initially with sizeable cash outlays for capital improvements. This means we will be in a so-called high leverage period where, in spite of substantial revenues, we will have high fixed cost with little net income and a deficit in working capital.

In the course of the hearings, I was asked—

> Is it your opinion that the Pennsylvania will not have sufficient cash flow in the future to meet its maturing obligations?

My answer was—

> Yes, I think ultimately if this downward trend continues, we will have some serious problems. To be perfectly honest and realistic, I believe we can, through the sale of assets, continue to raise sufficient cash to meet obligations for an indefinite period ahead, but as I said yesterday in effect, we have been in slow liquidation in my judgment for about 10 to 12 years now and there always comes an end to that sort of thing.

These then, gentlemen, are among the real and compelling reasons which prompted our latest diversification program. If we had not responded in that manner, the present situation would have developed sooner and in my opinion would have been much worse.

A statement prepared in late May in connection with the request for a guaranteed loan, clearly indicated that as of that time, Penn Central Co., exclusive of the railroad operations, was in a strong

and profitable position, but the whole system was being dragged down and its financial strength sapped by the rail operational losses.

The following figures were given to the Government at that time:

[Millions of dollars]

	1970 (forecast)	1969	1968
Earnings of Penn Central Co. before transportation company rail losses	243.5	197.5	207.8
Losses on rail operations [1]	270.9	219.6	139.5
Consolidated ordinary	−27.4	−22.1	68.3

[1] Includes passenger service losses: 1970 (forecast), $120.0; 1969, $104.8; and 1968, $100.2.

One other major factor which must be taken into consideration is that, unfortunately, it has become customary in the railroad business to have wage increases made effective retroactively. At the same time, tariff increases always lag substantially behind, cannot be made retroactive, and usually are totally insufficient to meet these increased costs.

I might say an article by Mr. Johnson, chairman and chief executive officer of Illinois Central Industries appeared in the New York Times on August 2, pointed out almost identically the same thing, and I quote from this article:

The old timetable that regulates railroad rates is behind the times, while inflation—threatening all segments of our national economy—is derailing the liquidity and earnings of the railroad industry.

It goes on to say:

While the regulatory machinery turns ever so slowly, remember that railroad wage settlements are generally retroactive; rate increases, on the other hand, can never be retroactive. This results in a punishing time lag—one that generally involves hundreds of millions of dollars lost forever.

Time is running out if something is not done soon. Railroad working capital has been disappearing, and liquidity problems are serious for a considerable number of railroads.

He ends up at the conclusion of the article:

But should the ICC be unable or unwilling to respond more quickly to inflation and other economic pressures of our time, we may be moving to the point where we will have to make a difficult choice—saving regulation or saving railroad services.

For many railroads, it is almost the end of the line.

And with your permission, Mr. Chairman, I would like to make this part of the record.

Senator HARTKE. Yes, that will be made a part of the record.

(The article follows:)

[From the New York Times, August 2, 1970]

POINT OF VIEW: AMERICAN RAILROADS ARE AT ECONOMIC CROSSROADS

The following article was written by William B. Johnson, chairman and chief executive officer of Illinois Central Industries, Inc.

The railroads of America are at an economic crossroad, with no clear signals ahead.

We have gotten off schedule somewhere along the line. The old timetable that regulates railroad rates is behind the times, while inflation—threat-

ening all segments of our national economy—is derailing the liquidity and earnings of the railroad industry.

The block to further necessary economic movement is this transportation regulatory structure will all its inherent delay and rigidity. You wonder, indeed, whether that body of regulations is not hopelessly unable to respond to the swift-moving and compelling economic forces we all now feel.

Well recorded experience with the present machinery of regulation cries out for a reform of the system so that regulation can endure as a worthwhile institution. As it now stands it is the instrument of the eventual destruction of the public services it should be regulating and preserving.

We hope that the leadership for such reform will come from within the government—but if the inflationary spiral climbs much longer, it had better come soon.

Inflation now is being led by an unfortunate combination of annual wage increases coupled with little productivity increase from the worker. Thus—and it's a fact of business life—profit margins are under pressure.

Railroad managers are no different from other business managers. They must meet these wage increases by growth, by improved efficiency through capital spending, or by raising prices. The usual sound approach is a combination of all three.

Now, growth in volume is currently inadequate to absorb the burden of wage increases in railroading and in most businesses. Capital spending and price increases are the only reasonable alternatives for progress.

But here the flag is down for the railroad industry because of some special problems that include regulation. Here is some background to the situation:

Capital spending has been too little for too many years to produce such fundamentals as adequate railroad car fleets, satisfactory road beds, modern shops, and a computer and communications technology fully capable of handling the complex movement of all kinds of goods all over the nation. Great progress has been made over the years, but there is still so much catching up to do.

Meanwhile, just to keep pace with the rate of national, growth, the railroads will need to develop the capability to handle 50 per cent more tonnage in 1980 than is moved today.

Then add this to the situation: New money, plus that needed for refinancing maturities, is very expensive—when it is available at all.

Here we come to the crux of the problem—while these capital needs are crying out to be filled, the railroad industry's internal growth through earnings is stifled by the slowness of procedures for raising rates.

While the regulatory machinery turns ever so slowly, remember that railroad wage settlements are generally retroactive; rate increases, on the other hand, can never be retroactive. This results in a punishing time lag—one that now generally involves hundreds of millions of dollars lost forever.

Time is running out if something is not done soon. Railroad working capital has been disappearing, and liquidity problems are serious for a considerable number of railroads. At the end of last year, net working capital for the entire industry was only $60-million, compared with $477-million at the end of 1966. It is obvious that this is a threat to many carriers' ability to conduct their operations satisfactorily, much less to rebuild and develop properties for tomorrow's requirements and opportunities.

Only a more sensitive and responsive regulatory process can alleviate the problem. Another freight-rate increase will soon again be confronting the carriers, the users and the regulators. But legislation may take too long to save some of the railroads.

Although the Interstate Commerce Commission must work within the laws written by Congress, it seems imperative that some lawful means be found for rate increases "geared in time" to meet the cost burdens for which they are granted.

This means that they must be virtually automatic, unfettered by the delays sought by some shippers or the delays inherent in the regulatory procedures.

In this regard, there is some encouragement in a suggestion made last year by the Department of Transportation that "the time is ripe for the commission to consider whether this pattern should be permitted to continue or whether the commission should instead authorize the railroads to adjust

their rates in smaller increments on a more frequent basis." Further encouragement comes unofficially from an officer of the National Industrial Traffic League.

There also are examples and precedents in procedures of the Federal Communications Commission. The I.C.C., for example, could hold hearings into the feasibility of both an automatic procedure and a formula to trigger its operation when needed. This, too, would take time, but, hopefully, it would need to be done only once.

But should the I.C.C. be unable or unwilling to respond more quickly to inflation and other economic pressures of our time, we may be moving to the point where we will have to make a difficult choice—saving regulation or saving railroad services.

For many railroads, it is almost the end of the line.

Mr. BEVAN. I think it is only fair to say there are no two railroads in the United States exactly alike, their problems and difficulties vary widely, and each has different considerations involved when the question of rate increases comes up. Even recognizing this factor, it still seems that the railroad industry has been its own worst enemy in not making everyone realize that it is not possible to operate an industry effectively under these conditions and on the low rate of return realized by the railroads for years.

In conclusion, I would like to suggest that the following type of program is essential if the railroad industry is to survive under the private enterprise system:

No. 1. Some method must be found to wipe out the disastrous effects of retroactive wage increases, coupled with the tremendous lag in rate increases. Since each railroad provides the ICC with complete information monthly, the Commission certainly should be in a position to know at all times the financial condition of the railroads individually and as a whole, as well as their requirements. Perhaps some legislation may be required, but it seems to me that, immediately upon settlement of a wage case, the Commission should be in a position to act, and to act promptly, in authorizing necessary rate increases without long and protracted hearings.

No. 2. The Government should determine as promptly as possible just what passenger service is required in the public interest; provide some method by which additional service can be added, or unnecessary service cut. In other words, maintain flexibility, but have just a stipulated amount of service. Require the railroads to provide the stipulated service; and make the railroads whole on a fully allocated basis because the industry can no longer afford, and cannot fairly be required, to subsidize the riding public. I believe strongly in mass transportation. In the long run, in congested areas such as the Northeast corridor, it is the only answer to the transportation problem. There is obviously a substantial cost involved in making the railroads whole for the services required, but I believe that in the end, the Government will effect substantial savings by sounder utilization of mass transportation, as against providing more freeways and expressways by the appropriation of huge amounts of Federal funds for highways.

Experts have testified that $1 for mass transportation is equivalent to $20 spent on highways.

No. 3. Some plan must be adopted to make it possible for the railroads to finance acquisition of the equipment essential to eco-

nomic operation. I believed that there was a pressing need for such a plan as far back as 1957. I therefore developed a plan later known as the Symes Plan, which I personally presented to the full board of the Association of American Railroads on April 12, 1957.

The plan was never implemented, primarily because certain of the wealthier railroads did not see any urgency in this area and were fearful that such a plan might be the first step toward nationalization. In my judgment, however, the plan would have constituted one step forward in preserving the railroad industry as private enterprise. Attached to my statement is a copy of this plan, together with a full statement presented to the Association of American Railroads as to the need for it. And this was in 1957.

While other plans are now under study and discussion, I still believe this one offers the greatest flexibility to meet the individual requirements of each railroad and at the same time minimizes the cost to the Government.

No. 4. There is no question in my mind that the impact of the Penn Central and its difficulties in the financial market will make further financing in the railroad industry difficult and costly for most, and impossible for many. Therefore, a guaranteed loan program for purposes other than equipment in my judgment has become an absolute necessity. I therefore support passage of legislation designed to accomplish that objective.

That concludes my prepared statement. I shall, of course, be happy to attempt to answer any questions you gentlemen may have.

Senator HARTKE. Thank you, Mr. Bevan. Mr. Bevan, a question that arises and has been recurring here is a question of the diversification and utilization of the assets of the Penn Central Transportation Co., the Penn Central Co., and the Pennsylvania Co., with recurring information about the Great Southwest Corp., which is 80 percent owned by the Pennsylvania Co., which is owned by the Penn Central Transportation Co., which in turn is owned by the Penn Central Co.; is that correct now, so far?

Mr. BEVAN. I believe you stated it correctly.

Senator HARTKE. As a financial expert, I suppose you find it easier to understand those holdings, and so forth.

Mr. BEVAN. I have lived with the system for a good many years. I think for all practical purposes, you may disregard Penn Central Co. It just actually came into being on October 1, 1969, and it is little more than a shell except for the two small oil companies.

In our discussion we can think in terms of the transportation company and directly under it the 100-percent owned Pennsylvania Co. That may clarify the situation a little bit.

Senator HARTKE. In regard to Great Southwest, what is its present financial condition?

Mr. BEVAN. I do not know. We had some problems at the time I left the company. Like every company, the money situation was tight and, of course, with tight money and high interest rates for mortgages and lack of availability, they had some financial problems. We did not think they were insoluble. We were working on them. I understand—and this is only indirectly but it is understandable—I understand that what has accentuated the situation subsequent to

my leaving was that when Penn Central itself, the transportation company, went into reorganization and, as a result, certain financing commitments that Great Southwest had in Europe evaporated.

In other words—and I know this from personal experience of our own financing—up until the time this happened, the Penn Central enjoyed a very high regard and reputation in Europe, but they considered this a material adverse change and I understand that a lot of the commitments they had for financing went out the window, but I do not know much more about it than that.

Senator HARTKE. Great Southwest is not included in the reorganization, is that not true?

Mr. BEVAN. That is correct, but I think psychologically in Europe their whole attitude was based on Penn Central. For years, Penn Central's stock had been held abroad and I think they just became frightened and did not know what would happen when Penn Central went into reorganization.

Actually, this was what seriously damaged our ability also to float a Pennsylvania Co. issue, and you may recall that the rating services downgraded Pennsylvania Co. issue, the proposed issue, from BAA to BA, which made it almost impossible to sell, and in my conversation with them they said, "Well, basically, we are afraid that the transportation company is headed for trouble and therefore we do not know what effect that will have on Pennsylvania Co." So there is an impact here all the way through.

Senator HARTKE. Yes; now, the reports are, though, as of August the 6th in the *Wall Street Journal*, that the Great Southwest had a consolidated net loss of operations of $3½ million in the first half compared to consolidated net profit of $20 million in the year earlier period. Is that true?

Mr. BEVAN. I do not know. I have not seen the statements. I heard that they sold off some properties to raise cash and it may be that they sold those at a loss.

Senator HARTKE. Let me ask you, were you not in charge of this operation up until recently?

Mr. BEVAN. Yes.

Senator HARTKE. I am rather surprised at an "I do not know."

Mr. BEVAN. Well, I do not know anything—I mean, I have not seen anything that had happened since June 8. I was going to say for the year 1970—well, in 1968, Great Southwest earned $34 million before taxes and, of course, we do not pay taxes. In 1969, they earned $51 million and they were budgeted for $63 million in 1970. At the time—well, very shortly before I left, the last review of the situation for the first half was that they were going to show for the first half somewhere between $28 and $30 million profit.

My supposition—and this is the only thing I can go on—I heard they sold some properties to raise cash, and my guess is that they were sold at distress prices and, therefore, sustained a loss on them, but they sacrificed in order to raise cash.

But the last operational budget that I saw before leaving, we were confident we were going to make between $28 and $30 million the first half of the year and $63 million for the year.

Senator HARTKE. Well, they have recorded a $3½ million loss.

Mr. BEVAN. I would guess that they have sold some properties at distress prices and that this accounts for it.

Senator HARTKE. Are you trying to say it is just a bookkeeping loss?

Mr. BEVAN. Well, to be precise, they probably sold some properties below the price at which they were carried on the books to raise cash. In other words, they may have been carried on the books at $30 million and they may have sold them for $20 million.

I know that the first quarter of 1970 was the second-best first quarter in the history of Great Southwest.

Senator HARTKE. Why did they do that—in other words, you are going down two different roads. On the one hand, the whole argument has been that this diversification, and the Great Southwest being one of the principal sources, has been a great asset to the railroad and the transportation company; on the other hand, it is being pointed out now that because the transportation company is operating in reorganization is a cause of their collapse.

Do you see the predicament in which you place us? This appears to me that rather than Great Southwest being a supporting feature for the transportation company, that the transportation company was a supporting feature for Great Southwest.

Mr. BEVAN. No; I think—well, psychologically——

Senator HARTKE. Well, do all of these people deal in psychological facts? I am talking about money.

Mr. BEVAN. I am, too.

Senator HARTKE. I do not think they filed for reorganization under the Bankruptcy Act because of psychological facts, did they? Was there not a shortage of cash, a shortage of cash flow?

Mr. BEVAN. That is correct.

Senator HARTKE. In other words, as far as the transportation company going into reorganization, they did not have the psychological hangover; they had a financial hangover.

Mr. BEVAN. No question about that. I agree with you. What I am saying is there is a chain reaction and when the transportation company went into reorganization it did have an effect on all these others and it threatened transportation going on and that is what caused trouble on the Pennsylvania Co. issue and this caused, as I understand it—this is hearsay—that this caused in Europe—they considered this an adverse change and they withdrew their commitments for financing for Great Southwest.

This is what I mean by psychological. It is actual. It happens. You do not want to get involved with a system where one company is in reorganization and you do not know how many more are going to go in or what is going to happen.

Senator HARTKE. Well, let us be very clear. The transportation company is in reorganization?

Mr. BEVAN. Right.

Senator HARTKE. It is your contention that the transportation company was the great financial drain upon the Penn Central Co.?

Mr. BEVAN. On the whole system.

Senator HARTKE. In other words, the Penn Central Co.'s biggest financial drain was the Penn Central Transportation Co?

Mr. BEVAN. That is correct.

Senator HARTKE. Now, the reorganization proceedings have alleviated the necessity to fulfill the obligations of the Penn Central Transportation Co. and thereby should have relieved a financial strain and the psychological load rather than increased it, should it not?

Mr. BEVAN. Well, except people do not know, looking at it from the outside in, they do not know what is going to happen to any of these companies, whether they are going to be sold off or what is going to happen to management or anything else, and there are too many intangibles so it does have a serious effect.

I understand that they lost a lot of their commitments in Europe for financing which is a tangible, concrete result of what I am talking about. Great Southwest today has excellent properties, there is no question about it, but because of the failure of these commitments to go through—I cannot absolutely vouch for it—I understand that they have had to sell some property to raise such cash which they expected to get in Europe.

Senator HARTKE. What your contention is, then, is that the European money managers you are, playing a principal role in this whole operation. Is that a correct assumption?

Mr. BEVAN. Well, by play a principal role, I think their failure to—their withdrawing their financial commitments, as I understand, is what has tightened the squeeze on Great Southwest on its liquidity.

Senator HARTKE. Are you referring to Swiss banks?

Mr. BEVAN. I do not know which commitments were withdrawn. As I say, I have only gotten this secondhand. They had a number of commitments in Europe. I would say there were six or eight of them altogether. If I remember correctly at this point, one was Swiss; another was a group of Dutch banks. There were about six of them in all and I do not know which ones were withdrawn.

Senator HARTKE. Some of them were Swiss. How many were Swiss?

Mr. BEVAN. I do not have that information here and I cannot tell you.

Senator HARTKE. But some of them were, right?

Mr. BEVAN. My recollection is that there was one Swiss loan involved.

Senator HARTKE. How much of a role in the whole Penn Central operation does the European money and the Swiss banks play, or have they played, I should say, before and during the time that you were there?

Mr. BEVAN. I think it would be safer, Senator Hartke, if I got that information and submitted it to you.[1] I would rather not guess on it.

Senator HARTKE. Well, I am not asking you to guess and you can supply it for the record, but you are the chief financial officer and you have expressed in great detail here your satisfaction as to the financial arrangements that you handled in this company, and have laid its troubles at everybody else's doorstep. But according to the registrations filed with the ICC, the stockholders registered on the

[1] See letter of January 4, 1971, from La Brum and Doak in part 3 of these hearings.

books of the company as of June the 15th as owning at least 1 percent of the outstanding stock of the company, listed two Swiss banks; one, the Credit Suisse at 761,373 shares; the Sociéte Banca Suisse, which is 312,401 shares.

Mr. BEVAN. They used to own—I will put it this way—at the peak, before merger at one time, about 12 to 14 percent of our stock was registered in the name of Swiss banks.

Senator HARTKE. And who was behind this veil of secrecy there? You did not know who owned as much as 12 percent?

Mr. BEVAN. No; there is no possible way for us to know.

Senator HARTKE. Well, one of the factors which I think you put your finger on and is exactly true if you talk about the psychological difficulties of the Great Southwest Corp. is the fact you just stated, that one of the things is that the people do not know and investors do not know what really is going on.

Now, in May of 1968, reported in the Baltimore Sun, the Penn Central Co. announced that it planned to diversify and you were with them at that time, were you not, as the chief financial officer?

Mr. BEVAN. Yes, I was.

Senator HARTKE. The statement was allegedly made by Chairman Stuart Saunders saying that the money to diversify would come from the disposition of the 1,700,000 shares of Norfolk & Western stock and other sources, and that they were going to spend $500 million in a variety of fields.

Now, in line with that, it is very difficult and it has been very difficult for the staff to really unravel the investments of the Penn Central either before the merger or afterward, but there was one investment which is on the public record because there was a proceeding under the Federal Aviation Act. That was the record of the Pennsylvania investment into Executive Jet.

Now, since it was acquired originally in 1962, has Executive Jet ever returned any gain to the Penn Central?

Mr. BEVAN. No. I would say very frankly, Senator Hartke, that because of a variety of circumstances, this was not part of our acquisition program. This was done as an investment. As a land carrier we could not control an air carrier and so we made this as an investment which we anticipated would be profitable. For a variety of reasons in retrospect I would never have done it. I think this was one bad investment, in hindsight, but we—it was made as an investment and not part of diversification because as a land carrier we could not control an air carrier and we took stock that was nonvoting. We had nobody on the board. We were not allowed to participate in the management in any way.

If I had it to do over again, I would not do it, knowing what I know now. But at the outset, we said that on the diversification program you make some mistakes and you make some good investments and you hope for a good batting average. I think our batting average has been good but I would freely admit if I had to do it over again I would not invest in Executive Jet.

Senator HARTKE. Was Executive Jet an investment of the funds of the Pennsylvania Central Co.?

Mr. BEVAN. No; Executive Jet was an investment of the Pennsyl-

vania Co. There were not funds for it which came from the Penn Central Transportation Co.

Senator HARTKE. No funds from them?

Mr. BEVAN. No.

Senator HARTKE. How did they get the stock? Was not the stock of N. & W. part of—originally, in 1968—the merger operation acquired?

Mr. BEVAN. I am sorry, I do not understand your question.

Senator HARTKE. How did you acquire the stock of N. & W.?

Mr. BEVAN. We have had N. & W.——

Senator HARTKE. This was in the Pennsylvania Co.'s holdings?

Mr. BEVAN. Over a long period of years whenever Pennsylvania Railroad needed additional funds, the Pennsylvania Co. would acquire N. & W. at the going market price and for a long time now the Norfolk & Western has been in the Pennsylvania Co.

Senator HARTKE. How much did the Pennsylvania invest in the corporation of the Executive Jet Aviation Corp.?

Mr. BEVAN. Approximately $21 million.

Senator HARTKE. And who made this decision to invest the funds into this venture?

Mr. BEVAN. Well, I would say that——

Senator HARTKE. Was it originally brought to you by General Lassiter?

Mr. BEVAN. It was originally brought to us by General Lassiter whose concept it was, but he was brought to us by Glore Forgan, the investment banking firm in New York.

Senator HARTKE. And who in Glore Forgan brought that to your attention? Was that Mr. Charles Hodge?

Mr. BEVAN. That is correct.

Senator HARTKE. Now, what kind of study or evaluation did you make of this proposal before you invested?

Mr. BEVAN. Well, we went into it fairly comprehensively, and actually, originally, we thought probably we could set this up where we would not invest more than about $6 million in total, and we set it up on what you might call a debt basis, and the amount of money we put in the stock was very small and the rest of it was put up in the form of debt.

We anticipated that after they once got on their feet that we would sell out the debt and it would be refinanced and we would have at a very small price a substantial percentage of the common stock. But we were hit by a variety of things, like CAB decisions, that although we tried as carefully as we could not to—they finally said that we did control through economic domination.

We were also hit by the fact that—not in Executive Jet, because their record has been good—but that at the outset there were several accidents involving Lear planes and gave the Lear jet a bad name for a while, which I think has been proven wrong now because it was a matter of people operating them without sufficient experience.

We also were hit with tight money conditions and a variety of other things, but we had expected originally that our total investment would not exceed $6 million but then we had to carry them through the tight money period and we hit all kinds of other problems.

Senator HARTKE. Was there any limit put on the amount of funds that could be committed to Executive Jet?

Mr. BEVAN. No. It was decided from time to time on the basis of the current situation. Finally, there was agreement with the CAB that we would not put any more funds in without their prior approval. That was about 2 years ago.

Senator HARTKE. And then the cease-and-desist order was issued in June 1969, right?

Mr. BEVAN. That is correct.

Senator HARTKE. And there was a fine imposed against the corporation as a result of that?

Mr. BEVAN. That is correct.

Senator HARTKE. An extremely large fine, right; the second highest in the CAB's history?

Mr. BEVAN. That, I did not know. If I remember correctly, as a fine we paid about $75,000.

Senator HARTKE. Now, that is part of the fine. But you invested $21 million into this Executive Jet operation; is that true?

Mr. BEVAN. That is correct.

Senator HARTKE. When was it supposed to start making money?

Mr. BEVAN. Well, as I remember it, the projections indicated they would start making money I think it was about the third year.

Senator HARTKE. That would be 1965?

Mr. BEVAN. I think that is correct.

Senator HARTKE. Was this the projections made by the board members of the Pennsylvania Co. or by Glore Forgan or who presented this projection for you?

Mr. BEVAN. Well, let me put it this way. It was my responsibility in this area. I made the recommendation to our board of directors which was accepted.

Senator HARTKE. You made the recommendation to your board of directors. What proposal was made to you that interested you in making this recommendation to the board?

Mr. BEVAN. Well, as I said, the Glore Forgan brought it to us.

Senator HARTKE. Glore Forgan was the one who made the original proposal to you?

Mr. BEVAN. That is correct.

Senator HARTKE. Through Mr. Hodge again, right?

Mr. BEVAN. That is correct, and we made studies of our own. We talked to a number of people. At that time I remember, among others, we talked to Pan American because they had been thinking in terms of not the same but a similar type of plan. The company itself had had the Battelle Institute make a number of studies and they had others by Cornell University as I remember. There were a whole series of them and we put them together and, as I say, originally this was supposed to be—we thought if things worked out that we would be limited to about $6 million.

Senator HARTKE. So you accepted the proposal by Glore Forgan with the acquiescence of the other railroad directors?

Mr. BEVAN. They approved of it on my recommendation.

Senator HARTKE. They approved it; is that correct?

Mr. BEVAN. That is correct.

Senator HARTKE. Was there any discussion at this time with the fellow shareholders in this operation of the Penphil Corp.? First, let's establish who is the Penphil Corp.

Mr. BEVAN. The Penphil Corp. was a small, informal investment company set up by a number of us who were linked by friendship to invest for capital appreciation. It was a very small affair and run quite informally. I was a stockholder.

Senator HARTKE. You were a shareholder of Penphil?

Mr. BEVAN. That is right.

Senator HARTKE. And an organizer of it?

Mr. BEVAN. Yes; I think that is correct.

Senator HARTKE. Was Paul Fox, vice president of administration, one of the members?

Mr. BEVAN. Yes, he was.

Senator HARTKE. Was William Gerstnecker, vice president corporate, Penn Central, a member?

Mr. BEVAN. Right.

Senator HARTKE. And was Robert Haslett, the vice president of investments of Penn Central, a member of this?

Mr. BEVAN. Right.

Senator HARTKE. And Mr. Charles Hodge was also a member?

Mr. BEVAN. Right.

Senator HARTKE. And this was held in the name of Mrs. Hodge; is that right?

Mr. BEVAN. I think that is correct.

Senator HARTKE. And this is the same Mr. Hodge who is at Glore Forgan; is that right?

Mr. BEVAN. That is correct.

Senator HARTKE. And was Mr. Hobart C. Ramsey, formerly of Glore Forgan, a member?

Mr. BEVAN. He was a member, a limited partner.

Senator HARTKE. And Alphonse Manero, formerly at Glore Forgan, right?

Mr. BEVAN. Right.

Senator HARTKE. And Theodore K. Cramer, vice president of accounting and tax for the Penn Central, correct?

Mr. BEVAN. No; not Cramer.

Senator HARTKE. Do you know Mr. Theodore Warner?

Mr. BEVAN. Warner, yes; that is correct.

Senator HARTKE. Brown L. Whatley, who is the president of the Arvida Corp.

Mr. BEVAN. That is right.

Senator HARTKE. And Angus G. Wynne, the president of Great Southwest Corp., is that correct?

Mr. BEVAN. Right.

Senator HARTKE. In other words, is it a correct assumption to say that Penphil Corp. was basically people from Penn Central, Glore Forgan, and some of the subsidiaries of the Pennsylvania Co.

Mr. BEVAN. Well, there are a number of other people in there as well.

Senator HARTKE. Yes; I understand that.

Mr. BEVAN. Right.

Senator HARTKE. According to the record. Was there any discussion then—I will come back to the question I asked first—was there any discussion with the fellow shareholders in the Pennsylvania about the fact that the Penphil Corp. was also interested in Executive Jet?

Mr. BEVAN. Penphil never had any interest or owned any stock or had any interest of any kind in Executive Jet.

Senator HARTKE. Did they make an investment through Mr. Hodge or through his firm, Glore Forgan, in Executive Jet?

Mr. BEVAN. No, sir.

Senator HARTKE. At no time?

Mr. BEVAN. At no time.

Senator HARTKE. Now, you said a moment ago that you expected not to invest more than $6 million in total; is that right?

Mr. BEVAN. That is correct.

Senator HARTKE. When did it exceed that, the $6 million mark?

Mr. BEVAN. I would guess it went up gradually and—I would imagine, Senator, it was about 1965 or 1966.

Senator HARTKE. In other words, this was about the same time that you had anticipated that it would be making a profit; it went the other way and it was already proved to be a bad investment and required even more than you anticipated in investment into the Executive Jet operation. Is that not true?

Mr. BEVAN. Well, what we anticipated was that it would be able to finance requirements on its own, but business was slower coming than anticipated, as I said, because of this unfortunate situation regarding the reputation of the plane which turned out to be successful, and the tight money conditions that we had just started——

Senator HARTKE. Tight money conditions in 1965 and 1966?

Mr. BEVAN. It started, as far as companies of this sort were concerned.

Senator HARTKE. In 1965, the beginning of the tight money situation was apparent at that time in the marketplace.

Mr. BEVAN. Well, let me restate it.

Senator HARTKE. Now, wait a minute. I do not want it restated. Let's just make it clear. Let's not blame tight money back in 1965 and 1966. There is no question that that is when the policy was initiated, but it had not come to fruition yet.

Mr. BEVAN. What I was saying, we had just started in 1965 and 1966 to have outside financing. I think there were three banks—three or four banks—that had come in the picture and had done financing for EJA. Exactly what the time of those different banks is I cannot tell you at the moment. But we had just started this program which was going to be—we thought it was going to take us out completely.

Senator HARTKE. What were the names of those banks?

Mr. BEVAN. There was the National Newark & Essex in Newark, N.J. There was the Philadelphia National Bank in Philadelphia; and First National—I think it was First National Bank of Columbus, Ohio. We thought we were on the verge of moving this company into what was——

Senator HARTKE. You planned to sell this company; is that right?

Mr. BEVAN. Well, we planned to refinance all the debt and get our money out of it and keep the stock, which the stock represented only an investment of about $375,000, if I remember correctly.

Senator HARTKE. Who planned to sell this? Who was in charge of the selling of it? Who told you they were going to sell?

Mr. BEVAN. I said we planned to refinance it. Their future requirements, first of all, would have been—we expected to be handled by banks and others, and then at some point we thought we could sell out or have refinanced by the banks the debt that we had in them. We had not gotten to the point of actually planning it. We were pleased with the fact that it had gotten to the point where three banks were willing to come into the situation.

Senator HARTKE. Yes, but you had already exceeded your estimate of your investment. You had determined already that this was a bad investment and you were trying to—you were refinancing the operation, and did not Mr. Hodge try to sell it at that time?

Mr. BEVAN. First of all, we did not think that it was a—we did not think it had proved a bad investment. The business was increasing, but the timing had been slowed up. We also ran into another thing which for some time, because of our interest in it which we did not know when we went into it, that for quite a while they were not allowed to advertise at all under a CAB regulation.

Senator HARTKE. Then did you make an effort to sell it and dispose of it around about 1965?

Mr. BEVAN. No, we did not.

Senator HARTKE. You did not?

Mr. BEVAN. No.

Senator HARTKE. Then you did go into another acquisition; is that right?

Mr. BEVAN. Another acquisition?

Senator HARTKE. Yes, the purchase of the Johnson Flying Service; is that not correct?

Mr. BEVAN. Yes, we did. My recollection is that there were 13 supplemental carriers and I think it was early in 1967, if I remember correctly, that they found out the Johnson Flying Service was the oldest one in the country and was available for purchase, and they entered into a contract to buy it and subject to CAB approval, and I think around May or June of 1967 the CAB approved the acquisition of Johnson Flying Service subject to the elimination of economic domination by the Pennsylvania Railroad.

Senator HARTKE. That is right. In other words, it was all very clear that as far as Pennsylvania Railroad was concerned or any other transportation company that it could not be in the business of aviation; is that not correct?

Mr. BEVAN. Yes, and we did not think we were. On the advice of counsel we had done everything that we thought we could possibly do, not to manage the affairs of the company or control it, but they did find, regardless of our opinion, we were in economic domination.

The counsel gave us a series of so-called benchmarks of what was required in order to eliminate our economic domination, and on the basis of those benchmarks Glore Forgan went out and got commitments for approximately $22 million of financing that would have reduced our percentage of the debt down to a figure that seemed to be in line with the benchmarks and to reduce our common stock ownership, as I remember, to 39 percent; and he had the firm

commitments for these and everybody felt we were in the clear and this plan was taken down and given to the CAB; and unfortunately, in December of 1967, the CAB returned it to the examiner and said in their opinion this did not meet their requirements and the examiner should restudy it and probably should decide on the fact that we had to divest ourselves.

Senator HARTKE. When did you decide to set up the Swiss subsidiary?

Mr. BEVAN. Swiss subsidiary?

Senator HARTKE. Yes.

Mr. BEVAN. Well, you are referring to EJA, SA?

Senator HARTKE. Yes, sir.

Mr. BEVAN. That was done fairly near the beginning on the basis that a great many of these companies had contracts with some of the best companies in the United States, on the basis that when these people went abroad they could also have their contracts applied to European operations as well, that this would be very helpful both places.

Senator HARTKE. In other words, they were going to do the same type of operation that Executive Jet was going to do?

Mr. BEVAN. Yes.

Senator HARTKE. It was going to do it in Europe, right?

Mr. BEVAN. That is correct, and if Company A had a contract here in the United States but went to Europe they could pick up the telephone and get the same service abroad under the same contract.

Senator HARTKE. Was not part of the reason for this the fact though that you had some 20 planes and they were not being utilized and needed another opportunity to find use of these 20 planes?

Mr. BEVAN. No.

Senator HARTKE. That was not true?

Mr. BEVAN. We did not have—we did not acquire all 20 planes at once. They were done over a period of time and I do not think there have ever been more than four planes in total in Europe. Basically, one of the primary reasons for signing up in America was they liked the idea of having the service in Europe as well.

Senator HARTKE. Yes, but the fact of it is you were not using all the planes that Executive Jet had in the United States, is that not true?

Mr. BEVAN. They were all being used. They were not being used to the greatest——

Senator HARTKE. To the extent necessary to make it a going operation; is that not true?

Mr. BEVAN. That is correct.

Senator HARTKE. When did you decide then to start buying 707's?

Mr. BEVAN. Well, when—well, in 1967.

Senator HARTKE. This was when the tight money program was on, right? In 1967, when you described in detail all the financial difficulties you were having with the Penn Central Co., all the difficulties anticipated, you decided to go into a program of buying 707's; is that correct?

Mr. BEVAN. Of course, we did not—we were not managing the company, had no one on the board, had no voting power whatsoever. The company decided to——

Senator HARTKE. Was not Mr. Hodge on the board?

Mr. BEVAN. Mr. Hodge was on the board, that is correct.

Senator HARTKE. And Mr. Hodge was in Penphil? Pardon me, I cannot keep these corporations straight. There are only 175 of them and sometimes it is a little difficult to unravel them, let alone keep the names straight.

Mr. BEVAN. Penphil was an informal investment group and it had nothing to do with EJA.

Senator HARTKE. We are going to come back to the question of another one of these outfits, the International—the travel agency. What is the name of the travel agency?

Mr. BEVAN. Holiday International Tours.

Senator HARTKE. They all go together, do they not?

Mr. Bevan, they do, do they not?

Mr. BEVAN. No, they honestly do not.

Senator HARTKE. They are all in an operation here. I guarantee you it is very difficult for me to weave a way through here. It is sort of like going down through the Notre Dame Four Horsemen and trying to find an open lane. I guarantee you it is going to be real rough to try to find out where we are going, but we are trying to get to the goal line.

When did you decide to start buying 707's?

Mr. BEVAN. I think they started with the approval of the board of directors of Executive Jet on the advice of General Le May.

Senator HARTKE. That is General Le May?

Mr. BEVAN. That is correct.

Senator HARTKE. Now, we have Arthur Godfrey in this outfit, too, right?

Mr. BEVAN. That is correct. Jimmy Stewart was, also.

Senator HARTKE. And Jimmy Stewart?

Mr. BEVAN. He is an Air Force general as well.

Senator HARTKE. International jet set, right?

Mr. BEVAN. They were trying—and we had nothing to do with the selection of the directors, but it was planned that when Johnson Flying Service was acquired, General Le May would come back and the board considered him as one of the most knowledgeable people in this area in the country. He was going to come back and run the big plane program of hauling freight when Johnson Flying Service was acquired. So sometime in there when they felt that this financing program had gone to a point where it was going to be done, they thought this cleared the way for acquisition of Johnson Flying Service, and they signed letters of intent and they had to get in line to get these planes so they could use them at Johnson Flying Service when the blow struck in December of 1967 and the CAB sent it back to the examiner for further review. Then they were faced with a problem when these planes started being delivered of finding temporary homes for them because they could not use them themselves and we started at that point to find somebody who was acceptable to CAB to buy us out and we had a—in the spring of——

Senator HARTKE. I know. What I am trying to find out is when you decided to start buying these 707's. It is like the song—everybody is talking at me and I do not hear a word they say.

Mr. BEVAN. We did not.

Senator HARTKE. Now, the CAB found to the contrary, did they not? The CAB found to the contrary and the CAB made a decision there in which they said in fact that the transportation company did in fact have control. Now, you can contend they did not, but the CAB finding is to the contrary.

Mr. BEVAN. That is right.

Senator HARTKE. And on the basis of that CAB finding there was a fine paid, the second highest fine paid in the whole history of the CAB. In addition to that, the transportation company was operating not only in the field of Executive Jet and not only in the Johnson Flying Service, but also into Trans Avia and also International Air Bahamas; right? So in addition to that, you set up a Swiss corporation to engage in the flying service in Europe. The whole pattern here is not just one corporation, not just one activity in the aviation field into which you moved. Here the transportation company invested in an operation set up similarly to an international travel service which ultimately became so significant that Pan Am came in and filed their complaint with the CAB. Now is this not in effect what actually happened?

Mr. BEVAN. No, sir.

Senator HARTKE. It is not what happened? All right, you correct what I said.

Mr. BEVAN. All right. The CAB found we had economic domination and therefore indirect control, but I can tell you, regardless of the decision, that we never went to a board meeting; we never had even an observer there; we had nothing to do with the selection of the directors or anything else. So I am speaking from our side of the picture.

We made none of these decisions, regardless of what may have been found to be the case legally.

Senator HARTKE. Let me make it clear, I am not, at this moment, alleging there was any wrongdoing. I am just trying to get the facts straight.

Mr. BEVAN. I am trying to give them to you.

Senator HARTKE. I hear what you are saying here again but let's come on back to when you talked about Mr. Hodge in these operations and you say you did not have meetings, but on page 13 of the CAB hearing in docket No. 17657, on the 14th day of October 1969, in finding No. 34, this statement is contained in their findings.

Just for the sake of the record, I should make it clear that the origination of the statement says that the findings of the CAB are in no way an agreement that they are true and that they do not make any admissions with respect to any issue or fact or conclusion of law. But respondent agreed not to contest the statements of fact and conclusions of law set forth in the agreement.

Now, on page 13, in item 34 in the findings, I quote: "In order E–26170, dated December 30, 1967, the Board found that Charles J. Hodge of Glore Forgan was the PRR's alter ego in dealing with EJA." So to contend that there was no understanding as to who was involved here seems to beg the question, quite honestly, Mr. Bevan—and I think really—I will listen to you but I do want to find out why you went into the operation of buying 707's; how they were going to be financed in a time when it was extremely difficult to fi-

nance the railroad operation itself; what you were going to do with them; and exactly how they fit into this picture with the two other airlines, including the Bahamas outfit, Trans Avia, and also with that travel agency, Holiday International Tours?

Mr. BEVAN. Well, Senator Hartke, as I say, at some point in there, and I cannot give you the exact dates—the board of EJA authorized the first signed letters of intent for two 707's and two 727's when they were satisfied that they were going to get the Johnson Flying Service, and that——

Senator HARTKE. Let me put this point in here. The finding of the board was that Mr. Hodge was operating on behalf of Pennsylvania Railroad.

Mr. BEVAN. We did not agree to that.

Senator HARTKE. I am not asking you to agree to it. I am just pointing out that you made this decision when you acquired the Johnson Flying Service to acquire these planes, the two 707's and the two 727's, full well knowing that there is no question whatsoever that as far as the Pennsylvania Railroad was concerned that it was not allowed to be in the aviation business. Is that not true, and that is the ultimate finding of the CAB, is that not true?

Mr. BEVAN. Yes, that is true, but you see, what they did say in this first one, what they actually approved was the acquisition of Johnson Flying Service by EJA subject to the elimination of economic domination by the Pennsylvania, and the financing program we followed on the advice of counsel and counsel gave us benchmarks which were supposed to meet the elimination of this economic domination, and this was a $22 million financing program and this financing program would—was to take care of most of the—or a part of the plan of financing the planes.

Senator HARTKE. How much did the planes cost?

Mr. BEVAN. I think the 707's were to be about $6½ to $7 million, if I remember correctly, and the 727's I believe were $3½ million. These are approximates. I just do not remember.

Senator HARTKE. This is the total obligation then of around $20 million minimum?

Mr. BEVAN. Right.

Senator HARTKE. What was the carrying charges on that?

Mr. BEVAN. Well, this program—this financing program never went through.

Senator HARTKE. You did acquire possession of the planes?

Mr. BEVAN. Yes.

Senator HARTKE. And you did acquire the obligation of carrying the financial charges of buying the planes?

Mr. BEVAN. That is correct. I have not gotten up to the actual acquiring. When they thought that they had this program and this was to provide a part of the money for the planes, then they thought that they were going to be in a position to acquire Johnson Flying Service and that we would be in a position to maintain our stock investment of about 39 percent because others would actually control the situation, not us. So we went ahead and ordered the planes and then the CAB in December threw out that financing plan so, therefore, the company was faced with the planes arriving and no place to put them.

Two 727's were financed—were purchased and financed. One 707 was purchased and financed. And the fourth 707 was acquired under a lease, long-term lease, I think an 8-year lease.

Senator HARTKE. When was the decision made that International Air Bahamas and Trans Avia should be acquired by Executive Jet?

Mr. BEVAN. Well, they never were acquired by Executive Jet. What happened was that these planes as they came were—the management looked around as quickly as possible for places to put them on a rental basis because they could not operate them themselves and I think United Airlines took one for a while; Trans-Caribbean Airlines had one or two of them; Air Lift was involved, and as they filled their needs and the planes started to come back in—I think it was in May of 1968, one 707 was back and it was put out under lease to International Air Bahamas which I think started operations in July of 1968, if I remember correctly.

Senator HARTKE. You say that Executive Jet did not acquire International Air Bahamas and Trans Avia; right?

Mr. BEVAN. Right.

Senator HARTKE. On page 9 of the same CAB report, I want to read to you finding No. 24—

that the sums deposited by EJA in the Commercial Credit Bank to facilitate the acquisition of Trans Avia included the $500,000 which EJA borrowed from the Pennsylvania Railroad acting through ACC on April the 30th, 1968. EJA repaid this loan on May the 15th, 1968 and this loan was authorized with the knowledge that the funds were to be deposited to facilitate the acquisition of Trans Avia by Mr. Bevan and Mr. Gerstnecker of the PRR. Is that true or not?

Mr. BEVAN. Well, the stock—Executive Jet did not acquire it.

Senator HARTKE. Is the statement I read to you true or not?

Mr. BEVAN. Basically, as I got it, yes, but if I could say one thing, the Trans Avia at that time was acquired by a Mr. Hirshman.

Senator HARTKE. Who is Mr. Hirshman?

Mr. BEVAN. I only met him once in my life. I guess he was Swiss. He is a prominant industrialist over there and they had to have Swiss people on the board and he came on the board of EJA, SA. He lent money on several occasions and he also was going to have a—I guess you would call it a joint venture of a maintenance base in Europe with EJA, SA which they were going to operate. He is the one who acquired Trans Avia stock at that time.

We put up in an account that we lent EJA $500,000. He said that they had not gone through with their part of the obligation in financing this maintenance base over there and therefore he was short of money, but if we would lend him $500,000 this could be put up as a free deposit and this would facilitate his raising the money to make the second and I think it was his last payment for acquisition of Trans Avia. We did that.

And the following week, our counsel in Washington—counsel was present the day we made the decision—but our counsel in Washington said—

Well, there is nothing wrong with this legally but, unfortunately, last week I advised the examiner that we would not make any more advances to EJA without telling him ahead of time and I had not had a chance to communicate with you and tell you, so, therefore, to keep faith with the examiner you should get that money back.

So we requsted the money back from EJA and got the money back.

Senator HARTKE. Now, when the acquisitions of International Air Bahamas and Trans Avia were acquired, when you got into those operations, is it not true that it was anticipated that the 707's were going to be leased to these airlines by EJA?

Mr. BEVAN. No. They only went to them as a last resort when they found—when the planes were actually used by other airlines first as long as we could have them use them. They were used there and they were only put in these other companies as a last resort to keep them from being idle on the ground and——

Senator HARTKE. Let's get this straight about Mr. Hirshman. First, exactly where he was in this operation. Before these jets were actually delivered, is it not true that Executive Jet decided that Hirshman should get out of Trans Avia and also out of Air Bahamas?

Mr. BEVAN. No.

Senator HARTKE. Did he get out?

Mr. BEVAN. Yes.

Senator HARTKE. Why?

Mr. BEVAN. I think it was in—what was the date of the cease-and-desist order?

Senator HARTKE. That was the 14th day of October 1969.

Mr. BEVAN. I was trying to determine whether this was 1968 or 1969. We met in May 1968 and EJA's CAB counsel advised them at that point they were preparing to go into the CAB for approval of United States Steel and Burlington Industries taking over our interests in the company.

Senator HARTKE. Who was going to take over?

Mr. BEVAN. United States Steel and Burlington Industries. CAB counsel for Executive Jet, I think it was in May of 1968, advised them that if they went into these hearings with Hirshman holding Trans Avia and having apparently some either owning or controlling IAB and being on the board of EJA, SA, that would say that in effect he was acting as their agent and therefore that they should advise Mr. Hirshman—they should request Mr. Hirshman to resign from EJA, SA and to get out of Trans Avia and IAB, and it is my understanding that all three of those things were done and I think that is a matter of record in the CAB hearings.

Senator HARTKE. Who was it sold to then?

Mr. BEVAN. I believe it was sold to Mr. Goetz.

Senator HARTKE. Who is Mr. Goetz?

Mr. BEVAN. Mr. Goetz was a very wealthy German industrialist.

Senator HARTKE. And he also is in the aviation business?

Mr. BEVAN. He did have and then he later sold out and I cannot tell you when—he had Sudwestflug, which was later German Air, and which sometime later he sold out.

Senator HARTKE. Is it not true that he sold out because he also was not permitted to be involved in holding another airline?

Mr. BEVAN. You mean by the CAB?

Senator HARTKE. Not by the CAB, by his own authorities. He was prohibited, was he not? Mr. Goetz was a financial man who had control of this airline who was prohibited also from holding, just like the Pennsylvania Railroad, prohibited from owning a transportation

company; he was also prohibited from owning another airline in that part of the world, especially in Switzerland, a Swiss-based operation?

Mr. BEVAN. Well, he never was involved in a Swiss-based operation.

Senator HARTKE. He had German Air but he was also——

Mr. BEVAN. He had German Air but then he either did acquire or was about to acquire Trans Avia, but I think he came to the conclusion, as you said, that it either was not wise or it was illegal, I am not sure which, and he arranged for somebody to acquire from Hirshman—some company, and I think the same with IAB.

Senator HARTKE. How much was paid in this transaction?

Mr. BEVAN. IAB was later sold to Icelandic.

Senator HARTKE. Now, Icelandic, has anything ever been paid by Icelandic for this operation?

Mr. BEVAN. Yes.

Senator HARTKE. How much?

Mr. BEVAN. I do not know. We were not a party of the transaction.

Senator HARTKE. Is it true that anything has ever been paid?

Mr. BEVAN. It is my understanding it has, yes.

Senator HARTKE. Or is there just a contract? Is this a paper transaction or a real one?

Mr. BEVAN. As far as I know, it is real, but we were not a party to it so I do not have the details.

Senator HARTKE. How much was paid in the transaction for the sale of Trans Avia and Air Bahamas?

Mr. BEVAN. I do not know. We were not a party to it.

Senator HARTKE. But there is still a contract which was held by International Air Bahamas to lease one of these planes that you spoke about?

Mr. BEVAN. There were two leases. One lease was between EJA and Trans Avia, and that was a so-called dry lease which was purely a financial lease. The IAB lease was what was called a wet lease and that provided for them providing the pilots and maintenance as well as the planes.

Senator HARTKE. They were very slow in paying for these planes; is that correct?

Mr. BEVAN. That is correct, and they were only put there because the management could not find——

Senator HARTKE. At this stage, how much was the total investment of the Penn Central or the Pennsylvania Railroad in EJA? Was that not after the time that you were about to the place where you had the total amount of $21 million that we spoke about earlier?

Mr. BEVAN. Well, let me put it this way. If my recollection is right, the lease with IAB was made in May and I think they started operating in July of 1968 and it was about that time that we had finished putting up any money as I recall. It was just—our investment at that time was in the neighborhood of $20 or $21 million and that is the time we made the deal with United States Steel.

Senator HARTKE. And United States Steel backed out, though?

Mr. BEVAN. Well, what happened—not actually. What happened was that everybody's counsel was very optimistic about this deal

going through and they would be glad to have us out of it and we would have showed our good faith by getting out, and Burlington was interested because they were about to buy a number of planes because they had a problem of flying their rugs out of some of their plants and they saw in this a good way to acquire an interest in the company and that they could also use it to substantially their own benefit.

This all predicated—they—all counsel thought this whole thing could be put through in a period of about 6 months. Well, Pan Am did not like the idea of more of us being in the picture and liked it even less with having United States Steel and Burlington in the picture and, therefore, they came in with these various allegations and counsel finally decided that it was going to take a year and a half or 2 years to get this thing through and whether they could get it through or not nobody could tell.

We did not want to go through the expense and time of that and Burlington said this just did not suit them at all, and they asked to withdraw. They did withdraw and United States Steel said they would like to withdraw but they thought the whole concept was good and would it embarrass us if they put in a new application on their own to acquire Johnson Flying Service for themselves. They thought this had great potential and we said it was perfectly all right with us but our experience had been such that—with the CAB—that we said we did not think they have very much chance of doing it either. They went ahead, however, and the last I heard the examiner's report was against allowing them to acquire Johnson Flying Service. I do not know.

Senator HARTKE. Mr. Bevan, what I asked you was at that time how much was the investment?

Mr. BEVAN. I say, at that time, our investment was—it had just about reached the limit of $21 million as I remember, $20 to $21 million.

Senator HARTKE. All right. Now, what was the return on this investment as far as the Pennsylvania Central was concerned?

Mr. BEVAN. Well, we got very little. We had interest up to a point and after that we did not, so——

Senator HARTKE. Practically nothing, right?

Mr. BEVAN. Practically nothing.

Senator HARTKE. So you had $21 million invested in this proposition and it returned absolutely nothing from it. Why were you not more vigorous in protecting the Penn Central's investment by insisting on the collection of the unpaid rents on the 707's?

Mr. BEVAN. Well, as I say, despite all decisions and everything else to the contrary, the actual facts were—and we kept maintaining in our position because we did not want to do anything to give anybody a chance to say we were not—but we were not involved, but I am sympathetic with the management from the standpoint they had nowhere else to put the planes. They kept the planes with stronger credit airlines as long as they possibly could. They were getting something here. If they pulled out completely they would not only lose what they were getting but they would also lose any hope of recovering in the future any of the past rental, and General Lassiter's concept has turned out to be perfectly sound.

Icelandic is operating that at a profit; as I understand it, ever-increasing profit.

Senator HARTKE. But you never collected anything from any of these people?

Mr. BEVAN. Yes, some was collected.

Senator HARTKE. How much?

Mr. BEVAN. I cannot tell you that.

Senator HARTKE. Practically nothing, I thought you said.

Mr. BEVAN. No. I said we got nothing on our—practically nothing on our investment.

Senator HARTKE. Right.

Mr. BEVAN. I am talking now about EJA collecting some of the rentals.

Senator HARTKE. Did not EJA acquire a debted interest in IAB of approximately $2,600,000?

Mr. BEVAN. I think the accumulated rent was that, and I think the final settlement they got some cash plus a right to receive 10 percent of the earnings of IAB over the next 10 years, which might very well exceed the total amount of the back rental.

Senator HARTKE. Now, let me ask you, did Penphil have any role in any of these decisions?

Mr. BEVAN. Absolutely not.

Senator HARTKE. Did you or Mr. Gerstnecker, vice president of the Penn Central, ever acquire an interest in Trans Avia?

Mr. BEVAN. No, sir.

Senator HARTKE. You did not?

Mr. BEVAN. No, sir.

Senator HARTKE. Now, as we said before, you did pay a fine of $65,000; is that right?

Mr. BEVAN. It was $65,000 or $75,000, yes.

Senator HARTKE. Now, has Penn Central since that time divested itself of its interest in Executive Jet Aviation?

Mr. BEVAN. All of its securities, both debt and stock, have been trusteed for some time with a bank and will be until divestiture is made.

Senator HARTKE. Now, did Penphil have any role in EJA?

Mr. BEVAN. No, sir.

Senator HARTKE. Let's come back to this travel agency. What about Holiday International Tours?

Mr. BEVAN. Well, at one point a travel agency was brought to Penphil—I forget the full name of it but it is a Fugazy travel agency.

Senator HARTKE. Let's establish ownership first. Did Pennsylvania Railroad have any interest in Holiday International Tours?

Mr. BEVAN. None whatever.

Senator HARTKE. Did Glore Forgan Staats have any interest in them?

Mr. BEVAN. No, only to the extent that later the members of Penphil—I mean the Penphil acquired an interest in Holiday International.

Senator HARTKE. Penphil acquired an interest in Holiday International Tours and the Pennsylvania Railroad did not have an interest in EJA or Holiday International Tours?

Mr. BEVAN. None whatever.

Senator HARTKE. And Glore Forgan Staats did not have individually any, in their own corporate name, interest in Holiday International Tours; is that right?

Mr. BEVAN. That is right.

Senator HARTKE. What about the directors, though, of all of these?

Mr. BEVAN. If I could go back just a minute, Fugazy was offered to Penphil and that was the travel agency and we turned it down because it was larger than we could handle because this was only a small group and it also needed management and we were not prepared to provide management. This is Penphil I am talking about.

We liked the idea of the travel agency because most of us figured with greater leisure time this was an interesting area. General Lassiter brought to us I think it was a classmate of his in college, a Mr. Lifsey, and a Mrs. Bowen. Mrs. Bowen was supposed to be—she was English and third generation family in the travel agency business. She had a small travel agency in I think it was Tampa—I am not sure. She thought there was no future in retail travel agency business. She wanted to go into wholesale travel agency business and move the operation to Miami.

Several of us met with Mr. Lifsey and Mrs. Bowen. We were impressed by her knowledge of it and she said it would take up to I think it was $200,000 over a 2-year period perhaps to get on her feet, and we agreed to finance her up to that to the extent required in return for 50 percent in the travel agency. We advanced her $65,000. We never got anything back. That is the only investment we ever lost money on and we lost 100 percent of it.

Senator HARTKE. Now, is it not true that if the travel agency did well Penphil would benefit?

Mr. BEVAN. If the travel agency did well, yes.

Senator HARTKE. Penphil would benefit; is that right?

Mr. BEVAN. That is correct.

Senator HARTKE. Is it not true also that if EJA and IAB or Trans Avia did well the agency would benefit? Is that not correct?

Mr. BEVAN. No. Well, the travel agency never had anything to do with Trans Avia to the best of my knowledge and belief. This deal to acquire this travel agency was—we advanced I think it was in January of 1968—we paid $25,000 for the stock and 50 percent of the stock and advanced $40,000. When we agreed to make the deal IAB was solely an inactive certificate. It was only in May of that year following that IAB was reactivated—not reactivated but activated—it was an active certificate, and this is the first time I ever even heard the name IAB when I heard that they were going to lease a 707 which was sitting on the ground to Trans Avia.

They started operations in July. I did not even know the final name of the travel agency. I was very much involved around that time with merger problems and I think they started operations in July and I think the record will speak for itself, but I think it was in August that our CAB counsel, Bryce Clagett, called me and asked me if I had ever heard of Holiday International Tours and I said it meant nothing to me, and he said, "Well, have you ever heard of Penphil?" I said, "Yes," and I told him what it was. He

said, "Well, they have been working with IAB on promoting their business or being a sales agent"—I do not know just what you call it. That was the first I knew that there was any connection whatsoever between them. I therefore talked to four or five people in Penphil and said I just did not think that we could be involved in anything that had any connection in any way with it, and so we called Mrs. Bowen and told her we wanted out and we would sell back our stock and take her note for it, and this was done immediately and we never collected anything of the $65,000, the $25,000 for our stock or the $40,000 that we advanced to her to start the business.

Senator HARTKE. Well, Mr. Bevan, according to the CAB findings——

Mr. BEVAN. Could I just finish this, Senator? It was alleged by Pan Am or one of the other intervenors that this was done by the Penn Central in order to promote IAB which in turn alleged control of IAB and that this was pawn in the Pennsylvania Railroad. Actually, nothing could be more ridiculous.

If we wanted to promote IAB we would not have taken a one or two personnel travel agency that was just starting out to promote IAB. We could have very easily asked—we have had longstanding relations with American Express and Thomas Cook and the logical thing, if we are going to go that route, would have been to ask them to help this company starting out to get them some business. So the whole thing was an allegation and without any foundation whatever.

Senator HARTKE. But the finding was that the Pennsylvania Railroad and Glore Forgan members of Penphil were instrumental in causing Penphil to play a primary role in the establishment of HIT as a travel agency.

The CAB went on to say further that a primary purpose of HIT was to procure U.S. passengers to travel on large aircraft owned by EJA, including aircraft to be leased to IAB and other carriers.

As I said before, the finding of the CAB was that Charles Hodge, who was a member of Penphil and a member of Glore Forgan, was the PRR's alter ego in dealings with EJA, which leaves a conclusion, in my opinion, which is unfortunate.

The first is that this Executive Jet Aviation was a terrible investment as far as the Penn Central is concerned.

Mr. BEVAN. In retrospect I agree with you.

Senator HARTKE. One that should have been disposed of a long time ago instead of continuing to pour money into this white elephant.

Mr. BEVAN. Well, in retrospect I agree with you, except this—and bear this in mind—even on the date, even despite everything that had happened, as late as 1968 Burlington Industries and United States Steel, which are pretty intelligent companies and successful companies on their own, were anxious to take over our position, and they saw, apparently, the same potential in the situation that we did, but we had been so absolutely hamstrung by the CAB that we could not do anything.

So here are two industrial companies, even after all those unfortunate things, who were ready and still thought it was a good business proposition to go into it.

Senator HARTKE. Did you not stand to gain personally as a result of the success of EJA? And was not Mr. Hodge to stand a gain by the success of EJA? And was this the reason why you hesitated of disposing of this organization which was such a financial drain on the Penn Central?

Mr. BEVAN. I had no basis or way whatsoever to gain by the success of EJA other than having recommended it as an investment. Naturally I wanted the company to come out whole or make a profit. But there was no way possible that I could have gained myself. But it is confirmation of the fact that everything does not turn out right, including some of these things; and we said when we went into diversification that we would make some mistakes.

But in retrospect I agree it was a mistake. But here are two industrial companies that in 1968 still saw the same type of potential that we saw originally and wanted to take over.

Senator HARTKE. Well, but if the travel agency did well, as I said a moment ago, Penphil did well, they would have benefited you directly, personally?

Mr. BEVAN. To a minutia, yes. I owned about 3 percent of Penphil.

Senator HARTKE. It would have benefited you personally; and if as the statements in the finding of the CAB are correct, that if EJA, IAB, and Trans Avia did well, then the agency would benefit; so as far as Penphil was concerned, they did have a direct interest in keeping the planes flying whether the rents were paid on the planes or not; is that not true?

Mr. BEVAN. No. As far as I know, the travel agency never had any connection with Trans Avia at all; and as soon as we found out that—as soon as I found out that they were doing any business with IAB—IAB was not even operating when we made the deal to do the travel agency.

Senator HARTKE. But they still had the leased planes?

Mr. BEVAN. No, they did not. The decision to lease a plane came to them in the following May, and that was a decision of EJA when they could not put the plane anyplace else. So there was no connection.

Senator HARTKE. And there has been no return on that?

Mr. BEVAN. Yes, there was.

Senator HARTKE. There was $2,600,000 still owed on that?

Mr. BEVAN. No, there is a cash payment, and I cannot tell you now what it was. In the final settlement they get 10 percent of the earnings of this airline for 10 years, which may well exceed $2,600,000.

Senator HARTKE. Or it may be nothing. There is no showing as of now that Icelandic has ever paid anything for it.

Mr. BEVAN. The first payment was due this September, and my secondhand information is that Icelandic made a profit last year, so there will be a payment.

Senator HARTKE. What is the relationship between Penn Central and Glore Forgan Staats? Is that a close relationship?

Mr. BEVAN. We had many close relationships. They are one of our bankers. The three bankers that worked with us on the merger—

both sides—were Morgan Stanley, First Boston, and Glore Forgan.

Senator HARTKE. Mr. Hodge, Charles Hodge, is he also a director of the Great Southwest?

Mr. BEVAN. Yes, he is. He had helped to start that company.

Senator HARTKE. And of Arvida?

Mr. BEVAN. That is right, sir.

Senator HARTKE. Do Glore Forgan officers own 385,705 shares of Macco Corp.

Mr. BEVAN. No. Macco is 100-percent owned by Great Southwest. They took their commission in common stock of Macco when we acquired Macco in 1965, I think it was, and that in turn was exchanged for Great Southwest stock at the time it was taken over.

Senator HARTKE. They did own it beforehand? Right?

Mr. BEVAN. They took their commission for selling Macco in common stock. We had ahead of them—we paid $40 million for Macco, and we took $40 of preferred in payment of it, and the common stock was a very residual item. But they took their commission in the form of stock rather than cash.

Senator HARTKE. All right. Now, was Glore Forgan Staats—were they one of the three principal underwriters for the reported $100 million issue; is that correct?

Mr. BEVAN. Yes, that is right.

Senator HARTKE. Was this a close relationship?

Mr. BEVAN. Yes, it was.

Senator HARTKE. Has this close relationship been carried over by the efforts of the Penn Central to obtain federal assistance?

Mr. BEVAN. No. To the best of my knowledge and belief they never came into it.

Senator HARTKE. Did Mr. Hodge make any contacts on behalf of Penn Central?

Mr. BEVAN. To the best of my knowledge, no.

Senator HARTKE. Who did make the first contacts on behalf of the Penn Central?

Mr. BEVAN. For a government loan?

Senator HARTKE. Yes.

Mr. BEVAN. Mr. Saunders.

Senator HARTKE. And who else?

Mr. BEVAN. Well, as I remember the course of events, Mr. Saunders had been having some continuing talks with Secretary Volpe having to do with the condition of the whole industry and the problems we were confronted with. Then later when I was working on some other things, so I was not there—later I believe he and Mr. O'Herron and I think Mr. Gorman made some presentations both to the ICC and to Secretary Volpe, about our general financial situation, that the merger was not going well, and things of that sort. I was not there so I am not quite sure of the scope of it, although Mr. O'Herron went over some of the figures with me.

Then when things became more serious, my recollection is that Mr. Volpe spoke to Secretary Kennedy about it, and then later I think Mr. Saunders had one brief conversation with Mr. Kennedy. But then later an appointment was made, and Mr. Saunders and I went down and outlined the seriousness of the situation to Secretary Kennedy.

Senator HARTKE. Arvida Corp. is in Florida, right?

Mr. BEVAN. Right.

Senator HARTKE. Who owns most of Boca Raton? Arvida?

Mr. BEVAN. I wish it owned it all. They owned the Boca Raton Hotel and Club—and they sold out some—they own some beachfront property. There is not too much left, and they have, I would guess, about 6,000 or 8,000 acres of property across town which is now in the course of development.

Senator HARTKE. And they have a debt of about $50 million; is that correct?

Mr. BEVAN. I think that is right, yes.

Senator HARTKE. Who are Arvida's creditors?

Mr. BEVAN. The largest one is the Aetna Life Insurance Co., which has a mortgage on the entire hotel property.

Senator HARTKE. Is the Boca Raton National Bank one of the creditors?

Mr. BEVAN. I do not believe so.

Senator HARTKE. How about the First Bank & Trust of Boca Raton?

Mr. BEVAN. The First Bank and Trust did have a line of credit there, recently established, of about a million dollars.

Senator HARTKE. How about the University National Bank of Boca Raton?

Mr. BEVAN. There is no connection as far as I know.

Senator HARTKE. Does Penphil have any stock in any of these banks?

Mr. BEVAN. Penphil has stock in University Bank and the First Bank & Trust.

Senator HARTKE. To what extent do you stand to gain personally from the operations of Arvida?

Mr. BEVAN. None.

Senator HARTKE. Through Penphil or otherwise?

Mr. BEVAN. None.

Senator HARTKE. None whatsoever?

Mr. BEVAN. Only to the extent that the general area prospers and the banks do well.

I might say I have never owned any Arvida stock, nor has Penphil.

Senator HARTKE. During the time that you were chief financial officer of the Penn Central, and where you said in your statement that the working capital was steadily deteriorating, did you dispose of some of your holdings in Penn Central?

Mr. BEVAN. Well, the working capital position has been deteriorating for a long time. I disposed of some of my holdings in the spring of 1969.

Senator HARTKE. In the spring of 1969?

Mr. BEVAN. Well, the first half-year of 1969.

Senator HARTKE. In the first half of the year? Was that when they also paid out the $43 million dividend?

Mr. BEVAN. Well, they paid out about $20 or $28 million in the first half of the year. The third-quarter dividend was paid in September.

Senator HARTKE. Is that the same period of time to which you referred in your statetment that the working capital deficit was decreased in 1969 by $25 million?

Mr. BEVAN. In 1969. The working capital—maybe there is a misprint.

Senator HARTKE. That is right; 1969.

Mr. BEVAN. In 1969 the working capital deficit of the transportation company decreased by $25 million.

Senator HARTKE. And that is when you were disposing of your stock, right?

Mr. BEVAN. I disposed of it in the first half—some of it in the first half of 1969, yes, sir.

Senator HARTKE. Why did you dispose of it?

Mr. BEVAN. Maybe we do not understand each other. The working capital position of the Penn Central Transportation Co. improved to the extent of $25 million in the year 1969.

Senator HARTKE. But you were still short of cash?

Mr. BEVAN. We have been short of cash ever since I have been with the railroad.

Senator HARTKE. And you were disposing of your holdings at that time, right?

Mr. BEVAN. That is correct.

Senator HARTKE. Why?

Mr. BEVAN. Well, let me say this, Senator Hartke. Number one, I have a completely clear conscience on this. I have had other business problems since things started happening. I have not had a chance to review this with counsel. It is a matter of at least one suit, perhaps more.

I do not have my papers here. I did not think this was part of it. I believe that when I have had time to go over with counsel and over this suit, that it will be very clear that I have operated properly, and I have an absolutely clear conscience.

And I will say this: In 1969 I was still completely confident that we were going to come through this.

Senator HARTKE. In your statement you refer repeatedly to the need for an adequate cash flow.

Mr. BEVAN. That is correct.

Senator HARTKE. Why did it pay out the dividend then in 1969 in the amount it did? Why did it pay it out in cash? Why not in stock?

You said that the situation on cash had been critical for years.

Mr. BEVAN. Working capital, too.

Well, in the first half of the year of 1969, we earned $25 million. We were looking at what we thought was in excess of $50 million for the year. It was a very close decision as to what should be done.

In retrospect, it would have made little difference, but actually not a great deal.

We had tried to build an investment status for our common stock, looking forward ultimately to the sale of convertible bonds and things of that sort. If you do not have a steady dividend policy, it hurts the investment quality. We thought we were in a transition stage. We did not think that it was going to take us—that the railroad operation would be as bad as it has been—and I am not criticizing anybody. It was just an underestimate. And we felt confident that our other operations, which I have cited figures on in my statement, should more than offset the bad railroad operation, and

we expected at any time for the railroad operation to improve. If we could even get the railroad on the break-even basis, we would, overall, have been in fine shape.

Senator HARTKE. Now I am going to recess here for lunch and I hope you can come back at 2 o'clock. Could you do that?

Mr. BEVAN. Certainly.

Senator HARTKE. Let me ask you, sir, is the same pattern of intertanglement, interrelated operations of individuals, with various people very closely associated at the top of certain corporations in all these 175 subsidiary corporations that you described today? Is it as complicated, and does it also show that same lack of concern for disposition of what was knowingly a losing operation? Is that a pattern for all the other 175, or is this just an unusual case?

Mr. BEVAN. You mean Executive Jet?

Senator HARTKE. Yes.

Mr. BEVAN. Executive Jet was one that, well, we felt that we could get on its feet; but then we found our operations were too hampered, and we could not.

It is not something that you can readily dispose of. You have to get to a certain point. We got to the point where——

Senator HARTKE. You got to the point where you put $21 million worth of the assets of the failing railroad into it, right?

Mr. BEVAN. No assets came from the railroad.

Senator HARTKE. They came from the corporation whose assets could have been diverted to, and provided for, our transportation system?

Mr. BEVAN. That is right. On the other hand, we did get to a point where we had two top industrial companies that were prepared to——

Senator HARTKE. I am not talking about two top industrial companies who looked at it. I am talking about what happened to it.

Mr. BEVAN. They actually made an agreement to acquire.

Senator HARTKE. They cancelled the agreement. The point I am making is not what happened specifically in this case; but this pattern of intertwining relationships between members, individuals, corporations, and the Pennsylvania Railroad, the Penn Central Co., the stockholding company, the airlines, and the individual agencies—is this the same pattern that exists pretty generally in this whole transportation mess?

Mr. BEVAN. Let me say this, because I can hardly answer that "Yes" or "No" because I do not quite agree with what you say, if I understand you correctly. But let me say this: A very large number of these corporations are leased lines that have no operations of their own. They are leased to the railroad and operated as part of the transportation system. There are other companies that are shell companies or one-purpose companies to be used as a means of financing equipment, tugboats, cars, which are leased to the railroad. There are others that are basically a single project in the real estate field.

Then there are other companies that are just a lot of small railroads that we have not been able to merge into the Penn Central.

Senator HARTKE. But you see, what we are faced with here, Mr. Bevan, is the fact that this is its history. Now we are coming back

to a corporation—and the transportation of passengers and freight in this country is seriously threatened.

Mr. BEVAN. That is right.

Senator HARTKE. We are faced with the proposition that the ICC has been informed by the Penn Central that they are going to end the transportation company. The transportation company presently, even under the reorganization, is going to be faced with a cash problem in a very short period of time, whether that time is one which is projected by the Penn Central to be in December or whether it is earlier as anticipated by the ICC. The problem presents itself quite clearly at this time as to whether or not in fact there will be a sale of certificates by the trustee, whether it is going to be possible to sell any certificates. There is already an objection raised by the New Haven people as to the sale of the certificates. The problem presents itself as to whether or not this legislation, if it be adopted, would permit any funds to be loaned to the transportation company in its reorganization, and then whether or not there is going to be in the same situation as to some of these corporations—we have attempted to get through one of the 175? Whether or not this is the type of investment which the taxpayers of America can be expected to even see any return whatsoever in keeping the transportation company going.

Now I will say to you that——

Mr. BEVAN. Most of these——

Senator HARTKE. Pardon me?

Mr. BEVAN. A very substantial number of these companies are merely, in one form or another, a transportation company.

Senator HARTKE. I hear what you are saying. The point is, from what you have said here this morning, even the Great Southwest, which was held out as one of the big assets by the reports on it, is in financial trouble now due to the liquidity crisis, and the liquidity crisis appears to be that its main supporting operation was the railroad system, and that this railroad system has therefore precipitated the difficulty for all these other subsidiary corporations. If that is true, what are we going to be faced with as far as the airlines are concerned? What are we going to be faced with as far as other failing corporations are concerned?

Mr. BEVAN. Frankly, I think the whole transportation industry is faced with a very serious difficulty.

Senator HARTKE. You have a transportation crisis of major proportions on our hands. The airlines are in trouble too. Who is going to move the people?

Mr. BEVAN. I think you and I are saying the same thing.

Senator HARTKE. I am not saying the same thing about going through this tangled mess of financial operations. There are a lot of people who just wonder why in the world people charged with the responsibility of providing transportation to the public take so much time to deal with Swiss bankers and with the Bahamas Airline and travel agencies.

Mr. BEVAN. We did not, sir. We never had any relationship of any kind whatsoever with Air Bahamas on the part of management.

We went abroad to raise additional funds for the transportation company because of the tightness of money here. We had done all we could do. We raised in these 2 years $950 million for the trans-

portation company. I do not think there are any railroads in the United States that have done that, and this was in the face of a railroad that was losing money at a very rapid rate.

Senator HARTKE. Losing money because the funds, the resources and the money were being diverted, evidently, from the railroad system instead of keeping it viable and keeping the railroad system up to date and preventing the accidents and improving the facilities and getting the equipment and making sure that the railroad merger went into effect.

There is a serious question, I would imagine, that is being presented as to the adequacy of the management in regard to its financial investments during this time, and certainly there is a question raised as to the fiduciary responsibility of the individuals charged with that investment as to whether or not they carried it out in the interest of the transportation system or for some subsidiary corporation or, if for some subsidiary corporation, which had only an indirect relationship from which individuals possible could benefit.

You can see those problems, I am certain, and I think they are quite obvious.

Mr. BEVAN. Well, as I said, in this period we invested $144 million cash in this diversification. At the same time we spent somewhere between $1.6 billion and $1.8 billion in the transportation company. And $144 million would not have sustained this transportation company for more than a matter of days longer, and it was only because we were only able to raise the money we did because the financial community believed in the worth of this diversification program.

I might say, Senator, that in Arvida and in Great Southwest, Macco, we are in three of the fastest growing States in the country, and I sincerely hope for the benefit of the transportation company—and I thing these are major hopes in bringing this situation out of a very difficult period.

Senator HARTKE. Let me say to you, Mr. Bevan, that the point still remains, that as much as we have tried to find out the financial situation in the past, my primary concern is to find out if we can put together an operation or any legislation which can provide for continuation of a viable transportation system.

We will adjourn for lunch.

(Whereupon, at 1 p.m., the committee was recessed, to reconvene at 2 p.m., this same day.)

AFTERNOON SESSION

Senator HARTKE. Good afternoon.

Let me make clear, Mr. Bevan, that in our conversations this morning as far as I am concerned—and I will repeat this—basically our idea here is to make sure we have a railroad system which is going to keep functioning and one that is viable in the whole transportation field.

At the same time that necessarily involves the question as to what happened that led to the collapse of such a financial operation, and the biggest transportation unit in the United States.

Now we were talking about the corporate finances right before lunch and as a result of the Penn Central collapse, *Fortune* magazine has written an article in the August 1970 issue, which I am sure you have reviewed.

Mr. BEVAN. I have.

Senator HARTKE. I want to refer to some of their comments and have your reaction to them.

In other words, was it the——

Mr. BEVAN. Pardon me just a moment, I want to get the file.

Senator HARTKE. That is all right, he can sit there if he wants to.

Mr. BEVAN. If it is all right, Senator, I will keep him here.

Senator HARTKE. Just identify him for the purpose of the record, please.

Mr. BEVAN. Would you introduce yourself?

Mr. GERMAN. I am Edward D. German, and I am an attorney at law.

Senator HARTKE. All right. What they allege there is that there was a bookkeeping system which made it very difficult to figure out exactly what was happening and where.

They call it a "unique bookkeeping system" in which the Penn Central was able to show remarkable profits, and so on.

Was it the first quarter of 1970 that Penn Central report scared these investors or do you think it was the bookkeeping described in Fortune magazine that had the effect of scaring them?

In other words, what they didn't know, or what they did know, which was it that scared them most?

Mr. BEVAN. Well, as I have indicated in my statement, Senator, it is my belief that the financial community became more and more concerned as these operating losses of the railroad mounted.

There was very little indication that we were able to get them under control also. As far as I would say—well, I would also say that for the most of the merger period of course accounting and budgeting administrations were not under my jurisdiction.

From the date of the merger until the fall of 1969 they came in under Mr. Perlman's supervision. I will attempt, however, to answer to the best of my ability the comments in Fortune magazine to the extent that you would like me to.

Senator HARTKE. What they say here——

Mr. BEVAN. The story is filled will inaccuracies and misstatements throughout, and I have always categorically denied the statement they attribute to me at the end of the article.

Senator HARTKE. They report here that normal operating expenses, wages, and phase-out costs were taken out of capital rather than income, thereby inflating Penn Central's reported profits by so much.

Mr. BEVAN. Well, I would only say——

Senator HARTKE. Was that a procedure that was clear or what?

Mr. BEVAN. Let me say this, that both—all of our accounting has been done to meet ICC requirements in one way and for our stockholders' reports that have all been audited and have been done in accordance with accepted accounting procedures.

Now with wages and the phase-out costs, wages where you are involved in capital projects are capitalized. This is the only way you can do it.

In other words, we manufacture a lot of freight cars on our own property in our own shops. Wages involved in these represent part of the cost of the freight car and are capitalized. This is normal accounting procedure.

Wages involved in the operation of the company, maintenance of equipment for example, are expense items and have been expensed.

Phase-out costs I assume they mean by this the retirement of people or property in connection with the merger were not capitalized.

Senator HARTKE. Well, they say that sale of real estate which should have been designated as extraordinary items were credited to normal income as were profits from security sales.

It says that receipts were written off as standard costs to avoid the depreciation and thereby enhancing earnings.

Mr. BEVAN. Well, several questions are involved there. We happen to be probably the largest real estate operation in the country. This is part of our ordinary and reoccurring business and these and the security transactions all of which have been reviewed by the Peat Marwick accounting firm are a part of our customary income.

The one item I think you would referred to at the end—could I have that again?

Senator HARTKE. Well, this was assets written off as standard charges to avoid the annual depreciation, is that what you are referring to?

Mr. BEVAN. Yes.

Senator HARTKE. In the large block of securities that was exchanged, the paper profit from the transaction was credited to normal income in installments over the ensuing years even though no cash had come in.

Mr. BEVAN. That is a completely inaccurate statement.

Number 1, as far as the writeoff of facilities is concerned, and again I say this, it was not within my jurisdiction, I am giving you the benefit of what I know about it, but this was done because our people decided that we had on our books passenger facilities at unrealistically high prices in relation to what is happening to the passenger business.

So to that extent our balance sheet was inflated. After making appraisals of these facilities they wrote them down to estimated salvage value to bring our balance sheet in line and more in conformity with the true facts of the situation.

This again was reviewed by Peat Marwick and Mitchell before it was done.

Senator HARTKE. Well, what is the bookkeeping system? Did it accurately reflect the condition of the railroad as it was reported? Did it reflect it so outsiders could really tell what was going on or did it take an expert on the inside to understand this bookkeeping system?

Mr. BEVAN. No; this was very clearly labeled and explained in our report and it was to tell the people the assets were carried on the books at a certain figure. We no longer think that that figure is realizable and we have written them down, I think it was by $121 million to what we think are present-day prices. This is standard bookkeeping.

It actually made no difference in the cash setup in any way due to the fact our cash flow was not affected in any way.

But it was giving the outsider the true picture, the truest picture we could of what it was, and it was reviewed by Peat Marwick before we did it.

It was explained thoroughly and in my judgment the next 2 or 3 years I would think that the ICC would require every company to do this.

Senator HARTKE. Was the cash flow——

Mr. BEVAN. This didn't change cash flow.

Senator HARTKE. I understand but was that obvious, was it obvious there was a deficiency in the cash flow in 1969?

Mr. BEVAN. Yes; there was a source and application fund at the end of the report.

Senator HARTKE. Was it apparent at the time that the dividend was declared? Was it apparent that this was a serious problem at the time the dividend was declared in 1969?

Mr. BEVAN. We have reiterated throughout that our cash position was tight and continuing tight. Actually as I said in 1969, our working capital improved by $25 million.

Senator HARTKE. Well, did it improve enough really to validate the idea of proceeding with a dividend of that nature? Was it your recommendation that the dividend be declared?

Mr. BEVAN. Which dividend?

Senator HARTKE. The first one up in the first half of 1969?

Mr. BEVAN. Well, I would say this: We had most of the time working capital deficit, most of the railroads have working capital deficits, as I outlined in my statement.

I explained that at the end of 1969 that two items in there actually we did not consider current although technically we had to put them in current liabilities and under the proper accounting procedures.

There were three financial committee meetings which dividends were discussed at and I think the records will show that there was not a single dissent in approving the payment of the dividend and these were of course only recommendations to the board.

I was not a member of the board at that time but I think the records again will show in the minutes that not a single director dissented from approving the dividends.

Senator HARTKE. Did Mr. Perlman agree with that at that time; do you know?

Mr. BEVAN. Well, all I can say is that it is my understanding that no one dissented either in the finance committee—Mr. Perlman was a member of the finance committee—or in the board of directors.

Senator HARTKE. In the next to the last paragraph in the *Fortune* article they make this assertion:

> The accounting profession has as a whole contributed to the debacle by making acceptable practices that are an open invitation to distortions and outright fraud.

Will you comment on that?

Mr. BEVAN. Well, I think it is completely false.

Senator HARTKE. Let me ask you this——

Mr. BEVAN. We have one of the largest and considered most reputable accounting firms in the country and we were audited by them and were also audited by naturally, by this ICC.

I think the article shows a complete lack of comprehension of accounting and I think there are many unfair innuendoes in there and everything else.

Senator HARTKE. The ICC told us that on June 23 that the accountants—that is Peat Marwick & Mitchell Co. had refused to make working papers available. Is there any reason why they would be reluctant to turn over working papers to the ICC? Do they have anything to hide?

Mr. BEVAN. To the best of my knowledge they did not, but I didn't know they had refused, and I am not in a position to answer that.

Senator HARTKE. Would you have recommended that they turn them over to them? Is there any reason why you see why the ICC should not have the working papers?

Mr. BEVAN. I think that is a question between Peat Marwick and the ICC.

I don't know why they refused and therefore I can't say whether they should have or should not have refused. They may have some reasons in connection with this *Fortune* article. I don't know. But I don't know that they had refused.

But to the best of my knowledge, there is nothing to hide any place. I think everything is clearly labeled throughtout.

But again from the time of the merger, until the fall of 1969, I had no responsibility for the accounting.

Senator HARTKE. When the Norfolk & Western stock was being disposed of and Mr. Saunders made the statement he was going to have $500 million for investment purposes—wouldn't it have made better sense at that time to improve the railroad itself instead of investing these into outside nontransportation facilities?

Mr. BEVAN. Well, let me say this; the figure of $500 million is one that never could have been realized because you couldn't sell the stock that way.

Senator HARTKE. Well, this is the statement of——

Mr. BEVAN. There is no way that you could——

Senator HARTKE (continuing). This was announced by Mr. Saunders. I didn't pick up this amount.

Mr. BEVAN. I understand.

Senator HARTKE. He says $500 million was going to be available for investment.

Mr. BEVAN. It was a combination of that and another thing. Norfolk & Western start as late as—well, October 1964 I believe sold at $150 a share. At the time—we weren't consulted about this in any way—but at that time they suddenly announced they were going to merge with the C. & O. and B. & O. and the stock dropped from $130 to $120 a share overnight and it's been going down steadily ever since and this morning it's $55 a share.

Mr. HARTKE. But what would you——

Mr. BEVAN. So we never got through an actual determination. But basically if we found the right companies we could have increased the cash flow materially over what we realized on the Norfolk & Western which would have meant bigger dividends from the Pennsylvania Co. to the transportation company.

Senator HARTKE. In your opinion, Mr. Bevan, as the financial officer for this railroad for a long time, is it going to be possible for the trustees to sell these certificates?

Mr. BEVAN. You mean without a Government guarantee?

Senator HARTKE. Without a Government guarantee.

Mr. BEVAN. Well, I have not had an opportunity to see the cash flow that will result from—I don't know what the decision of the trustees and the court is going to ge as to what items they should continue to pay principal and interest on and which one they will decide to default on. So it is quite difficult, I just don't know what that cash-flow picture is going to be and I think a great many of the decisions have not been made that will have much to do with this. I want to say, I want to state very carefully what I say because I don't want in any way to hurt anything.

Without passing on the integrity of the trustee certificates, I want to say that in the present temperament of the market, the scarcity of funds and everything else, I am inclined to think that it would be very difficult to sell them without a Government guarantee. Without an ability to sell, of course, the railroad would cease to operate.

Senator HARTKE. So it is your conclusion basically that the financial condition of the railroad is so serious that they would probably have to be included within the guarantee provision in the Government Loan Act that was passed or otherwise they would be seriously flirting with the danger of not being able to continue to operate the railroad?

Mr. BEVAN. Well, as I say—I qualify it to the extent that as I understand it the trustees, or—they have not reached decisions in these areas.

Senator HARTKE. I understand.

Mr. BEVAN. On how much they will pay interest on and how much principal they will pay or what rentals or a whole series of things. Until a whole series of these questions have been answered, unless that is done, you can't set up a cash flow that will be meaningful. I think in the current difficult market conditions and the shock of having the largest railroad in the country go into reorganization, I personally think they will find it very, very difficult to sell certificates without a guarantee.

Senator HARTKE. All right, then why can't they correct this by selling off part of the assets?

Mr. BEVAN. Well, a good many of their assets are already pledged. Others such as lease line stocks held, and securities of the system, of the railroad, are not particularly good as collateral today with the railroad in reorganization. If you sold off, say, Great South West, then you would—it would go first of all to liquidation of the outstanding debt of the Pennsylvania Co. Then the outstanding debt of the $300 million revolving credit, because the stock of Pennsylvania Co. is held by the banks as collateral for the revolving credit. So what you would really be doing is you start selling those and you go into liquidation and that situation develops. It is hard to get cash through the sale of assets bound onto the operation of the railroad.

Senator HARTKE. Well——

Mr. BEVAN. We are getting into a legal area which I really shouldn't be in because I don't know exactly the full powers of trustees, but these key assets are pledged one way or the other. I

would think it would be difficult to get those funds and use them for operation as against paying off the debt.

Senator HARTKE. What you are saying in substance then is that there is no way to keep this railroad going, to make a profit and to pay off its debts. All we are going to do if we guarantee a loan, is add to its loan obligations for which the Federal Government will ultimately have to pay. What we ought to do is give them a grant?

Mr. BEVAN. No; I have not gone that far, Senator. At least I didn't mean to. I said this morning that I think that they have some key assets that should be worked on very hard and I think they are good and I think they have a strong future if they are not liquidated. It is going to be difficult but if ways and means are found to get proper rate increases and other things, and I think that the objective should be to try to get the railroad on a break-even basis and the system itself would then be making substantial amounts of money that could then support it.

Senator HARTKE. What you are saying in substance then is all this diversification which has been alleged to be so useful to the railroad, that when it comes to a time of crisis and need, they really become valueless and useless to the transportation company?

Mr. BEVAN. Well, we are in a market where everything is——

Senator HARTKE. Where nothing has any value?

Mr. BEVAN. I beg your pardon?

Senator HARTKE. In a market where nothing has any value?

Mr. BEVAN. No, I just cited an example of one of the most prosperous railroads in the United States—and this has substantially hurt the Penn Central—that is the fact that Norfolk & Western has gone from $151 down to $55.

We had a total of about 3 million shares so that for every drop of a point, if we still had the whole 3 million shares would be $3 million for one point drop in the market. So that there has been a very great deterioration in the asset value because of the general market decline.

Senator HARTKE. How much of an increase in rates do you anticipate would be needed to make the passenger service viable?

Mr. BEVAN. I don't think you can make the passenger service viable. I think as I said in my statement——

Senator HARTKE. Should it be closed down?

Mr. BEVAN. No; I am a strong advocate of mass transportation. But I think the Government should determine what service is in the best interest of the public and it should be supplied by the railroad, but they should be made whole for doing it and I think in the long run that this would be far cheaper than spending the kind of money that is being spent on freeways and highways. I think that mass transportation particularly in the northeast and other concentrated centers is an absolute must. It also has something to do with your air pollution as well.

Senator HARTKE. What about the freight service? How much increase in freight rates is necessary to keep that part of it viable?

Mr. BEVAN. I can't tell you at this point. We felt that the time we were studying the budget for the year that in view of what we

anticipated in increased wage and material costs, that we needed around 12 percent.

Senator HARTKE. Around 12 percent?

Mr. BEVAN. Yes.

Senator HARTKE. You are familiar—without being critical of what happened in regard to the postal service—but there has been provided a 14 percent increase nationwide in postal wages. Do you anticipate that in any way the railroads will not expect a similar increase in wages as other industries?

Mr. BEVAN. No, I haven't said that and I think that wage increases have gotten—have been at least comparable, but the difficulty is the tremendous—the fact that almost every wage increase is retroactive. At the same time there is a lag of almost a year in rate increases, and for the most part they have been inadequate to meet the increased labor costs; whereas industrial companies are in position to settle and immediately raise their prices.

Senator HARTKE. But you have two rate increases in the last 8 months.

Mr. BEVAN. That is right, but we also had—well, in 1969 we had a wage increase retroactive to January 1, if I remember correctly, and that cost us somewhere between $75 and $80 million. In November we had a rate increase that yielded us for the balance of the year of $7 million.

Senator HARTKE. You mean you would have to have an increase in that rate increase of at least 10 times what you received in order to break even? Is that what you are telling me?

Mr. BEVAN. No, what I said is that we show a deficit on 1969 just on account of lag, in the amount of about $88 million and you just can't do business that way. We were——

Senator HARTKE. Let me ask you with all these problems you are talking about and with the amount of increase in rates that you are talking about and the problems that you say concerning financing and the difficulty of cash flow, is there any reason, is there any real hope that you can keep the railroad system going? Are we on the edge of utter collapse of the whole railroad transportation system?

Mr. BEVAN. Well, I said this morning the railroad industry is in very serious trouble and in my opinion I think that it will take an entire program——

Senator HARTKE. How much money are we going to have to guarantee in loans here in your opinion? How much will it take Penn Central to bail itself out operating with Government loans?

Mr. BEVAN. Well, you can't take one single item and say on the basis of that what it is. It is a combination of how much passenger service the Government is going to require us to maintain. Are they going to give us—are they going to give the Penn Central reimbursement for that? What sort of rate increases are they going to get? And when will they get them? As I say, you can't take one fragment of it and give an explicit figure because they are all interwoven. But I think it is an absolute necessity to the whole national setup that it be kept—that the industry be kept viable. It is amazing really that under the conditions that have existed that they have

stayed alive this long. The steel companies several years ago said they could not keep their plants modern on a 15-percent return and I think last year the industry as a whole, including the wealthy railroads got a return of 2.8 and this has been going on for years and years.

Senator HARTKE. But you can't give us any idea of what you think it will be?

Mr. BEVAN. I couldn't except on the overall program.

Senator HARTKE. Well, how much on the overall program? In other words, is it going to take $10 billion, is that what we are talking about?

Mr. BEVAN. Ten what?

Senator HARTKE. 10 billion? You are talking about $750 million, of which $450 million must go into the Penn Central, which is what they say they need. That is their allegation.

You say $450 million probably won't carry them through very long after that.

Mr. BEVAN. Well, I don't know, because——

Senator HARTKE. Every study we have from the ICC shows, that according to the ICC, the wage increases have always been overstated by the railroad industry, but on the other hand it also shows that every rate increase has been followed subsequently by a drop in the rate of return which evidently is being occasioned by the loss of business due to the rate increase.

Mr. BEVAN. There is some diversion.

Senator HARTKE. Can you help this subcommittee come out of a dilemma? Here you are the No. 1 financial expert for the largest merged railroad organization in the United States and I am asking you to give us an estimate as to what we are dealing with here, whether we are dealing with an open-ended operation which is going to continue to have to have money poured into it, into the railroad industry ad infinitum?

Mr. BEVAN. Well, from the passenger service side, I don't think there is any question about it.

Senator HARTKE. Well, if you cure the passenger side, I have done the best I can to try that, and it's still stuck. I can't unstick it, I am not in the House of Representatives. But the point remains after you have cured that, what you have told me is that that still does not cure the problem.

Mr. BEVAN. Well, here the situation—in 1969 our loss just from railroad operations was $220 million.

Senator HARTKE. What was that?

Mr. BEVAN. $220 million.

Senator HARTKE. For what?

Mr. BEVAN. That is loss on railroad operations.

Senator HARTKE. $220 million, that was your loss on railroad operations, is that right?

Mr. BEVAN. Yes. We had passenger loss of $105 million.

Senator HARTKE. But those passenger losses are subject to an awful lot of dispute. That is on a fully allocated basis?

Mr. BEVAN. Yes, but you got to get those—that's right.

Senator HARTKE. And the ICC has consistently disagreed with that assumption.

Mr. BEVAN. But if you don't allocate it, if you don't allocate it there, you have to get it someplace.

Senator HARTKE. I understand that, but the point of it is, is what you are saying you want to be reimbursed to the extent of $105 million and that will alleviate about half of your total losses last year?

Mr. BEVAN. That's right.

Senator HARTKE. That is what you are saying?

Mr. BEVAN. That's right.

Senator HARTKE. I understand that. But if you alleviate it and say all of it is due to passenger service and we pick up that, then you don't have any losses. That would be a rather simple viewpoint in trying to correct the difficulty. What I am trying to find out is how much money is the taxpayer of America expected to pour into the railroad system to keep it viable? That is what we want to know. We want to know what it takes for passenger service and freight service. Are we talking about millions? Are we talking about billions? How long a time are we talking about?

Mr. BEVAN. Well, first of all, so you don't go backward, you have to meet this situation where you have a tremendous lag in rate increases following wage increases. This has been very harmful over a great many years. So that that has to be done. But I think that to get the railroad back in the shape that they should be both as far as equipment is concerned and as far as roads themselves are concerned—roadbeds—and get more working capital that you are talking billions. But a lot less than what is poured into the road program. But this has been going on for years and years and years.

Senator HARTKE. I understand.

Mr. BEVAN. So it's not an easy matter to bring it back because as I stated this morning the whole industry has a working capital deficit now of almost $200 million. This includes your more wealthy railroads.

Senator HARTKE. Are we faced with financial collapse of the entire railroad system then?

Mr. BEVAN. I think that's possible. Unless a program is worked out very rapidly, I think that's possible. But I think that is what Mr. Johnson was saying this morning from the Illinois Central, which I put into the record. I think that is true generally.

Senator HARTKE. Are we on the edge of a financial panic then in this country?

Mr. BEVAN. I would hope not, but each thing can have a chain reaction and there is no question that we have not felt the full impact of the Penn Central situation on the economy as yet, and as you know as well as I do, there are other companies that are on the brink both in the railroad industry and out. Each one is going to have a serious impact.

Senator HARTKE. Now, Mr. Bevan, I thank you for your time.

Mr. BEVAN. You are welcome.

(The exhibits to the prepared statement follow:)

EXHIBIT 1

PENNSYLVANIA RAILROAD SYSTEM (CONSOLIDATED BASIS)[1]—FUNDED DEBT PUBLICLY HELD

Year ended Dec. 31	Bonded and other debt			Equipment obligations			Total funded debt			Total interest charges		
		Increase or decrease			Increase or decrease			Increase or decrease			Increase or decrease	
	Amount	Amount	Percent	Amount	Amount	Percent	Amount	Amount	Percent	Amount	Amount	Percent
1952	$765,266,612			$350,738,605			$1,116,005,217			$39,250,041		
1953	739,311,077	—$25,955,535	3.39	346,001,119	—$4,737,486	1.35	1,085,312,196	—$30,693,021	2.75	39,189,747	—$60,294	0.15
1954	715,451,257	—23,859,820	3.23	317,469,622	—28,531,497	8.25	1,032,920,879	—52,391,317	4.83	38,136,445	—1,053,302	2.69
1955	682,979,708	—32,471,549	4.54	304,488,931	—12,980,691	4.09	987,468,639	—45,452,240	4.40	36,189,232	—1,947,213	5.11
1956	661,078,926	—21,900,782	3.21	301,065,156	—3,423,775	1.12	962,144,082	—25,324,557	2.56	35,573,279	—615,953	1.70
1957	639,882,668	—21,196,258	3.21	294,323,958	—6,741,198	2.24	934,206,626	—27,937,456	2.90	34,835,135	—738,144	2.07
1958	626,533,740	—13,348,928	2.09	286,092,541	—8,231,417	2.80	912,626,281	—21,580,345	2.31	34,231,502	—603,633	1.73
1959	608,134,537	—18,399,203	2.94	274,329,645	—11,762,896	4.11	882,464,182	—30,162,099	3.30	33,782,932	—448,570	1.31
1960	588,262,809	—19,871,728	3.27	264,835,860	—9,493,785	3.46	853,098,669	—29,365,513	3.33	33,329,347	—453,585	1.34
1961	581,791,116	—6,471,693	1.10	253,411,069	—11,424,791	4.31	835,202,185	—17,896,484	2.10	33,318,254	—11,093	0.03
1962	563,658,555	—18,132,561	3.12	236,872,183	—16,538,886	6.53	800,530,738	—34,671,447	4.15	32,582,129	—736,125	2.21
1963	548,223,632	—15,434,923	2.74	233,016,236	—3,855,947	1.63	781,239,868	—19,290,870	2.41	32,056,979	—525,150	1.61
1964	531,491,801	—16,731,831	3.05	229,842,710	—3,173,526	1.36	761,334,511	—19,905,357	2.55	32,050,134	—6,845	0.21
Total		—233,774,811	30.55		—120,895,895	34.47		—354,670,706	31.78		—7,199,907	18.34

[1] Excludes funded debt of Buckeye Pipe Line Co. (acquired July 24, 1964) amounting to $31,096,552 as of Dec. 31, 1964, which amount is included in Pennsylvania RR. System consolidated balance sheet, p. 25.

Exhibit 2

Financial Position of the Railroad Industry and a Plan for Meeting Equipment Needs

The transportation industry is vital to the American economy, both in times of peace and war, and for a long number of years the railroad industry has represented the backbone of the transportation industry. With the motor and air carriers either reaching or approaching maturity in the post-war era, competitive forces exist in the transportation industry to a greater degree than ever before.

The railroads performed a truly Herculean task during World War II. Their absolute essentiality in such periods was clearly indicated by what transpired during this war. The railroads carried more than 90% of all military freight and 97% of all organized military traffic. In 1944 they carried about 70% of all intercity freight traffic moved. In the same year they handled over 95 billion passenger miles, more than twice the total for any year in history prior to the war.

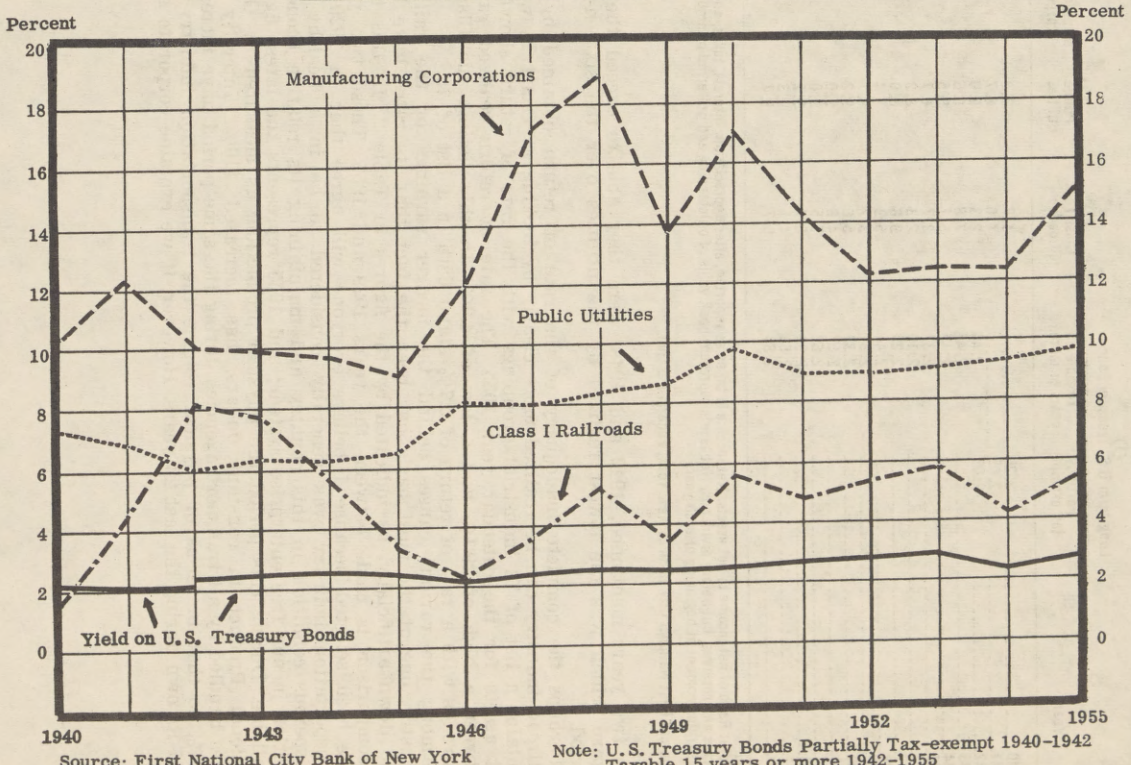
Unfortunately the industry as a whole faced the post-war period with a very badly worndown plant as a result of the all-out effort during the war. This fact, coupled with estimated total expenditures by the Federal government for domestic inland transport facilities in the ten years following the war of over $5 billion, consisting of $3 billion 600 million for highways, $700 million for airports and air navigation aids and $800 million for inland waterways, has made the post-war period a difficult one for the railroads. In addition, outmoded restrictive regulatory procedures and the inability of the industry to earn its fair share in the inflationary economy in which we have been living have placed the railroad industry in a most serious position. Furthermore, ironically it appears that despite an optimistic outlook for business prosperity over the next ten years, it is going to be very difficult for the railroads to participate in the expanding economy because of the many problems which face them.

The earnings of the railroad industry for many years have been totally inadequate to assure a strong, sound and stable industry, which we consider to be absolutely necessary to a prosperous economy. Because of inadequate earnings, the railroad industry has been materially weakened, both from a competitive and financial standpoint, and is in a serious condition today.

I do not think there is anything new to any of you about what I have just said, but we have been analyzing the railroad situation in an attempt to see the extent to which all of these factors have affected us financially and otherwise. As a result of that analysis, we have prepared several charts which I would like to present to you as specific evidence of the generalities we have been talking about.

First is the matter of the inadequacy of railroad earnings. To illustrate this, let us examine for a moment Chart A entitled "Comparison of rate of return on net assets with yield on long term U.S. Treasury Bonds." By net assets we mean the book value of outstanding preferred and common stocks and surplus accounts at the beginning of each year. In this chart we compare the rate of return realized over the period 1940 through 1955 on long term Government Bonds with the return realized by manufacturing corporations, public utilities, and Class I railroads. You will note that in the case of the manufacturing corporations the rate of return in 1940 amounted to a little over 10%, declined to about 9% in 1945, sky-rocketed in the post-war period to a peak of almost 19%, and then declined somewhat, but amounted to 15% in 1955. Throughout, the highest return realized by the railroads was always below the lowest return realized by the manufacturing companies. During the same period the return realized by public utilities ranged between 6% and approximately 10%. On the other hand, the Class I railroads as a whole, with the exception of the two war years 1942 and 1943, during this whole period never equalled the return of the public utilities. As a matter of fact, in only

COMPARISON OF
RATE OF RETURN ON NET ASSETS
WITH YIELD ON LONG-TERM U. S. TREASURY BONDS



Source: First National City Bank of New York
Federal Reserve

Note: U. S. Treasury Bonds Partially Tax-exempt 1940-1942
Taxable 15 years or more 1942-1955

CHART A

TABLE 1.—COMPARISON OF RATE OF RETURN ON NET ASSETS WITH YIELD ON LONG-TERM U.S. TREASURY BONDS 1940–55

[In percent]

Year	(1) Long-term U.S. Treasury bonds		(2) Class I railroads	(3) Public utilities	(4) Manufacturing corporations
	Partially tax exempt	Taxable 15 years or more			
1940	2.26		1.7	7.2	10.3
1941	2.05		4.6	6.7	12.4
1942	2.09	2.46	8.3	6.0	10.1
1943		2.47	7.8	6.5	9.9
1944		2.47	5.7	6.5	9.8
1945		2.37	3.7	6.7	9.1
1946		2.19	2.3	8.2	12.1
1947		2.25	3.8	8.0	17.0
1948		2.44	5.3	8.4	18.9
1949		2.31	3.2	8.7	13.8
1950		2.32	5.6	9.8	17.1
1951		2.57	4.8	9.0	14.4
1952		2.68	5.5	9.0	12.3
1953		2.93	5.7	9.2	12.5
1954		2.53	4.1	9.3	12.4
1955		2.80	5.7	9.7	15.0

Note: Ratio of net income to net assets. Net income is taken as reported, after depreciation, interest, taxes, and other charges and reserves, but before dividends. Net assets represent book value of outstanding and preferred common stock and surplus account at beginning of each year.

Source: First National City Bank of New York, Federal Reserve.

the two years mentioned, 1942 and 1943, were they able to exceed the 6% return which was the lowest realized by the utilities over the sixteen-year period.

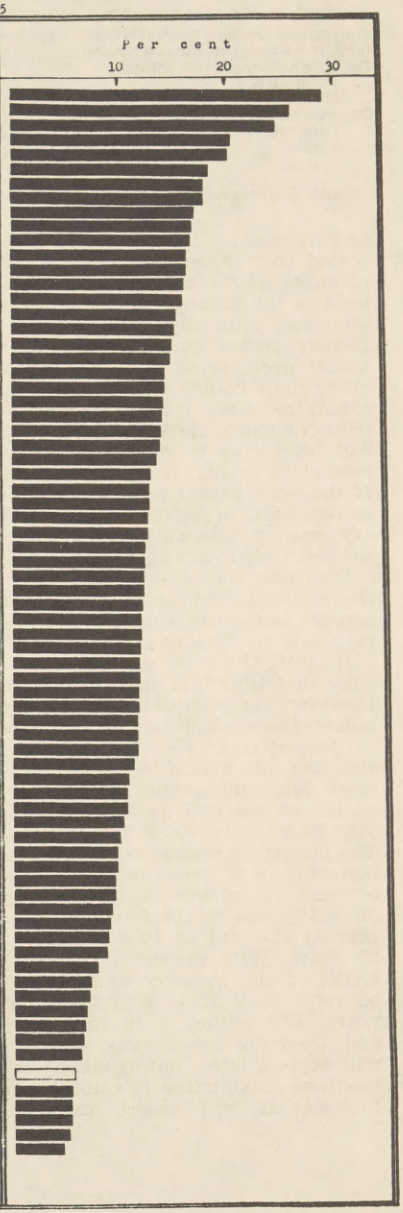
Perhaps the complete inadequacy of the rate of return obtained by the railroad industry can be realized more clearly by looking at Chart B, which contains a list of 73 industrial groupings with the rate of return shown on net assets for the calendar year 1955. The rate of return realized ranges between a high of 29.1% and a low of 4.6%. In this listing, the Class I railroads with a rate of return of 5.7% stand 68th in a list of 73.

Among the various causes behind the meager earnings of the railroad industry, one of the most basic has been the fact that its rates have been held down artificially, as indicated by the figures in Table 2. In this table a comparison is made between the years 1929 and 1955. These two years have been selected because I believe everyone will agree that in 1929 the transportation industry was generally considered to be in a healthy and prosperous condition in this country and maintaining its relative economic position in our free enterprise system; and 1955 represents the latest figures available. During this period the physical production, as measured by Gross National Product in constant dollars, has increased 116%. Intercity ton miles handled by all transport agencies during the same period have increased 113%, so that in terms of physical volume the transportation industry has held its own during the last 26 years. However, if we examine corporate sales

CHART B

RATE OF RETURN ON NET ASSETS - LEADING CORPORATIONS
Calendar Year 1955

Industrial Group	Per cent return on Net Assets
1. Autos and trucks	29.1
2. Other mining, quarrying	26.2
3. Aircraft and parts	24.7
4. Glass products	20.5
5. Cement	20.3
6. Drugs and medicines	18.3
7. Chemical products	17.7
8. Instruments, photographic goods, etc.	17.7
9. Office equipment	16.9
10. Nonferrous metals	16.7
11. Sales, finance	16.6
12. Paint and varnish	16.4
13. Other stone, clay products	16.4
14. Other business services	16.1
15. Soap, cosmetics, etc.	16.0
16. Automobile parts	15.3
17. Iron and steel	15.2
18. Tires, rubber products	15.1
19. TOTAL MANUFACTURING	15.0
20. Petroleum products and refining	14.2
21. Lumber	14.2
22. Soft drinks	14.1
23. Air transport	13.9
24. Paper and allied products	13.8
25. Metal mining	13.7
26. Chain stores - food	13.4
27. Printing and publishing	12.9
28. Electrical equipment, radio and television	12.8
29. Other metal products	12.8
30. Construction	12.6
31. Furniture, wood products	12.6
32. Mail order	12.3
33. TOTAL AMUSEMENTS, SERVICES, ETC.	12.3
34. Miscellaneous transportation	12.2
35. Dairy products	12.2
36. G R A N D T O T A L	12.0
37. Baking	11.9
38. TOTAL MINING, QUARRYING	11.9
39. Miscellaneous manufacturing	11.8
40. Other food products	11.7
41. Tobacco products	11.7
42. Household appliances	11.6
43. Machinery	11.6
44. Shoes, leather, etc.	11.5
45. Building, heating, plumbing, equipment	11.5
46. Restaurant and hotel	11.5
47. TOTAL TRADE	11.1
48. Hardware and tools	10.7
49. Chain stores - variety, etc.	10.6
50. Department and specialty	10.6
51. Real estate	10.1
52. Electric power, gas, etc.	9.9
53. Commercial banks	9.7
54. TOTAL PUBLIC UTILITIES	9.7
55. Telephone and telegraph	9.5
56. Shipping	9.5
57. Railway equipment	9.0
58. Agricultural implements	8.8
59. Amusements	8.6
60. Wholesale and miscellaneous	8.5
61. TOTAL FINANCE	7.7
62. Textile products	7.1
63. Clothing and apparel	7.0
64. Meat packing	6.7
65. Brewing	6.5
66. Distilling	6.4
67. TOTAL TRANSPORTATION	6.1
68. Class I railroads	5.7
69. Coal mining	5.6
70. Sugar	5.5
71. Fire and casualty insurance	5.5
72. Investment trusts	5.3
73. Traction and bus	4.6



Source: First National City Bank of New York.

TABLE 2.—TRENDS IN THE TRANSPORTATION INDUSTRY COMPARED WITH ALL OTHER INDUSTRY

	1929	1955	Percent increase
Gross national product in constant 1947 dollars (billions of dollars)	$149.3	$322.4	115.9
Intercity ton-miles (millions of ton-miles)	600,055	1,277,681	112.9
Corporate Sales (millions of dollars):			
Transportation	$9,688	$23,493	142.5
All other	$128,952	$533,538	313.7
Corporate profits after taxes (millions of dollars):			
Transportation	$902	$654	−27.5
All other	$7,357	$20,479	178.4

Source: Economic Almanac, National Industrial Conference Board.

or revenues for industries other than transportation, we find that during this period they increased 314% as compared to an increase of only 142% in the revenues of the transportation industry. This clearly indicates how the price level in the transportation industry has been artificially held down. As a consequence, naturally enough, this has seriously affected profits. During this 26-year period corporate profits of the transportation industry showed an actual decrease of 27% as compared to an increase of 178% for industry other than transportation. If transportation sales had gone up to the same extent as other corporate sales, in the year 1955 alone the transportation industry would have received an aditional $16 billion of revenues. And if it had been able to maintain its relative position with other industries with respect to profits, it would have realized an additional $1 billion 850 million. If these additional profits are divided on the basis of traffic volume, approximately half, or $900 million would have flowed to the railroads. Needless to say, such a substantial addition to net income would have materially aided the railroads to strengthen their existing weak position.

Whatever the causes back of the situation, it appears perfectly obvious that the railroads have not received an adequate return. Because of this failure several important changes have taken place which would indicate that the railroads' position has been severely damaged, possibly irreparably.

In 1940, the total debt of Class I railroads amounted to $11.3 billion, and since that time this debt has increased to $9.7 billion, which is all to the good. However, there has been a very substantial change in the composition of this indebtedness which has serious import to railroad managements.

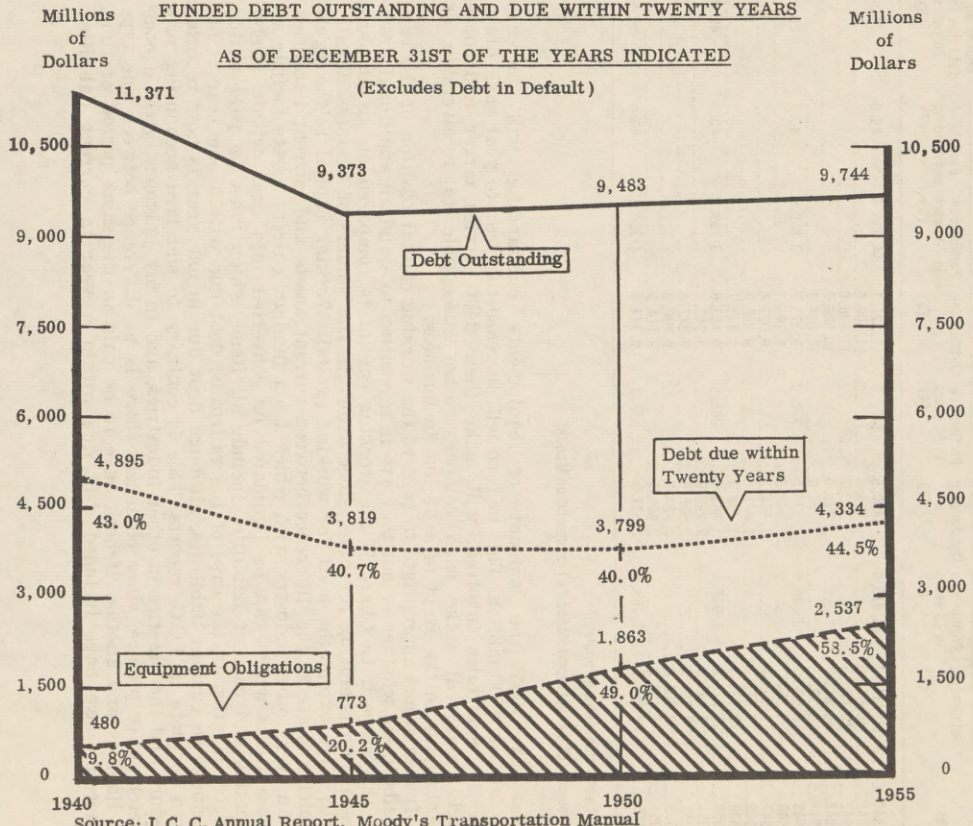
Illustrative of this latter point is Chart C dealing with funded debt outstanding due within 20 years of Class I railroads. In 1940 we find that of the total debt outstanding as of that date, $4.9 billion or 43% would mature within 20 years. This figure is little changed in 1955, and at the end of that year $4.3 billion or 44.5% of the debt was scheduled to mature in 20 years. The important change is with respect to equipments. Less than 10% of the debt maturing in 20 years in 1940, or $480 million to be exact, was in the form of equipments, whereas in 1955 of the debt maturing in 20 years, $2.5 billion or 58.5% was in the form of equipment obligations. To clarify this, it means that at the end of 1955 almost half the debt outstanding would mature in 20 years. With respect to bonded debt this is not too serious provided the credit of the industry and of the individual companies is such that it can be refinanced. It is significant, however, that of this debt maturing in 20 years, $2.5 billion is in the form of equipments, which are non-refundable and therefore must come out of the industry's cash. For reasons which I will explain later, unfortunately we believe that the amount of equipment obligations outstanding is going to continue to rise markedly to the extent that the market will absorb them, and we estimate, assuming this premise,

CLASS I RAILROADS & LESSORS

FUNDED DEBT OUTSTANDING AND DUE WITHIN TWENTY YEARS

AS OF DECEMBER 31ST OF THE YEARS INDICATED

(Excludes Debt in Default)



Source: I. C. C. Annual Report, Moody's Transportation Manual
(Lessors debt 12/31/55 Estimated)

CHART C

TABLE 3.—CLASS I RAILROADS AND LESSORS—FUNDED DEBT OUTSTANDING AND DUE WITHIN 20 YEARS AS OF DEC. 31 OF THE YEARS INDICATED (EXCLUDES DEBT IN DEFAULT)

[dollars in millions]

Year	Bonded debt		Equipment obligations		Total funded debt			Percent of equipment debt to all debt due in 20 years (8)
	Outstanding (1)	Portion due in 20 years (2)	Outstanding (3)	Portion due in 20 years (4)	Outstanding (5)	Portion due in 20 years (6)	Percent of outstanding (7)	
1940	$10,890.6	$4,415.0	$480.5	$480.5	$11,371.1	$4,895.5	43.0	9.8
1941	10,676.0	----------	624.6	----------	11,300.6	----------	----------	----------
1942	10,425.3	----------	710.7	----------	11,136.0	----------	----------	----------
1943	9,813.7	----------	775.0	----------	10,588.7	----------	----------	----------
1944	9,302.5	----------	781.6	----------	10,084.1	----------	----------	----------
1945	8,600.7	3,046.4	773.0	773.0	9,373.7	3,819.4	40.7	20.2
1946	8,354.7	----------	844.6	----------	9,199.3	----------	----------	----------
1947	7,993.4	----------	1,084.2	----------	9,077.6	----------	----------	----------
1948	7,911.2	----------	1,441.0	----------	9,352.2	----------	----------	----------
1949	7,735.3	----------	1,708.4	----------	9,443.7	----------	----------	----------
1950	7,622.8	1,936.1	1,863.5	1,863.5	9,483.6	3,799.6	40.0	49.0
1951	7,445.5	----------	2,298.2	----------	9,743.7	----------	----------	----------
1952	7,254.5	----------	2,592.9	----------	9,847.4	----------	----------	----------
1953	7,106.6	----------	2,684.3	----------	9,790.9	----------	----------	----------
1954	7,106.8	----------	2,608.1	----------	9,714.9	----------	----------	----------
1955	[1] 7,207.5	1,796.8	2,537.3	2,537.3	[1] 9,744.8	4,334.1	44.5	59.5

[1] Lessor companies estimated.

Source: ICC annual report; Moody's Transportation Manual.

that by 1965 the amount of equipments outstanding will increase by 20% or $500 million. This in turn will increase the year to year cash drain on the companies involved, will make their debt service larger and more rigid, and will make each company more susceptible to receivership or bankruptcy in the event of a decline in business.

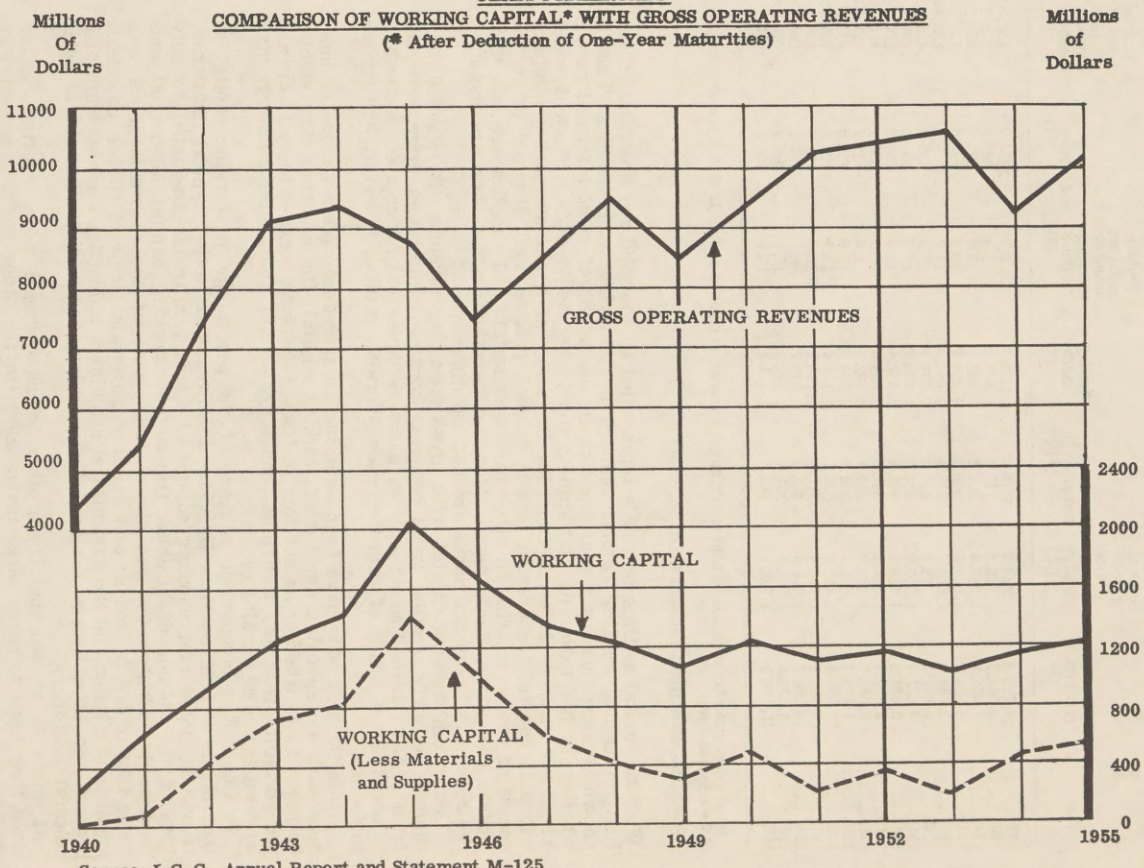
It now seems appropriate to turn to the working capital position of the railroads to see whether or not they are in a position to stand an additional drain in this respect. In Chart D the working capital is compared on an absolute basis with operating revenues, since after all, the volume of business dictates to a large extent the need for working capital. Working capital is the figure which represents the difference between current assets and current liabilities.

In every other industry with which I am familar, current assets include all those items which can be liquidated or converted into cash within twelve months, and current liabilities include all items which must be paid within twelve months. In the case of the railroads, debt due within one year is not included in current liabilities, although debt due in one year is now reported as a footnote in I.C.C. reports. This is contrary to standard accounting procedure and the practice in other industries, and in my judgment gives a completely false picture, since obviously there is no difference between one type of liability and another if both have to be paid in the same period of time. Therefore, we have included debt due within a year in current liabilities.

CLASS I RAILROADS

COMPARISON OF WORKING CAPITAL* WITH GROSS OPERATING REVENUES

(* After Deduction of One-Year Maturities)



Source: I. C. C. Annual Report and Statement M-125

CHART D

TABLE 4.—CLASS I RAILROADS—COMPARISON OF WORKING CAPITAL, AFTER DEDUCTION OF 1-YEAR MATURITIES, WITH GROSS OPERATING REVENUES

[Dollars in millions]

Year	Operating revenues (1)	Excess of current assets over current liabilities (2)	1-year maturities (3)	Working capital (4)	Working capital as percent of operating revenues (5)	Materials and supplies (6)	Working capital (less materials and supplies) (7)
1940	$4,296.6	$548.2	$175.0	$373.2	8.7	$334.7	$38.5
1941	5,346.7	816.5	177.2	639.3	11.9	460.1	179.2
1942	7,465.8	1,263.4	301.3	962.1	12.9	503.9	458.2
1943	9,054.7	1,569.1	308.8	1,260.2	13.9	532.5	727.7
1944	9,436.8	1,662.7	228.4	1,434.3	15.2	603.9	830.4
1945	8,902.2	2,255.0	220.9	2,034.1	22.8	595.8	1,438.3
1946	7,627.7	1,913.5	232.8	1,680.7	22.0	653.9	1,026.7
1947	8,684.9	1,628.3	245.8	1,382.4	15.9	758.0	624.4
1948	9,671.7	1,597.8	331.5	1,266.3	13.1	852.2	414.2
1949	8,580.1	1,383.0	320.4	1,062.5	12.4	725.4	337.2
1950	9,473.1	1,531.7	308.5	1,223.2	12.9	725.8	497.3
1951	10,390.6	1,440.5	330.1	1,110.4	10.7	909.6	200.9
1952	10,580.8	1,515.4	317.6	1,197.9	11.3	839.8	358.1
1953	10,664.2	1,444.5	405.3	1,039.2	9.7	839.9	199.3
1954	9,370.8	1,507.1	341.9	1,165.3	12.4	698.0	467.2
1955	10,106.3	1,598.7	385.5	1,213.2	12.0	666.2	547.0

Note: 1-year maturities computed on basis of debt due in 6 months, as reported on Dec. 31 of each year and June 30 of the subsequent year.

Source: ICC annual report, statement M–125.

Working capital as thus defined is represented by the solid red line. The broken line represents working capital reduced by materials and supplies. This is shown because there is a real question in the minds of most informed people whether or not materials and suplies should be included as a current asset. These are entirely different from the inventory of a manufacturing company which is generally converted into a finished product and disposed of in the course of twelve months. In other words, materials and supplies are not, with certain exceptions, liquid assets. However, whether or not they are included, the results in the comparisons are not too different.

Comparing working capital with gross operating revenues, it is noted that there is a fairly parallel trend between working capital and gross revenues from 1940 to 1946. From there on, gross revenues have increased somewhat, primarily as a result of rate increases. Working capital, however, has tended to decline.

While the railroads have been handling an increased dollar volume of business with a decreasing amount of working capital, the question may rightly be posed as to whether or not this in itself is serious because there is always the posibility that any individual company, or any individual industry, may have an excess of working capital.

In Chart E, a comparison is made of the percentage of working capital to the volume of business done by Class I railroads and other typical industries. It will be noted that working capital of Class I railroads amounted to only 12% of the volume of business transacted; working capital of the oil and food products industries was almost twice that of the railroads; steel was twice that of the railroads; and building materials, tire and rubber, chemical, metals and mining, and the agricultural machinery industries were substantially beyond even these figures, ranging all the way up to 48.7% in the case of agricultural machinery.

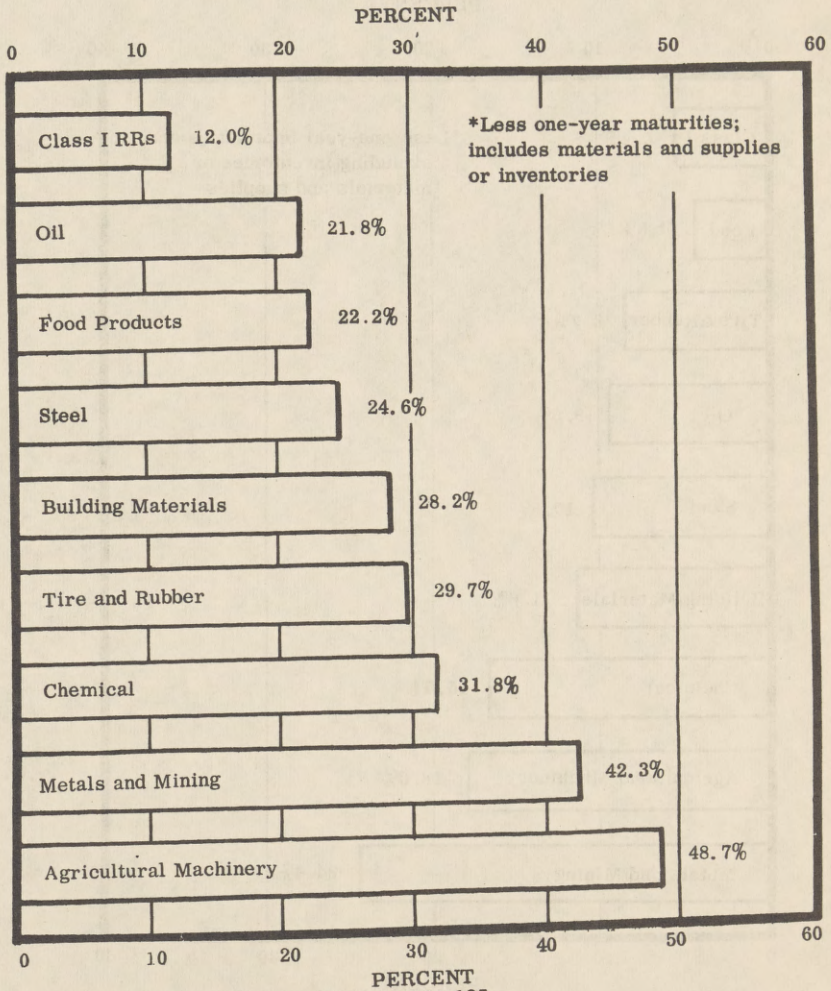
It might be argued that these other industries need more working capital since they have to carry large inventories. On the other hand, it is certainly true that their inventories constitute a better current asset than our materials and supplies which are included in current assets for purposes of comparison. However, as shown in Chart F, if we take out inventories in the case of other industries, and materials and supplies in the case of the railroad industry, you will notice that, with one exception, the Class I railroads still have the smallest working capital as a percentage of volume of business done.

It may also be contended that the railroads should be able to get along with smaller working capital because they do not have to carry a large volume of accounts receivable, since the bulk of transportation bills are payable within 48 or 96 hours. There is one exception to this, however. Fairly substantial accounts receivable are due by various agencies of the Federal Government, and these are carried for longer periods of time. In addition,

CHART E

PERCENTAGE OF WORKING CAPITAL *TO VOLUME OF BUSINESS

1955

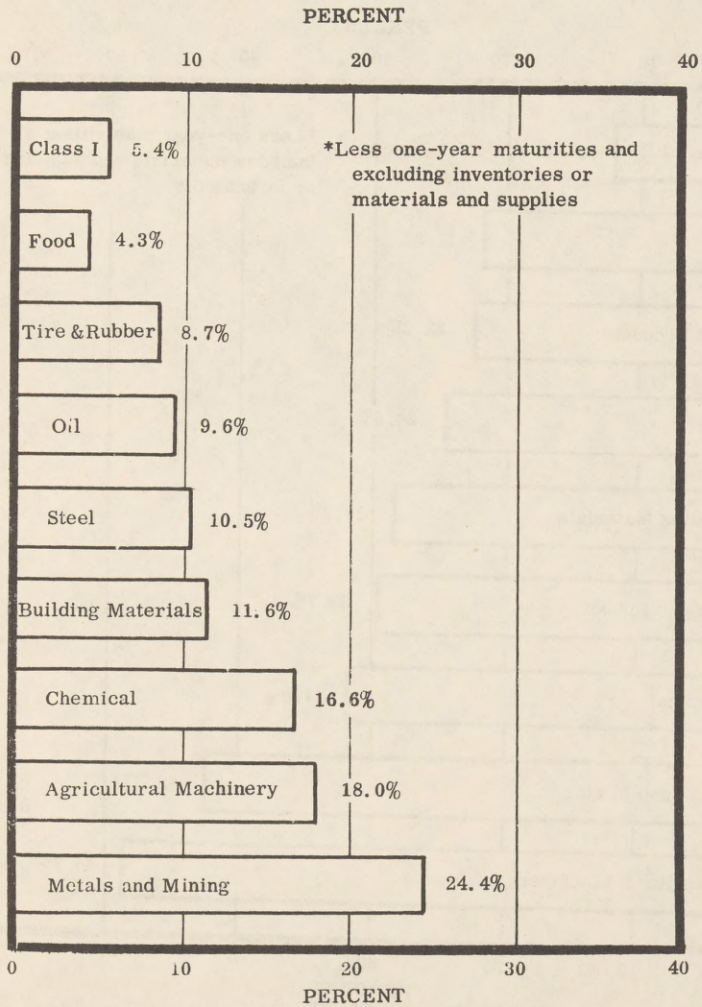


Source: I. C. C. Annual Report, Statement M-125
and Studley Shupert & Co., Inc. Industry Composite

CHART F

PERCENTAGE OF WORKING CAPITAL *TO VOLUME OF BUSINESS

1955



Source: I. C. C. Annual Report, Statement M-125
and Studley Shupert & Co., Inc. Industry Composite

Table 5.—PERCENTAGE OF WORKING CAPITAL TO VOLUME OF BUSINESS[1]—1955

[Dollars in millions]

	Sales (1)	Working capital (2)	Percent of working capital to sales (3)	Working capital less inventory (4)	Percent of working capital less inventory to sales (5)
Class I	$10,106.4	$1,213.2	12.0	$547.0	5.4
Food	2,331.6	517.4	22.2	99.7	4.3
Tire and rubber	4,509.2	1,340.2	29.7	394.1	8.7
Oil	18,083.8	3,942.1	21.8	1,734.2	9.6
Steel	11,155.6	2,742.6	24.6	1,174.8	10.5
Building materials	3,670.7	1,033.7	28.2	424.1	11.6
Chemical	6,306.0	2,005.4	31.8	1,045.0	16.6
Agricultural machinery	2,262.5	1,102.7	48.7	407.3	18.0
Metals and mining	1,606.5	679.9	42.3	391.2	24.4

[1] Less 1-year maturities.

Source: ICC annual report, statement M–125, and Studley, Shupert & Co., Inc. industry composite.

and I will cover this later on, the debt of the railroads represents a higher percentage of their capitalization than in the case of any other industries shown in these charts. Further, as we have seen from the chart on debt, the railroads have a very substantial amount of annual equipment maturities which are peculiar to this industry, and overall the debt service of the railroads is much higher than in any of the other industries with which comparisons are made.

In any event, the working capital position of the industry, has deteriorated and it now seems clear that the situation has not been eased by what transpired in the past year. Preliminary figures indicate that the Class I railroads lost about $200 million in working capital in 1956, and if we exclude materials and supplies as a current asset, they lost more than $250 million. To put it another way, the railroad industry ended 1956 with working capital of approximately $1 billion and if we exclude materials and supplies, the figure is around $275 million.

To illustrate what this deterioration in the railroads' working capital means from the standpoint of their daily operations, the monthly payroll of the railroads, including the current wage settlement pattern, averages $465 million. Compare this figure with the current working capital of $275 million, excluding materials and supplies since to a great extent they do not constitute a liquid asset, and you will find that working capital is equal to little more than the semi-monthly payroll. As of the end of 1955, working capital, excluding material and supplies, was equal to the payroll for about 40 days while in 1945 it was equal to 4½ months.

Therefore, with inadequate working capital, the railroads are in a position where they must meet current expenses out of current receipts and in the event of a decline in business, they have no alternative but to reduce expenses accordingly.

In adition to inadequate working capital, there is another serious problem with which the railroads have been struggling and which is going to increase their difficulties as far ahead as we can see. The notorious lack of earning power of the railroad industry has made it extremely unpopular as an outlet for capital seeking investment. There are only about a handful of common stocks of railroad companies today that even to a small degree are being purchased by institutional investors. Naturally with the low earnings of the railroads and with the large number of companies that went through reorganization in the thirties, their basic credit standing has been undermined.

As a practical matter today the only important vehicle to the majority of American railroads for raising new funds is through Equipment Trust obligations secured by liens on new rolling stock. Equipment Trust obligations mature serially over a period of years, generally speaking, 10 to 15 years, and usually the railroads put up in cash 20% to 25% of the cost of the equipment involved. These obligations also cannot be refunded so at maturity must be met out of the cash drawer. There has been a very substantial

increase in these obligations in the post-war period. This is natural in view of the fact that the railroads have been forced to rely almost entirely on this method to obtain funds to purchase a vast majority of the equipment.

As of January 1, 1946, the total outstanding equipment obligations in the industry were $773 million, and at the end of 1955 they were $2 billion 537 million. This has tended to saturate the market and it has only been with increasing difficulty that the investment bankers purchasing equipment trust issues have been able to dispose of them. As an indication of the decreasing interest in railroad equipment obligations, as of today the industry is in effect dependent almost entirely on two investment banking groups for the sale of their equipments. Between them these two groups handle about 85% of all equipment trust obligations marketed.

To further accentuate the seriousness of the situation, the size of the potential market has been materially reduced. In the past, savings banks have been one of the major outlets for equipment trust obligations. However, in the past few years a number of states, including New York and Pennsylvania, have empowered the savings banks to buy preferred and common stocks. This coupled with the fact that most savings banks have been very substantially increasing their mortgage portfolios, has resulted in a very limited demand on their part for equipment trust obligations.

On top of this, the commercial banks of the country, long-time purchasers of equipment obligations, have been hard pressed to find sufficient funds to meet loan demands, and I think you are well aware of the tightness of money at the present time. As a result, and we see no immediate prospect of relief in this connection, the commercial banks are primarily reducing their investment portfolios in order to raise funds for additional loans. Despite this liquidation, as of the beginning of this year the commercial banks of this country were in debt to the Federal Reserve to the extent of $370 million. Therefore it seems apparent that there will be a further liquidation of securities by the commercial banks. Consequently it may be many years before they again, if ever, become an important factor in the equipment market.

In other words, the credit standing of the railroads has deteriorated, they have been more and more restricted for their source of funds to the equipment trust market, and that in turn has become saturated and from a supply standpoint the size of the market is shrinking.

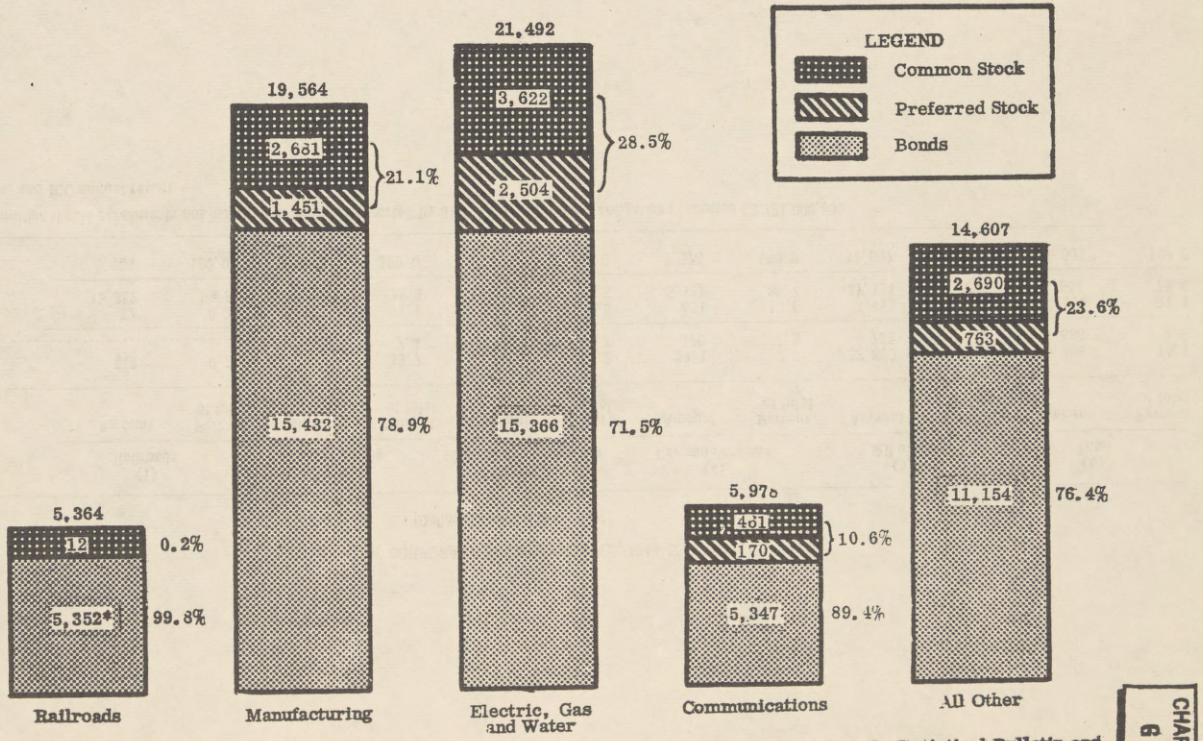
Many railroad companies are extremely worried at the present time as to how they are going to be able to finance equipment purchases, not in the year 1960 or 1965, but in 1957. If it should become impossible to finance equipment purchases, obviously it will become impossible for the railroads not only to meet expanding demand but to replace equipment which is wearing out year by year. If this is true, then in turn, they will be unable to provide the service necessary to industry in general and will obviously not have the ability to meet the demands of a wartime economy. This sounds like a bleak picture, but factually it is true and the only possible offset is that we are hopeful that through the solution of a number of the problems cited today such a tragic eventuality will ultimately be averted.

Again, to show how the popularity of the railroads from an investment standpoint has decreased and the credit of the industry eroded contrasted to other industries, Chart G shows that of the new securities issued by the railroads in the period 1948 through 1955, as compiled by the Securities and Exchange Commission, only $12 million, or two-tenths of 1%, represented stock or equity financing. Most of this can be traced to two railroads. In 1951, the Nickel Plate raised $5,065,000. through the sale of common stock to reimburse its treasury for capital expenditures made, and in 1955 the Western Maryland realized $5,272,000. in this manner to provide a part of the funds required to pay off the accumulated arrears of dividends on its preferred stock.

Contrasted with this is the showing in manufacturing industries where 21% of the new securities issued represented stock or equity financing, or 28%

NEW CORPORATE SECURITY ISSUES 1948 - 1955

(Millions of Dollars)



* Includes $3,721 million equipment obligations.

Source: S. E. C. Statistical Bulletin and I. C. C. Annual Report

CHART 6

TABLE 6.—NEW CORPORATE SECURITY ISSUES, 1948–55

[Dollars in millions]

	(1) Railroads		(2) Manufacturing		(3) Electric, gas, and water		(4) Communications		(5) All other		(6) Total	
	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total	Amount	Percent of total
Common stock	$12	0.2	$2,681	13.7	$3,622	16.8	$461	7.7	$2,690	18.4	$9,466	14.1
Preferred stock			1,451	7.4	2,504	11.7	170	2.9	763	5.2	4,888	7.3
Total stock	12	0.2	4,132	21.1	6,126	28.5	631	10.6	3,453	23.6	14,354	21.4
Bonds	[1] 5,352	99.8	15,432	78.9	15,366	71.5	5,347	89.4	11,154	76.4	52,651	78.6
Total	5,364	100.0	19,564	100.0	21,492	100.0	5,978	100.0	14,607	100.0	67,005	100.0

[1] Includes $1,537,000,000 of conditional sale agreements not included in amounts reported by SEC. Total equipment obligations included $3,721,000,000.

Source: SEC statistical bulletin, and ICC annual report.

for electric, gas and water, 10% for comunications, and 23% for all other industries.

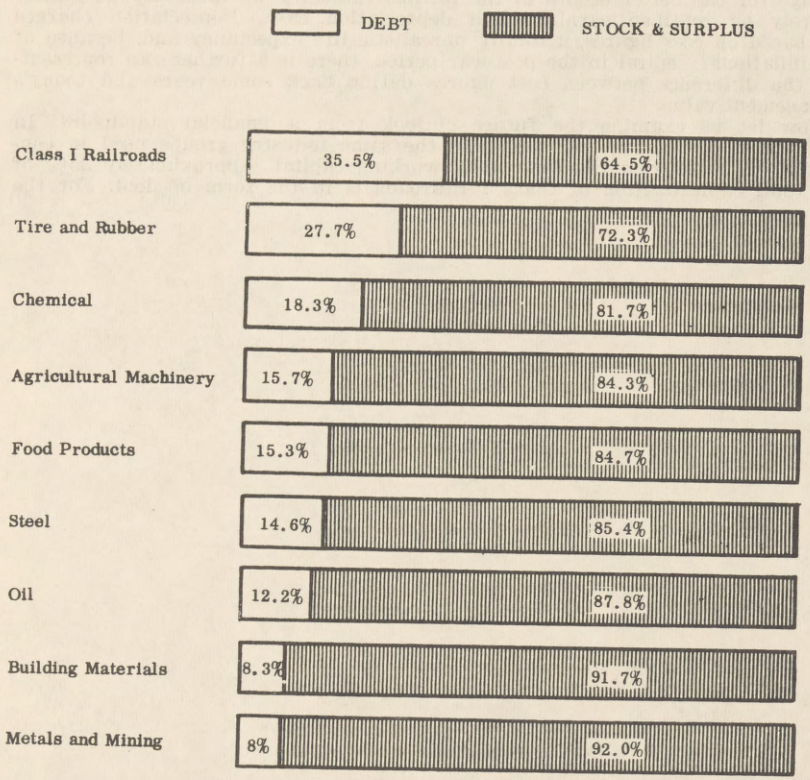
In the communications industry, nearly half of the securities classed as bonds were of the convertible type issued by one company, and its experience indicates that 99% of such bonds are converted into stock. If adjustment is made for this conversion, then 53% of the communications industry financing was represented by equity financing. Furthermore, of the $5 billion 352 million of bonds issued by railroads, $3 billion 721 million, or 70%, were equipment obligations, and again I repeat they mature serially over a 15-year period, or less, are not subject to refunding, and, therefore, must be met from the cash earnings of the railroads.

Therefore, to finance improvements to the road, to obtain down payments for equipment financing, and to finance any expansion, until some drastic change for the better occurs in the railroad industry we must depend almost entirely on retained earnings and depreciation cash. Depreciation charges are based on cost figures, a totally unrealistic life expectancy and, because of the inflationary spiral in the post-war period, there is a further gap representing the difference between cost figures dating back some years and today's replacement value.

Now let us examine the future outlook from a financial standpoint. In Chart H a comparison is made with the same industry groups used in connection with my remarks concerning working capital. Approximately 35% of the total capitalization of Class I railroads is in the form of debt. For the

CHART H

PERCENTAGE OF DEBT AND STOCK & SURPLUS
TO TOTAL CAPITALIZATION
1955



Source: I.C.C. Annual Report, and
Studley, Shupert & Co., Inc. Industry Composite

other industries shown the percentage of debt to total capitalization ranges from a low of 8% in the case of the metals and mining industry to a high of 28% in the case of the tire and rubber industry.

Not only does the debt of the railroads constitute a higher percentage of capitalization than is generally found in other industries, but more important, as we have seen from the chart dealing with the composition of debt, a higher proportion of that debt is in the form of equipment obligations which are non-refundable and which impose an ever-increasing drain on cash. This condition is not found in the other industries.

Looking ahead ten years, it appears from Chart I that the cash outlay for

payment of existing debt maturities, both bond and equipment, plus an estimate of maturities resulting from projected equipment financing, will mean that over this period the Class I railroads will be called upon to put out $4 billion 213 million or roughly $420 million a year just to meet maturities. Now if we add to that the interest charges on this debt, we find that we come up with a total figure for debt service during the ten-year period of almost $8 billion, actually an average of $785 million a year. With one possible exception, all of this must be paid out in cash, since obviously interest charges are not susceptible to refunding, nor are equipment maturities. The bond maturities, which it is true in some cases might be refunded, only amount to $713 million, or less than 10%.

CHART 1

CLASS I RAILROADS AND LESSORS

CASH OUTLAY FOR PAYMENT OF DEBT

1956–1965

LEGEND

Interest		$3,640,000,000
Bond Maturities		713,000,000
Equipment Maturities		3,500,000,000
Actual	$2,285,000,000	
Projected	1,215,000,000	
		$7,853,000,000

MILLIONS OF DOLLARS

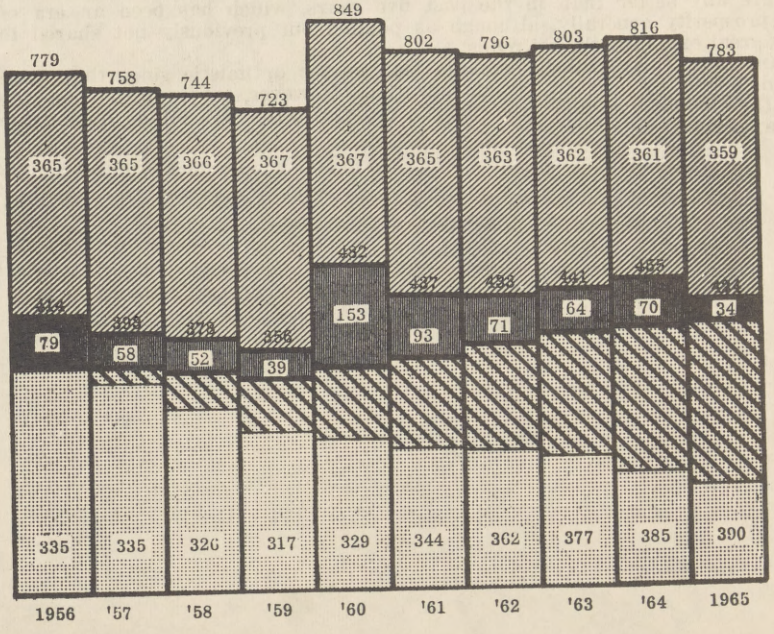


TABLE 7.—CLASS I RAILROADS AND LESSORS CASH OUTLAY FOR PAYMENT OF DEBT

[Millions of dollars]

	Equipment obligations			Bonded debt as of December 31, 1955 (4)	Total outlay (5)	Estimated annual interest (6)	Total outlay including interest (7)
	As of December 31, 1955 (1)	New financing (2)	Total (3)				
1956	335	----------	335	79	414	365	779
1957	308	27	335	58	393	365	758
1958	272	54	326	52	378	366	744
1959	236	81	317	39	356	367	723
1960	221	108	329	153	482	367	849
1961	209	135	344	93	437	365	802
1962	200	162	362	71	433	363	796
1963	188	189	377	64	441	362	803
1964	170	215	385	70	455	361	816
1965	146	244	390	34	424	359	783

Note: Equipment maturities account new financing computed on basis of issuance each year of $400,000,000 of equipment obligations to mature serially over 15 years.

Source: Estimate by Financial Department, P.R.R. Co. based on information contained in Moody's Transportation Manual and ICC annual report.

Chart J sets forth the sources and applications of funds on a cash basis for the industry as a whole, as projected over the next ten years. On the left-hand side are indicated the amounts of cash it is estimated will be available and the sources from which they will be derived. First of all is the item of $6 billion 600 million representing depreciation. This figure is arrived at based on figures compiled by the A.A.R. as received from various Class I railroads as to their projected capital expenditures. Next is $4 billion which will be derived through financing, or in other words, through the sale of equipment obligations. Here again, although the announced intentions of all the Class I railroads indicate very large expenditures for equipment, we have felt called upon to limit the amount that can be realized to $400 million a year as being the amount we believe the market may be able to absorb. The net income figure of $8 billion 400 million is based on average earnings of the railroads over the last five years. Obviously we had to make some assumptions in this connection, and as of now, we know of no reason why the railroads will fare any better than in the past five years, which has been an era of great prosperity generally, although as pointed out previously not shared in to any great extent by the railroads.

If anything, this earnings estimate may be too optimistic since they have been distorted by accelerated amortization. However, as indicated on the chart the amount available from all sources aggregates $19 billion during the ten-year period.

CHART J

CLASS I RAILROADS
SOURCE & APPLICATION OF FUNDS
TEN YEARS 1957 - 1966
(Estimated)

MILLIONS OF DOLLARS

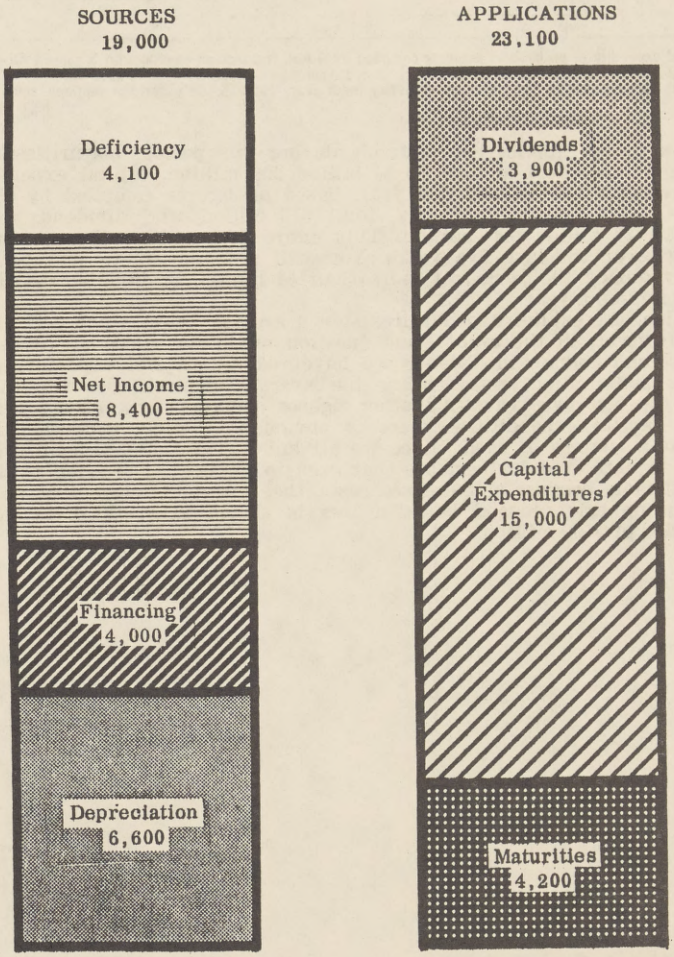


TABLE 8.—CLASS I RAILROADS, SOURCE AND APPLICATION OF FUNDS (ESTIMATED)—10 YEARS, 1957–66

[Millions of dollars]

	Funds [1]	Funds [2]
Sources:		
Net income	8,400	8,400
Financing	4,000	4,000
Depreciation	6,600	6,300
Total	19,000	18,700
Applications:		
Dividends	3,900	3,900
Capital expenditures	15,000	11,200
Maturities	4,200	4,200
Total	23,100	19,300
Deficiency	4,100	600

[1] Assumes—Capital expenditures on basis of estimate compiled by A.A.R. Net income—average for 5 years 1952–56. Financing—$400,000,000. Equipment obligations issued each year. Dividends—average for 5 years 1952–56.
[2] Assumes—Capital expenditures on basis of average outlay for 5 years 1952–56. All other assumptions same as ootnote 1.

Turning now to the application of funds during this period, maturities of bonded and equipment debt amount to $4 billion 200 million, capital expenditures at an average of $1½ billion a year, based on figures compiled by the A.A.R. from Class I railroads directly, total $15 billion, and dividends are estimated to be $3 billion 900 million. This figure is based on the average dividends paid over the last five years. You will not that there will be a cash deficiency during the period of more than $4 billion, or in other words, just over $400 million a year.

In our opinion, the capital expenditures shown are far below what actually are needed. However, in the event some question might be raised as to this item, in the second column in Table 8 we have reduced capital expenditures to $11 billion 200 million, representing the average expenditures for this purpose over the last five years. All other figures are the same, except that with reduced capital expenditures there is obviously a slight reduction in depreciation as a sources of cash. Since we all know that these expenditures have been inadequate, and furthermore that even to duplicate the same facilities would cost more because of increased costs, they are definitely out of line. However, even on this reduced basis, a loss is shown in working capital during the period of $600 million.

This $600 million figure compares with working capital of all Class I railroads at the end of 1956 of about $1 billion, so that if such a cash loss is sustained, working capital would be cut about 60%. If, as shown in the chart, the loss in cash is over $4 billion, the industry would have a working capital deficit of $3 billion. Obviously, in such an event, the railroads could not operate in solvency.

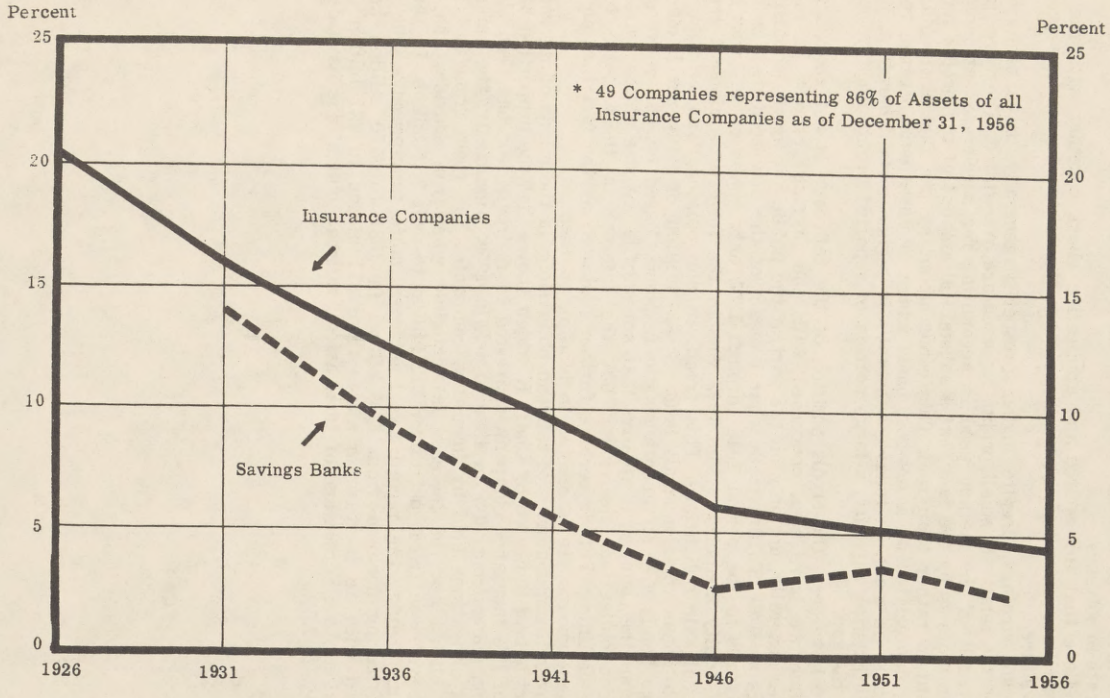
We believe that this source and application chart, together with the other charts we have examined, points up clearly that there are serious problems which we face.

Railroad earnings, despite higher prosperity generally, have been meager and even the relatively small profits reported are over-stated. They are inflated as the result of the method used in accounting for accelerated amortization, and even more so by the fact that a substantial amount of the profits reported are phantom rather than real. This comes about by the fact that equipment is being depreciated on a low-cost basis which is unrealistic because replacements must be made on today's substantially higher costs. Therefore, just to maintain existing capacity, a large portion of reported profits must be applied to close the gap.

As we have seen, the credit position of the railroads is not good, and for some time we have been concerned with the lagging interest in railroad securities generally, not only on the part of the public but by the sophisticated investors as well. To illustrate what I mean, of the new securities issued by the railroads in the period 1948 through 1955 only 2/10ths of 1% was in the form of equity financing, while 70% was in the form of equipment trust or conditional sale obligations. This trend, in our opinion, was brought forceably into focus when a small issue of $35 million of Southern Pacific first mortgage bonds met an unenthusiastic response. Based on our conversations throughout the country, it appears that not only is the size of the market for equipment obligations decreasing but the interest in these obligations is steadily declining. This is perhaps further indicated by the fact that only two investment groups are interested in bidding on them.

The overall unpopularity of railroad obligations in the minds of institutional investors is best indicated by Chart K which shows that the proportion of total assets of life insurance companies invested in railroad debt has been steadily declining, going from 20% in 1926 to 4% in 1956. Admittedly, the amount of railroad obligations held by insurance companies has risen from $2.4 billion to $3.6 billion but the increase is negligible when you consider that their assets have risen from just under $12 billion to over $82 billion. In the case of savings banks, the record has been even more unimpressive, the dollar amount having declined from $1.5 billion in 1931 to $770 million in 1955 compared with an increase in assets from $11 billion to $31 billion during this period. As a percentage of total assets, railroad obligations have declined from 14% to 2.5%.

PROPORTION OF ASSETS OF INSURANCE COMPANIES*
AND SAVINGS BANKS INVESTED IN RAILROAD BONDS



Source: Moody's Bank and Finance Manual
National Association of Mutual Savings Banks

Note: Data for Savings Banks for year 1956 or for the years prior to 1931 not available

CHART K

Immediately following the war naturally enough the railroads had a great need for new equipment. Fortunately, from the standpoint of the market, money was plentiful. In addition to normal resources, both the life insurance companies and the banks were converting governments into higher yielding assets. For example, between the end of 1945 and the end of 1951 the life insurance companies reduced their government holdings from approximately $20 billion to $10 billion, thus making an additional $10 billion available to industry in general.

As a result, during the first six years after the war, 1946 to 1951, inclusive, the railroad industry was able to place an average of $464 million equipments or conditional sales annually. However, during the past five years industry in general has been faced with a tightening money market, and despite steadily rising interest rates the sale of equipments has become more difficult. In this period the railroad industry financed only $397 million of equipment obligations annually.

Taking everything into consideration, we do not believe it would be advisable for the industry to count on being able to sell more than $400 million annually on the average over the next ten years, or in other words, the same amount as during the past five years. We sincerely believe that existing sources of capital are going to be insufficient to meet all the requirements of industry overall during the next ten years. As an indication of this, I think it is interesting to note certain figures taken from the March 15th issue of Finance, compiled by Salomon Bros. & Hutzler, one of the leading investment banking firms in the country and I might add the firm which heads one of the two groups which today are still buying equipment trust issues. Their figures indicate the following: They estimate the supply of new long term investment funds for the year 1957 at $22.1 billion and the demand for long term investment funds at $23.2 billion. In other words, there is an indicated deficiency in long term investment funds for the year 1957 alone of $1.1 billion.

Obviously, if there is a deficiency in the amount of funds available, the industries with the least popular appeal are going to suffer most with respect to their ability to obtain financing. If, as indicated before, the industry is only going to be able to issue $400 million annually of equipments over the next ten years, on a 80–20 basis this would mean that equipment capital expenditures of $500 million could thus be financed.

This figure compares with an average of approximately $750 million spent for equipment each year over the past five years, and we know this amount was insufficient to meet equipment demands. We also know that with the price increases that have occurred during this period even this $750 million annually would not pay for an equivalent number of units today.

The picture looks even worse if we turn to the industry's own estimates as compiled by the A.A.R. of equipment capital expenditures of $1 billion each year, or twice what in our opinion can be financed through conventional sources. If you accept Mr. Symes' estimate that the industry will have to spend $2 billion a year overall, equipment expenditures would run almost $1.5 billion a year or three times the estimated amount which we feel can be financed.

Under the circumstances, although some may take exception to our estimate as to the fact that the market cannot support more than $400 million a year of financing, it is obvious that even if this figure is upped materially it will fall far short of requirements. From our standpoint this emphasizes how necessary it is going to be to develop an entirely new approach to financing some of these requirements.

Under the circumstances, we believe that it is essential for the railroad industry to tap new reservoirs of capital. For that reason we have taken a new approach in formulating a plan for future financing of equipment expenditures of the railroads, which can be briefly outlined as follows:

Plan

1. A new government agency shall be created, to be known as the Railway Equipment Agency, or with some similar nomenclature, with initial capital of $500 million, with the understanding that more will be advanced by the government from time to time as may be needed.

2. The railroads shall have the right to apply to this equipment agency for long term net leases for such new equipment as they may desire. The

exact length of such leases shall be on the same basis for all companies, but shall be varied in term, taking into consideration the true economic life of the type of equipment in question. For example, diesels probably should be leased for 15 years and freight cars for 20 years, passenger equipment perhaps on a 10-year basis.

3. The basic rental shall be determined as follows: The interest factor shall be ¼ of 1% above the estimated cost of money to the agency for the length of period involved. During the period the rental shall also be sufficient to completely amortize the cost of the equipment, less the estimated scrap value of the equipment at present-day prices. Then rental shall be absolutely net and all repairs of whatsoever nature shall be made by the leasing railroad.

4. The agency shall have the right to borrow up to four times its capital; in other words, up to 80% of the cost of the equipment. At the end of the lease for any equipment, the governmental body having control over the stock piling of strategic materials for national defense purposes shal have the option of purchasing any equipment it desires from the transportation agency at the fair value of the equipment, to be determined at that time. Any equipment not thus purchased for stock piling for defense purposes shall be sold for scrap by the transportation agency, with the proceeds recaptured by the transportation agency.

5. Any lessee, subject to the approval of the equipment agency, may assign its lease to any other railroad in the event it no longer has a demand for the equipment, but in no event shall the new lessee receive a lease other than for the balance of the period remaining to the original lessee. Also, in the event that any lessee defaults under the terms of its lease, the equipment agency may recapture the equipment and re-lease it to another railroad for the remaining balance of the term, but in no event for a longer period.

6. In the event there are more applications for equipment than can be handled expeditiously (this is particularly likely to be true not only at the outset but in the event of emergencies or in periods of an upsurge in traffic), allocation of equipment shall be made by the railroad equipment agency on the basis of gross revenues of the various companies applying in relation to the total revenues of the industry, using figures for the year immediately preceding.

Advantages of Plan

A. From the standpoint of the government:

1. The plan as outlined will not cost the government anything, as contrasted to the subsidies handed out to other segments of the transportation industry. In addition, it is probable that the ¼ of 1% interest differential, plus the differential between the current estimated scrap value and the ultimate scrap value or proceeds realized from sale to the government stock piling agency, should be sufficient to pay the costs of administration, give the government a return on its funds, and ultimately the return of its initial capital.

2. The government will be assured that the railroad industry will be maintained in first-class condition, prepared for any emergency, and with adequate capacity.

3. The government will have an opportunity to stockpile a substantial amount of equipment against a war emergency at a relatively low cost.

4. The government will be assured of protection of the capacity of the railway equipment industry, so vital in the event of an emergency.

5. Maintenance of the physical condition of the railroads at a high level will serve as a stimulant to the peacetime economy and should bring in additional revenues in the form of income.

B. From the standpoint of the railroad industry:

1. It should be possible for the railroad industry to put its entire plant in first-class condition without damaging its credit. This is true not only with respect to rolling stock but road as well, since funds thus released from the equipment budget will be available for modernization of yards, signal control, and the roadway generally.

2. Such a program should make it possible for the industry to expand its capacity, thus insuring its participation in the expanding economy and stimulating the latter by providing a modern, efficient, low-cost transportation system to serve its needs properly, and also further aiding the economy through its

increased purchases, and on a more regularized basis, from the whole railroad equipment industry.

3. With a modernized efficient plant, the industry should operate more efficiently, thereby keeping costs of transportation at the lowest practicable level and at the same time earning greater profits.

4. As a result of the government agency placing the orders for much of the equipment, a far greater degree of standardization of equipment should be possible, thus reducing the overall cost of equipment and thus holding down the cost of transportation.

5. Through the program outlined, the railway equipment industry should be able to put its production on much more of a mass-production basis, expand its capacity and strengthen its position.

6. If the government finds itself in a position of leasing equipment to the railroads, then obviously, because of its financial stake in the railroad industry, it will naturally have an interest in the railroads' welfare.

7. This plan embodies the principle of the user paying full cost for government services rendered. Therefore, it if goes through, it should strikingly point up by comparison the fact that certain other segments of the transportation industry are not paying their way.

8. By virtue of the fact that the proposed lease arrangement would be with a government agency rather than a private corporation, all tax questions are automatically resolved. At the present time the Department of Internal Revenue is questioning the Equitable lease arrangement, which might have serious tax consequences to various lessees. Such questions would be eliminated and it should be possible also to get through the lease arrangement what is tantamount to realistic depreciation geared to the actual economic life of the equipment. Of course in this connection we would get the depreciation in the form of tax deductible rental.

9. An additional objection to the present pattern of leasing equipment from a private corporation is that it is costly by reason of the loss of the residual value. Under this plan the railroad at least gets credit for the estimated scrap value of the equipment.

C. From the standpoint of the public:

1. The public in general, both individually and through industries, will thus be assured of the finest in low-cost mass transportation at the lowest possible cost.

2. This is adopting one hundred percent the Eisenhower administration policy that industry should pay as it goes for services rendered by the Government.

Overall, the simplicity of the plan itself has much to recommend it, together with one other important fact, namely, that it is possible to work it out on a completely voluntary basis. It is not necessary for all railroads in the industry to approve of the plan or to participate in it, but it would be available to all, and over a period of time it would appear almost a certainty that the industry as a whole would utilize it.

RAILWAY EQUIPMENT AGENCY SCHEDULE OF RENTALS, INTEREST FACTOR—3¾ PERCENT PLUS ¼ PERCENT

(4 PERCENT)

Type of equipment	Cost of equipment	Present day scrap value [1]	Cost to be amortized	Term of lease (years)	Total rental due under lease
Freight cars	$70,000,000	$10,300,000	$59,700,000	20	$95,064,860
Diesels	20,000,000	700,000	19,300,000	15	26,116,755
Passenger cars	10,000,000	325,000	9,675,000	10	11,884,560
Total	100,000,000				133,066,175

[1] Government would be the beneficiary of difference between present day scrap value and value at the end of the lease.

Annual rental

1st to 10th year	$7,682,816
11th to 15th year	6,494,360
16th to 20th year	4,753,243

UNIT RENTAL

Type of equipment	Unit cost	Present day scrap value	Cost to be amortized	Term of lease (years)	Rental	
					Monthly	Daily
Freight cars	$8,500	$1,250	$7,250	20	$48.10	$1.60
Diesels	200,000	7,000	193,000	15	1,450.93	48.37
Passenger cars	140,000	4,500	135,500	10	1,386.87	46.23

The proposed plan for financing the equipment needs of the railroad industry in essence is quite simple. It provides for the establishment of a new government agency with initial capital of $500 million and the right to borrow $2 billion additional, making a total of $2½ billion available to the railroad industry for equipment. This equipment would be acquired by the agency and leased to individual railroads at a rental which would be sufficient to pay back the government agency the cost involved and provide a profit so that even the original capital eventually would be returned to the government.

The immediate reaction to this plan inevitably seems to be that "we want less of government in business rather than more." The Eastern railroads, who have endorsed this plan heartily, subscribe to that principle. However, realities dictate drastic action at this time.

Almost every industry has been aided, at one time or another, by the government. During the early 1930's the Reconstruction Finance Corporation came to the aid of the banks by subscribing to preferred stock. Many industries are protected by tariffs. Certain industries will benefit from the St. Lawrence Seaway. Others are profiiting from inland waterway developments. The farmers have been afforded the advantage of price supports. Railroad competition, except for the pipe lines, have been heavily subsidized, both directly and indirectly. The oil industry has been aided through depletion allowances. Therefore, it should not be disturbing that the railroad industry should be seeking temporary help to get it over a transition period during which it must completely rehabilitate its plant.

Furthermore, for almost 20 years the railroad industry, its shippers, and the public have been plagued with recurring car shortages in times of good business. No one either within or outside the industry has been able to come up with a solution to this problem, and the situation is getting worse rather than better. Car shortages are greater and existing equipment is older.

The greatest danger to the industry is that if it is not equipped to take care of the needs of the country in times of national emergency or to take care of the peacetime needs of the shippers and the public, the government might well use this as justification for nationalization. Therefore, in principle, we are all in agreement. None of us want "government in business." The only question is that of mechanics as to how to prevent nationalization.

During the past five years the railroad industry has spent about $700 million each year for the purchase of equipment. This has not been enough since it has not solved the car shortage. Also $700 million a year will not purchase the same number of units in the future because of the increased costs.

During the same five-year period when $700 million was spent annually, approximately $400 million a year was financed through equipment obligations. The balance was taken from depreciation reserves, retained earnings, and working capital. Much came from the latter source. As of July 31, 1959, the working capital of the railroad industry, taking out materials and supplies which really are not a current asset, and putting in debt due within one year, which obviously represents a current liability, was sufficient to meet the payroll of the industry for only a little over 3 weeks. On a comparable basis working capital in 1946 was sufficient to cover payroll requirements for four and one-half months. In other words, working capital of the industry is at minimum levels.

Now turning to equipment requirements: About 24% of the Class I freight car fleet is over 30 years old. Over 40% is more than 20 years old which is certainly the maximum desirable age in this era of rapid technological process. To eliminate all over-20-year cars of the Class I roads within the next 10 years would involve replacement of more than 1,128,000 cars, or an annual average of more than 112,000.

In addition to these requirements, it seems evident that the Class I fleet should be expanded. The National Association of Shippers Advisory Boards

has indicated that the total fleet should approximate 2 million cars as compared with the present 1,700,000, or an additional 300,000 cars. Therefore, a 10-year program to replace overage cars and adequately expand the fleet would involve construction of 1,428,00 cars, or an annual average of more than 142,000.

As long ago as 1948, the Office of Defense Transportation estimated that the Class I railroads should begin installation of new freight cars at the rate of about 10,000 cars per month, or 120,000 each year. Because the proposal could not be implemented, the situation at the present time obviously requires a more extensive remedy.

Based on an average cost per freight car of not less than $10,000, the annual expenditure for new freight cars should be in the neighborhood of $1.4 billion.

The motive power situation is basically satisfactory from the standpoint of age. In this area, the future equipment program will have to deal with expansion to meet increased business demands and to provide adequate service in the event of a national emergency. Of course, there will be a continuing need to replace the now relatively new power units when they have outlived their usefulness from a practical maintenance and operating standpoint.

The age of railroad passenger train cars obviously requires correction. More than half of these cars are over 30 years old while only 15% are 10 years or less.

All of thes facts point to the need for a tremendous program of railroad equipment construction. The railroads should be spending not less than $1.5 billion in each of the next ten years to up-date and increase their available equipment. And such a program would do not more than meet the normal demands which will be placed upon the industry in our growing economy.

Assuming that 80% of the $1.5 billion is financed, this would mean financing $1.2 billion each year. In other words, financing requirements are three times the amount which was actually financed during the past five years when, for at least part of the time, there was an easy money market.

To add to the difficulties, the demand for equipment obligations today has diminished. Commercial banks for many years were a steady purchaser of equipment obligations. Today their problem is to reduce their investment portfolios in order to meet the increasing demand for loans. They are not big buyers of equipment and for the most part limit what they do buy to small amounts from railroads who are depositors. The savings banks have also been heavy purchasers of equipments in years past. Today, however, they have increased the percentage of their assets which are going into mortgages quite substantially and in addition they are buying common stocks which is an innovation for them within the past several years. Also, endowment and pension funds, because of the fear of inflation, are now steadily increasing the percentage of the funds which they put in common stocks, correspondingly decreasing the amount available for fixed obligations. The life insurance companies represent one of the biggest accumulations of funds; but here again, they likewise are increasing the percentage they put into mortgages and also fairly recently they have become purchasers of common stocks—so all in all the market for equipments has decreased considerably in size.

The requirement of the railroads for funds for equipment amounts to about three times the total they were able to obtain over the last five years and we do not believe such amounts will be available to the railroad industry over the next few years. Even if as much as $1.2 billion were available in total, it would not be equally available to each railroad. It is essential to overcome a car shortage that not only should the total amount be available to the industry but each company within the industry must be table to finance its share of total requirements.

It has been said that all companies can do this provided they step up the amount of interest they are willing to pay. Increasing the rate of interest does not increase the supply of money and also our competitors in the utility and industrial fields, who are likewise in the market for funds, are quite capable of stepping up the interest rate which they are willing to pay pay and probably better able to do so, therefore nothing actually is accomplished through increasing the rate of interest toward increasing the amount of funds available to the railroad industry.

It has also been said this plan would mean that ultimately the government agency involved would end up owning all the railroad equipment in the country, and, therefore, nationalization would be a simple and natural sequence. Actually this not a realistic appraisal of the situation. There are certain built-in points in this plan which provide an economic incentive to only use this

agency during this transition period to the minimum extent necessary. At least the top third of the companies in the industry probably will never use the agency since they can finance their requirements and do it more cheaply than through this agency. The middle third might well use both conventional borrowing and finance through the agency to some extent at the same time. The lowest third of the industry probably would use it for a considerable period of time but ultimately, as its credit position improved, it likewise would return to conventional financing. Actually, in the case of the lowest third, even if for some time to come the roads involved required all their equipment through leasing from this agency, it would be many years before even a substantial portion of their equipment was owned by the agency.

There has been some misunderstanding about the plan because it has been considered merely a device to finance at lower cost—such is not the case. Actually, probably only the lowest third could finance their requirements through the agency better than in the conventional market. The agency would borrow in the open market on its own credit but would not have the guarantee of the United States Government; therefore, neither the debt limit nor the capital budget of the government would be affected.

There are five such agencies at the present time borrowing on their own. The cost of money to these agencies ranges from ¼ to ½ of 1% higher than the cost to the Federal Government. This is a very important point since we are not attempting to use a brand-new method of financing merely to get a small advantage in the interest cost. The basic fact is that the funds are not available in the conventional way to the railroad industry in the amounts required and, therefore, we must find a new source.

The Transportation Act of 1958 authorizes Government guarantee of railroad loans up to a total of $500 million. This may well be the means of keeping some roads out of receivership or bankruptcy but it is not at all suitable for meeting the freight car supply problem.

A Government guarantee of loans necessarily contemplates a direct increase in debt for the borrower. From the standpoint of the railroads, there is a limited amount of debt which they can afford to put on their balance sheets. Leasing avoids placing debt on the balance sheet and while it may be said that leasing is tantamount to borrowing, it is true only to a limited extent. There are many industries and companies in the country today who are using leasing just to keep debt off their balance sheet.

Probably the most serious objection to Government guarantees is that once a railroad resorted to such an arrangement, it would almost certainly discourage private lenders from participating in financing future requirements without the Government guarantee. Furthermore, those companies obtaining government guarantees go into the private market, tap the same capital sources and compete directly against railroads with good credit. This in turn makes it more difficult for those companies with good credit to continue to finance their requirements in the conventional manner. Ultimately, the result might well be that the Government would be drawn into guaranteeing all railroad indebtedness and there would be no surer way of putting the railroad industry under Government control.

Private leasing arrangements are sometimes available to a limited extent. The Pennsylvania has succeeded in using such lease arrangements to handle a large portion of the current car program I have previously mentioned. However, this method of financing is not available to all railroads nor could it ever produce the volume of funds needed by the entire industry.

One of the big advantages of the proposed leasing arrangement is that it is completely voluntary. Only those companies who have need for it will use it and when they no longer have a need for it they have an economic incentive to go back to conventional methods. Without going into detail, there are a number of reasons why companies would tend to go back as fast as they find it possible to do so and still raise the required amount of funds.

The statement has been made that is this is done for the railroad industry it opens up the same possibility to the truck lines, the waterways and the airlines, and a multitude of other means of transport. This plan follows completely the announced policy of the Eisenhower administration that the user should pay full cost for services provided by the government. If the airlines, for example, wish to avail themselves of the same plan, it would seem perfectly obvious that they cannot on one hand retain present subsidies

and at the same time adopt a new policy of user paying full cost—the two are inconsistent and do not go hand in hand. If they are willing to forego their present subsidies and avail of a similar plan then the taxpayer would be away ahead and the transportation industry would be on a sounder footing since each segment of the industry would find its own economic niche not distorted by subsidies.

Despite the fact that under the terms of the plan the government would recapture its full cost, plus a profit, it has been alleged that this represents subsidy since there is a tax gimmick involved. This likewise is not true because by intelligent use of the so-called sum of the digits, or declining balance method of depreciation, on an overall basis the railroads would not fare any better under this plan than if they owned the equipment. Therefore, from this, or any other angle, the plan does not involve subsidy.

There are many advantages to the plan. In the long run it will not cost the government anything as contrasted to subsidies handed out to other segments of the transportation industry. The government will be assured that the railroad industry will be maintained in first-class condition, prepared for any emergency and with adequate capacity to meet expected demands.

The government will be assured of protection of the capacity of the railway equipment industry, so vital in the event of an emergency.

Maintenance of the physical condition of the railroads at a high level will serve as a stimulant to the peacetime economy and should bring in additional revenues in the form of income taxes.

It should be pointed out that if the railroads can lease equipment from the government agency substantial amounts of cash now going toward down-payments of equipment would be released so that additional expenditures could be made by the railroads on centralized traffic control, modernization of yards, elimination of curvatures, so that not only would there be an improvement in the equipment but also in the roadway facilities.

From the standpoint of the railroad industry, this plan would go a long way in aiding the industry to put its entire plant in first-class condition without damaging its credit. Such a program would make it possible for the industry to expand its capacity thus insuring its participation in the expanding economy and stimulating the latter by providing a modern, efficient, low-cost transportation system.

With a modernized plant, the industry should operate more efficiently and the public in general, both individually and through industries, will be assured of the finest in mass transportation at the lowest possible cost.

Basically, it is difficult to see how anyone can object to this plan since it represents a constructive solution for the car shortage which is obviously beneficial to everyone and no company has to participate in it against its will—it is completely voluntary.

To sum up: The railroads have been going through an important transition period. In recent years they have been called upon to completely change their physical form of motive power from steam to diesel. Losses from passenger traffic have continued to mount and in our inflationary economy we have been adversely affected by restrictive regulation. As a result, the railroads have used up much of their cash resources. More equipment is needed to adequately serve shippers. Funds available to the railroad industry in the marketplace are insufficient to meet future demands. The only means available is to find a new source of capital, therefore, the Railway Equipment Agency plan for leasing railroad equipment is the only way to solve the problem.

It should be understood that the railroads are optimistic as to the economy expanding over the next few years. They believe that it will be necessary for the railroads to assume an important part in this expanding economy. However, to do so it seems clearly evident that they must be placed in a position where they are able to acquire new tools to help to do the job properly.

Also, it should be understood that this proposal alone does not represent an answer to all the problems of the railroad industry. The Transportation Act of 1958. is a step in the right direction but much remains to be done. Several different solutions are all being actively worked on. This plan represents one of the most important and it should be implemented immediately

(Whereupon, at 2:45 p.m., the hearing was adjourned, to reconvene at 10 a.m., the following day.)

FAILING RAILROADS

FRIDAY, AUGUST 7, 1970

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

The committee met, pursuant to adjournment, at 10:15 a.m. in room 5110, New Senate Office Building, Hon. Vance Hartke, presiding.

Present: Senator Hartke.

Senator HARTKE. The committee will come to order.

The first witness we will hear this morning will be Mr. L. E. Dennis, Jr., Executive Director, Brotherhood of Railway and Airline Clerks.

STATEMENT OF L. E. DENNIS, JR., EXECUTIVE DIRECTOR, BROTHERHOOD OF RAILWAY & AIRLINE CLERKS; ACCOMPANIED BY C. L. DENNIS, INTERNATIONAL PRESIDENT; AND JAMES J. KENNEDY, JR., LEGISLATIVE COUNSEL

Mr. L. E. DENNIS. Thank you, Senator.

We have had a little change of appearances today. In my statement I indicate that President Dennis was unable to be here because of important business, but he has rearranged his schedule because of the nature of the proposal we are going to make today, and our feeling that it is of vital importance, so we are going to sort of ride tandem here and share the testimony.

To my right is Mr. C. L. Dennis, the international president of the Brotherhood of Railway & Airline Clerks; to his right is Mr. James J. Kennedy, Jr., our legislative counsel.

My name is Leslie E. Dennis. I am the executive director of the Brotherhood of Railway, Airline & Steamship Clerks, Freight Handlers, Express & Station Employes, AFL–CIO.

Our union, BRAC, represents virtually all of the crafts and classes of clerical and related employes, telegraphers, communications employes, and patrolmen on all of the railroads in the United States.

The BRAC is the largest transportation union in the AFL–CIO. With 320,000 members, of whom approximately 250,000 are connected with railroading, we are the largest railroad union in the United States.

There are approximately 94,000 employees working for the Penn Central Railroad. The BRAC represents about 24,000 of these employees. We represent the single largest bloc of the employees of this system.

Our interest, then, in the legislation before you is rather obvious. We are here advocating a course of action which we feel is in the best interests of our members on the Penn Central and other railroads in similar condition, and our members in the railroad industry as a whole. We also hope that what we have to say will be seen in the light of the general public interest in a vital railroad system.

The errors of Penn Central management have already been displayed before you. The problems of Penn Central, and railroads in general, are complex. Complexity, however, is not an adequate excuse for inaction. This committee's recognition of both the need for action and the complexity of the problem is of course why you are holding these hearings and why they have been so extended. But nonetheless, we feel it is now time for action.

We do not care to belabor any longer the failures of the Penn Central merger. We opposed it from the beginning, we predicted its problems, and, unfortunately, we were right. More important than that, we can already see the possibilities of a domino effect of the Penn Central debacle.

The Boston & Maine, and the Central of New Jersey railroads were in reorganization prior to the bankruptcy of the Penn Central. The New Haven, of course, though bankrupt, was made a part of the Penn Central system. Now the Lehigh Valley Railroad has filed under title 77 of the Bankruptcy Act. The Secretary of Transportation has already testified that there will very likely be additional railroads faced with this same problem in the immediate future if some cash infusion does not take place.

The spinning off of assets from the railroad industry is a matter of great concern to everyone. But it is hard to trace. You are just beginning to develop the kind of record which will establish the nature of this spin off. Suffice it to say that all these nonrailroading companies and assets had to be purchased with something. And since the something came out of the railroad, we can only speculate what kind of railroads we would have today if the money had been plowed back from whence it came.

Thus do we recognize the failures of railroad management. We have cried long and hard that our industry needs investigation. We have suggested changes. We have advocated development of a new national transportation policy which would place railroads in their proper role and perspective. But little happens.

What is needed is a new program. The railroads have proposed part of what is needed—in their astro plan. But it is not enough. The Senate has taken another forward step in adoption of the passenger train legislation. But it is not enough.

We hear pleas and plans for maintaining existing railroad services—freight and passenger. That is not what is needed.

Where is the need for a passenger train which is virtually a portable garbage dump because there is planned cleaning program?

Where is the need for ill-equipped trains which have constantly failing air conditioning systems?

Where is the need for a passenger train system which does not contemplate connecting service?

Where is the need for a system in which purchasing a train ticket is almost as difficult as getting a loan at a bank?

Where is the need for dirty, filthy stations which are desecrated relics of a bygone era?

Where is the need for a freight service which ties up goods in a yard for 4, 5, and even 6 days?

Where is the need for a freight service that forces customers to come and unload their own materials at some far-off railroad siding?

Where is the need for a freight service with rates so complicated that a small business is more inclined to buy its own fleet of trucks—or use someone elses?

These are just a few of the existing facts of life that we will continue to perpetuate if we simply shore up our present railroad system. They are not the things we need in a railroad system.

What do we need?

We need: Fast, efficient, comfortable transportation of people and goods from one point to another; clean, modern, effective equipment and terminals; rapid delivery of transported material; effective handling of baggage; trains which provide comfort, decent meals and courteous handling of customers.

Many of use have experienced train service in foreign countries. I, for one, have ridden the trains of Japan, Germany, England, France, Italy, Switzerland, and Canada. Every one of these nations far surpasses the United States in passenger train service. The trains are cleaner, faster, easier to get to, reasonably priced, and comfortable. They have rational interconnecting schedules across the whole of Europe. It is far more difficult to change trains in Chicago than to go from country to country by train in Europe.

Our freight service, on the other hand, stands up far better. It is superior to that found in many parts of the world. But is is inferior in terms of what it could be. It is inferior in terms of what it should be.

In the decade ahead, we must develop a far more efficient and comfortable method of moving people and goods from point to point. We must stop polluting our atmosphere with the tons of gasoline and jet fuel exhaust that we now dump in finding an alternative to rail transportation. Consider, for a moment, the fact that one commuter train can carry the equivalent number of people as 2 miles of four-lane, bumper-to-bumper highway traffic. Then think about air pollution caused by traffic.

The steel wheeel on the steel rail is inherently the most efficient existing mode of transportation. It is only the operators—owners, management, and employees, and the policies of our government—Federal and State—which destroy this inherent efficiency.

Before this system collapses from financial mismanagement, regulation of the wrong things, dispersal of needed assets, something must be done. Before we have more Penn Centrals, Lehigh Valleys, Jersey Centrals, Boston & Maines, we must do something.

This is our program:

First: The House of Representatives must pass the passenger train legislation which the Senate has already adopted.

Second: We feel the Congress should adopt a program similar to the AAR astro program for long-range improvements of the railroad industry.

Third: We feel the Congress should carry out an intensive

investigation of railroad ownership, control, and finances, as well as a careful examination of the investment priorities of the railroad industry. This investigation should lead to the development of a set of congressional priorities for a national transportation system and policy.

Fourth: Most immediately, before the whole system starts to collapse from the causes I have described, we feel the Congress must provide some type of Government supported or guaranteed loan to keep the railroads running.

Since you have many spokesmen for the first three steps, allow us, if you will, to concentrate on the fourth step—a loan investment program for the railroad industry.

You are familiar, I am sure, with the various forms of Government subsidy now operated in the transportation industry. We subsidize airlines. We subsidize airports. We subsidize air traffic control. We subsidize the merchant marine. We subsidize trucks by building highways and then giving them a subsidized tax rate in order to let them use these rights-of-way. We subsidize inland boating by clearing, dredging, and maintaining the rivers, canals, and ports which form their right-of-way. We subsidize transit systems.

What do we do for the railroads? Very little. There appears to be at least three bills before this committee. In addition, I have seen several attempts at a compromise bill. In any event, the major thrust seems to be directed to the Department of Transportation's proposal for a $750 million loan guaranty program in one form or another.

It is obvious, from the length of these hearings, that no one is particularly anxious to leap into this program. It is clear that many members of both the House and Senate have severe doubts about the wisdom of the proposed loans, at least in the various forms in which it has been presented.

People fear that the bankers will get their hands on the money, and that there will be no real effect on railroad service. Or there is fear that railroad management will simply fritter away the new money. Or many other fears, based on the sheer size of the problem, the lack of real programs dealing with all the complex issues, et cetera. So nothing happens, except that we continue to have more hearings and see new versions of the proposal.

We in railway labor do not have unlimited faith in railroad management. Far, far from it. We are constantly engaged in difficult, often bitter disputes over complex labor relations matters. My union, in fact, is only one step away from setting a nationwide strike date in the railroad industry. But despite these disputes, which deal with our very bread and butter, we do have a basic faith in the public need for the industry we labor in. We do know that railroads are an essential and unique mode of transport which must be maintained and improved if our society is to grow and prosper. Considering all this, and the fact that there had been a notable reluctance to act on the present legislation, we wish to offer a new proposal for your consideration.

President Dennis will present the proposal.

Mr. C. L. Dennis. We propose that the Congress adopt legislation which would allow $1 billion to be invested directly in the

railroad industry for the specific purpose of improving railroad service—both passenger and freight.

We propose that the $1 billion be set aside for this purpose from the monieys of the Railroad Retirement Fund.

We propose that loans for this purpose, from the Railroad Retirement Fund, be guaranteed by the Government of the United States as to both principal and interest.

That's the guts of our proposal. Let us now look at the details.

At present, we have almost $5 billion in the Railroad Retirement Fund. This is money which was collected from railroad employes and railroad management. In every sense of the word, those of us from the railroad industry may properly call it our money. But what is this money presently being used for?

The Government of the United States is presently using our money to guarantee mortgages through FHA; to build airports; build highways; fight poverty; fight wars; and almost every other activity carried out by the Government. Our money is on loan to the Government. How it uses that money is the Government's business, at present.

One thing is clear: Not 1 cent of the money we have loaned the Government of the United States is directly invested in the industry from which it came. Not 1 cent is put in to insure the development of a healthy railroad industry. Not 1 cent goes toward establishing new railroad services which would mean new and better jobs for railroad employees.

For the record, I submit herewith a listing of the investments of the Railrod Retirement Fund based on the 1969 annual report of the Railroad Retirement Board:

Mr. L. E. DENNIS. Those are updated to 1970.

Mr. C. L. DENNIS. Yes; last night we updated the 1969 annual report to the 1970 annual report.

On the top of the page we have that report headed "Investments of the railroad retirement account and railroad retirement supplemental account, June 30, 1970." I will skip reading those figures.

Senator HARTKE. All of those figures, the entire statement, including the charts, will be made a part of the record, so you may skip reading that part.

Mr. C. L. DENNIS. Thank you.

(The chart follows:)

INVESTMENTS OF THE RAILROAD RETIREMENT ACCOUNT AND RAILROAD RETIREMENT SUPPLEMENTAL ACCOUNT
JUNE 30, 1970

Type	Face amount (millions)	Purchase price (millions)
Total	$4,724.0	$4,714.2
Special issues, total	3,751.3	3,751.3
Bonds	1,344.4	1,344.4
Notes	2,387.3	3,387.3
Certificates	19.6	19.6
Public issues, total	952.7	942.9
Bonds	593.7	583.8
Notes	199.0	199.1
Participation certificates	160.0	160.0
Federal National Mortgage Association issues	20.0	20.0

Mr. C. L. DENNIS. You will note that the special issues constitute a significant proportion of these funds. According to information given to the Senate/House Conference Report on H. R. 15733, a bill to amend the Railroad Retirement Act, these special issues, constitute $3,731,752,000 as of June 30, 1970. These special issues are moneys which the U.S. Government is able to use for general treasury purposes.

The Railroad Retirement Board is composed of one member selected from railway labor, one from railroad management, and one to represent the general public. This tripartite board is charged with overall responsibility for the fund.

Under present law, the Treasury Department may invest these funds only on a very restrictive basis. In actual fact, through the medium of special issues, the Government of the United States does the actul investing as it desires.

We propose that the Congress allow the Railroad Retirement Board to loan up to $1 billion of the fund to railroads, under a Government guarantee of the loans, at ½ percent above the prime interest rate. This would, of course, make these loans very attractive. It would put into the industry $1 billion which would not be controlled by the banks. With a Government guarantee on the goans, the basic railroad retirement system would be perfectly safe, but the money would be used to build the industry on which the fund is based. The money would be loaned from whence it came.

We propose that any railroad receiving such a loan, as a condition of the granting of the loan, must submit a specific plan for using the money to improve existing railroad passenger and freight services, or add new services or facilities. The Department of Transportation would establish standards and pass on the programs and loans, subject, if necessary, to review by the Department of Treasury, or a special commitee of Congress, or all of these. Thus, it would be required that this money be used for improvements. In terms of a liquidity crisis, this would not appear to be the answer to the problem. Consider, however, the fact that low-interest loans for capital improvements would, presumably, free up some borrowing power for other types of loans. Consider, also, what effect such loans would have on the banking community, which is currently gouging the railroad industry for fantastic rates of interest.

Let us now look at the effect of this proposal on the railroad retirement fund. Since the loans would be backed by Government guarantees, the fund is safe. Since the loans will be attractive, it is likely that they will be taken, and we will see a massive investment in capital improvements. Since the loans will be taken, we can expect a significantly improved return on investment for the railroad retirement fund. For the record, I include herewith the average interest yield on investments under the persent railroad retirement fund.

(The chart follows:)

Investments of the railroad retirement account and railroad retirement supplemental account, June 30, 1970

Type	Average yield (percent)
Total	5.850
Special issues, total	5.623
Bonds	4.049
Notes	6.492
Certificates	7.750
Public issues, total	4.761
Bonds	4.027
Notes	6.061
Participation certificates	5.825
Federal National Mortgage Association issues	5.820

Mr. C. L. DENNIS. Under a proposal worked out between the Senate/House Conference Committee on Railroad Retirement and the Treasury Department, there will be a considrable improvement in the interest yield on the so-called special issues. This improvement will return an additional $195 million to the fund over an 8-year period as a result of the Government paying a higher interest rate. However, even if all this money were invested at the highest rate, it would yield only 7¾ percent interest. In fact it will be a long time before that is the case.

For the record, I submit herewith the chart from the conference committee report on H.R. 15733, dealing with the proposed interest rate payments on these special issues.

(The chart follows:)

RAILROAD RETIREMENT ACCOUNT: CURRENT HOLDINGS OF SPECIAL ISSUES AS OF JUNE 30, 1970—FINAL

[In thousands]

Date	4 percent	4⅛ percent	4¾ percent	5¾ percent	6½ percent	Total	Proposed investment 7¾ percent	Total holdings special issues, June 30, 1970
June 30, 1971								
June 30, 1972								
June 30, 1973								
June 30, 1974	$72,129	$23,110	$409,289			$504,528		$504,528
June 30, 1975	185,901	23,110		$482,623		690,824		690,824
June 30, 1976	185,901	23,110			$647,948	856,149		856,149
June 30, 1977	185,901	23,110				208,201	$847,447	1,055,648
June 30, 1978	185,901	23,110				208,201		208,201
June 30, 1979		208,201				208,201		208,201
June 30, 1980		208,201				208,201		208,201
June 30, 1981								
June 30, 1982								
June 30, 1983								
June 30, 1984								
June 30, 1985								
Total	812,493	531,952	409,289	482,623	647,948	2,884,305	847,447	3,731,752

Note: Amount available for investment June 30, 1970: $847,447.

Mr. C. L. DENNIS. At the current prime interest rate of 8 percent, an 8½ percent loan of $1 billion would return some $85 million in interest to the railroad retirement fund per year. This would be some $7,500,000 above the highest possible Government interest yield—which will not, of course, be available in this scale for at least 8 years.

Thus, while safely investing part of our money in our industry, we can, at the same time, significantly enhance our fund. The increased income can be used to increase benefits, improve the strength of the fund, compensate for a declining base and, most importantly, pay for the revision in benefits which our members are demanding—most notably a plan for retirement at age 60 with 30 years of service.

We propose that this program be reviewed by the Congress every 2 years. It is very possible that after an initial favorable experience, the Congress will find it wise to considerably expand the program, consistent with Government guarantees and the soundness of the fund.

That is our plan. We do not have a draft bill, since we thought it best to first present the broad outlines of the concept. We will be happy to submit a draft bill for your consideration in the near future.

We urge that this committee give this proposal its careful consideration. We request that this committee ask our fellow railroad trade unionists, railroad management, and the Department of Transportation to declare their respective positions on the proposal. We will be happy to meet with any of those interested to work out details on a draft bill.

In conclusion, we are convinced that action must be taken. We feel that this form of loan is the most natural available. We who work in the industry, who believe in it, are prepared to help develop and expand that industry by committing a portion of our retirement fund to the cause of a vital and improved railroad industry.

I hope that you will give this matter your urgent consideration.

Thank you.

Senator HARTKE. Thank you, Mr. Dennis.

I have to say your proposal does strike me as being unique. At least it is somewhat refreshing to this extent, that it is a different approach than is going through the cracker barrel.

I assure you we will give it every consideration. Have you talked to the members or the trustees of the present fund? Have they been consulted on this whatsoever, the management, labor and public members?

Mr. C. L. DENNIS. The Railroad Retirements Board, that is, one of the members, the labor member, and their attorneys and their actuaries were present at a meeting yesterday of the Congress of Railroad Unions of which our organization is a member. I discussed the broad general outlines of the proposal, reading most of this to them, and they all thought that it was an excellent approach to the problem.

Senator HARTKE. If we do follow such an approach, wouldn't this in effect increase the deficit of the Treasury to the extent that these funds were utilized for this purpose?

Mr. C. L. DENNIS. No, it wouldn't increase the deficit.

Senator HARTKE. Wouldn't they have to find another place to get money?

Mr. L. E. DENNIS. They would have to find somebody else's billion dollars to use.

Mr. C. L. DENNIS. Oh, the treasury, yes.

Senator HARTKE. Yes. As far as the Treasury is concerned, this would reduce their available funds, available cash, to the extent of one billion dollars, isn't that true?

Mr. C. L. DENNIS. The U.S. Treasury, yes. But this is really our money, not the treasury's money. We loan it to the treasury, and really the treasury has been paying us interest; they are going to pay us a little more interest now than they have been paying us in the past. To some extent I believe that the Treasury Department was in on the proposal to loan the $750 million, which was going to come from someplace.

And this billion dollars is coming from the railroad people and railroad companies' pension fund, the Treasury Department will lose the advantage of investing it as they see fit, instead it will be earmarked for investment in the railroad industry from whence the money came.[1]

Senator HARTKE. What you are saying in substance is you feel the trust fund should be utilized for the benefit of the industry for which it has been basically placed in the first place.

Mr. C. L. DENNIS. We think this will sort of be the answer to the maiden's prayer, excuse me, but because it is going to benefit the industry, it is going to benefit the employees, and it is going to eliminate this bad image that has been created by this Penn Central fiasco.

Senator HARTKE. In regard to the funds themselves, as I understand it, you are insisting, or would insist the funds be utilized for the basic purposes of transportation, that is, improving facilities and for the management and operation of the transportation business itself. Is that correct?

Mr. C. L. DENNIS. That is correct. Not for paying off loans to banks.

Senator HARTKE. Yes, I understand that.

You would limit that. But what would there be to prevent a railroad from taking these funds and making sure they were earmarked all of the way through and then taking other funds which ordinarily might be utilized for maintenance and operation, and channeling those for other purposes.

Mr. L. E. DENNIS. The key word, Senator, would be improvement. We propose that these loans be made for improvements, not for simply maintenance of what they already have, but for new capital investment, essentially.

The problem at this point is there appear to be very few available funds for new capital investment. The 1958 Act in reality went back and covered previously expended funds for capital investments.

This would not be possible under our proposal. This would be directly related to new investments and new capital expenditures.

One might say they were going to build the boxcars anyhow, that they might perhaps charge off that against this, but with the money

[1] See Treasury Department letter in part 3 dated January 8, 1971.

market the way it is, and with the interest rates the banks are charging, the fact is most railroads are not making the capital improvements that they should be making to improve their service.

Senator HARTKE. Would this money be available to the Penn Central while it is in reorganization, in your opinion?

Mr. L. E. DENNIS. Yes. We believe the bill should be drafted in such a way that it would and should be.

Senator HARTKE. Would it be available to keep railroads out of bankruptcy?

Mr. L. E. DENNIS. In the sense that it would allow them a diversion—the capital improvements could be made with this money and they would therefore be able to use other money to meet whatever debt-service problems they have, or other financial problems; and, yes, it would help railroads or help to prevent railroads from going into bankruptcy.

One point just for the record——

Senator HARTKE. Is that a good utilization of your trust funds?

Mr. L. E. DENNIS. I think—that is exactly what I was getting to. First we have to look at what is the railroad retirement fund. It is usually compared to the social security fund. It is not the same thing.

Social security is a base retirement fund, the railroad retirement fund amounts to almost double that in most cases.

In fact, it is a combination of a Government sort of plan and the equivalent of a privately bargained pension plan which you find in most other organized industries.

Those privately bargained plans, you will find, when you examine them, are consistently reinvested in the industries out of which they came. This is a national development in the whole history of pension trust funds. So that in looking at our supplemental account, our supplemental retirement system, which is obviously a union-negotiated fund administered by the Government, that part at least we could say is the equivalent of a private pension fund that you would find in other industries that are less compelx.

So I think it is a completely appropriate and proper utilization of the monies in this fund.

Senator HARTKE. There is no question that if you did it at this rate, you would move, you say, above the prime rate, which means you would receive maybe 3 percent more than you are receiving now. Is that right?

Mr. L. E. DENNIS. Right. It would tremendously enhance the viability of the fund, the fund now, of course, operates on a declining basis because of declining elements in the industry and we have to compensate for that in some way.

This would be a significant way of doing it, by investing it at a much better rate of interest. And it would provide the services and the changes that our people have demanded.

Mr. C. L. DENNIS. In fact, Senator, the bill just recently passed providing for a faster turnover of the lower interest yielding paper, "our 15 percent bill," also provides that a commission be established to investigate the railroad retirement fund and the Railroad Retirement Act, to see where we are going 5 or 10 years from now, because of the number of people in the railroad industry and the

larger number taking pensions, and, of course, compared with social security, with just the opposite being true, an expanding base, more people paying in to social security, and a smaller proportionate number taking pensions to the base. We have had a problem, we want to do what we can to correct any deficit that might appear in the railroad retirement fund.

Our 5 billion dollars keeps growing every year, but, we don't think we have been getting enough interest. But we have 5 billion dollars there.

Social security has about $27 million in their reserve. But they have 75 to 80 times as many people under social security as we have under railroad retirement. They have only six times as much in reserve, but 75 to 80 times as many people.

And so this commission is supposed to study the Railroad Retirement Act and, I think, in 18 months, make a recommendation back to Congress.

Mr. L. E. DENNIS. One of the fears of the Senate-House Conference Committee on H.R. 15733 was that the declining base was going to put the Government in a position where it might have to subsidize the fund eventually.

The kind of proposal we have presented here, I think, would go a long way toward alleviating that very problem. So we are talking about a Government subsidy of the retirement fund if we don't do something. We are talking here about a way of avoiding that kind of subsidy and at the same time assisting the industry.

Senator HARTKE. I want to thank you gentlemen. Certainly we will submit this proposal to those individuals, other unions and management and whatever other pertinent people we think will be concerned.

I gather what you are saying is you prefer to have this money used to fight to save the railroads rather than fighting to save Vietnam.

Mr. L. E. DENNIS. Yes, sir.

Senator HARTKE. All right.

Mr. Paul A Gorman, chairman of the board of Penn Central and Mr. O'Herron, executive vice president in charge of finance.

Senator HARTKE. You may proceed, sir.

STATEMENT OF PAUL A. GORMAN, CHAIRMAN OF THE BOARD, PENN CENTRAL CO., AND JONATHAN O'HERRON, EXECUTIVE VICE PRESIDENT OF FINANCE

Mr. GORMAN. Thank you, Mr. Chairman. My name is Paul A. Gorman. I am chairman of the board of Penn Central Co.

Since June 8 of this year—at that time we had a reorganization and I assumed that title—I have only been with the railroad 8 months and I am not a railroad man. I don't pose as one. But I have been a businessman for over 40 years and I do know a profit and a loss, and I know good service from bad service and I also know that the only thing we have to sell in the railroad industry is service.

I came to the railroad because I thought that something had to be done to improve the railroad situation. And I thought that if

anyone could do it, I could. I believe I have made a contribution to the railroad since I have been there and certainly there is a lot more improvement to be made.

I can tell you that we have a fine group of employees and officers in the railroad and they are anxious to make that improvement.

My remarks this morning should be considered as those of an individual because the trustees are in effect running the railroad. I am only there for a period where we can have an orderly transition of the supervisory functions to the trustees.

As I started to say, my philosophy for improving the railroad is to identify the loss areas and also to maximize our profits in those areas where we are making a profit, To sell more of that kind of business. Our main loss, as I have been able to determine it, has been in the passenger service end of the railroad. And the losses have been something in the order of $100 million on a fully allocated cost-basis per year and about half that, or possibly a little more, on an out-of-pocket basis.

Longhaul passenger service in my opinion is an economic waste, because on some days there are fewer people riding the train, for example, from New York to Chicago, than there are crewmen by the time the train gets there. On the other side of the coin, I am convinced the only way mass transit can succeed, commuter traffic can succeed, is that rail be a part of that, because they can haul a lot of people in a very short time.

In connection with the economics of the business, our economic health is sort of in the hands of the ICC. They approve our tariffs and there was an increase of 6 percent last November, and another one just announced recently, where it is now 6 percent as of June. And they also approve the number of trains that are run.

We have made a filing to discontinue 34 longhaul passenger trains. If those are approved, it is estimated that more than $20 million could be saved on an out-of-pocket basis. We also think that because of the merger quite a number of miles of our track are now superfluous, and in fact we have identified about 5,700 miles of track that should be abandoned.

The ICC has been informed of this. Some formal applications have been made for certain segments and we are in the process of abandoning some of those segments. This is all primarily freight and it is in areas like abandoned coal mines and spur tracks, things like that, that could easily be abandoned without harming anybody.

Our own management improvements in the railroad go to the point of trying to be more efficient, getting employees to be more efficient, and I suspect that the number of employees at the end of the year will probably be some 4,000 less than when we started, because of combinations of jobs and retirements, things like that, where the people are not being replaced.

In fact, the number of regions on the railroad have been cut from eight to six and a number of those areas, similar areas, have been taken care of already. I would like to make a statement that the railroad didn't get where it is overnight. Frankly, I don't think it is going to get the kind of improvements to bring it back to where it ought to be overnight either.

The problems are many, they are difficult, and it will take some time to solve them. I can tell you that there are over 90,000 employees and management people on the railroad trying to improve service and there are thousands of shippers who want that service improved and they are depending on us.

I happen to believe that the railroads are important to this country and that the country needs them, and the country needs the Penn Central. I think the railroads are worth saving. And I think possibly the bill that I am here testifying on this morning would be helpful in that direction.

I think also that the trustees may find it necessary to raise some money and they could do this through the route of trustee certificates, and maybe a guaranty of the nature that is included in this bill would be helpful to them. I would hope so. That is the end of my statement.

Senator HARTKE. All right, sir.

Mr. O'Herron.

Mr. O'HERRON. Yes, sir, good morning Senator Hartke. I am executive vice president in charge of finance of the Penn Central Co.——

Senator HARTKE. They need one.

Mr. O'HERRON. (continuing) Subsidiary of Penn Central Transportation Co. My headquarters are in Philadelphia. I joined Penn Central about a year ago. I had been executive vice president and treasurer of the Buckeye Pipe Line Co. which is a wholly-owned subsidiary.

My remarks this morning were prepared for submission to the committee in mid-July, before the appointment of the trustees, and therefore the opinions I express are my own and not necessarily the views of the trustees, although I have reviewed the statement in depth with many of my associates at Penn Central.

I appreciate the opportunity to appear before this committee to express Penn Central Transportation Co.'s wholehearted support of legislation that will provide Government guarantees for loans to railroad companies. Prompt passage of such legislation is urgently needed to provide for continuation in the public interest of railroads whose operations are in jeopardy and whose borrowing power, like that of Penn Central, is virtually exhausted.

A few weeks ago, I guess it was over a month ago, I appeared before the House Commerce Committee to testify in behalf of H.R. 18125. My strong support of this proposed legislation was somewhat overshadowed, in the press at least, by the attention given some of my observations regarding the role of the U.S. Government and its agencies and their relations to the plight of Penn Central Transportation Co.

I come before you this morning with some observations that I hope will clear up areas of possible misunderstanding and will assist the committee in formulating an approach to solving the problems of the railroad industry.

I have four principal points to make in my testimony this morning.

First, I would like to explain the relationship between the three principal companies that make up Penn Central.

Second, I would like to reflect on a few of the factors that, in my opinion, caused the Penn Central Transportation Co. to file for reorganization.

Third, I will give you some specific facts that should lay to rest the myth that Penn Central Transportation Co.—the railroad—has been bled of cash to support diversification into nonrailroad activities.

And fourth, I have some personal thoughts for your consideration that I hope might be useful in determining a solution to the problems of Penn Central Transportation Co. and other eastern railroads.

Senator Hartke, I know you have before you a chart depicting the organization of the Penn Central and the Penn Co., which I believe you have had a number of discussions on, so I would like to turn now to my second point, and I would like to make sure everybody here understands the scope of the Penn Central Transportation Co. and its railroad operations.

The railroad operates some 22,000 miles of line in 16 States, two Canadian Provinces, and the District of Columbia.

The railroad operates about 3,000 freight and passenger trains each day aand moves almost 1 million tons of freight and about 300,000 passengers each 24 hours.

The railroad provides jobs for more than 94,000 people with employment costs in excess of $1.1 billion annually.

The territory served by the railroad has a population of 100 million people, including 72 of the 195 metropolitan areas having populations of over 100,000.

The territory served by the railroad includes 55 percent of the Nation's manufacturing plants and 60 percent of the nation's manufacturing employees.

Turning now to my second point, the question continually being asked is how did Penn Central Transportation Co. get into such financial trouble. There are a number of problems common to the entire railroad industry that are most evident in eastern roads and most acute for Penn Central. I would like to comment on some of them:

(1) Passenger deficit: The Penn Central situation is aggravated by the burden of operating more than one-third of the Nation's money-losing passenger trains. Our passenger problem continues as the greatest single burden, and you have had discussions many times about the total out-of-pocket cost of running the passenger trains. I would like to illustrate that a minute.

I live in Darien, Conn., which is 37 miles from New York City. A commutation ticket per ride amounts to a little over $1. However, before the commuter gets on the train he parks his car in a private parking lot at a cost of 75 cents and picks up a newspaper for a cost of 15 cents.

Both the parking lot fees and the cost of the newspaper were recently increased 50 percent, but the rail fare is the same as it was in 1962.

(2) Archaic pricing: This is a very complex subject, and there are many rationales and opinions to reflect on when the subject of

railroad pricing is brought up. Let me present it very simply. The tariff rate for transporting an automobile by rail from Detroit to New York has increased from $34 in 1946 to $56 today—a rise of 67 percent.

Contrast this with the retail price of the automobile, which has risen over 200 percent. Please—I would like to make it clear I am not criticizing the automobile industry; they are among our best customers. All I am pointing out is that transportation rates by rail have not kept pace with price increases in other industries. Even Government-owned operations have to keep pace with increased costs. The July 20 *Wall Street Journal* has an article reporting that the Tennessee Valley Authority confirmed its plans to effect a rate increase that will increase the cost of electricity to the region's consumers by about 23 percent.

(3) The burden of competing against subsidized competition: The railroads also suffer the effect of huge Federal subsidies—normally granted in the form of assumed capital costs—given the railroads' competitors. To be sure, part of these subsidies are recovered in the form of user charges, notable from highway and air carriers, but even there the unrecovered portion has a major economic impact. I saw some figures the other day which indicated that Government expenditures for highways, air transport and waterways exceeded $20 billion last year.

The other day I saw an overlay of the Federal highway system on top of the Penn Central transportation railway network and you could hardly tell the difference.

If someone gets on the train and rides from New York to Boston, about 400 yards on either side you can see the Connecticut Thruway and various other highways paralleling the track.

I have two other points we have talked about before and this is the low utilization of freight car equipment and short average hauls, which I would like to have in the record, but I will pass to the third point.

My third point covers the myth that diversification bled the railroad of cash. Penn Central's much discussed diversification into nonrailroad investments was made largely between 1963 and 1968. In the same period management placed great emphasis upon its responsibilities in conducting railroad operations, investing $1.6 billion in plant and equipment—eight times the investment it made in diversification, and a substantial amount of these funds was generated internally from investments of the Pennsylvania Co.

I would like to discuss now an idea for solving the problems of the Penn Central. Plans must deal with both short-term and long-term solutions. The legislation your committee is considering is a clear first step to restoring a viable railroad industry in the east. Passage of legislation providing relief from the intercity passenger service burden will also represent a great step forward.

Our railroad is seeking to eliminate losses from commuter service and from uneconomic freight operations both through cooperation with governmental authorities and through regulatory relief. At the same time our company is involved deeply in far-reaching programs to improve our railroad efficiency.

I would like to suggest that a task force be formed under appropriate auspices to deal with this very complex matter. This task force would include representatives from the Government and its agencies, labor, shippers, the financial community and representatives of management of the eastern roads.

We need to obtain a fresh perspective through understanding and cooperation among diverse interests to reach mutually agreeable and advantageous solutions.

The objective of the proposed task force would be first to analyze and research the fundamental problems as they specifically affect Penn Central and other eastern railroads, some of which problems I have outlined to you this morning.

Second, the task force would be charged with the responsibility for examining alternate solutions and presenting a comprehensive series of recommendations for solving the problems common to the Eastern lines.

The kind of study I have in mind would in no way interfere with the ASTRO program which has been brought forward under sponsorship of the Association of American Railroads. It would, instead, complement this program by devising ways in which proposals of the ASTRO program can be adopted most advantageously to the Eastern roads.

By suggesting this task force, however, I do not want to delay any of the constructive proposals and legislation that are currently under consideration.

I submit that this task force should be activated promptly and should deliberate with all speed in order to make its recommendations by the early part of 1971.

In conclusion, I would like to submit for the record the text of an editorial from the *Wall Street Journal* of July 23. The thrust of this article is what is needed is a responsible rescue operation and not an attempt to assess the blame on anyone.

I would like to comment also on our cash position as of last night. We have $35.8 million in our bank account as of last night, compared with an estimate we made for the 7th of August of about $24 million. We are about $10 million, as of last night, higher than what we estimated.

Senator HARTKE. When was the estimate made?

Mr. O'HERRON. In the latter part of July for the month of August, but it was similar to the one we made in late June for the month of August. It is almost identical.

Senator HARTKE. Thank you.

I would like to comment before I ask any questions for the record, that since I have become chairman of the Surface Transportation Subcommittee, a little over a year ago, we have had innumerable hearings, some of them quite lengthy on transportation legislation.

I want to say that I agree with those people who have stated that at least the eastern railroads do have serious problems; I concur in that general overall approach. I concur that probably the blame is not all in one place, but it can be shared by the Congress perhaps, ICC, the administration, State and local governments, industry, labor, and so on.

But we have done more on this committee in this short year's time than just sit through hearings. We have taken some action. For example, this committee and the full Senate has approved a railroad passenger bill. The railroad passenger bill is still to be acted on by the House. A bill to eliminate discriminatory state taxation and we have passed a bill to extend the High-Speed Ground Transportation Act.

We have also begun an intensive review of the philosophy of transportation, including its impact on the environment through hearings on the national transportation bill, introduced by the chairman of this committee, Mr. Magnuson, cosponsored by myself and other members of this committee.

I just want the record to be made clear on this point. I do not intend to in any way hesitate to keep pushing for improved transportation facilities in the United States. And I am hopeful this financial failure of one segment of our transportation system, if it can be called a system, will give us some additional information upon which we can base some action, hopefully bold, innovative action, whether it be short term or long term, which will develop a better balance and consequently better service in the transportation of people and goods throughout the country.

Mr. O'Herron, I wonder if there is an explanation for the difference between your chart on the Penn Central, included as an exhibit to your statement, which omits one of the three principal holdings of the Penn Central Co. the 1969 Penn Central Annual Reports of Affiliated Corporations, and its chart, which bears the date of July 9, 1970, from the Penn Central Co. office of the president-comptroller, in that the Penn Central International is not listed?

Mr. O'HERRON. This book I know I sent you not too long ago. This chart that I believe you are looking at now was just an attempt to put forward the major operating companies, a schematic of the company.

Senator HARTKE. What is Penn Central International?

Mr. O'HERRON. Penn Central International is a shell company, not an operating company.

Senator HARTKE. A shell company for what purpose?

Mr. O'HERRON. The shell company was formed in Curacao as the vehicle for borrowing $59 million in Swiss franks in Europe. It is a standard method that is used in order to borrow foreign currencies.

Senator HARTKE. This was borrowed from the Swiss banks, right?

Mr. O'HERRON. That is correct.

Senator HARTKE. You say it is a standard procedure; for whom?

Mr. O'HERRON. For any company borrowing foreign currencies. You set up a Curacao company or a company domiciled outside of the United States as a shell company.

Senator HARTKE. What is the reason that you need a shell company?

Mr. O'HERRON. The basic purpose of the shell company has to do with some complex provisions, of both the United States and foreign tax codes, in order that you do not have to withhold dividends on interest paid to foreigners. And this is reciprocated

by the fact that the dividends are not withheld in the foreign country.

Senator HARTKE. In the report of the stockholders registered on the books of the company as of June 15, 1970, and owning at least 1 percent of the outstanding stock of the company, as submitted to the ICC on July 13, there are listed two Swiss banks holding in excess of one million shares of stock between the two of them. Do you know who the beneficial owners of these stocks are?

Mr. O'HERRON. I do not know the beneficial holders of any of our common stock. As you well know, sir, many shareholders maintain nominee accounts, it is a very standard practice, in the United States it is common practice and we have never tried to pierce through, we have never had a reason to and could not do it if we wanted to.

Senator HARTKE. You do not think the railroad can pierce that veil either?

Mr. O'HERRON. No, sir, in terms of a nominee, this would be against the law for the nominee to tell us.

Senator HARTKE. Mr. Gorman, will the legislation which is before us at the present time help the Penn Central in its reorganization?

Mr. GORMAN. This is a personal opinion. I think it would help the trustees, possibly, if they decided to issue trustee certificates, to get those sold.

Senator HARTKE. Can the railroad keep on running for any length of time without this legislation?

Mr. GORMAN. That is a matter that the trustees should answer themselves. But I think there has to be an infusion of new money in here in order to keep it going.

Senator HARTKE. How long can they meet the payrolls at the present rate without an infusion of new money?

Mr. GORMAN. I will refer that to Mr. O'Herron. I think he has a cash flow statement here.

Mr. O'HERRON. I have submitted a cash flow statement to various committees and people in Washington who asked for it. I will just give you the facts I have submitted.

I have testified previously that the total cash requirements of the Penn Central, based on our forecasts, for the balance of the year in order to maintain a $30 million cash position, would be approximately $60 million. And this estimate was made in the latter part of July.

At this date I have no reason to change it. And we have applied to the ICC and to the judge to issue $50 million of trustee certificates.

As of the moment, the 7th of August, I am a little bit more optimistic than my figures indicate. On the other hand, 10 days from now I might be a little more pessimistic.

Senator HARTKE. According to the report which you submitted to the ICC, and your estimates at that time, you indicated there would be $37.4 million in July, but a cash overdraft of $30.2 million is forecast by December 31, 1970, is that correct?

Mr. O'HERRON. Yes, sir.

I just worked the arithmetic back. If you look at that, we indicate if we do not get an infusion of money, we will be at a negative $30 million. What I am saying is we ought to have about $30 million in our bank accounts, so, therefore, we need $60 million.

Senator HARTKE. So you need $60 million to keep operating?

Mr. O'HERRON. To keep $30 million in our bank accounts. We can probably operate with slightly less than $30 million.

Senator HARTKE. Unless you have an infusion of something of that nature, in other words, you will not be able to continue to operate the railroad; is that correct?

Mr. O'HERRON. That is correct, that order of magnitude. Based on our forecasts as of this moment, which in the past couple of months have been very accurate.

Senator HARTKE. How soon will they need this cash?

Mr. O'HERRON. Based on our daily forecasts, which we have done for the month of August and we have started to do it for September, as of today I would feel fairly uncomfortable if, looking forward, I could not see the cash coming in by the latter part of September.

Senator HARTKE. In other words, we are faced with a deadline, we have a swinging sword coming at us in October, October 1?

Mr. O'HERRON. I would say the latter part of September to be conservative, based on exactly what I see today, I can see us being able to continue to operate through mid-September.

Senator HARTKE. That is not a very pleasant picture.

Mr. O'HERRON. No, sir; it is not.

Senator HARTKE. We did not get a very pleasant picture from the Penn Central Co. yesterday either, did we?

Mr. O'HERRON. That is correct.

Senator HARTKE. I will note for the record the loss report of the Penn Central was for the period ended before the appointment of the Federal trustees to administer the railroad's affairs and the report does not therefore represent that of the trustees and is subject to readjustments, and that means either way?

Mr. O'HERRON. Yes, sir.

Senator HARTKE. In our attempt to receiive some of this information it has been brought to the attention of the committee that the Penn Central's management has refused to accede to the request of the ICC accountants that they be provided with working papers. Earlier they said the ICC said it was Peat, Marwick and Mitchell, and they had refused. Now it is understood it is the Penn Central which refuses.

I understand the trustees have agreed to fully cooperate with ICC on this, but the question still remains why did management and why did the accounting firm refuse to provide this requested information considering the circumstances?

Mr. GORMAN. I cannot tell you why the accounting firm did. But I think this committee and the ICC ought to have access to any information we have.

Mr. O'HERRON. I can respond to that in some detail. From the press I think it got a little garbled what working papers someone was referring to. These were working papers that pertained to the year ended 1969, closing, December 31, 1969 closing. It had nothing to do with the proposed Government loan, because there were no working papers whatsoever.

Senator HARTKE. What was there to hide in the 1969 report?

Mr. O'HERRON. There was not anything to hide at all.

Senator HARTKE. If there is nothing to hide, why didn't they provide them?

Mr. O'HERRON. Mr. Hanson of Peat Marwick spoke with Mr. Paolo yesterday and they have the papers. They are available to them.

Senator HARTKE. I know they agreed, now. But this is under the authority of the trustees. Why did the management refuse?

Mr. O'HERRON. No.

Senator HARTKE. They did not refuse?

Mr. O'HERRON. In our discussions with Mr. Paolo we made the point these working papers were the property of Peat Marwick Mitchell & Co., not the property of the Penn Central Co.

Senator HARTKE. And Penn Central Co. paid them?

Mr. O'HERRON. They paid for the services rendered by that firm. Let me go a step further. This is not customary; in fact, it is highly unusual for any accounting firm, to my knowledge, to provide working papers for any outside organization. In other words, this is private industry and I guess there is probably some legal restrictions to it.

Senator HARTKE. It is under the jurisdiction of the ICC which is designed basically, whether it works this way or not, to improve the transportation system, to help it.

Was there something to hide?

Mr. O'HERRON. Absolutely nothing. They had the papers, and we presented this to Mr. Paolo yesterday. As Mr. Gorman says, our whole records are an open book and we made that very clear to ICC in the past couple of weeks.

Senator HARTKE. All I can say is the ICC indicated to us that this prevented them from making that type of judgment which they thought was necessary. I could not understand why it would take such prodding to break some of this material loose. I understand, Mr. Gorman—of course you have been in charge of the operation only a short time and of course—do you intend to leave soon? Is that a fair question?

Mr. GORMAN. Tuesday.

Senator HARTKE. Well, that is soon. That is right. Can you tell us, though, in spite of the fact that you were there a very short time, and do intend to leave this coming Tuesday, what can be done to preserve this company, or should it be preserved. I suppose that is the first question. Should the company be preserved? Some people question whether or not the railroad industry has a place in the public transportation business.

Mr. GORMAN. I thoroughly believe there is a place for it. I don't think this country can afford to be without a railroad system. But it doesn't necessarily mean we have to have all of the trackage that we have today. There are many areas where we may deliver only one freight car a month over a line of 100 miles. That is uneconomical. It ought to be discontinued. And that is part of the 5,700 miles of trackage that I recommend be discontinued. It is in the process of being considered by the ICC now. But you see we are regulated and the railroad can't stop those uneconomical operations just when they want to. It requires approval and maybe a hearing. That is as

it should be, as long as we are a public utility. But to answer your question, I think this country needs the railroads. I don't think we can in time of emergency get along without them. All you have to do is have one traffic jam today on any highway and things stop, particularly around the large cities.

Sure, the railroad service has not been as good as it should be, but it doesn't stop by a traffic jam of that sort. I just think it is a necessity for this country to maintain at least the freight operations of the railroads.

Senator HARTKE. You question, then, by implication at least, whether or not it should continue to be in the passenger business whatsoever?

Mr. GORMAN. The long-haul passenger business I question very seriously.

Senator HARTKE. How about short haul?

I think in the short haul, in a highly populated area like the Northeast quadrant, there is a place for the rail business. And certainly there is a place in the commuter end of the business. Who should run it in the commuter end of the business is another question. I frankly believe that this is a State and local obligation and it does not necessarily mean that stockholders ought to provide that money unless the public is willing to pay enough in terms of rates to support the industry.

Senator HARTKE. How much fare increase in your opinion would be necessary, Mr. Gorman, to make the fares compensable as far as the requirements of the operating expenses are concerned?

Mr. GORMAN. In the commuter end?

Senator HARTKE. An across the board.

Mr. GORMAN. I think they probably would have to be double.

Senator HARTKE. Double for the commuter end for the short haul?

Mr. GORMAN. Right now, however, we are going forward with a 25 percent increase in New Jersey. This is the first attempt to get a rate increase in 10 years in the commuter traffic. And costs and everything else have gone up tremendously in that period of time.

Senator HARTKE. Have you filed for such a rate increase?

Mr. GORMAN. Now we have, yes.

Senator HARTKE. When?

Mr. GORMAN. Within the last month or so. The last several weeks.

Senator HARTKE. You were elected in September, is that correct?

Mr. GORMAN. No, December—well, I came on the property December 1.

Senator HARTKE. But you were elected in September?

Mr. GORMAN. To the board.

Senator HARTKE. Yes. I thought you were elected president at that time.

Mr. GORMAN. Effective December 1.

Senator HARTKE. Yes.

Did you realize at that time when you were elected in September the financial difficulties of the Railroad?

Mr. GORMAN. No.

Senator HARTKE. When did you first learn that it was in serious financial difficulty?

Mr. GORMAN. It is kind of hard to say. But when you find that you have to borrow money to keep going, and that reached my attention earlier this year.

Senator HARTKE. The board did not inform you of its serious condition, although all of these people that have come in here, including the chairman, Mr. Saunders, and Mr. Bevin, the financial manager, told you the last half of 1969 was very bad, they didn't warn you about this?

Mr. GORMAN. Well, it isn't the board's job to warn me on that score.

Senator HARTKE. Why not? You mean you are supposed to know it on your own?

Mr. GORMAN. I am grown up and if I can't determine that from whatever financial information I have, that is my problem.

Senator HARTKE. Well, but you see I don't look upon this as a personal problem of yours. I think that the problem here is that this is a problem for the country and they didn't take the time or the effort to warn you about the impending financial problems of the Penn Central?

Mr. GORMAN. Mr. Saunders told me they were short of cash. That is all I was told about the financial condition of the company.

Senator HARTKE. When did you really feel definitely that you were in trouble?

Mr. GORMAN. Well, in the period of, I guess, about May, when the attempt to get bank loans failed.

Senator HARTKE. In other words, you were not a participant in the procedures which came here in March and talked to the Federal officials about the difficulties financially.

Mr. GORMAN. No. You see the division of responsibility on the railroad was this: Mr. Saunders was the chief executive officer, and he had certain organizations reporting to him. Mr. Bevin was the chief financial officer. He had certain responsibilities under his wing. And I had the responsibility for the operation of the railroad. And believe you me, that is a tremendous job.

Senator HARTKE. I understand that that is a tremendous job. But you mean to say they didn't keep you informed?

Mr. GORMAN. Well, it is a question of what you call being kept informed. Not on a day to day basis, of course not.

Senator HARTKE. I am not talking about a day to day basis. You indicated you didn't really know about the condition until May. Everyone else indicated they knew it earlier this year. No one has given us that late a date of the impending disaster.

Mr. GORMAN I said in May I was aware of the fact that they were having difficulty getting bank loans.

Senator HARTKE. I am talking about when you were aware of the fact of the impending financial crisis.

Mr. GORMAN. If you mean bankruptcy by your reference to financial crisis, that depended on whether or not the bank loans were available. If they were available——

Senator HARTKE. I didn't say anything about bankruptcy. The fact of the matter is the railroad is not in bankruptcy today, it is in reorganization. But what I am asking you is a rather simple question,

I think. You had a real serious problem on your hands financially, at least in May, there is no question about it, when the bond issue didn't go through. But before that you certainly must have been alerted by someone in the operation that things were not going very well and you had serious problems, you were faced with a big loss in the first quarter.

Mr. GORMAN. Well, we had a big loss in the last quarter of last year.

Senator HARTKE. Yes. That is when you first came aboard.

Mr. GORMAN. I came aboard December 1.

Senator HARTKE. The first thing you were faced with was a tremendous loss as compared to an estimate to the contrary.

Mr. GORMAN. That is right.

Senator HARTKE. And this gave you no warning whatsoever?

Mr. GORMAN. Oh, certainly. I was aware we had a loss.

Senator HARTKE. What did you do about it? Anything?

Mr. GORMAN. I set about to try to develop a program to improve the situation. We got our budgets set for the first time in the railroad, and had them approved by the board in January.

Senator HARTKE. Did you see the budget proposals of Mr. Perlman which he submitted?

Mr. GORMAN. No.

Senator HARTKE. Mr. Saunders didn't show those to you?

Mr. GORMAN. At what time did Mr. Perlman submit the budgets?

Senator HARTKE. As I recall, some time in June of 1969. He said they stayed on the desk.

Mr. GORMAN. I don't know where they were. But I came on the property December 1, and the first order of business was to get the budget going for 1970.

Senator HARTKE. But you didn't have the opportunity to review the budget proposals of Mr. Perlman, who had been operating the company before.

Mr. GORMAN. That is right.

Senator HARTKE. Any reason you can give us why they would not have been given to you, the benefit of the previous operating chief executive?

Mr. GORMAN. It may have been there. I am not saying I was denied it, understand.

Senator HARTKE. But you didn't see it?

Mr. GORMAN. No.

Senator HARTKE. When did you first fear you would have to go into reorganization?

Mr. GORMAN. I beg your pardon?

Senator HARTKE. When did you first have the fear you would have to go into reorganization? When did that occur?

Mr. GORMAN. It occurred when the Government guarantee of loans was denied the railroad.

Senator HARTKE. Did you suggest at that time any other methods of raising cash?

Mr. GORMAN. I think all other methods had been exhausted.

Senator HARTKE. Can you explain for the record who is involved in the reorganization, that is, what power do the trustees in bank-

ruptcy really have over the assets of the Pennsylvania Co., that is the holding company itself?

Mr. GORMAN. The Pennsylvania Co. is not really the holding company. The Pennsylvania Co. is an investment company that is 100 percent subsidiary of the Transportation Co. and they have full power over that.

Senator HARTKE. What power do the trustees have over the assets of the Pennsylvania Co. They are not involved in reorganization——

Mr. GORMAN. No, they are not in reorganization and they have full power, if they would exercise it.

Senator HARTKE. What about the assets? Are there any assets there of the Pennsylvania Co. which could be touched in order to help the Transportation Co.?

Mr. GORMAN. The assets are there, but the stock is pledged, as I understand it, for loans that have been made and the money found its way into the Transportation Co.

Senator HARTKE. Do you have any idea what assets are encumbered, and which are not, either you or Mr. O'Herron?

Mr. O'HERRON. Yes. Let's go back to the Pennsylvania Co. I believe you know the assets that are essentially in Pennsylvania Co. They are Norfolk & Western stock, which is encumbered, the Arvida stock which is not encumbered, Great Southwest which is not encumbered and Buckeye Pipe Line Co. Those are the principal assets. Buckeye Pipe Line is encumbered. The stock of Pennsylvania Co. is held as collateral against a $300 million bank loan in the Transportation Co. There are also other debts in Pennsylvania Co., which I feel, based on certain legal opinions that have been rendered to me, has priority over any of the assets in Pennsylvania Co. before the Transportation Co.

Senator HARTKE. Mr. Gorman, on June 10 did you make a speech concerning the prospects for the Penn Central Railroad?

Mr. GORMAN. I didn't make any speech. I have not made any public speeches. There may have been a press conference on that date.

Senator HARTKE. Didn't you talk to some investment executives at that time?

Mr. GORMAN. No, sir. I have never talked to any investment executives.

Senator HARTKE. You didn't talk to the Federal Reserve people, members of the Federal Reserve Board?

Mr. GORMAN. No, I haven't talked to the members of the Federal Reserve Board at all.

Senator HARTKE. On June 10, you made a statement someplace:

> The management of the company has recently been changed by the replacement of the executive officer.

This is a statement from the Federal Reserve Bank of New York that I am reading from.

> In a recent statement, the new chief executive described his plans to recruit a new management team with particular references to improving the chief operations officer and improving the chief financial officer.

Isn't it true you gave a rather glowing account at that time of some of the things that could be accomplished to improve the company's position.

Mr. GORMAN. I don't consider it a glowing account at all. This date is not June 10. I didn't ever meet with the members of the Federal Reserve bank. I met a group of representatives of other banks. I can't tell you the exact date, but it can be determined.

Senator HARTKE. All right. Was that at the Federal Reserve bank?

Mr. GORMAN. Yes.

Senator HARTKE. What in substance did you say at that time? Did you give an indication at that time of the impending financial collapse of the railroad?

Mr. GORMAN. I said about what I said here today, that we have a good management group there, we have 90-odd thousand people that are interested in making this railroad go, that we needed financial assistance, and that I felt that with that assistance, we could make it go.

Senator HARTKE. Let me ask you this: There have been some allegations about Penn Central's management problems. In your opinion how good are the controls over inventory and scrap, scrap sales?

Mr. GORMAN. Well, I think——

Senator HARTKE. Let me be specific. It has been brought to the attention of the committee that in Selkirk, N.Y., the Penn Central storage depot inventory indicates there is between $15 to $18 million shortage of materials in stock.

Mr. GORMAN. I would say that that couldn't possibly be true.

Senator HARTKE. That is not possibly true?

Mr. GORMAN. No.

Senator HARTKE. About how much shortage is there?

Mr. GORMAN. I don't know how much shortage there is. But I can tell you the total inventory on the railroad, the whole railroad, probably is not more than about $90 million. Certainly that much in Selkirk would be unusual at any one time.

Mr. O'HERRON. We are running that rumor down, Senator Hartke. I got a call from the ICC on it.

Senator HARTKE. Yes. We will have the ICC look into it. What about the alleged shortage in Indianapolis?

Mr. GORMAN. I don't have any knowledge of it. The auditors are checking, because there is a rumor and we always check those things out.

Senator HARTKE. And a shortage of funds, right?

Mr. GORMAN. Anything that doesn't look right.

Senator HARTKE. But you are aware of that rumor?

Mr. GORMAN. Yes, sir; as of yesterday.

Mr. O'HERRON. The third one was dismantling some freight cars.

Senator HARTKE. That is right.

Mr. O'HERRON. One was a facility at Omaha, Nebr., and we don't have any facilities there.

Senator HARTKE. How about Kankakee, Ill.

Mr. O'HERRON. We are looking into that one.

Senator HARTKE. All right. Would you submit that information to the committee when you find out about it? [1]

Mr. O'HERRON. Yes, sir.

Senator HARTKE. You are checking into those?

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[1] See letter of Dec. 22, 1970 from the Penn Central Co. in part 3 of these hearings.

Mr. O'HERRON. Absolutely sure.

Senator HARTKE. And ICC has alerted you to that.

Mr. O'HERRON. Yes, sir, with a phone call. We said thank you very much and got right on it and informed Mr. Gorman.

Senator HARTKE. Just a few questions on your statement, Mr. O'Herron.

You refer to an item which was included in your statement, which you passed over, low utilization of freight car equipment. Whose fault is that, really? Isn't that the railroad's fault?

Mr. O'HERRON. Certainly, it is a portion——

Senator HARTKE. In other words, it is not the fault of the ICC or Congress that you cannot fully utilize the freight cars?

Mr. O'HERRON. No, as I say, these are the types of things we would like to start on, and trying to find out whose fault it is, what the problems are.

Senator HARTKE. It is not the Government's fault?

Mr. O'HERRON. Oh, no.

Senator HARTKE. It is management's fault? Is it unmanageable?

Mr. O'HERRON. No, it is not unmanageable. I don't believe any problems in business are unmanageable.

Senator HARTKE. You disagree with Mr. Saunders who said it was unmanageable?

Mr. O'HERRON. I didn't see the context of what that phrase was used in.

Senator HARTKE. I saw the context. He said it couldn't be managed. He said it wasn't a question of bad management.

Mr. O'HERRON. I think I know what he had in mind, a lot of problems are beyond our control, that we need additional assistance from various other groups in order to solve the problem.

Certainly a lot of them we can solve ourselves, but we need a lot of help from other groups.

Senator HARTKE. On page 8 you refer again to what we have heard repeatedly in these hearings, what I call the doctrine of truth by assertion, rather than by facts, and that is a philosophy which has extended outside of the field of the Penn Central. I mean, there are certain places in Washington where also that seems to be the prevailing philosophy.

But anyway here is a situation, you say eight times the investment in plant and equipment as it made in its diversification, a substantial amount of these funds have been generated internally. But we have never been able to find out the shift of cash, the stock options, how they were pledged.

We went through one of the options yesterday to some extent, superficially in my opinion. But could you unravel how all of these things, 175 corporations move back and forth and who used what for what.

Mr. O'HERRON. I think we would be here for another week.

Senator HARTKE. Longer than a week.

Mr. O'HERRON. At least a week.

Senator HARTKE. In the short time you have been there, have you been able to unravel any of them.

Mr. O'HERRON. There has been considerable interest and discussion on this. I have appointed a group of my associates, including some outside auditors, and this was appointed over a month or 3 weeks ago, to put this down into the most infinite detail so that everybody who wants to look at it and get the response to any of your questions, it will be done.

Now, Pennsylvania Co.——

Senator HARTKE. I wish we had other people as cooperative as you are.

You are going to submit that to us, right?

Mr. O'HERRON. It is, yes, sir. We have so much to submit, but we want to try to solve the future problems and then if we have enough energy left, we will come back and do some of the spade work. But we will try to do both simultaneously. We have been going 7 days a week, 14 hours a day on this problem. I would like to submit for the record that all of us are very, very sorry to see Mr. Gorman leave.

Senator HARTKE. You refer to the questions of differences in operating conditions in the East and West and South and you refer to how you have been mired down with similar handicaps.

Why don't you proceed on an industrywide basis to make those applications in your rate cases on a regional basis?

Mr. O'HERRON. I think this is under consideration right now. There is a rate increase, I understand, that is being discussed within the industry and there might very well be a regional one.

Senator HARTKE. You refer to the ASTRO program, and not overly enthusiastically.

Mr. O'HERRON. I am very enthusiastic about anything where we can buy or lease equipment.

Senator HARTKE. Then you discuss your proposal for a task force.

Mr. O'HERRON. Yes, and this is a very imaginative one, like Mr. Dennis' proposal, which I thought was very imaginative. We had some conversations this morning and I think I can say that he thinks our approach to establish a task force would be useful and constructive to think about.

Senator HARTKE. Are you leaving, too?

Mr. O'HERRON. No, sir.

Senator HARTKE. You are going to stay with the trustees?

Mr. O'HERRON. They have asked me to stay and I have responded that I would.

Senator HARTKE. I personally am glad. I am glad you are going to stay.

Mr. O'HERRON. It is public service, Senator, I assure you.

Senator HARTKE. Let me say to you, I haven't passed out many compliments in these hearings; I compliment you at least on your

approach in coming up to say that you would like to come up with a task force to deal with these complex matters, and with a fresh perspective.

I just hope that you can continue to move in that fashion. I want to assure you that as far as I am personally concerned and I believe the committee, we will be more than interested in trying to cooperate with that type of approach.

Mr. O'HERRON. A lot of people say the railroads have been studied to death for years and years and maybe this is true, but Mr. Dennis and I are willing to take another whack at it anyway.

Senator HARTKE. I want to thank you for coming and being with us.

(The statement follows:)

STATEMENT BY JONATHAN O'HERRON, PENN CENTRAL EXECUTIVE VICE PRESIDENT

Mr. Chairman and members of the committee, I am Jonathan O'Herron, Executive Vice President in charge of finance for Penn Central Company and its wholly owned subsidiary, the Penn Central Transportation Company. My headquarters are at Six Penn Center Plaza, Philadelphia, Pennsylvania. I joined Penn Central a year ago and previously was executive vice president and treasurer of Buckeye Pipe Line Company, a wholly owned subsidiary.

I appreciate the opportunity to appear before this Committee to express Penn Central Transportation Company's wholehearted support of legislation that will provide Government guarantees for loans to railroad companies. Prompt passage of such legislation is urgently needed to provide for continuation in the public interest of railroads whose operations are in jeopardy and whose borrowing power, like that of Penn Central, is virtually exhausted.

A few weeks ago, I appeared before the House Commerce Committee to testify in behalf of H.R. 18125. My strong support of this proposed legislation was somewhat overshadowed, in the press at least, by the attention given some of my observations regarding the role of the U.S. Government and its agencies and their relations to the plight of Penn Central Transportation Company. I come before you this morning with some observations that I hope will clear up areas of possible misunderstanding and will assist the Committee in formulating an approach to solving the problems of the railroad industry.

I have four principal points to make in my testimony this morning. First, I would like to explain the relationship between the three principal companies that make up Penn Central. Second, I would like to reflect on a few of the factors that, in my opinion, caused the Penn Central Transportation Company to file for reorganization. Third, I will give you specific facts that should lay to rest the myth that Penn Central Transportation Company—the railroad—has been bled of cash to support diversification into non-railroad activities. And fourth, I have some personal thoughts for your consideration that I hope might be useful in determining a solution to the problems of Penn Central Transportation Company and other Eastern railroads.

Attached to this statement is a simple chart depicting the principal components of the Penn Central Company. The Penn Central Company was formed as a holding company on October 1, 1969, and at that date acquired all the common stock of the Penn Central Transportation Company. The Transportation Company has controlling stock interest, directly or indirectly, of some 170 companies, including a number of small operating and lessor railroads. At the time that the holding company was formed, its only asset was the

stock of the Transportation Company. Subsequent to October 1, 1969, there has been no asset rearrangement for the benefit of the holding company at the expense of the Transportation Company, and none of the assets of the Transportation Company has been used to the benefit of holding company activities. On the contrary, the credit of this newly formed holding company was used to borrow $59 million, and the proceeds of this loan have been employed by the Transportation Company. The only acquisitions made by Penn Central Company occurred in February of 1970, when two oil companies were purchased in exchange for an issue of convertible preferred stock. Not a dime of cash was used for these acquisitions. These two companies, together with the Transportation Company, are the only operating assets of Penn Central Company.

Perhaps part of the confusion about Penn Central's corporate structure is the seeming overlap of corporate names. We have Penn Central Company, Penn Central Transportation Company, and Pennsylvania Company. I have covered the first two names, and now I would like to focus on the most significant subsidiary of Penn Central Transportation Company; namely, Pennsylvania Company.

Pennsylvania Company operates as an investment company, with its principal interests in companies not directly related to the railroad operations of the Transportation Company. The Company's investments include holdings in Norfolk & Western Railway Company and other railroads, all of the common stock of the Buckeye Pipe Line Company, and controlling interests in two real estate development companies, Great Southwest Corporation and Arvida Corporation. In a few minutes I will focus on how Pennsylvania Company acquired these assets.

Before turning to my second point, I think it might be of interest to state some specific facts regarding the scope of railroad operations of the Transportation Company:

1. The railroad operates some 22,000 miles of line in 16 states, two Canadian provinces and the District of Columbia.

2. The railroad operates about 3,000 freight and passenger trains each day and moves almost one million tons of freight and about 300,000 passengers each 24 hours.

3. The railroad provides jobs for more than 94,000 people with employment costs in excess of $1.1 billion annually.

4. The territory served by the railroad has a population of 100 million people, including 72 of the 195 metropolitan areas having populations of over 100,000.

5. The territory served by the railroad includes 55 per cent of the nation's manufacturing plants and 60 per cent of the nation's manufacturing employes.

Turning now to my second point—the question continually being asked is how did Penn Central Transportation Company get into such financial trouble. There are a number of problems common to the entire railroad industry that are most evident in the Eastern roads and most acute for Penn Central. I would like to comment on some of them.

1. Passenger deficit—The Penn Central situation is aggravated by the burden of operating more than one-third of the nation's money-losing passenger trains. Our passenger problem continues as the greatest single burden. Depending upon the theory used in the cost calculation, the annual deficit amounts to some $60 million on a cash out-of-pocket basis and over $100 million on a fully allocated basis. The reason for such staggering deficits is that the railroad has been prevented from recovering the cost of providing the service. Let me give a simple illustration. I live in Darien, Connecticut, which is 37 miles from New York City. A commutation ticket per ride amounts to a little over one dollar. However, before the commuter gets on the train he parks his car in a

private parking lot at a cost of 75 cents and picks up a newspaper for a cost of 15 cents. Both the parking lot fees and the cost of the newspaper were recently increased 50 per cent, but the rail fare is the same as it was in 1962. Incidentally, I used these facts to illustrate our passenger problem in an interview with one of the leading newspapers in this country the other day, but I noted that they didn't show up in print.

2. Archaic pricing—This is a very complex subject, and there are many rationales and opinions to reflect on when the subject of railroad pricing is brought up. Let me present it very simply. The tariff rate for transporting an automobile by rail from Detroit to New York has increased from $34 in 1946 to $56 today—a rise of 67 per cent. Contrast this with the retail price of the automobile, which has risen over 200 per cent. Please—I would like to make it clear I am not criticizing the automobile industry: they are among our best customers. All I am pointing out is that transportation rates by rail have not kept pace with price increases in other industries. Even Government-owned operations have to keep pace with increased costs. The July 20 *Wall Street Journal* has an article reporting that the Tennessee Valley Authority confirmed its plans to effect a rate increase that will increase the cost of electricity to the region's consumers by about 23 per cent.

3. The burden of competing against subsidized competition—The railroads also suffer the effect of huge Federal subsidies—normally granted in the form of assumed capital costs—given the railroads' competitors. To be sure, part of these subsidies are recovered in the form of user charges, notably from highway and air carriers, but even there the unrecovered portion has a major economic impact. I saw some figures the other day which indicated that Government expenditures for highways, air transport and waterways exceeded $20 billion last year.

4. Low utilization of freight car equipment—This is a very complex subject, but I think it can be best illustrated by noting that an average freight car in service in this country is carrying revenue freight for less than three hours per day. As a further illustration of this point—it is estimated that the average freight car spends over 40 per cent of its time standing idle at the shipper's dock. This low rate of utilization makes it very difficult to earn a profit because of the high fixed cost of capital which must be absorbed.

5. Short average hauls and high cost of operating in congested metropolitan areas—These are horrendous problems for Penn Central, and can be solved only with a fundamental change in the method of doing business. The average trip for a Penn Central freight car amounts to 37 miles per day, and 20 per cent of the cars handled by Penn Central generate revenue of less than $100 per car.

In addition to these items, there are countless other reasons that have contributed to making Penn Central Transportation Company unprofitable. These include delays in effecting tariff increases adequate to meet the spiraling impact of inflation on interest charges, wage rates, supplies and plant and equipment expenditures; unproductive work rules; full crew laws in some states; discriminatory state and local taxes; and railroad retirement costs levied at a much higher rate than other industries contribute to Social Security.

My third point covers the myth that diversification bled the railroad of cash. Penn Central's much discussed diversification into non-railroad investments was made largely between 1963 and 1968. In the same period management placed great emphasis upon its responsibilities in conducting railroad operations, investing $1.6 billion in plant and equipment—eight times the investment it made in diversification, and a substantial amount of these funds was generated internally from investments of Pennsylvania Company. Despite all talk to the contrary, the management of Penn Central has recognized its obligation to strengthen the railroad system to the best of its ability.

At the time when the non-railroad investments were made, the railroad itself was yielding only a chronically small rate of return and management made investments designed to provide additional sources of support for railroad operations.

My fourth point deals with what can be done, in my opinion, to solve the operating problems of Penn Central and the Eastern railroads.

Plans must deal with both short-term and long-term solutions. The legislation your Committee is considering is a clear first step to restoring a viable railroad industry in the East. Passage of legislation providing relief from the intercity passenger service burden will also represent a great step forward.

Our railroad is seeking to eliminate losses from commuter service and from uneconomic freight operations both through cooperation with governmental authorities and through regulatory relief. At the same time our company is involved deeply in far-reaching programs to improve our railroad efficiency.

The situation of the Penn Central and other Eastern railroads is probably one of the most complicated business problems that has ever confronted this country. It cannot be solved by hackneyed, warmed-over points of view that cater to one or another specific interest group. There must be a dramatic and revolutionary change in rail operations in the East. This can only come about through the deliberations of a highly intelligent and motivated group of men representing various communities of interest that are affected by the operation of the railroad.

Gentlemen, I would like to suggest for your consideration that a Task Force be formed under appropriate auspices to deal with this very complex matter. This Task Force would include representatives from the Government and its agencies, labor, shippers, the financial community and representatives of management of the Eastern roads.

We need to obtain a fresh perspective through understanding and cooperation among diverse interests to reach mutually agreeable and advantageous solutions.

The objective of the proposed Task Force would be first to analyze and research the fundamental problems as they specifically affect Penn Central and other Eastern railroads, some of which problems I have outlined to you this morning. Second, the Task Force would be charged with the responsibility for examining alternate solutions and presenting a comprehensive series of recommendations for solving the problems common to the Eastern lines.

Railroad operating conditions in the East are so different from those of the West and South that they deserve separate diagnosis and attention. Furthermore, their study requires close cooperation between all the Eastern roads who have been mired down with similar handicaps and obstacles for so many years.

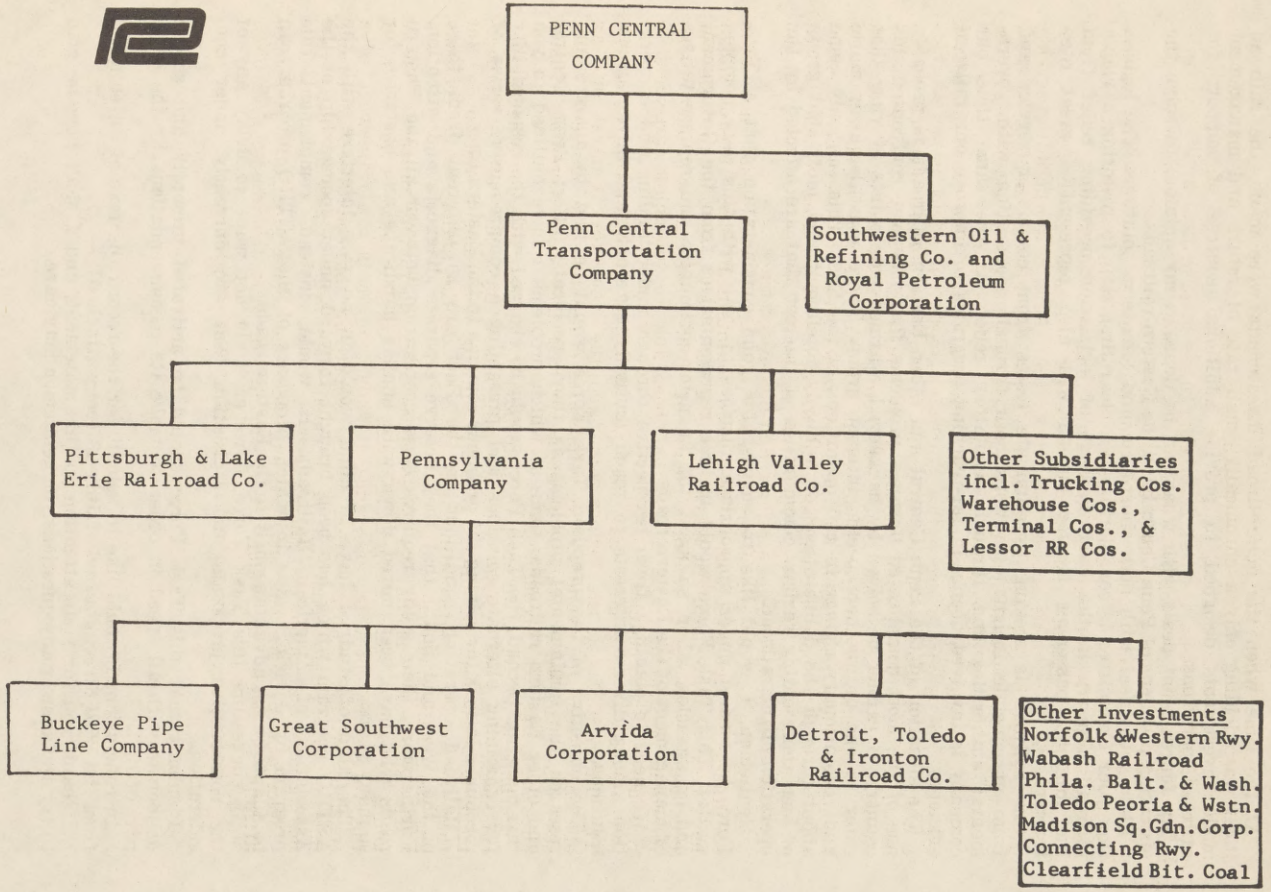
The kind of study I have in mind would in no way interfere with the ASTRO program which has been brought forward under sponsorship of the Association of American Railroads. It would, instead, complement this program by devising ways in which proposals of the ASTRO program can be adapted most advantageously to the Eastern roads.

By suggesting this Task Force, however, I do not want to delay any of the constructive proposals and legislation that are currently under consideration.

I submit that this Task Force should be activated promptly and should deliberate with all speed in order to make its recommendations by the early part of 1971.

In conclusion, I would like to submit for the record the text of an editorial from the *Wall Street Journal* of July 23 (copy attached).

I thank you for your attention to this statement, and I shall now be glad to try and answer any questions you gentlemen may have.


PENN CENTRAL COMPANY
Penn Central Transportation Company
Southwestern Oil & Refining Co. and Royal Petroleum Corporation
Pittsburgh & Lake Erie Railroad Co.
Pennsylvania Company
Lehigh Valley Railroad Co.
Other Subsidiaries incl. Trucking Cos. Warehouse Cos., Terminal Cos., & Lessor RR Cos.
Buckeye Pipe Line Company
Great Southwest Corporation
Arvida Corporation
Detroit, Toledo & Ironton Railroad Co.
Other Investments
Norfolk &Western Rwy.
Wabash Railroad
Phila. Balt. & Wash.
Toledo Peoria & Wstn.
Madison Sq.Gdn.Corp.
Connecting Rwy.
Clearfield Bit. Coal

[From the New York Wall Street Journal, July 23, 1970]

EVERYONE'S TO BLAME

Now that the Penn Central is in bankruptcy proceedings and other railroads are in trouble, nearly everyone has his own ideas as to what went wrong. The air is filled with charges and counter-charges.

The railroads put a lot of the blame on labor unions and excessive Federal regulation. Labor unions claim that the fault lies with railroad mismanagement and that Federal regulation has, if anything, been insufficient.

Well-organized groups contend rail passenger losses stem in large part from the lines' deliberate attempts to drive away the public by downgrading service. The railroads, in response, argue that favored Federal treatment of air and highway transportation, along with changing public taste, has made it impossible for them to compete for passengers.

Recriminations go on and on, and there's at least some truth in nearly every charge. As if to prove the railroads' contention about union featherbedding, a rail union even now is trying to force the lines to hire thousands of additional firemen, even though every impartial agency that has ever considered the dispute has concluded there is no need for such personnel.

The Interstate Commerce Commission, the Federal rail regulator, is by no means solely responsible for the heavy-handedness of Government regulation. The ICC is only carrying out the directions of Congress which devised a system to cover a period when the railroads' competitors were wagon trains and canal barges, not airplanes and high-speed trucks.

As for the loss of passenger business, probably it would not have been so drastic if high-level service had been maintained. The railroads might have been able to maintain service, too, if they had been able to work out occasional reasonable rearrangements of route patterns without almost interminable hearings, and if they had been able to get union agreement to reasonable work schedules.

The railroads' own mismanagement played a part in all of this, of course. The failure to mesh the Pennsylvania and the New York Central into an efficient system, for example, surely indicates either that the managers didn't study the situation carefully beforehand or that they were incredibly clumsy once the merger was accomplished.

Perhaps it will be of interest to historians if Congress or some other agency can decide that the trouble with the railroads is 25% the fault of management, 25% the fault of unions, 25% the fault of Government, and so on. But that sort of scapegoat-pointing isn't going to do the nation or its economy any good at the moment.

The simple fact is that the nation does need functioning railroads. That's going to require some Federal financial help, possibly quite a lot of it. If the Government provides assistance, it should do so in the framework of a sensible national transportation policy, something that has been noticeably missing up to now. And the Government has every right to insist that management and unions play their part.

What's needed, in short, is a responsible rescue operation, not a prolonged attempt to assess the blame. There's plenty of that for almost everybody.

(Whereupon, at 12 noon, the hearing was adjourned.)

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

(This opinion was referred to on page 95).

New Haven Inclusion Cases.*—October Term, 1969

New Haven Inclusion Cases, Nos. 914, 916, 920, 1038, and 1057
On Writs of Certiorari to the United States Court of Appeals for the Second Circuit
New Haven Inclusion Cases, Nos. 915, 917, and 921
On Appeals From the United States District Court for the Southern District of New York

[June 29, 1970]

Mr. Justice Stewart delivered the opinion of the Court.

These cases represent the latest stage of the litigation arising from the merger of the Pennsylvania and New York Central railroads, which we upheld two Terms ago in the *Penn-Central Merger Cases*, 389 U.S. 486. A condition of that merger was Penn Central's promise to take in the New York, New Haven & Hartford Railroad Company as an operating entity—a promise that Penn Central fulfilled on December 31, 1968, 11 months after its own formation. The ultimate question presented by the cases now before us is the price Penn Central must pay for the assets of the New Haven.**

I

1. *The Penn Central.* The proposed combination of the Pennsylvania and New York Central railroads first came under consideration by the parties and the Interstate Commerce Commission more than 12 years ago, a decade prior to its eventual consummation.[1] The two railroads formally sought permission to merge under the Interstate Commerce Act, 49 U.S.C. § 1 *et seq.*, on March 9, 1962.[2] On April 6, 1966, the Commission authorized the merger of the two roads.[3] The union of the two carriers was the largest railroad merger in the history of the Nation,[4] bringing together the companies that "dominate rail transportation in the Northeast."[5] In 1965 the component roads enjoyed a total operating revenue in excess of $1,500,000,000 and a net annual income

*No. 915, *The New York, New Haven & Hartford Railroad Company First Mortgage 4% Bondholders Committee* v. *United States et al.*; No. 917, *Manufacturers Hanover Trust Company* v. *United States et al.*; No. 921, *Chase Manhattan Bank, N.A.* v. *United States et al.*, on appeal from the United States District Court for the Southern District of New York, argued March 30, 1970. No. 914, *The New York, New Haven & Hartford Railroad Company First Mortgage 4% Bondholders Committee* v. *Smith et al.*; No. 916 *Manufacturers Hanover Trust Company* v. *United States et al.*; No. 920, *Chase Manhattan Bank, N. A.* v. *Penn Central Company et al.*; No. 1038, *Penn Central Company* v. *Manufacturers Hanover Trust Company et al.*; and No. 1057, *United States et al.* v. *The New York, New Haven and Hartford Railroad Company First Mortgage 4% Bondholders Committee et al.*, on certiorari to the United States Court of Appeals for the Second Circuit in advance of judgment, argued March 30, 1970.

**On June 21, 1970, the Penn Central Transportation Company filed a petition for reorganization under § 77 of the Bankruptcy Act, 11 U. S. C. § 205, in the United States District Court for the Eastern District of Pennsylvania. Whether the financial obligations dealt with in the present opinion may become subject to modification in or because of those proceedings is a question with which the present opinion in no way deals.

[1] See *Penn-Central Merger Cases*, 389 U. S., at 494; *Baltimore & Ohio R. Co.* v. *United States*, 386 U. S. 372, 379.

[2] *Pennsylvania Railroad Company—Merger—New York Central Railroad Company*, 327 I. C. C. 475, 479 (*"Merger Report"*).

[3] *Ibid.*

[4] *Baltimore & Ohio R. Co.* v. *United States*, 386 U. S., at 392.

[5] *Penn-Central Merger Cases*, 389 U. S., at 493.

of over $75,000,000.[6] The two companies held some $72,000,000 in working capital and $1,242,000,000, in combined investments.[7] With about 19,600 miles of road "sprawling between the Great Lakes on the north . . . and the Ohio and Potomac Rivers on the south," [8] Penn Central was at its inception nearly twice the size of the next largest railroad system in the country and three times that of the third largest.[9]

The predicted economies effected by the merger were likewise enormous; it was thought that within about eight years of the combination they would exceed $80,000,000 annually. [10] Those savings represented a value, capitalized at 8%, of $1,000,000,000.

On June 9, 1967, after considerable litigation involving protective conditions for various affected railroad competitors,[11] the Commission issued a modified order authorizing the Penn-Central merger.[12] On October 19, 1967, a court of three judges, convened in the United States District Court for the Southern District of New York to review the Commission's order pursuant to 28 U.S.C. §§ 1336, 2284, and 2321–2325, upheld the Commission's action.[13] On January 15, 1968, this Court affirmed with minor modifications, and thereby sustained the validity of the merger.[14] Two weeks later, on February 1, 1968, Pennsylvania and New York Central merged.

2. *The New Haven.* The New York, New Haven & Hartford Railroad is now an operating division of the Penn Central system. At the time of the merger, however, it was an independent Class I railroad operating some 1,500 miles of line in the Commonwealth of Massachusetts and the States of Rhode Island, Connecticut, and New York; as such, it was the sixth largest railroad in the northeast region and the largest in New England.[15] With an operations area extending from Boston to New York and connecting with nine other Class I railroads, the New Haven served 12 cities of greater than 100,000 population, as well as a number of important defense establishments.[16] In 1964 the railroad employed about 9,800 people and paid them annual wages amounting to $70,000,000.[17] About 30,000 commuters used the line every day to reach work in New York City alone.[18] As described by the Commission,

"The New Haven has both a large passenger and freight business. It is the fourth largest passenger-carrying railroad in the United States, and has the second highest commuter revenue of all such roads. . . . The volume of its freight business . . . is substantially greater. . . . It is the largest freight railroad in New England and ranks tenth in freight traffic among all railroads

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[6] *Ibid.*
[7] *Baltimore & Ohio R. Co.* v. *United States,* 386 U. S., at 380.
[8] *Merger Report,* 327 I. C. C., at 489.
[9] *Baltimore & Ohio R. Co.* v. *United States,* 386 U. S., at 447 (DOUGLAS, J., dissenting).
[10] *Penn-Central Merger Cases,* 389 U. S., at 493; *Merger Report,* 327 I. C. C., at 501.
[11] As part of its initial merger order, the Commission had prescribed special traffic and indemnity provisions for the benefit of the Delaware & Hudson, Boston & Maine, and Erie-Lackawanna railroads. The Commission had not yet determined whether those three "protected carriers" should be included in either Penn Central or the recently formed Norfolk & Western, but concluded they required sheltering conditions if they were to survive the interim period pending decision as to their ultimate disposition. *Merger Report,* 327 I. C .C. at 531–532. On September 16, 1966, following objections to the initial order from various parties, the Commission abrogated the indemnity provisions originally prescribed for the protected carriers and announced it would reconsider its earlier decision, with possible modifications to be given retroactive effect. *Pennsylvania Railroad Company—Merger—New York Central Railroad Company,* 328 I. C. C. 304 (*"Reconsideration Report"*). On October 4, 1966, a three-judge District Court in the Southern District of New York declined, one judge dissenting, to enjoin enforcement of the Commission's order. *Erie-Lackawanna R. Co.* v. *United States,* 259 F. Supp. 964. Later, the District Court again denied injunctive relief sought by bondholders of the New Haven railroad. *Oscar Gruss & Son* v. *United States,* 261 F. Supp. 386. On March 27, 1967, this Court reversed and remanded *Erie-Lackawanna* with instructions that the Commission complete its proceedings relating to the protected roads. *Baltimore & Ohio R. Co.* v. *United States,* 386 U.S. 372. We later vacated and remanded *Oscar Gruss* for reconsideration in light of *Baltimore & Ohio,* 386 U. S. 776. Ensuing developments are recounted in the text.
[12] *Pennsylvania Railroad Company—Merger—New York Central Railroad Company,* 330 I. C. C. 328 (*"First Supplemental Report"*).
[13] *Erie-Lackawanna R. Co.* v. *United States,* 279 F. Supp. 316.
[14] *Penn-Central Merger Cases,* 389 U. S. 486.
[15] *Baltimore & Ohio R. Co.* v. *United States,* 386 U. S., at 381; *New York, N. H. & H. R. Co. Trustees Discontinuance of Passenger Service,* 327 I. C. C. 77, 79 80 (*"Suburban Discontinuance Case"*).
[16] *New York, N. H. & H. R. Co., Trustees, Discontinuance of All Interstate Passenger Trains,* 327 I. C. C. 151, 163 (*"Interstate Discontinuance Case"*).
[17] *Id.,* at 163–164.
[18] *Id.,* at 169.

in the eastern district. . . . Its freight service is considered to be of extreme importance to the industrial well-being of Southern New England." [19]

The financial history of the New Haven was for decades a history of extreme vicissitudes. The company's decline and fall, with passage into, out of, and back into railroad reorganization, have been chronicled elsewhere.[20] It first went into reorganization under § 77 of the Bankruptcy Act, 11 U.S.C. § 205, on October 23, 1935. Due in large measure to the difficulties of including formerly leased lines in the reorganized road, nearly 12 years elapsed from the filing of the debtor's petition in the United States District Court for the District of Connecticut to that court's eventual order approving consummation of the Commission's plan of reorganization.[21]

The railroad emerged from reorganization in 1947 with a vastly simplified debt structure in which only the most senior holders of secured interests survived.[22] But in the following years the financial condition of the company again deteriorated, prompting it to seek at first partial and then total discontinuance of passenger service on the former Old Colony lines in Massachusetts.[23] By 1959 the financial condition of the New Haven was such as to render the chance of surplus earnings "slight at best." [24] Through late 1960 and into early 1961 the company's management expended great efforts to stave off bankruptcy by obtaining loans or grants from the federal and state governments.[25] By the middle of 1961, current liabilities exceeded current assets by $36,310,000,[26] and the company was losing cash at the annual rate of $18,000,000.[27]

Finally, on July 7, 1961, the New Haven again petitioned for reorganization under § 77 in the United States District Court for the District of Connecticut, a step that the court was later to find had been far too long delayed:

"[I]n the interest of its creditors, its employes and the public [the railroad] should have petitioned . . . long before it did. The grave problems which . . . beset the reorganization would have been less acute and infinitely more manageable if bankruptcy had not been put off until its cash was almost entirely depleted, credit was practically gone, maintenance was down and in all other respects the bottom was out of the barrel." [28]

Immediately upon their taking over the New Haven, the trustees appointed by the reorganization court were obliged to borrow $8,000,000 to meet the payroll.[29] The situation did not improve with the passage of time. "[I]n spite of spartan economies and a sizeable reduction in numbers of employees, the costs of operation . . . offset savings and eroded away the accumulated cash." [30] On July 6, 1964, the New Haven trustees petitioned the Commission, pursuant to § 13a (2) of the Interstate Commerce Act, 49 U.S.C. § 13a (2), for authority to discontinue suburban passenger train service in the Boston area. There followed a public hearing, an adjournment to afford Massachusetts authorities an opportunity—ultimately unavailing—to negotiate a contract with New Haven for continuation of some service, and a motion by the New Haven for expedited disposition "by reason of the critical nature of New Haven's finances, the irretrievable drain which the operations in question impose upon New Haven's resources, and the increasing adverse effect which New Haven's situation has upon the public interest and upon New Haven's

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[19] *Suburban Discontinuance Case*, 327 I. C. C., at 80.

[20] See generally *Baltimore & Ohio R. Co.* v. *United States*, 386 U. S., at 452–454 (DOUGLAS, J., dissenting); L. Brandeis, Financial Condition of the New York, New Haven & Hartford Railroad Company and of the Boston & Maine Railroad (1907); L. Brandeis, Other People's Money 129–136 (1933); Report of the Joint New England Railroad Committee to the Governors of the New England States 53–73 (1923); E. Sunderland, A Brief History of the Reorganization of The New York, New Haven and Hartford Railroad Company 1–5 (1948); Capture of the New Haven, Fortune Magazine, April 1949, p. 87 *et seq.*

[21] See In re New York, N. H. & H. R. Co., 169 F. 2d 337, 338 n. 6, cert. denied *sub. nom. Mulcahy* v. *New York, N. H. & H. R. Co.*, 335 U. S. 867.

[22] See *In re New York, N. H. & H. R. Co.*, 378 F. 2d 635, 640.

[23] *Commission of Department of Public Utilities* v. *New York, N. H. & H. R. Co.*, 178 F. 2d 559, cert. denied, 339 U.S. 943 *In re New York, N. H. & H. R. Co.*, 163 F. Supp. 59.

[24] *In re New York, N. H. & H. R. Co.*, 278 F. Supp. 592, 606, aff'd, 405 F. 2d 50, cert. denied *sub nom. Abex Corp.* v. *Trustees*, 394 U. S. 999.

[25] 278 F. Supp., at 606.

[26] *Id.*, at 601.

[27] *In re New York, N. H. & H. R. Co.*, 289 F. Supp. 451, 456; *In re New York, N. H. & H. R. Co.*, 281 F. Supp. 65.

[28] *In re New York, N. H. & H. R. Co.*, 278 F. Supp., at 606.

[29] *In re New York, N. H. & H. R. Co.*, 405 F. 2d, at 52.

[30] *In re New York, N. H. & H. R. Co.*, 281 F. Supp., at 65–66.

creditors. . . ." The Commission granted the trustees' application, concluding that for a period beginning four years before the 1961 reorganization petition and continuing thereafter, New Haven's financial condition had been "critical" and "drastically weak . . . ." [31]

By 1965 it was evident that the New Haven was on the verge of collapse.[32] Its year-end current assets amounted to $20,521,000, some $16,685,000 less than current liabilities plus long-term debt payments due within the coming year. The obligations payable after one year totaled $189,042,000. The retained income account showed a deficit of $81,672,000; the working capital account, a deficit of $16,700,000. For the year the net railway operating income showed a deficit of $16,000,000, with overall net income a deficit only $1,000,000 less. The company was in default in its payments of both principal and interest on its long-term debt.[33] In the view of the trustees, New Haven was "absolutely faced with economic obsolescence if it continues as an independent, short-line, terminal railroad." [34]

On October 11, 1965, the New Haven notified the Commission, pursuant to § 13a (1) of the Interstate Commerce Act, 49 U.S.C. § 13a (1), of its intention to discontinue all its interstate passenger trains effective March 1, 1966.[35] If carried into effect, the proposed discontinuance would have drastically curtailed passenger train service in New York and Massachusetts, and ended it completely in Connecticut and Rhode Island.[36] In the spring of 1966 the Commission, noting that over an 11-year period New Haven had experienced "an unending succession of reverses," concluded that "[t]here now is totally lacking any hope or plan for future survival of this carrier, except that held out by its merger into a trunkline railroad." [37] The Commission acceded in part to the trustees' notice of discontinuance, but invoked its statutory power to keep many of the trains in operation on the ground that "passenger as well as freight service by the N[ew] H[aven] is a national necessity and that termination of either would lead to distress in Connecticut, Massachusetts, and Rhode Island, and would severely damage New York City and the Nation generally." [38]

As 1966 gave way to 1967, the New Haven's situation deteriorated still further. As of April 1967 the reorganization court thought "the prospect for the continued operation of the Railroad was very dim." [39] The road lacked even a current expense fund from which to satisfy the "six months" creditors, and the court thought it "highly unlikely that there ever will be." [40] In July 1967 the reorganization court found that the New Haven's situation had become "desperately critical"; its cash depletion was "so serious that, if the present rate of loss continues, there will be insufficient left by late September to meet the payroll of approximately $1,400,000 per week." [41]

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[31] *Suburban Discontinuance Case,* 327 I. C. C., at 80, 106.

[32] By this time the railroad's freight operations were also operating at deficit levels. The Commission explained this aspect of the problem as follows:

"Southern New England is a deficit area in terms of food, fuel and the raw materials for industry. Accordingly, in serving this economy, the New Haven is a short haul railroad with a heavily unbalanced flow of traffic and equipment. As a terminal railroad it faces the constant problems and added costs of switching and deadheading foreign line freight cars to move them back off its own lines. Moreover, as a result of national and regional economic and industrial shifts, New England's outbound products have become increasingly high-value and light-weight in character. With the expansion in the region of a modern, comprehensive highway system during the past 20 years, this outbound freight traffic has become especially susceptible to diversion from rail to private and for-hire trucking service." *Interstate Discontinuance Case,* 327 I. C. C., at 170.

[33] *Interstate Discontinuance Case,* 327 I. C. C., at 164.

[34] See *id.,* at 175.

[35] See *Merger Report,* 327 I. C. C., at 488.

[36] *Interstate Discontinuance Case,* 327 I. C. C., at 152.

[37] *Id.,* at 172, 173.

[38] *Penn-Central Merger Cases,* 389 U. S., at 507.

[39] *In re New York, N. H. & H. R. Co.,* 281 F. Supp. 65.

[40] *In re New York, N. H. & H. R. Co.,* 278 F. Supp., at 602.

[41] See *Erie-Lackawanna R. Co.* v. *United States,* 279 F. Supp., at 333. The three judge court, writing in October 1967, expressed full agreement with these findings:

"No one has contested the forecast of the NH Trustees that their cash will run out at the end of 1967; no one has indicated any probable source of funds for that beleaguered property other than the merged Penn-Central. . . . For our part we are unwilling to take responsibility for such devastating hardship as even a temporary cessation of NH's operations would bring to New England and New York and in a lesser degree to other sections of the country when in our view there is no reason why the merger should not proceed; indeed we believe we have no right to do so. . . . [W]ith the situation now so serious, there can hardly be doubt that it is better to accept what is good for the New Haven than permit the patient to die while in quest of the best." 279 F. Supp., at 335, 355.

As 1967 came to an end, so did the New Haven's cash reserve. By August 31 the cash balance fell to $4,500,000—a precarious condition for a company requiring $1,750,000 a week simply to meet current operating expenses.[42] The trustees estimated that as of December 31, 1967, the balance would decline to $3,100,000 and two months later would fall to $850,000.[43] The New Haven's financial position had thus eroded to the point where its shutdown was "imminent . . . ." [44]

3. *The inclusion negotiations.* From the outset of the § 77 proceeding in 1961, the trustees of the New Haven and the reorganization court charged with conservation of the debtor's dwindling assets recognized that "a merger with a large trunk line railroad would be the most promising and feasible means of continuing the viability of the New Haven's transportation system . . . ." *In re New York, N. H. & H. R. Co.*, 289 F. Supp. 451, 456; cf. 281 F. Supp. 65. After Pennsylvania and New York Central filed their merger application before the Interstate Commerce Commission in 1962, the New Haven trustees sought inclusion in the new company, both by private negotiations with the component roads and by a petition to the Commission filed June 26, 1962. See *In re New York, N. H. & H. R. Co.*, 378 F. 2d 635, 636; *Merger Report*, 327 I.C.C., at 480. As the reorganization court said, it was "apparent that the inclusion of the New Haven in the Penn-Central merger was the only salvation for the New Haven as an operating railroad . . . ." *In re New York, N. H. & H. R. Co.*, 289 F. Supp., at 456; see also *In re New York, N. H. & H. R. Co.*, 304 F. Supp. 793, 800.

The Commission, as we have noted, authorized the merger of the two roads in 1966. But in so doing, it found that "[w]ithout some radical change in circumstances, even if this merger application were denied, N[ew] H[aven] would face a nearly insuperable task in bringing itself out of bankruptcy." *Merger Report*, 327 I.C.C., at 522. The Commission concluded that the proposed Pen-Central combination, "without complete inclusion of N[ew] H[aven], would not be consistent with the public interest . . . ." *Id.*, at 524. Accordingly, it required "all the New Haven railroad to be included in the applicants' transaction," and conditioned its approval of the merger upon that inclusion, *id.*, at 524, 527. In so doing, the Commission spelled out Penn Central's obligation towards New Haven in unequivocal language. Condition 8 of the Merger Report stipulated as follows:

"The Pennsylvania New York Central Transportation Company shall be required to include in the transaction all the New York, New Haven and Hartford Railroad Company . . . upon such fair and equitable terms as the parties may agree subject to the approval of the Bankruptcy Court and the Commission. Within 6 months after the date this report is served, the parties shall file with the Commission for its approval, a plan for each inclusion. In the event the parties are unable to reach an agreement (and subject to approval by the Bankruptcy Court) such inclusion shall be upon such fair and equitable terms and conditions as the Commission may impose.

"Jurisdiction is hereby reserved for such purposes. Consummation of the merger by applicants shall indicate their full and complete assent to these requirements." 327 I.C.C., at 553.

Condition 16 of the Merger Report reiterated that

"[c]onsummation of the transaction approved herein shall constitute on the part of The Pennsylvania Railroad Company and the New York Central Railroad Company, their successors and assigns, acquiescence in and assent to the conditions stated in this appendix and in the attached report." *Id.*, at 555.

Having determined to require the inclusion of New Haven in Penn Central as a condition of merger, the Commission remitted the parties to private negotiation of the terms of inclusion. *Id.*, at 527. The New Haven trustees on the one side, and the Pennsylvania and New York Central railroads on the other, had already been bargaining for some time, having drafted preliminary documents, dated December 22, 1964, and February 5, 1965, that provided for Penn Central's assumption of New Haven's freight operations. *Oscar Gruss & Son* v. *United States*, 261 F. Supp., at 393; *Interstate Dis-*

[42] *Pennsylvania Railroad Company—Merger—New York Central Railroad*, 331 I. C. C. 643, 651 (*"Second Supplemental Report"*).
[43] *Ibid.*
[44] *Id.*, at 653.

continuance Case, 327 I.C.C., at 175 n. 6. On April 21, 1966, two weeks after the Merger Report, they executed a Purchase Agreement for the transfer of substantially all the New Haven assets to Penn Central. *Penn-Central Merger Cases*, 389 U.S., at 508; see *In re New York, N. H. & H. R. Co.*, 378 F. 2d, at 636.[45] The Purchase Agreement provided for the transfer of the New Haven properties to Penn Central, with the consideration in exchange to consist in part of cash and in part of stocks and bonds of Penn Central.[46]

In September 1966 the trustees filed a petition with the reorganization court reciting the background of the negotiations with Penn Central, the New Haven's large and growing deficits, and the insufficiency of internally generated cash to meet operating demands. In the trustees' view, inclusion in Penn Central afforded "the only practicable means for reorganization of the Debtor that is consistent with the best interest of the public and of all parties interested in the Debtor's estate . . . ." They submitted that operations should continue so long as inclusion was possible, and that the court should grant them leave to press for inclusion on the basis of the Purchase Agreement. *In re New York, N. H. & H. R. Co.*, 378 F. 2d, at 637. On October 24, 1966, the reorganization court authorized the trustees to present the Agreement to the Commission, noting that the goal of preserving the New Haven operations "has been the policy from the beginning of these proceedings . . . ." Three days later the trustees and the Pennsylvania and New York Central railroads petitioned the Commission for approval of the New Haven's inclusion on the terms of the Agreement.

On November 16, 1967, the Commission ratified the Purchase Agreement as the basis for the inclusion of New Haven in Penn Central. *Pennsylvania Railroad Company—Merger—New York Central Railroad Company*, 331 I.C.C. 643 ("*Second Supplemental Report*"). It looked upon the fact that the parties had been able to reach agreement as an indication that even though the New Haven trustees were selling properties having no value as an operating entity, they nevertheless had enjoyed a degree of bargaining power by virtue of the requirement that Penn Central take in New Haven as a condition of the merger. 331 I.C.C., at 657. "[W]here a transaction is bargained at arm's length," said the Commission, "each side is presumably capable of determining its own best interest, and our primary function is to discover whether the transaction will be in the public interest." *Id.*, at 656. The Commission then undertook its independent analysis of the value of the New Haven properties. Although the Purchase Agreement "carrie[d] some probative force as to the values of the properties involved, it [was] by no means controlling." *Id.*, at 657. The Commission must still determine the price "on the basis of all the evidence pertaining thereto, not merely the agreement and supporting evidence." *Id.*, at 660 n. 12.

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[45] The transfer was to be free and clear of all liens and encumbrances, with certain minor exceptions. The liens and encubrances would shift to the proceeds of the sale and thus remain an obligation of the New Haven estate.

By negotiating a purchase and sale of the New Haven assets, the parties to the agreement elected not to attempt a recapitalization of New Haven, an enlarged merger that would bring New Haven into the Penn Central system as a corporate entity, or a lease of the New Haven operating assets. At one point, when it appeared the New Haven might not long survive, the Commission had directed the parties to negotiate a lease to be "imediately available upon consummation of the Penn Central merger," but the negotiators reported they were unable to do so and instead suggested various loan-loss formulas. *Penn-Central Merger Cases*, 389 U. S., at 508; *Erie-Lackawanna R. Co.* v. *United States*, 279 F. Supp., 334; *Second Supplemental Report*, 331 I. C. C., at 648.

[46] Subsequent modifications to the Agreemnt were executed October 4, 1966, and December 20, 1967.

The bondholders were not bound by the trustees' acceptance of the Purchase Agreement. The trustees acted on behalf of the debtor, subject to the directive of the reorganization court, but they never submittd the Agreement to that court for its approval. Morover, they has stipulated with Pennsylvania and Central that they would not challenge the terms of the Purchase Agreement. The preliminary memoranda negotiated between the trustees and the two railroads contained a provision, substantially embodied in § 11.7 of the Agreement itself, that New Haven would not make or file "any further statement, stipulation or other document in the pending Pennsylvania-Central merger proceedings before the I. C. C. . . ., or any judicial review thereof, other than in connection with (a) a position relating to the New Haven taken by any other party . . ., or (b) a failure of the I. C. C. to find either (i) that the New Haven should be included in such merger or (ii) that jurisdiction is to be retained by the I. C. C. for later determination of any petition by the New Haven for such inclusion, *provided, however*, that any such statement, stipulation or other document made or filed by the Trustees shall not be inconsistent with the provisions and intent of this Agreement." The reorganization court suggested that the bondholders rather than the trustees press for early inclusion due to the impropriety of the trustees' taking "any action which would be or appear to be a repudiation of [the contract's] letter or spirit." See *Erie-Lackawanna R. Co.* v. *United States*, 279 F. Supp., at 333; and see *Oscar Gruss & Son* v. *United States*, 261 F. Supp., at 393–394.

Upon its independent review of the record, the Commission found that the asset value of the New Haven properties to be transferred to Penn Central and of the consideration to be given in exchange was $125,000,000. The Commission concluded that payment of that sum by Penn Central to the New Haven estate would be both "just and reasonable" as a condition of the merger under § 5 of the Interstate Commerce Act, and "fair and equitable" as part of a plan of reorganization under § 77 of the Bankruptcy Act. Unwilling to defer the merger until inclusion could take place but recognizing that the danger of an end to all New Haven operations was "very real," 331 I.C.C., at 654, the Commission authorized financial aid from Penn Central to prop up the debtor during the interim period between merger and inclusion to ensure New Haven's continued functioning until its acquisition by Penn Central. See *Penn-Central Merger Cases*, 389 U.S., at 509.

4. *The inclusion litigations.* At this juncture the Commission's determination of the terms of inclusion was subjected to simultaneous judicial review in two separate forums. On January 23, 1968, eight days after this Court's approval of the merger and eight days before the merger itself, the New Haven bondholders commenced five actions in the United States District Court for the Southern District of New York to set aside the Commission's Order. The three-judge District Court reconvened to hear the actions and shortly thereafter consolidated the five cases into one. On March 29, 1968, the Commission certified the first step of its plan for the reorganization of the New Haven—the sale of its assets to Penn Central—to the reorganization court.[47] Pursuant to § 77(e) of the Bankruptcy Act, 11 U.S.C. § 205(e), the New Haven bondholders filed their objections to the Commission's plan following notice given by the reorganization court. Thus, the identical question of the price Penn Central must pay for the New Haven assets came at the same time before the three-judge District Court in New York and the single-judge District Court in Connecticut.

On July 10, 1968, the three-judge court, following extensive briefing and argument on the numerous issues underlying the price question, found itself unable to agree with the Commission in several major respects. It therefore vacated so much of the Commission's order as found the terms of Penn Central's acquisition of the New Haven's assets to be just and reasonable and remanded the cause for further proceedings. *New York, New Haven and Hartford Railroad Company, First Mortgage 4% Bondholders' Committee* v. *United States*, 289 F. Supp. 418. On August 13, 1968, also after extensive briefing and argument, the reorganization court independently returned the Commission's plan for further proceedings. *In re New York, N. H. & H. R Co.*, 289 F. Supp. 451. On the overriding question of price, the two courts were in accord: by fixing the worth of the New Haven at $125,000,000, the Commission had substantially understated the value of the properties to be transferred. The three-judge court estimated the understatement to be on the order of $45,000,000 to $50,000,000; the reorganization court, $33,000,000 to $55,000,000. 289 F. Supp., at 440, 465.

Meanwhile, the continuing drain on the New Haven's dwindling cash reserves called for—and received—drastic action. Upon remanding the Commission's proposed plan under § 77, the reorganization court ruled that unless the Commission ordered inclusion by January 1, 1969, the court would entertain a motion to dismiss the reorganization proceeding, resulting in termination of all the New Haven's train service. 289 F. Supp., at 459. The court recommended that the Commission direct the early inclusion of New Haven with a partial payment of the purchase price, deferring other issues to later resolution. *Id.*, at 466.

On the remand, the Commission reopened the record for the reception of further evidence and briefing in accordance with the instructions of the two reviewing courts. Its revaluation of the New Haven properties, announced

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[47] The reorganization court had authorized the New Haven trustees to pursue a "two-step" plan before the Commission, in which the debtor's estate would sell its assets to Penn Central and then the trustees would file a specification of the terms to be accorded the security holders. In 1967, the Court of Appeals for the Second Circuit affirmed the District Court's authorization order with certain modifications not here pertinent, postponing consideration of the merits of the "two-step" plan because of the prematurity of the question as then presented. *In re New York, N. H. & H. R. Co.*, 378 F. 2d 635, 639. Pursuant to the plan of reorganization, the New Haven is to be reconstituted as a closed-end, nondiversified management investment company. See *Pennsylvania Railroad Company—Merger—New York Central Railroad Company*, 334 I. C. C. 25, 93 (*"Fourth Supplemental Report"*). The reorganization court has withheld disposition of the second or "distributive step of the plan pending this Court's resolution of the question of price. *In re New York, N. H. & H. R. Co.*, 304 F. Supp. 1121, 1123–1124.

on November 25, 1968, resulted in an increase in total worth of some $37,700,000, yielding a new price of $162,700,000 for the properties to be transferred. *Pennsylvania Railroad Company—Merger—New York Central Railroad Company*, 334 I.C.C. 25, 53 (*"Fourth Supplemental Report"*). But the Commission then invoked "other pricing considerations" not taken into account at the time of its prior report. Application of the new considerations effected a reduction of $22,081,000 from the newly calculated asset value, leaving a net value of $140,600,000—$15,600,000 more than the Commission's initial estimate, but $17,400,000 less than the lowest range of value suggested by either of the two District Courts. In addition, the Commission required Penn Central to pay $5,000,000 towards the New Haven's interim operating expenses and, yielding to the directive of the reorganization court, ordered Penn Central to take over the New Haven properties by January 1, 1969. 334 I.C.C., at 74, 76.

The Commission certified its revised plan to the reorganization court on December 2, 1968. Within three weeks the bondholders filed their objections. On December 24, 1968, the reorganization court released the assets of the debtor's estate to Penn Central without approving the price terms set by the Commission. The court reiterated that failure to include New Haven in Penn Central by January 1, 1969, would result in immediate termination of all New Haven train service. On December 31 the estate transferred its assets to Penn Central.

At once the bondholders pressed for judicial review of the Commission's revised evaluation. With their objections to the plan of reorganization already pending before the reorganization court, representatives of holders of the debtor's first and refunding mortgage 4% bonds commenced two separate actions against the United States and the Commission before the three-judge District Court in New York. The Manufacturers Hanover Trust Company and the Chase Manhattan Bank, trustees under other mortgage bonds, commenced two more actions against the same defendants.[48] The three-judge court consolidated the four cases and granted intervention—to the New Haven trustees as parties plaintiff and to Penn Central, the Commonwealth of Massachusetts, and the States of Rhode Island, Connecticut and New York as parties defendant.

On May 28, 1969, the reorganization court again rejected the plan submitted by the Commission. Although it accepted the Commission's determinations on some issues, the court overruled the Commission with respect to its valuation of the New Haven's Harlem River and Oak Point freight yards and its added deductions introduced for the first time on the remand. The court also instituted its own "underwriting" plan to ensure equivalent value for the estate with respect to the Penn Central common stock given in partial consideration for the transferred New Haven properties. *In re New York, N. H. & H. R. Co.*, 304 F. Supp. 793. An order implementing decision and remanding to the Commission was entered on July 28, 1969. 304 F. Supp. 1136.

On June 18, 1969, the three-judge court filed its opinion in the bondholders' action. With one judge in dissent, the court upheld the Commission's valuation of the freight yards and its added deductions on the remand. The court also adopted the underwriting plan authored by the reorganization court. *New York, New Haven and Hartford Railroad Company, First Mortgage 4% Bondholders' Committee* v. *United States*, 305 F. Supp. 1049. A decree fixing the terms of judgment followed on September 11, 1969.[49]

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[48] The United States Trust Company, as indenture trustee under the New Haven's Harlem River Division mortgage, had been one of the bond holder plaintiffs on the first round. At the suggestion of the reorganization court, 289 F. Supp., at 464, it received recognition of its secured status on the remand, when the Commission directed Penn Central to assume the Division bonds. 334 I. C. C., at 70. The trustee sought no further review.

[49] In a *Fifth Supplemental Report*, decided July 10, 1969, and modified August 26, 1969, the Commission complied with the directive of the three-judge court to prepare and serve a proposed decree reflecting the changes ordered in that court's opinion of June 18, 1969. After making the required adjustments, the Commission ordered Penn Central to pay New Haven an additional $990,000 in stocks, bonds, and cash in the same relative percentages as provided in the *Fourth Supplemental Report*. In addition, the Commission called upon the parties to submit proposed terms of a detailed decree relating to the underwriting plan originated by the reorganization court and adopted by the three-judge court. 334 I. C. C. 528. The order of the Commission accompanying the *Fifth Supplemental Report* does not appear to have undergone judicial review. At any rate, it is moot in light of the action we take today with respect to the judgments of the New York and Connecticut District Courts relating to the *Second* and *Fourth Supplemental Reports*.

With the two District Courts thus in agreement, after two rounds of judicial review, on many of the substantial issues that had come before them, but in disagreement on matters amounting to more than $28,000,000 in value, the bondholders took direct appeals to this Court from the judgment of the three-judge court. They also appealed from the order of the reorganization court to the United States Court of Appeals for the Second Circuit. The United States, the Commission, and Penn Central took no appeals from the decree of the three-judge court but cross-appealed to the Court of Appeals from the order of the reorganization court. The Court of Appeals consolidated the appeals from the reorganization court, and the parties then petitioned this Court to grant certiorari to the Court of Appeals in advance of its judgment, pursuant to 28 U.S.C. §§ 1254 (1) and 201 (e), and Rule 20 of this Court. We noted probable jurisdiction of the appeals from the order of the three-judge court and, with respect to the judgment of the reorganization court, granted certiorari to the Court of Appeals before judgment, accelerating briefing and argument to permit disposition of these cases at the current Term. 396 U.S. 1056.[50]

II

We first consider the dual review to which the District Courts in New York and Connecticut subjected the price determinations of the Interstate Commerce Commission. From the outset all the parties in the three-judge court recognized that the pricing questions presented in the litigation there were also destined to come before the reorganization court under § 77 of the Bankruptcy Act.[51] Confronted with the prospect of duplicate litigation, the New Haven bondholders asked the three-judge court to enjoin the Commission's certification of its plan of reorganization to the District Court in Connecticut. Counsel urged that "if such certification is not restrained, the questions presented by the complaint herein under Section 5 (2) of the Interstate Commerce Act will also be before the Bankruptcy Court under Section 77 of the Bankruptcy Act . . . ." The three-judge court denied the bondholders' application for injunctive relief. In its view, "the balance of convenience tilt[ed] heavily in favor of allowing the Connecticut court to proceed to such extent as it is advised," since the grant of such an injunction could delay the reorganization proceedings for a substantial time.

In this ruling the three-judge was correct. The jurisdiction of the reorganization court was not open to question. Upon its approval of the New Haven's petition for reorganization in 1961, that court had acquired "exclusive jurisdiction of the debtor and its property wherever located . . . ." Bankruptcy Act, § 77 (a), 11 U.S.C. § 205 (a).[52] Subject to the court's control,

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[50] At the same time we affirmed the judgment of the three-judge court in No. 919, *Providence & Worcester Co.* v. *United States*, 396 U. S. 555, and denied certiorari in No. 918, *Providence* N *Worcester Co.* v. *Smith*, 396 U. S. 1062. In these cases, companions to the main litigation, the Providence & Worcester Company sought plenary review of the District Courts' orders insofar as they had sustained the Commission (1) in requiring Penn Central to operate its trains over the Providence & Worcester tracks as a leased line under the conditions of a former long-term lease to New Haven, subject to Penn Central's right to commence an abandonment proceeding before the Commission under § 1 (18) of the Interstate Commerce Act, 49 U. S. C. § 1 (18), and subject further to Providence & Worcester's securing a charter revision to eliminate voting restrictions against Penn Central as a principal shareholder; and (2) in limiting the liability of Penn Central with respect to certain claims of Providence & Worcester, both *in rem* and *in personam*, arising against the New Haven prior to the latter's inclusion in Penn Central. *See Manufacturers Hanover Trust Co.* v. *United States*, 300 F. Supp. 185 (opinion of three-judge court).

[51] A similar problem had presented itself in the immediately preceding round of the litigation arising from the merger. There the Commission's order had embraced not only the Penn Central combination and the takeover of New Haven, but the inclusion of the "protected carriers" in the Norfolk & Western system as well. See n. 11, *supra*. Despite the variety of issues and the number of parties, the cases eventually came before a single District Court, and the danger of multiple litigation in six or more different courts was avoided. See *Erie-Lackawanna R. Co.* v. *United States*, 279 F. Supp., at 323–324, aff'd *sub nom. Penn-Central Merger Cases*, 389 U. S., at 497 n. 2, 503, 505 n. 4. Even earlier, when the Commission had first ordered inclusion of all New Haven service as a condition to the Penn Central merger, it had pointed out that "since New Haven is in bankruptcy, its inclusion will entail reorganization problems under section 77 of the Bankruptcy Act which must be resolved in conjunction with any inclusion proceeding herein." *Merger Report*, 327 I. C. C., at 525; see also *id.*, at 527; and see *Second Supplemental Report*, 331 I. C. C., at 652.

[52] *Callaway* v. *Benton*, 336 U. S. 132, 142; *Meyer* v. *Fleming*, 327 U. S. 161, 164; *Thompson* v. *Magnolia Petroleum Co.*, 309 U. S. 478, 483; *Continental Illinois National Bank & Trust Co.* v. *Chicago, R. I. & P. R. Co.*, 294 U. S. 648, 662; cf. *Ex parte Baldwin*, 291 U. S. 610, 615; *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734, 737.

the trustees whom it appointed were empowered "to operate the business of the debtor." Bankruptcy Act, § 77 (c)(2), 11 U.S.C. § 205 (c)(2). They were thus charged with the dual responsibility of conserving the debtor's estate for the benefit of creditors and preserving an on-going railroad in the public interest. *Massachusetts* v. *Bartlett*, 384 F. 2d 819, 821, cert. denied, 390 U.S. 1003; 5 Collier on Bankruptcy ¶ 77.02, at 469-470 (14th ed. 1969).[53] With these goals in view, the statute bestowed a "broad and general" authority upon both the court and the trustees. Cf. *Palmer* v. *Massachusetts*, 308 U.S. 79, 85. The provisions of § 77 "doubtless suffice[d] to confer upon the [reorganization] . . . court . . . power appropriate for adjusting property rights in the railroad debtor's estate and, as to such rights, beyond that in ordinary bankruptcy proceedings." *Id.*, at 85-86; cf. Collier, *supra*, ¶ 77.11, at 498-499. Together, the court and the Commission "unquestionably" had "full and complete power not only over the debtor and its property, but also, as a corollary, over any rights that [might] be asserted against it." *Callaway* v. *Benton*, 336 U.S. 132, 147.[54] One such power was precisely that which the Commission was about to propose that the reorganization court exercise—the power to confirm a plan of reorganization providing for "the sale of all . . . of the property of the debtor . . . ." Act, § 77 (b)(5), 11 U.S.C. § 205 (b)(5). To that end the Commission was required to certify its proposal to the court as a prerequisite to judicial approval. Act, § 77 (d), 11 U.S.C. § 205 (d). Injunctive intervention by the three-judge court would thus have disrupted an essential statutory phase of the New Haven reorganization.

The United States also sought to avoid duplicate litigation—but by bypassing the New York rather than the Connecticut federal court. In a motion filed shortly after the commencement of the New Haven bondholders' suit in the three-judge court, the Government moved to dismiss the complaints for lack of subject-matter jurisdiction. In support of the motion it was argued that (1) until the Commission certified the terms of inclusion to the reorganization court, the Condition 8 under which Penn Central had pledged to take in New Haven was not satisfied and the Commission's order was not yet reviewable; (2) by virtue of the § 77 aspects of the case, the reorganization court had exclusive jurisdiction over the pricing questions sought to be presented to the three-judge court; and (3) even on the assumption that the three-judge court had jurisdiction, it should stay its hand as a matter of equity to avoid an unnecessary interference with the proceedings before the reorganization court.

The Government's motion to dismiss was opposed by Penn Central, the New Haven trustees, the State of New York, and the bondholders. Significantly, the Commission did not oppose the motion. Indeed, the Commission agreed with the United States that "most (and perhaps all) of the issues raised by the plaintiffs in this three-judge Court will be reviewable by the Rorganization Court," conceded that "the resulting concurrent jurisdiction is awkward, at least in theory," and concluded tentatively that "the scope of judicial review . . . in the Reorganization Court would, as a practical matter[,] be the same as in this three-judge Court." The three-judge court denied the Government's motion to dismiss. The bondholders' actions, the court said, came within the letter of the statutes authorizing review of orders of the Commission. The court conceded there was "an area of overlap" between the work of the New York and Connecticut forums, but thought nothing in § 77 or decisional law superseded that dual arrangement. See 289 F. Supp., at 424 n. 3.

The three-judge court correctly observed that in ordering New Haven's inclusion in Penn Central the Commission had properly exercised its authority under both § 5 of the Interstate Commerce Act and § 77 of the Bankruptcy Act. The fact that the New Haven was in reorganization under the Bankruptcy Act did not preclude the Commission from exercising its statutory power, in passing on the merger application of two railroads, to require the

[53] Cf. *Continental Illinois National Bank & Trust Co.* v. *Chicago, R. I. & P. R. Co.* 294 U. S., at 676; *Van Schlaick* v. *McCarthy*, 116 F. 2d 987, 992.

[54] In *Callaway*, this Court stressed the control the reorganization court has over the debtor's property, including any leasehold estate: "Clearly, control of the physical property must remain in the court which has the ultimate responsibility for operating it. And in order to protect the estate of the debtor from dissipation through losses suffered in the operation of the lessor's property, responsibility for the determination of the amount of the losses and provision for their recoupment from the lessor was properly lodged in the court supervising the reorganization of the debtor." 336 U. S., at 144.

inclusion of a third. Interstate Commerce Act, § 5 (2)(d), 49 U.S.C. § 5 (2)(d).[55] "The Commission can undoubtedly carry on § 5 proceedings simultaneously with § 77 reorganization proceedings . . . ." *Callaway* v. *Benton*, 336 U.S., at 140. Here the transfer of the New Haven assets was as much a part of a merger under § 5 as it was a plan of reorganization under § 77.

Moreover, at the outset of the litigation, the jurisdiction of neither the New York nor the Connecticut court was "complete." On the one hand, the reorganization court lacked coercive power over Penn Central: under § 77 it could neither approve nor disapprove the merger *qua* merger, and it could not compel Penn Central to purchase the New Haven assets. So far as § 77 was concerned, Penn Central stood in the position of a potential purchaser, willing but not obliged to buy the New Haven properties. Cf. *Callaway* v. *Benton*, 336 U.S., at 137; *Group of Institutional Investors* v. *Chicago, M., St. P. & P. R. Co.*, 318 U.S. 523, 550; *Old Colony Bondholders* v. *New York, N. H. & H. R. Co.*, 161 F. 2d 413, 434 n. 5 (Frank, J., dissenting), cert. denied *sub nom. Protective Committee* v. *New York, N. H. & H. R. Co.*, 331 U.S. 858; *In re New York, N. H. & H. R. Co.*, 54 F. Supp. 595, 619. On the other hand, the three-judge court could not by itself effect a conveyance of the New Haven properties to Penn Central, nor could it compel the debtor's trustees to do so without the consent of the reorganization court.

Moved largely by the concern that neither court might have jurisdiction over the entire case, the three-judge court was of the opinion that matters should proceed simultaneously in both forums with a view to bringing the § 5 and § 77 aspects before this Court at the same time. Given the complexities of the jurisdictional question and the importance of an expedited determination of the merits, the three-judge court produced an understandable solution to the problem insofar as it ensured that the entire case would come before this Court without the risk that the parties might have spent an extensive period litigating in the wrong forum.

But the circumstances of the case did not inexorably command review in two separate courts. There was no danger that application of the "fair and equitable" test under § 77 (e)(1) would yield results different from those to be produced by the "just and reasonable" test of § 5 (2)(b) for mergers or the "equitable" test for inclusions under § 5 (2)(d). See *Calloway* v. *Benton*, 336 U.S., at 140.[56] The reorganization statute mandates that any disposition of the debtor's properties must not be "inconsistent with the provisions and purposes" of the Interstate Commerce Act, Bankruptcy Act, § 77 (f), 11 U.S.C. § 205 (f), and "the requisite findings under the two acts are equivalent." *In re Chicago, R. I. & P. R. Co.*, 168 F. 2d 587, 594, cert. denied *sub nom. Texas* v. *Brown*, 335 U.S. 855. This Court has stressed that § 77 incorporates the elements of § 5, *St. Joe Paper Co.* v. *Atlantic Coast Line R. Co.*, 347 U.S. 298, 310, and we have ruled that where the Commission proposes a merger as part of a § 77 plan of reorganization, it must act "in accordance with all the requirements and restrictions applicable to mergers" under the Interstate Commerce Act, *id.*, at 309; cf. *Ecker* v. *Western Pacific R. Corp.*, 318 N.S. 448, 481; *New England Coal & Coke Co.* v. *Rutland R. Co.*, 143 F. 2d 179, 186. Here the Commission had demonstrated its awareness of the statutory interrelationship, specifically devising inclusion terms under § 5 to satisfy the requirements of § 77. *Second Supplemental Report*, 331 I.C.C., at 654.

Moreover, there was no reason to suppose that the reorganization court would be unable to adjudicate all the questions presented by the terms of the Commission's inclusion order. Although the three-judge court expressed concern that certain issues, such as a loss-sharing arrangement during the interim period between merger and inclusion, might not lie within the

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[55] Section 5(2)(d) provides: "The Commission shall have authority in the case of a proposed [merger] transaction under this paragraph involving a railroad or railroads, as a prerequisite to its approval of the proposed transaction, to require, upon equitable terms, the inclusion of another railroad or other railroads in the territory involved, upon petition by such railroad or railroads requesting such inclusion, and upon a finding that such inclusion is consistent with the public interest."

[56] For the text of § 5 (2)(d), see n. 55, *supra*. Section 5 (2)(b) provides in pertinent part: "If the Commission finds that, subject to such terms and conditions and such modifications as it shall find to be just and reasonable, the proposed [merger] transaction is within the scope of [an earlier subdivision of the statute] . . . and will be consistent with the public interest, it shall enter an order approving and authorizing such transaction, upon the terms and conditions, and with the modifications, so found to be just and reasonable . . . ."

jurisdiction of the reorganization court, the reorganization court nevertheless reached those issues without, so far as the record discloses, jurisdictional objections from any party.

The three-judge court thus confronted a situation where it was asked to consider the same pricing questions, to be determined by recourse to the same standards of review, as the reorganization court. "[N]ot only would it . . . involve . . . a duplication of labor to [accept] . . . jurisdiction but it might"—and in fact did—"result . . . in contradictory rulings upon the same issue[s]." *Palmer* v. *Warren*, 108 F. 2d 164, 167, aff'd, 310 U.S. 132. In these circumstances the three-judge court might well have stayed its hand under the traditional principle that "the court first taking over the res, draws to itself power to determine all claims upon it." *Palmer* v. *Warren*, *supra;* cf. *Oklahoma* v. *Texas*, 258 U.S. 574, 581; *Palmer* v. *Texas*, 212 U.S. 118, 126, 129; *Wabash R. Co.* v. *Adelbert College*, 208 U.S. 38, 54; *Farmers' Loan & Trust Co.* v. *Lake Street Elevated R. Co.*, 177 U.S. 51, 61. We recognize that that principle has commonly applied in cases where both courts assert *in rem* jurisdiction over the property in dispute, and that here the three-judge court's jurisdiction was *in personam* in character. But the conflict was nonetheless one "between two coordinate courts of concurrent, overlapping jurisdiction, neither belonging to a class which by paramount law is categorically given a jurisdiction over the particular subject matter paramount to the jurisdiction of the other." *In re New York, N. H. & H. R. Co.*, 26 F.Supp. 18, 24, aff'd *sub nom. Palmer* v. *Warren*, *supra*. And given that conflict, the three-judge court could have followed the settled proposition that "the court which first acquired jurisdiction through possession of the property is vested, while it holds possession, with the power to hear and determine all controversies relating thereto." *Lion Bonding & Surety Co.* v. *Karatz*, 262 U.S. 77, 89.

Surely a vesting of primary jurisdiction in the reorganization court comports with the basic purpose of § 77. Congress enacted that statute in part "to prevent the notorious evils and abuses of consent receiverships," *New England Coal & Coke Co.* v. *Rutland R. Co.*, 143 F. 2d, at 184, of which one of the more egregious was the requirement of an ancillary filing and order of appointment in the federal court for every district in which the debtor had property. See Collier, *supra*, ¶ 77.02, at 467. Although, of course, the jurisdiction of the three-judge court was not ancillary to that of the reorganization court in a technical sense, dual review of issues ultimately going only to the valuation of the debtor's estate would resurrect the discredited practice of the equity receivership—it "would tend greatly to foment conflicts between coordinate courts and compel creditors, in the protection of their interests, to ride the circuit, demonstrating the basis of their positions in successive courts." *In re New York, N. H. & H. R. Co.*, 26 F. Supp., at 23.

But we need not decide the question exclusively on the grounds just set out. For in the circumstances in which the United States presented its motion to dismiss in this case, the course of prior litigation had left the three-judge court virtually nothing to decide. On January 15, 1968, this Court had upheld the validity of the Penn Central merger under § 5 of the Interstate Commerce Act, conditioned on the inclusion of New Haven on terms subject to objections to be "registered and adjudicated in the bankruptcy court or upon judicial review as provided by law." *Penn-Central Merger Cases*, 389 U.S. at 511. We had permitted a postponement of the inclusion of New Haven on the basis of Penn Central's acceptance of the inclusion requirement, *id.*, at 509, and because by its act of merger Penn Central would "perforce accept . . . appropriate conditions respecting the New Haven . . . ." *Id.*, at 510.

Two weeks later Penn Central merged. At that point the lack of jurisdictional "completeness" in the reorganization court, to which we have referred, was cured; for there now remained no question of Penn Central's obligation to take over the assets of the New Haven. With Penn Central having given its irrevocable consent to the inclusion of New Haven by its act of merger, it was evident that whatever terms the reorganization court might confirm, subject to review on appeal to the Court of Appeals followed by certiorari here, would bind Penn Central by virtue of its merger commitment. Of course, the terms of the inclusion must themselves be "just and reasonable" and "equitable" under § 5. But those terms now involved only the value to be accorded the assets transferred, and resolution of that issue was the essence of the § 77 process. "The heart of . . . a determination [of the validity of a plan of reorganization] is a finding of fact . . . as to the value of the debtor's property." *In re New York,*

N. H. & H. R. Co., 147 F. 2d 40, 49, cert. denied *sub nom. Massachusetts* v. *New York, N. H. & H. R. Co.*, 325 U.S. 884. See Collier, *supra*, § 77.14, at 538–539; cf. *Consolidated Rock Prods. Co.* v. *Du Bois*, 312 U.S. 510, 524–525; *First National Bank* v. *Flershem*, 290 U.S. 504, 527; *Second Supplemental Report*, 331 I.C.C., at 652. In short, with identical issues before the two courts, with those issues involving only questions going to the value of a § 77 debtor's estate, with congruent standards of review, and with the irrevocable promise of Penn Central to take in New Haven, the three-judge court should have stayed its hand in the New Haven bondholders' litigation.[57]

Prior decisions of other three-judge courts, affirmed by this Court on direct appeal, lend support to the proposition that the three-judge court should have deferred to the reorganization court. In *Chicago & N. W. R. Co.* v. *United States*, 52 F. Supp. 65, the debtor railway company brought suit against the Commission in the United States District Court for the Northern District of Illinois, seeking three-judge court review of a plan of reorganization previously approved by the Commission and the courts. The District Court noted its "limited power" under the statute providing for review by a court of three judges, 52 F. Supp., at 66. It conceded the "seemingly applicable language" of the three-judge-court statute to "any order of the Interstate Commerce Commission," but held that once the Commission has approved a plan of reorganization under § 77, "appeal from Commission orders in connection with bankruptcy proceedings lies only to a district court, of one judge) sitting in bankruptcy, not to a district court (of three judges) assembled under the Urgent Deficiencies Act." *Id.*, at 67.[58] On direct appeal, this Court summarily affirmed the District Court's judgment. 320 U.S. 718.

Even closer in point is a case that arose during the first reorganization of the New Haven Railroad—*Group of Boston & Providence R. Corp. Stockholders* v. *ICC*, 133 F. Supp. 488. Shareholders of the Boston & Providence, also undergoing reorganization, sought judicial review before a three-judge court of the Commission's refusal to provide joint rates as between New Haven and Boston & Providence—exclusively an Interstate Commerce Act function. See Act, § § 1 (4), 15(6), 49 U.S.C. § § 1 (4), 15 (6). The court held that to grant the shareholders the ruling they sought would contravene the revenue-allocation formula already adopted by the New Haven's reorganization court and affirmed by the Court of Appeals and the Supreme Court. The three-judge court accepted the view of the Commission that "so long as the Boston & Providence lines are operated by the New Haven as lessee for the account of the lessor . . . , the Connecticut district court . . . has exclusive jurisdiction to pass on the accounting for such operation." 133 F. Supp., at 493. Again, this Court summarily affirmed. *Boston & Providence R. Corp. Stockholders* v. *New York, N. H. & H. R. Co.*, 350 U.S. 926.

We therefore hold that the three-judge court here should have granted the Government's motion to the extent of deferring to the reorganization court in proceedings ultimately involving only the price to be paid for the assets of the debtor's estate.[59]

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[57] Such abstention would in no way have limited Penn Central's full participation in judicial review of the Commission proceedings. Penn Central came before the reorganization court as a "party in interest" under § 77 (e) and did not oppose the order of the court making it a party to the proceeding; the company participated fully in all further hearings in the reorganization court; it took a protective appeal from the judgment of the court remanding the matter to the Commission after the first round of review, and it appealed again from the judgment of the court following the second round of review. At no time has anyone questioned Penn Central's status as a party litigant in the reorganization court or challenged its right to make a full presentation of its case there, on appeal to the Court of Appeals, or on review by writ of certiorari in this Court.

[58] The District Court also relied upon the prior adjudication of the validity of the plan. See 52 F. Supp., at 66 n. 1, 67.

[59] It is noteworthy that when the Commission drafted the provision under which Penn Central was obligated to take in New Haven, it evidently contemplated that review would take place only in the reorganization court. Condition 8 of the Merger, Report, the text of which is set out in the text above at p. 12, required Penn Central to take in New Haven with terms of inclusion to be "fair and equitable"—language peculiar to the Bankruptcy Act, and instinct with legal significance peculiar to that statute. See *Case* v. *Los Angeles Lumber Prods. Co.*, 308 U. S. 106, 115–119; Bankruptcy Act, § 77 (e) (1), 11 U. S. C. § 205 (e) (1). Condition 8 subjected the agreement negotiated by the parties to "the approval of the Bankruptcy Court and the Commission." And it also provided, in the event the parties were unable to agree to the elements of inclusion, for the imposition of "such fair and equitable terms and conditions as the Commission may impose, . . . subject to approval by the Bankruptcy Court . . . ." Repeated references to terms of art in bankruptcy law and to the bankruptcy court cannot be thought to lack meaning. Still less can we assume that the studied omission of any mention of the three-judge court was without significance.

III

In turning to the judgment of the reorganization court, we first review the standards under which that court passed upon the Commission's rulings.

After 35 years of § 77, as amended, it is unnecessary to recanvass the two basic objectives of the statute—the conservation of the debtor's assets for the benefit of creditors and the preservation of an on-going railroad in the public interest. See generally Collier, *supra*, ¶ 77.02, at 469–470. Central to the statutory objective that the reorganized company should, if at all possible, emerge as a "living, not a dying . . . enterprise," *Van Schaick* v. *McCarthy*, 116 F. 2d 987, 993, is the understanding that "a railroad [is] not like an ordinary insolvent estate." *Palmer* v. *Massachusetts*, 308 U.S., at 86. (Footnote omitted.) To the traditional equity jurisdiction of the bankruptcy court, § 77 adds the oversight of the Interstate Commerce Commission, the agency "specially charged with the public interest represented by the transportation system." *Ibid.* The statute contemplates that "[t]he judicial functions of the bankruptcy court and the administrative functions of the Commission [will] work cooperatively in reorganizations." *Warren* v. *Palmer*, 310 U.S., at 138. (Footnote omitted.)

In structuring the cooperative endeavor of agency and court, Congress "placed in the hands of the Commission the primary responsibility for the development of a suitable plan" for the debtor railroad. *Ecker* v. *Western Pacific R. Corp.*, 318 U.S., at 468. As the Court said in *Group of Institutional Investors* v. *Chicago, M., St. P. & P. R. Co.*, *supra*, "The ratio of debt to stock, the amount of fixed as distinguished from contingent interest, the kind of capital structure which a particular company needs to survive the vicissitudes of the business cycle—all these have been reserved by Congress for the expert judgment and opinion of the Commission, which the courts must respect." 318 U.S., at 545. See also *In re New York, N. H. & H. R. Co.*, 54 F. Supp. 595, 604. In the development of the plan of reorganization, § 77 also has accorded the Commission primary responsibility for determining wherein lies the "public interest," which does not refer generally to matters of public concern apart from the public interest in the maintenance of an adequate rail transportation system, cf. *United States* v. *Lowden*, 308 U.S. 225, 230, but includes "in a more restricted sense," *ibid.*, concern for "the amount and character of the capitalization of the reorganized corporation," *Ecker* v. *Western Pacific R. Corp.*, 318 U.S., at 473–474; cf. *Massachusetts* v. *Bartlett*, 384 F. 2d, at 821, as well as the "adequacy of transportation service, . . . its essential conditions of economy and efficiency, and . . . appropriate provision and best use of transportation facilities." *Texas* v. *United States*, 292 U.S. 522, 531; *New York Central Securities Corp.* v. *United States*, 287 U.S. 12, 25. As is clear from the legislative history and § 77 itself, the deference to the Commission as initiator of the plan of reorganization stems from the "recognition by everyone of the advantages of utilizing the facilities of the Commission for investigation into the many-sided problems of transportation service, finance and public interest involved in even minor railroad reorganizations and utilizing the Commission's experience in these fields for the appraisals of values and the development of a plan of reorganization, fair to the public, creditors and stockholders." *Ecker* v. *Western Pacific R. Corp.*, 318 U.S., at 468. (Footnote omitted.)

But the respect given the Commission as draftsman of the plan of reorganization entails no abdication of judicial responsibility for the workings of the administrative agency. As we have had occasion to say in describing other aspects of the Commission's work, "Congress did not purport to transfer its legislative power to the unbounded discretion of the regulatory body." *Burlington Truck Lines, Inc.* v. *United States*, 371 U.S. 156, 167. Far from displacing the judicial function, § 77 strikes a "balance between the power of the Commission and that of the court." *Ecker* v. *Western Pacific R. Corp.*, *supra*. The chancellor remains "a necessary and important factor in railroad reorganization": the statutory objective is "attained only through properly coordinated action between the Commission and the court." *Id.*, at 474–475. (Footnote omitted.) It remains for the reorganization court to ascertain that the Commission "has given consideration to each element of value concerned in its over-all appraisal, and has not wrongly decided legal questions involved in the problems of valuation and of allotment of equivalent securities . . ." *Old Colony Bondholders* v. *New York, N. H. & H. R. Co.*, 161 F. 2d, at 420

But the reorganization court may also do more. Under § 77 (c) (13), 11 U.S.C. § 205 (c) (13), the court on its own motion may refer matters to a special master for the hearing of such evidence as the court may desire—a provision which permits the "building up of a group of men [entirely apart from the Commission] thoroughly informed in railroad reorganization matters." H. R. Rep. No. 1897, 72d Cong., 2d Sess., 6 (1933). And under § 77 (e), 11 U.S.C. § 205 (e), the court may itself hold hearings upon the Commission's certification of its plan of reorganization, at which the court is empowered to take evidence beyond that received by the Commission—a supplementary power, unknown to conventional judicial review, but deemed essential to the reorganization court's exercise of its extraordinary "cram down" powers.[60] See S. Rep. No. 1336, 74th Cong., 1st Sess., 3 (1935); H.R. Rep. No. 1283, 74th Cong., 1st Sess., 3 (1935). The statutory authority to appoint special masters and to hold evidentiary hearings reflects the unique powers possessed by the reorganization court in passing upon the Commission's proposed plan of reorganization.

In sum, Congress has confided to the reorganization court the "power to review the plan to determine whether the Commission has followed the statutory mandates . . . and whether the Commission had material evidence to support its conclusions." *Reconstruction Finance Corp.* v. *Denver & R. G. W. R. Co.*, 328 U.S. 495, 509; cf. *Penn-Central Merger Cases*, 389 U.S., at 498–499. In the reorganization court reposes ultimate responsibility for determining that the plan presented to it by the Commission satisfies the "fair and equitable" requirement of § 77. See *In re New York, N. H. & H. R. Co.*, 16 F. Supp. 504, 507. And at the heart of that determination, as we have already noted, is the valuation of the debtor's property. Here, as elsewhere in the reorganization proceedings, the court must look to the conclusion recommended by the Commission. See *Ecker* v. *Western Pacific R. Corp.*, 318 U.S., at 472–473; cf. *Freeman* v. *Mulcahy*, 250 F. 2d 463, 472–473, cert. denied *sub nom. Boston & Providence R. Corp.* v. *New York, N. H. & H. R. Co.*, 356 U.S. 939; *In re New York, N. H. & H. R. Co.*, 54 F. Supp. 595, 600. And often the Commission's conclusion will entail less a statement of mathematical certainty than an estimate of what the market will say when it speaks to the subject. "But that estimate must be based on an informed judgment which embraces all . . . relevant . . . facts . . . ." *Consolidated Rock Prods. Co.* v. *Du Bois*, 312 U.S., at 526. "The judicial function is to see to it that the Commission's 'estimate' is not a mere 'guess' but rests upon an informed judgment based upon an appraisal of all . . . relevant . . . facts . . . , and is not at variance with the statutory command." *Freeman* v. *Mulcahy*, 250 F. 2d, at 473. In performing that function, the court must proceed with awareness that its review of the Commission's conclusion on valuation, as with every other important determination that the court is to make, calls for an "informed, independent judgment" of its own. *Consolidated Rock Prods. Co.* v. *Du Bois*, *vestors* v. *Chicago, M., St. P. & P. R. Co.*, 318 U.S., at 564.

There remains to consider the scope of review in this Court in passing upon the judicial determinations of the reorganization court. That we have granted certiorari to the Court of Appeals in advance of the appellate court's judgment does not alter the fact that "our task is limited." *Penn-Central Merger Cases*, 389 U.S., at 498. It is not for us to pass upon the myriad factual and legal issues as though we were trying the cases *de novo*. "It is not enough to reverse the District Court that we might have appraised the facts somewhat differently. If there is warrant for the action of the District Court, our task on review is at an end." *Group of Institutional Investors* v. *Chicago, M., St. P. & P. R. Co.*, 318 U.S., at 564.

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[60] Pursuant to § 77 (e), 11 U. S. C. § 205 (e), "the judge shall confirm the plan [of reorganization] if satisfied that it has been accepted by or on behalf of creditors of each class to which submission is required . . . holding more than two-thirds in amount of the total of the allowed claims of such class which have been reported in said submission as voting on said plan, and by or on behalf of stockholders of each class to which submission is required . . . holding more than two-thirds of the stock of such class which has been reported in said submission as voting on said plan; and that such acceptances have not been made or procured by any means forbidden by law: *Provided*, That, if the plan has not been so accepted by the creditors and stockholders, the judge may nevertheless confirm the plan if he is satisfied and finds, after hearing, that it makes adequate provision for fair and equitable treatment for the interests or claims of those rejecting it; that such rejection is not reasonably justified in the light of the respective rights and interests of those rejecting it and all the relevant facts; and that the plan conforms to the [statutory] requirements . . . ."

IV

As we have earlier noted, the purchase and sale negotiated by Pennsylvania, New York Central, and the New Haven trustees rested upon the estimated liquidation value of the New Haven properties to be transferred, rather than the earning power of the New Haven as an operating entity. *Second Supplemental Report*, 331 I.C.C., at 657. The parties to the Purchase Agreement thus gave recognition to the reality of New Haven's desperate financial situation, as well as to the power of the reorganization court to order the sale of the debtor's properties at not less than the "fair upset" price under § 77 (b) (5) of the Bankruptcy Act. In approving the negotiators' approach to the price question, the Commission observed that asset value rather than earning power was the primary determinant because New Haven had "long been dry of earning power." 331 I.C.C., at 657. "If there is one thing on this record that is clear and undeniable," the Commission concluded, "it is that N[ew] H[aven] has neither earning power nor the prospect of earning power." *Id.*, at 687.

In light of "the chronic deficit character" of the New Haven operation, *id.*, at 658, the reorganization court understandably accepted the liquidation approach to valuation. "The concept of 'going concern value' is fictional as applied to the New Haven," it said, "because it ignores the Railroad's long and continuing history of deficit operations." 289 F. Supp., at 455. (Footnote omitted.)

Before the Commission, the New Haven trustees and Penn Central submitted complete studies of the debtor's liquidation value, consisting of current assets, special funds, investments, real estate, and other assets. As the Commission described it, "Liquidation value as used by both the N[ew] H[aven] trustees and Penn-Central [was] the estimated market value that would be realized in a total liquidation, less the cost of dismantling properties and other liquidation costs and after discounting proceeds to present worth." 331 I.C.C., at 697; cf. *In re New York, N. H. & H. R. Co.*, 304 F. Supp., at 797–798.

The New Haven study, based on the assets held by the debtor as of December 31, 1965, was made over a nine-month period by persons who, the Commission found, were familiar with the railroad, its operating area, and the nature and condition of its properties. The Penn Central study valued the assets as of December 31, 1966; it was made in under two months by persons less familiar with the railroad. Both studies revealed that nearly half the New Haven's asset value consisted of its holdings in real estate. The New Haven study produced a gross value for all assets, exclusive of New Haven's interest in the Grand Central Terminal properties, of $230,290,000; the Penn Central study, $150,321,000.

Consistent with the liquidation hypothesis, both New Haven and Penn Central deducted from the gross value of the New Haven assets the expenses that would be incurred if a liquidation in fact took place. These included not only the estimated expenses of sale but, in the case of bridges, trestles, and culverts, removal costs for conversion of the realty to nonrailroad use —costs that often left the assets with a net negative value. The New Haven trustees hypothesized both a six- and a 10-year liquidation period, with expenses for liquidation operations plus taxes and interest aggregating $59,481,000 and $76,847,000, respectively; Penn Central estimated the expenses of a 10-year sale to be $62,172,000. The net liquidation value of the assets was arrived at by deducting the liquidation expenses and certain current assets not to be transferred to Penn Central, along with a further discount to present worth to reflect the hypothesis that receipts would be coming in over a six- or 10-year period.

The Commission concluded that once the New Haven estate embarked on a liquidation sale, it would dispose of the assets as quickly as practicable; the Commission accordingly found that "the bulk of the liquidation could be completed within a period of 6 years." 331 I.C.C., at 663. The Commission also concluded that the 6% discount rate employed by New Haven and challenged as too low by Penn Central was offset by the conservative valuation of the assets themselves. *Id.*, at 664. The Commission's ultimate finding was that the liquidation value of the New Haven assets to be conveyed to Penn Central "is about $125 million as of December 31, 1966." *Id.*, at 688.

As we have noted earlier, the reorganization court did not accept the $125,000,000 figure, with a consequent remand and second round of review.

The bulk of the Commission's valuation has now won the approval of the reorganization court and is not challenged by any of the parties here. There remains in dispute, however, the valuation of several items, aggregating nearly $200,000,000, and it is to those items that we now turn.

1. *The Grand Central Terminal properties.* By far the largest component in the dispute over the liquidation value of the New Haven is the debtor's interest in the Grand Central Terminal properties. This real estate complex consists of several parcels in the area of midtown Manhattan bounded by 42d Street on the south, Madison Avenue on the west, 60th Street on the north, and Lexington Avenue on the east. Included in the properties are the Barclay, Biltmore, Commodore, Roosevelt, and Waldorf-Astoria hotels; the Pan American building as well as other office buildings along Park Avenue; and the Yale Club. The total assessed value of the Grand Central Terminal properties as of 1965 was $227,225,000.

The New Haven railroad acquired the right to run its trains into Manhattan in 1848, when it entered into an agreement for use of the tracks of the predecessor of the New York Central, to extend for the lives of the respective charters of the two companies. In 1848 New Haven also acquired an easement over the tracks by legislation of the State of New York. See *New York, N. H. & H. R. Co.* v. *ICC*, 55 F. 2d 1028, 1030. The 1848 agreement underlay various subsequent contracts in the 1870's, '80's, and '90's between the New York Central and the New Haven.

In 1903 and 1904 the State of New York enacted further legislation requiring the placement of the railroad tracks below ground through the 15-block stretch north of the present Terminal. It did not take the Central entrepreneurs long to realize that compliance with the legislative edict left the company a vast area of midtown Manhattan suitable for realty development. In 1907 Central entered into the basic contract with New Haven under which the present Grand Central Terminal was built. The 1907 instrument recited that it had become necessary to rebuild the Terminal, including yards and tracks, in order to provide facilities for the proper management and conduct of the two railroads. Central promised to buy needed land and rights-of-way; New Haven, to make payments in connection with the demolition of the old station and the construction of the new. The 1907 agreement further recited that nothing it contained should impair the right of the parties under the 1848 agreement. It then went on to provide that Central "doth demise, let and lease" the use of the railroad terminal to New Haven in common with Central. "Railroad terminal" was defined to "mean and include the land, and interests in land, and all improvements thereon . . . , and all rights in any ways on which said land may abut . . . ."

Paragraph 4 of the 1907 agreement provided for joint contributions by New Haven and Central to Terminal maintenance and operation, calculated on the parties' respective car and locomotive usage of the station. The paragraph also obligated New Haven to a minimum annual payment of $160,179.92 without regard to the percentage of its use of the Terminal. In addition, ¶ 14 of the agreement stipulated that the manager of the enterprise should credit all rentals and other compensation received from the railroad terminal to "the fixed charges or to the cost of maintenance and operation of the said Railroad Terminal, as the same may be applicable."

In 1909, Central and New Haven began the joint financing of construction on the property referred to in the 1907 agreement, and in 1913, they entered into a supplemental agreement in order "to express more fully the intent of the parties hereto as to the right of the New Haven Company and the Central Company with respect to the construction, maintenance and use" of the Terminal properties. The supplemental agreement recited that New Haven's right of user included "the right . . . to join with . . . Central . . . in the construction, holding, maintenance and leasing of buildings . . . upon the land included within the Railroad Terminal." The heart of the 1913 amendment was a detailed provision for the sharing and reimbursement of construction and maintenance costs, along with a reaffirmation of the procedure established in ¶ 14 of the 1907 agreement, under which all rentals were to be credited to the Terminal enterprise. In the following years the two parties entered into hundreds of subagreements relating to the leasing, financing, and sharing of rentals from buildings constructed in the Terminal area. Income from the buildings was credited to the fixed charges, and to the maintenance and operation of the Terminal itself.

None of the agreements between Central and New Haven expressly provided for the disposition of "excess income" left over after the satisfaction of the Terminal expenses. For half a century after the 1913 agreement, the "excess income" question was of academic interest only, since expenses annually exceeded revenues. But in 1964, and in each succeeding year, the accounts showed excess income. New Haven demanded part of it, and Central refused. The trustees then brought a contract action in the New York Supreme Court to protect New Haven's interest in the income.

When the New Haven trustees first began negotiations with Pennsylvania and Central for the inclusion of the debtor's assets in Penn Central, they proposed that New Haven's interest in the nonoperating Terminal properties be excluded from the takeover, with final disposition deferred until the outcome of the then-pending litigation. But Central insisted it would not consider inclusion of New Haven in the merger unless it got absolute title to all the Terminal properties. The New Haven trustees thereupon sought the advice of legal counsel. They were told that under the agreements with Central, New Haven not only had no fee or leasehold interest in the properties, but had no rights at all that would survive cessation of its train service in and out of the Terminal other than the reimbursement of monies already advanced towards construction of buildings in the area. Although the New York lawsuit was pending to determine New Haven's right to participate in the excess income; the trustees concluded that as an alternative to risking "tremendous expense and long delay" in litigation, 289 F. Supp., at 462, resolution of the inclusion negotiations was of sufficient value to warrant their transferring the debtor's interest, whatever it might be, to Penn Central for no consideration whatever in exchange.

From the outset the bondholders dissociated themselves from the trustees on the question of the debtor's rights in the Terminal properties. Some of the New Haven creditors claimed the value of those rights to be $20,000,000—the sum of unreimbursed advances for building construction and capital improvements as carried on the New Haven books. Others said it was $50,000,000—the capitalization of one-half the excess income at 5%. Still others argued for one-half the value of the fee itself—nearly $115,000,000.

In its Second Supplemental Report the Commission eschewed responsibility for determining the legal rights of New Haven in the properties and set out only to value the debtor's claim. Confronting the complex legal relationship between Central and New Haven, with the consequent unpredictability of litigation, and unwilling to defer valuation of New Haven's interest to the completion of all possible contract actions between the two parties, the Commission set the value of the claim at $13,000,000. It arrived at this figure by taking the average of two unrelated sums: $5,000,000, representing Penn Central's estimate of the nuisance value of New Haven's claim; and $20,000,000, representing the capitalization of New Haven's share of the average of the excess income in 1964 and 1965, based upon its proportional usage of the Terminal.

Faced with the Commission's disclaimer of responsibility for resolution of the legal controversy between Central and New Haven, and given the Commission's Draconian solution to the question of value, the reorganization court appointed a special master to consider New Haven's legal interest in the Terminal properties.[61] Based on his study of the complex contractual relations between the two parties, of which we have touched above only on the salient features, the Special Master concluded that Central and New Haven had entered into a "joint venture or partnership . . . of some kind." The Special Master dismissed as untenable both Central's argument that by virtue of its sole ownership of the fee it would acquire full right, title, and interest in the Terminal properties upon the cessation of New Haven's train service, and the bondholders' argument that as a partner the debtor had an

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[61] Without pausing to assess the propriety of the method by which the Commission originally assessed the value of New Haven's interest in the Terminal properties, we think the reorganization court was correct in undertaking its own resolution of the contractual question. The validity of New Haven's claim "present[ed] a legal question which must necessarily be taken into account" in determining value. *Old Colony Bondholders* v. *New York, N. H. & H. R. Co.*, 161 F. 2d 413, 422, cert. denied *sub nom. Protective Committee* v. *New York, N. H. & H. R. Co.*, 331 U. S. 858. The legal question was one "to which the Commission's specialized skill and experience do not extend." 161 F. 2d, at 429 (L. Hand, J., concurring). The authority of the court to take further evidence is unquestioned, Bankruptcy Act § § 77 (c) (13), 77 (e), 11 U.S.C. § § 205 (c) (13), 205 (e)

undivided one-half interest in the fee. In 1907, when the parties entered into the basic agreement, Central had had title to the realty, and New Haven had had a perpetual right to the use of the tracks by force of state legislation. New Haven thus had "not come to the bargaining table in 1907 in the posture of a supplicant." The two railroads together had joined in the design and construction of a Terminal complex greater than either needed for its own requirements; they had undertaken a "major real estate development to extend over a period of many years"; and to those ends they had provided for a sharing of the Terminal expenses on the basis of their respective car usage, along with a commital of Terminal revenues to the operation of the project. As the Special Master put it, "There can be no question that by mutual agreement these revenues from all of the Grand Central Terminal properties were pooled to apply on the fixed charges and maintenance and operational costs of the Terminal."

In light of the conclusion that Central and New Haven had embarked on an enterprise akin to a partnership, the Special Master concluded that once the Terminal revenues satisfied expenses, the excess income belonged equally to each of the railroads. In his view, the car-use formula of the 1907 agreement ceased to be effective once revenue met expenses, and the principle of equality between partners took its place. The Special Master noted that the parties had not expressly dealt with the question whether New Haven's interest in the properties would end if New Haven ceased to use the Terminal. But he concluded that in such an event New Haven would still be entitled to half of the excess income; that right "would not and could not be terminated by the mere discontinuance of [New Haven] passenger service into and out of the Terminal." [62]

On the first round of review the reorganization court accepted the Special Master's report and incorporated it by reference in its own opinion. The court therefore remanded the matter to the Commission with instructions to value New Haven's one-half interest in the Terminal's future excess income. In addition, the court requested the Commission to "consider and make findings as to what value, if any, attaches to New Haven's present right to share in the income for the purpose of defraying its cost of operating in and out of the Terminal." 289 F. Supp., at 463.

In its Fourth Supplemental Report the Commission accepted the determination of the reorganization court that New Haven would have retained a right to one-half the excess income even upon liquidation. 334 I.C.C., at 30–31. Following an extensive consideration of future Terminal expenses and office-building and hotel income, the Commission projected a future excess income of $4,550,000 a year, of which New Haven's 50% share, capitalized at 8%, amounted to $28,438,000. 334 I.C.C. at 39. The new figure thus came to more than twice that awarded by the Commission on the first round.

The Commission also complied with the request of the reorganization court that it consider the value of New Haven's right of access into the Terminal. The Commission concluded that the right would have no value to New Haven unless a buyer were willing to pay for it; that the only potential buyer in

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[62] In 1912 Central and New Haven had erected the Hotel Biltmore through a subsidiary, each railroad supplying half the funds, which were finally reimbursed in 1957. In 1958 Central sought to lease the Biltmore to a controlled subsidiary over New Haven's objection. When New Haven refused to sign the lease, Central claimed that New Haven had broken its agreement and thereby had forfeited all interest in that portion of the enterprise. Central brought suit in New York state court to secure a determination of the parties' respective interests in the property. See *New York Central R. Co.* v. *New York, N. H. & H. R. Co.*, 24 Misc. 2d 414, 208 N.Y.S. 2d 605, aff'd as modified, 13 App. Div. 2d 309, 216 N. Y. S. 2d 928, aff'd *per curiam*, 11 N. Y. 2d 1077, 184 N. E. 2d 194. The conclusion of the New York courts paralleled those of the Special Master. The Supreme Court ruled that New Haven's right to share in rentals after credits to Terminal expenses survived reimbursement of its investment, 24 Misc. 2d, at 428, 208 N. Y. S. 2d, at 618. The Appellate Division agreed, holding that the parties had, "in effect, converted themselves into owners of the fee together" and that "the development of the lands over the tracks was but another step in the joint exploitation of the Railroad properties made possible by the covering of the tracks . . . in which [properties] each party had a joint interest. . . ." 13 App. Div. 2d, at 318, 216 N.Y. S. 2d, at 936. The latter court rejected the notion that after paying large sums of money for the construction of buildings and assuming the risk of loss operations in the Terminal enterprise, New Haven should have acquired no right "except the right to join docilely in each of the decisions made by Central." *Id.*, at 319, 216 N. Y. S. 2d, at 937. Although Central retained sole ownership in the fee, that fee was encumbered by the rights of New Haven. The Appellate Division concluded that New Haven's position *vis-a-vis* Central could be described as that of a partner. *Id.*, at 320, 216 N. Y. S. 2d, at 937.

sight was the State of New York, which would not need to bid for use of the Terminal; and, accordingly, that New Haven's right of user was valueless. 334 I.C.C., at 32. The bondholders' claim of value for the right of access, the Commission said, amounted to a demand for one-half of all of the income free of the Terminal expenses. *Id.*, at 32 n. 11. On the second round of review, the reorganization court agreed that the Commission's determinations must stand with respect to both the liquidation value of New Haven's interest in the Terminal properties and its right of free access into the station.[63]

Many aspects of the controversy over the Grand Central Terminal properties have now dropped from contention.[64] The bondholders no longer claim that New Haven is entitled to one-half the value of the fee. Penn Central no longer claims that its fee ownership of the properties reduced New Haven's status to that of a mere grantee retaining only the privilege of entry into the Terminal. All parties accept New Haven's right to the capitalized value of one-half the excess income.[65] What remains is the claim of the bondholders that New Haven is entitled to the capitalized value of its share not only of the excess income remaining after satisfaction of the Terminal expenses, but of the basic income meeting the expenses themselves. Yet the central finding of the reorganization court remains unrefuted: that by force of the agreements between New York Central and New Haven, the Terminal income was first to be devoted to meeting Terminal expenses; only then was the residue to become available for distribution to the two railroads. To be sure, the parties customarily referred to their respective shares of the Terminal revenues. But the Special Master found that the Terminal revenues were allocated to Central and New Haven on their respective car-use bases as an accounting convenience. The car-use formula established by the 1907 agreement "resulted, for accounting purposes, in the corresponding proportion of the revenue entering the Terminal Account being treated as the property of each railroad, and in each railroad's being relieved *pro tanto* from the amount of its liability to meet the charges . . . ."

The bondholders argue that the basic income of the Terminal could somehow be "freed up" from the obligation to meet Terminal expenses. But the Special Master considered and rejected that theory.

"Both parties . . . committed themselves to pouring these revenues from the entire Grand Central complex into the Terminal Account under paragraph

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[63] "The Special Master . . . concluded there was no value in the interest, principally because it is not the kind of interest that would survive liquidation; nor, if it did, could it be assigned. Moreover, there was no evidence that the expenses of maintaining the terminal would be any less. And the idea that the State of New York, or an interstate authority might pay, directly or indirectly, some consideration for availing itself of that use is highly speculative in view of the bargaining positions of the states and the disposition of the I. C. C. to require Penn Central to furnish such access free of charge to a state or public authority which assumed the commuter service, as a condition of Penn Central's getting rid of that much of the losing and burdensome passenger service. While mitigation of a burden may in some circumstances furnish a consideration, it is not a measurable one for the purpose of this issue in the case." 304 F. Supp., at 806.

[64] At one stage the litigation over the value of New Haven's interest in the Terminal properties also involved disputes over which of four different sets of account books the Commission should use, the base period from which the Commission might extrapolate future income and expenses, the rate at which the projected income flow should be capitalized, and the probable income flow from a new office building to be constructed on the site of the railroad station.

[65] The Bondholders Committee presses its challenge that the Commission has understated New Haven's share of excess income by $700,000 a year, with a capitalized loss of $8,750,000 in value. The challenge is predicated on the claim that the Commission improperly concluded that future hotel profits would not increase but would remain constant. 334 I. C. C., at 38. The reorganization court upheld the Commission in this regard, 304 F. Supp., at 806. We do not overturn its judgment on a matter such as this, calling for an informed prediction of future income, expenses, and the rate of return on invested capital in a specific business activity uniquely located in midtown Manhattan.

In addition, it is suggested that upon a cessation of New Haven Terminal operations the costs of maintaining the station would decrease, with a consequent augmentation in the excess income. Of course the station revenues would decrease as well—perhaps as much as or more than the expenses. In the absence of any record evidence on the point, we cannot assume that liquidation would thus have benefited New Haven.

On the second round of review the reorganization court ordered Penn Central to pay New Haven the latter's share of accrued excess income for 1967 and 1968, as a separate sum apart from the purchase price. 304 F. Supp., at 806–807. The Bondholders Committee now asks us to award interest with respect to this payment. The reorganization court rejected the claim, doubtless because the uncertainty of New Haven's legal interest in the excess income precluded a finding that the amount represented a liquidated obligation owed by New York Central. We agree with the court's ruling.

14 of the Agreement of 1907. The revenues were to enter that account and were to be expended, superior to the individual interests of each railroad, by being applied on payment of the fixed charges and expenses of operation and maintenance of the Terminal. Those revenues were pledged to that purpose regardless of whether New Haven utilized one per cent or fifty per cent of the Terminal's passenger facilities, or whether it used any of those facilities at all. It was not contemplated that if either railroad discontinued passenger trains into Grand Central the other would be saddled with the entire expense of a terminal larger than either railroad needed without being credited with these entire revenues from the Grand Central Terminal properties to the extent that they were required to meet expenditures . . . ."

Nevertheless, Chase Manhattan argues that the commitment of revenues is merely a creature of the agreement between Central and New Haven as construed by the Special Master, and that the transfer of New Haven's Terminal interests on December 31, 1968 "wiped out" that agreement. "The agreement thereafter was no longer in existence," says Chase, "and Penn Central now has this [basic] income (both the former New York Central's share and the former New Haven's share) free and clear of any restriction against its use in any way Penn Central sees fit." Stated in this fashion, the argument is self-defeating: since New Haven's right to the basic income derives solely from its agreement with Central, a "wiping out" of that agreement necessarily leaves New Haven without the right as well as without the obligation. But, more importantly, it simply is not true that Penn Central now has New Haven's former share in such income without "any restriction of any kind . . . ." Penn Central also has New Haven's loss operations into and out of the Terminal, and it must meet the expenses occasioned by those operations from some source. Since by definition New Haven's share of the basic income was, as an accounting matter, equal to its share of the Terminal expenses, by its 1968 transfer it has merely surrendered an amount equal to its gain: it has given up its share of the income pledged to the costs of operations at the Terminal, but it has relieved itself of the obligation to meet those costs. By the same token, Penn Central has gained New Haven's share of income, but with the matching loss of New Haven's expenses.

The bondholders' argument must be that entirely apart from the contractual arrangements with Central, New Haven had a valuable right of free access into the Terminal, which Penn Central has now taken over with no compensating payment in exchange. This argument, too, is without merit. It is a misnomer to describe New Haven's right of access to the Terminal as "free." New Haven had a right of entry, rather than a privilege, in the sense that it had access, independently of the consent of the fee owner of the tracks, by force of legislative edict. But the right bestowed by the legislature was conditioned "upon such terms . . . as [have] been or may hereafter be agreed upon by and between" New Haven and Central's predecessor. N. Y. Sess. Laws of 1848, c. 143, § 6. Thus the New Haven right of access has never been free from the obligations imposed by the agreements with Central.

But even if the access right were "free" in the sense that it could survive elimination of New Haven's agreements with Central, we agree with the reorganization court that the Commission correctly concluded it would have no value. And that is the case whether the right is deemed transferred to Penn Central, as in fact it was, on the date of inclusion, or whether, consistent with the liquidation hypothesis on which the parties valued New Haven's other assets, it is deemed to have been offered for sale to a third party upon New Haven's cessation of operations. In the former event, the analysis pertinent to New Haven's contract rights applies with equal force. Penn Central has in fact succeeded to New Haven's right of access, but it has also succeeded to New Haven's deficit operations. Conversely, New Haven has given up a right of entry in exchange for relief from the obligation to provide train service at the station. Indeed, to the extent that the expenses generated by New Haven's use of the Terminal exceeded the revenues attributable to that activity, Penn Central has lost and New Haven gained on the exchange.[66]

[66] The parties have devoted much discussion to Penn Central's negotiations with the States of New York and Connecticut for the transfer of the New Haven commuter service to a public authority. Manufacturers Hanover says the States have agreed to pay an annual toll to run the trains into the Terminal, thus demonstrating that the New Haven right of access does have value; Penn Central claims the States are to pay only for the use of the tracks and that it will give them a right of entry into the Terminal for nothing. Both sides point to newspaper articles in support of their arguments. None of this is record evidence, and we do not consider it.

The same result is reached if New Haven is deemed to have gone into liquidation. For the bondholders have never shown that anyone would pay a penny for the right to carry on New Haven's deficit-ridden Terminal operation. If nobody would pay a liquidating New Haven for the right to lose money, the right is, again, worthless. The Commission found that the only potential buyer would be the State of New York, moving to preserve the commuter service in the public interest. 334 I.C.C., at 32. Whether the State would have to pay *Penn Central* for the use of Penn Central's tracks and its share of Terminal expenses is not before us. On the liquidation hypothesis, the State would not have to pay Penn Central for New Haven's right of access, for Penn Central would not own it. And the State's paying *New Haven* depends on at least four independent contingencies: whether New Haven's right of access would survive liquidation; whether the right would exclude the power of Central to bestow a similar access right on a third party while New Haven's own went unused; whether, under the agreement with Central, the right would be capable of assignment; and whether the State, if required to pay New Haven anything to enter the Terminal, would choose instead to operate the commuter trains only to subway connections in the Bronx rather than all the way into Manhattan. We agree with the Commission and the reorganization court that these imponderables render the value of New Haven's right of access so speculative as to defy reasoned attribution of any value to it.

2. *The Bronx freight yards.* One of New Haven's principal real estate holdings consisted of two freight yards located on some 160 acres in the south Bronx, New York, between the East River on the one side and the Major Deegan Expressway and Bruckner Boulevard on the other. The Harlem River yard occupies nearly 4,000,000 square feet across the East River from Manhattan and Queens; it has been described by a qualified appraiser as "a unique industrial facility that could well be used by any heavy industrial concern." About a mile north of the Harlem River yard, and connected to it by the existing trackage of New Haven's Harlem Division line, lies the Oak Point yard, characterized by the appraiser as "one of the most desirable industrial facilities in New York City."

Two other facilities in the area are worthy of note. The first is the Hunts Point Market, located northeast of the Oak Point yard. The market is a $100,000,000 municipal installation and the central distribution area for the wholesaling of produce for the New York City metropolitan area. It lies on the promontory flanked by the Bronx and East Rivers, and is connected to the New Haven's Harlem Division line through a spur track owned by the city. The market is the largest receiver of rail traffic in the area, and plans are under way for further expansion. *Fourth Supplemental Report*, 334 I.C.C., at 43–44. The second facility is the former Port Morris yard of Penn Central, situated midway between the Harlem River and Oak Point yards and lying athwart the Harlem Division trackage that connects the two New Haven yards. Port Morris is linked by a branch line to Penn Central's Harlem Branch division, a principal element in the Penn Central System. An interchange track runs from the Port Morris branch line to the border of the Oak Point yard.

Before the Commission, the parties submitted five different estimates of the value of the Harlem River and Oak Point yards. The bondholders offered the testimony of an appraiser who thought the land would bring $32,000,000 for residential use and $26,000,000 for industrial use; the New Haven trustees offered the testimony of another appraiser who submitted two studies showing $22,650,000 and $18,090,990, both for industrial use; and Penn Central, that of a third appraiser who set the value, again for industrial use, at $15,585,000. In its Second Supplemental Report the Commission accepted the lower of the values proposed by the trustees' witness—$18,090,990. 331 I.C.C., at 668.

On the first round of judicial review the reorganization court thought that on the present record "there was substantial evidence to support the Commission's valuation and not enough to show that it was unfair or inequitable," but concluded that a clarification of the basis of the Commission's valuation was desirable. 289 F. Supp., at 464. On the remand, controversy centered on the alternative appraisals offered by the trustees' witness. It soon became evident that in valuing the freight yards the Commission had pursued the liquidation hypothesis with a vengeance. The higher appraisal of the trustees' witness had rested on the premise that upon cessation of New Haven opera

tions the Bronx yards would be available for continued industrial occupancy, with existing trackage and electrical facilities left in place. The presence of such facilities commanded at least a 10% premium in Bronx realty values. The witness' second appraisal had assumed that upon liquidation New Haven would strip the yards of these facilities, thereby depressing the value of the land and incurring substantial costs of removal. 334 I.C.C., at 42. Adoption of that assumption resulted in the loss of over $4,000,000 in value.[67]

In its Fourth Supplemental Report the Commission adhered to its acceptance of the lower of the witness' two estimates, reiterating its reliance upon the liquidation premise. That premise justified the assumption that New Haven would dismantle the yards once the rest of the railroad was scrapped, since with no link to Penn Central the yards would have no value either as operating facilities or for industrial use with railroad connections.

But the fact of the matter was that even on the liquidation hypothesis the New Haven yards did *not* lack rail connections to Penn Central. Penn Central already had in place a branch line running from its Port Morris yard to its Harlem Branch division. That Port Morris line, along with the interchange track running up to the border of the Oak Point yard and meeting the New Haven's line at that point, would have continued in place even upon a liquidation of New Haven. The trustees' witness acknowledged that in arriving at the lower of his two values for the New Haven yards, he had been unaware of the Penn Central link at Port Morris. Nevertheless, the Commission attributed no significance to the witness' unawareness of the Port Morris connection, because it concluded that even with the existing link to the New Haven yards, it was "extremely doubtful" that Penn Central would continue to provide service into the area after a New Haven liquidation. Once New Haven vanished, the Commission reasoned, Penn Central would be under no legal obligation to perform switching service beyond its own Port Morris line or to extend its line into the former New Haven yards. And the Commission accepted the testimony of a Penn Central witness that the company would have no economic incentive to provide service, because of the unprofitability of the perishable freight destined for the Hunts Point Market, as well as the absence of necessary track clearances and yard classifying facilities. 334 I.C.C., at 44–45.

On the second round of review the reorganization court ruled that the Commission had erred in rejecting the higher of the witness' two appraisals. "It is undisputed that the Port Morris branch was and is there and operating and Penn Central has not been authorized to abandon it." 304 F. Supp., at 807. The court overruled the Commission's determination that Penn Central would cease to provide service not only to the industrial enterprises in the 160-acre area of the two yards, but to the Hunts Point Market as well.

"The great bulk of produce for feeding of the millions of residents of metropolitan New York is brought in by rail through these yards to this market and distribution point. To assume that the State and City of New York would stand idly by and permit the life line to its huge and costly enterprise to be cut, just as it is in the midst of planning its necessary enlargement, because it was unwilling or unable effectively to bring pressures to bear or take steps on its own to preserve the connection with Penn Central is absurd . . . ." 304 F. Supp., at 807–808.

The ruling of the reorganization court is, at the least, free from the error that would require us to overturn its judgment on this matter. As the Commission's own report makes evident, the agency based its startling conclusion that Penn Central could deny service to the area not on the facts of record, but in adherence to the untenable assumption that on liquidation New Haven would have uprooted the valuable trackage and electrical facilities already in place. According to the Commission, "[t]he record does not support any

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[67] "An example of the difference in approach in the trustees' two appraisals is afforded by the so-called REA Building in the Harlem River yard. This building was specially built for REA Express with four tracks running through the center of its ground floor. In the first, and higher, trustee appraisal the building was valued at $675,000 because of these tracks and the railroad service they provided. In the second, and lower appraisal, it was assumed that the tracks were dismantled. This would require reconstruction of the ground floor. The building would then be suitable only for an entirely different type of tenant. Without tracks, it would have a lower rental value. Its appraised value was, therefore, reduced to $400,000 in the second appraisal. Differences in the values of various other tenant-occupied buildings in the two yards resulted from following similar procedures in their appraisals." 334 I. C. C., at 43. (Footnote omitted.)

finding of substantial need for Penn Central service that would justify the construction by that carrier of the trackage necessary to connect Harlem River and Oak Point yards and the latter yard and Hunts Point, *if N[ew] H[aven] were to be liquidated.*" 334 I.C.C., at 47. (Emphasis supplied.) Of course we may assume that Penn Central could not be forced to buy land and build track to provide service into areas, noncontiguous to its rail system, to which it did not hold itself out as a common carrier. But it is a far cry from that proposition to the statement that a common carrier could deny service to industrial and public activities simply because ownership of adjoining trackage had changed hands.[68] The record facts are that the trackage the Commission said Penn Central would have to construct is already in place, connecting the two yards and the market.[69] The Commission nonetheless continued to presuppose the removal of the New Haven's rail facilities. "On this record," the Commission reiterated, "*and the assumption of N[ew] H[aven]'s liquidation and the dismantling of its system,* Penn Central would not serve, and could not be compelled to serve, the Harlem River or Oak Point industries, or the Hunts Point Market." 334 I.C.C., at 47 (Emphasis supplied.) There is not a shred of record evidence to support the Commission's assumption as applied to the New Haven yards. It is not rational to suppose that the managers of the hypothetical liquidation sale, devoted to obtaining the highest possible price for the assets of the debtor, would have ignored the best use of the yard facilities and stripped them of more than $4,000,000 in value.[70]

3. *The added deductions.* On the remand the Commission recalculated the liquidation value of the New Haven, as directed by the reorganization court, and arrived at a new sum of $162,700,000. "A property value of this sort inheres in the assets," the Commission said, "if we assume that the railroad may immediately shut down and begin a 6-year program of selling off the road parcel-by-parcel, and virtually tie-by-tie." 334 I.C.C., at 53. But the Commission declined to approve the new figure as the proper liquidation value of the debtor.

"The liquidation value that results in this reopened proceeding exceeds the agreed price [of $125,000,000], obliging us to make a new determination as to whether the price resulting from such a valuation is fair.

"The establishment of liquidation value as a pricing floor on this record must assume that the N[ew] H[aven], may be shut down at once and be liquidated in parcels. Such a pricing theory assumes that the public may be denied an opportunity to be heard. It is wholly inconsistent with the requirement we have imposed on Penn Central to absorb the N[ew] H[aven], which requirement rests entirely upon the public's need for a continuing N[ew] H[aven]. Any assumption that N[ew] H[aven] may be shut down and broken up must necessarily permit the conclusion that Penn Central may be relieved of its inclusion obligation. It is inequitable to conceive at the same time both a right in the bondholders to break up the N[ew] H[aven] and an obligation on Penn Central to keep it going. The demands of equity are no more satisfied by conceiving that the bondholders have a constitutional

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[68] Under the Interstate Commerce Act, Penn Central is obliged to "provide and furnish transportation upon reasonable request therefor," Act, § 1 (4), 49 U. S. C. § 1(4), and to offer switch connections and cars for traffic to branch lines or private side track constructed by shippers to connect with the railroad wherever practicable and justified by the added business. Act, § 1 (9), 49 U. S. C. § 1 (9).

[69] Penn Central claims it could not provide service to the yards over the Port Morris branch because of clearance difficulties on the line. The reorganization court observed that Penn Central's own evidence largely refuted the contention. This finding of the District Court, based on its study of the record and its intimate familiarity with the subject matter, is free from clear error, and we do not disturb it.

[70] Penn Central's own witnesses conceded the Port Morris connection would "doubtless" enable the industries at Harlem River and Oak Point to continue their rail usage even after a New Haven liquidation; that someone, whether the City of New York or a third party, would have to acquire access for rail service to the Hunts Point Market; and that the only rational way to provide such service would be to move cars from the Penn Central system via the Port Morris connection. The Commission itself found that during a test month in the summer of 1968 more than 2,300 cars passed from the Penn Central main lines to the market and yard industries via the Port Morris connection. 334 I.C.C., at 44.

At one point Penn Central claimed that even on the higher of the two appraisals, the record evidence required a downward adjustment of $461,000. The reorganization court made a partial correction to reflect a conceded duplication, but implicitly rejected Penn Central's argument as to the balance. Since Penn Central does not press the issue here, we do not consider it.

right to shut down the N[ew] H[aven] which is superior to the public's right to keep it going.

"The foregoing liquidation value assumes that this Commission has no function under the Interstate Commerce Act to decide whether public convenience and necessity permit the abandonment of N[ew] H[aven]'s entire line or portions of it. In view of our often repeated findings that there is a public need for the services of this railroad, there is no warrant for assuming that the creditors may now break up the railroad or devote the properties to another use. The estate is not relieved of its obligation to serve the public. A price that is premised on outright rejection of that obligation is inequitable and awards the estate a windfall that is not supported by any record evidence." 334 I.C.C., at 54–55.

On the basis of this reasoning, the Commission then proceeded to take into account "other pricing considerations"—costs of liquidation it had not reached in its earlier report because of its conclusion that the $125,000,000 price arrived at by the parties was proper under the Interstate Commerce and Bankruptcy Acts.

"The alleged right to liquidation values derives from an alleged right to abandon; and there are recognized limitations on the right to abandon that in themselves limit the creditors' entitlement to the liquidation value we have computed under the court's instructions. Under section 1 (18) of the Interstate Commerce Act, the Commission is empowered to impose reasonable limitations on the abandonment right." 334 I.C.C., at 57.

The Commission's new "pricing considerations" consisted of two elements: a one-year delay the New Haven would have incurred in securing the approval of the Commission and the courts to abandon train operations; and a bulk-sale discount that a purchaser of all the debtor's assets, to whom the Commission could order the road to sell, would have commanded. Together the added deductions amounted to $22,081,000.

(a) *The one-year delay.* The Commission found that an application for a certificate of abandonment, as required by § 1 (18) of the Interstate Commerce Act, would have precipitated a lengthy process of administrative action and judicial review resulting in at least a one-year's delay in the commencement of actual liquidation operations. The Commission assumed that the year's delay would have occasioned a freeze on liquidation activity, following which the sell-off would have proceeded as projected in the Second Supplemental Report. The abandonment delay, the Commission found, would have added costs of $4,940,000 in preserving the assets of the estate, $2,500,000 in real estate taxes, and $7,946,000 in a discount of the sale receipts back to present worth.

On review the reorganization court rejected the delay concept, ruling that the added deduction violated the liquidation hypothesis upon which the debtor's assets had been valued. Neither the parties nor the Commission had previously postulated the deduction now imposed, because the liquidation hypothesis itself had presupposed a lawful abandonment of service. 304 F. Supp., at 798. That presupposition was rooted in the hard fact that for more than three years prior to December 31, 1966, the New Haven had been kept alive, despite its hopeless financial condition, solely in the name of the public interest and in anticipation of inclusion in Penn Central.

"By late 1963 it was clear to the Trustees of the New Haven and to the Reorganization Court that only two courses were open: the Trustees must press to accomplish the inclusion in a Penn Central merger or they must press for liquidation. The former was obviously in the public interest and the latter was not. The course of inclusion was followed; but because the merger and the reorganization proceedings stretched out far beyond what was originally forecast, the 'interim' became seven and a half years; and 'losses reasonably incident to working out the solution most consistent with the public interest' eroded the debtor's estate in excess of $60 million.

"Like Laban of old, the Commission would now require further servitude of the debtor—in this case the creditors. But the duty of the debtor's creditors to suffer losses for an interim period has already been fulfilled and the public interest has already been served to the extent that in fairness and equity the public had any right to demand." 304 F. Supp., at 800 (Emphasis omitted.)

The Commission and Penn Central take issue with the reorganization court's disallowance of the deduction for delay. The dispute between them and the

bondholders is not, however, broad in concept. It does not draw into question the right of the Commission to insist that New Haven obtain permission to abandon its operations: no one here quarrels with the proposition that in the event of a liquidation, New Haven would have been obliged to obtain a certificate from the Commission pursuant to § 1 (18) of the Interstate Commerce Act. The parties agree that since a delay occasioned by abandonment proceedings before the Commission, followed by judicial review, inheres in the liquidation process, the Commission may exercise its expertise in gauging the extent and expense of such a delay, and Penn Central need not pay for the consequent diminution in the value of the assets of the debtor. The dispute is, rather, a narrow one. It is simply whether, in the circumstances of this case, the valuation initially arrived at by the Commission already presupposed that the debtor had a certificate of abandonment in hand, so that assignment of a cost attributable to that factor amounts to an unwarranted double deduction.

Before this Court the Commission and Penn Central urge the view that until the remand the Commission had not taken the delay factor into account. They justify the deduction on the second round as a development of the governing liquidation hypothesis adopted on the first. Once we enter the world of a liquidation that never occurred, they say, the Commission merely refined the liquidation approach to reflect added expenses not initially considered because of the fairness of the price arrived at by the parties. The new price ordered by the courts compelled re-examination of the elements of liquidation, of which abandonment delay is surely one. And when it comes to predicting the likelihood of delay in passing on an application for a certificate of abandonment, the Commission is, as Penn Central puts it, "a uniquely qualified finder of fact . . . ." [71]

At once the "refinement" rationale confronts an imposing obstacle raised by the Commission's own Second Supplemental Report. That report makes clear that the Commission had the element of delay before it in making its original valuation, but declined to apply any deduction on its account. The Commission considered—and rejected—Penn Central's request "that an allowance be made *to the earliest date at which a liquidation could reasonably be anticipated* for the constant diminution of N[ew] H[aven]'s assets." 331 I.C.C., at 698. (Emphasis supplied.) That rejection necessarily implied that the Commission had recognized the cost attributable to the delay occasioned by an abandonment proceeding, but determined not to weigh it in the balance. Thus we deal not with a delay factor brought to light for the first time on the second round, but with one taken into account now even though deliberately excluded before. Justification, if any there be, must begin with the realization that the Commission changed its mind in midstream.

The reorganization court rejected the Commission's conclusion that the valuation date selected in the Second Supplemental Report—December 31, 1966—represented the date on which New Haven would have sought a certificate of abandonment rather than the date on which the railroad would have commenced its six-year sale. In doing so, the court relied on more than the Commission's shift in position between its second and fourth reports. The court rested on its express finding of fact that "but for the adoption by the Trustees of a course to serve the public interest, abandonment proceedings could and would have been commenced in late 1963 and liquidation would have been started, certainly by the valuation date of December 31, 1966." 304 F. Supp., at 801. That finding comes to us from the federal judge who has presided over the second New Haven reorganization since its inception. "In view of the district judge's familiarity with the reorganization, this finding has especial weight with us." *Reconstruction Finance Corp.* v. *Denver & R. G. W. R. Co.*, 328 U.S. 495, 533. Not only are we unable to say the finding is erroneous; we do not see how the record of these proceedings permits any other conclusion.

Indeed, the Commission and Penn Central do not challenge that conclusion. Instead, they seek support for the delay deduction by urging that if confronted with an abandonment application, the Commission would have had to "hear

[71] The Commission itself justified the refusal of the hearing examiner to take evidence on the question of delay by saying: "To the extent that evidence was proffered on the processing time of possible abandonment proceedings involving N[ew] H[aven], such matters are within our knowledge and evidence thereon was unnecessary." 334 I. C. C. at 29.

the communities that would be affected by the abandonment. If there is hope of a public takeover of segments, we must allow time for the States and communities to present their plans." 334 I.C.C., at 58. But apart from the fact that this Court itself once characterized the notion that the affected States or the Federal Government might take over the road and its operations as "sheer speculation," *Penn-Central Merger Cases*, 389 U.S., at 507, the reorganization court specifically rejected the Commission's argument.

"During seven and one-half years, the Federal Government, the states, the communities and the public in general were fully informed by the Trustees of the Railroad as to the inability of the New Haven to survive as an independent railroad. And, apart from seeking inclusion in a merged Penn Central, the Trustees were engaging in a holding operation to afford the public bodies, as the real guardians of the public interest, the opportunity to act—to take over or adopt measures to preserve the New Haven transportation system. Response to this was partial tax assistance and, in the latter half of the period, grants which covered about ⅓ of the annual passenger losses. . . . Otherwise nothing has come to the attention of this court, to indicate anything more than a highly speculative prospect, that any or all of the states concerned or their municipalities had the slightest interest in taking over and operating the New Haven or any segment of it.

"In spite of full awareness of the situation of the bankrupt line and with nothing to prevent their doing so, no standby legislation, for use if inclusion of the New Haven by Penn Central fell through, was ever enacted or sought to be passed in seven and one-half years by the Federal Government or by any of the states for the take over and operation of the New Haven freight and passenger system or a segment of it (except for the west-end and the Boston commuter services); nor was any plan ever filed by the governmental bodies incorporating such take over and operation." 304 F. Supp., at 800–801.[72]

We think the reorganization court was entirely correct in concluding that "The policy of imposing an interim burden of losses, through its deficit operation, on a railroad in reorganization is to afford a reasonable opportunity to the responsible agencies to arrange the continuation of the railroad's operation, but the law does not require the furnishing of two or three or four opportunities. The duty was more than amply fulfilled by the New Haven. The public interest has had one huge bite of the apple; it is not entitled to another." 304 F. Supp., at 801.

It is argued that the Commission nonetheless should be permitted to tax New Haven with the cost of a one-year delay because in fact the debtor sought no abandonment certificate from the Commission. The Commission and Penn Central attribute this failure to New Haven's self-interest. "The fact is," the Commission said, "that both the creditors and the trustees exercised

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[72] These findings comport with the observations of the reorganization court in February 1965, when the trustees sought permission to discontinue all passenger service:

"The record shows that the public interest has been thus far supported by the creditors of this estate with no substantial participation from the states.

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"Far from being indifferent to the public interest, the court has indulged that interest and allowed it to prevail over the creditors' rights for three and one-half years.

"In spite of this long interval, very little has been produced. Massachusetts never fulfilled its commitment to grant tax relief. New York, by conditioning future tax relief on a commitment by the Trustees to lease new equipment and conduct commutation service at present levels with no assurance that the deficits would be underwritten, has used it as a lash over the back of the debtor to compel it to do the State's will at a time when it has not had the strength to do so. Tax relief in Connecticut and Rhode Island was continued, but with a requirement that certain standards of service be met and, accordingly, that the passenger deficits continue to be incurred.

"If the public interest so urgently demands the continuance of the New Haven's passenger service, as the States seem suddenly to have discovered, they should have stopped taxing its property a long time ago. Commuters and other passengers demand better equipment and better service: the States insist upon imposing a continuing tax burden—everyone wants to draw the last ounces of blood out of this near corpse; but no one gives it the transfusion it so badly needs. It is now too late in the day to talk about saving the situation with tax relief. As the railroad has not been able to use its vital cash for taxes, liens have been accumulating ahead of the creditors, forcing them further down the ladder of priorities, and accelerating and compelling the action which the court has taken today. If this tax burden continues to grow and the Railroad is not otherwise relieved, the creditors will be compelled to move for liquidation of the New Haven and the court will have no recourse but to order it. If the states wish essential passenger services continued, an underwriting which goes far beyond tax relief will be necessary."

options, assuming the risks involved herein, and the bondholders may not now be heard to ascribe to someone else the responsibility for the selection of their course of action, or inaction." 334 I.C.C., at 58. (Footnote omitted.) But the continued operation of the New Haven as a railroad depleted the estate by at least $60,000,000. 304 F. Supp., at 800. We fail to see how the self-interest of either the estate or its creditors was bettered by that operation.

Nor is there any substance to the contention that by failing to press for immediate liquidation of the debtor, the bondholders somehow waived their right to object to the imposition of the deduction for delay. The record that shows the preservation of New Haven in the public interest long after it had ceased to be viable as an independent enterprise demonstrates at the most that the bondholders had resigned themselves to bearing the costs of interim operations pending inclusion in Penn Central. It contains no support for the proposition that they consented to the imposition of more than $15,000,000 in *hypothetical* costs on top of the tens of millions in *actual* costs they were forced to bear. As the reorganization court put it, "[S]uch a second round of loss superimposed on the first, like Pelion on Ossa, is as unfair and inequitable as can be imagined . . . ." 304 F. Supp., at 801. It cannot be sustained under any construction of the Bankruptcy Act.[73]

(b) *The bulk-sale discount.* New Haven's land holdings consisted of over 25,000 acres located along its rights-of-way in four States. In its Second Supplemental Report the Commission accepted the New Haven trustees' appraisal of the realty. The New Haven analysis was prepared by the company's general real estate agent, who relied in some instances on the studies of outside appraisers. The agent drew on a fund of actual experience, for the New Haven had long had a real estate department engaged in the disposition of nonoperating properties. From the inception of the New Haven trusteeship through November 1966, that department had completed 853 separate realty sales for a gross consideration of some $13,900,000. The Commission found that the large volume of past sales provided a "firm base" for the New Haven estimate. 331 I.C.C., at 667.

The New Haven agent assumed that the company would sell off its lots in normal-sized parcels. He gave specific consideration to each part of the railroad's property and reached his values on a zone-by-zone basis. He based his estimates of fair market value on his expert judgment, sales in the area, existing tax valuations, and the adaptability of the land to nonrailroad use. He discounted by 50% whenever the New Haven's records indicated questionable title; on the six-year liquidation hypothesis, he deducted $15,971,000 as the cost of operating the New Haven realty department; and on the further

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[73] What we have said disposes of the deduction for delay on the ground advanced by the reorganization court. Entirely apart from that explanation, a second line of reasoning leads to the same result. The delay deduction assumed the postponement of the commencement of liquidation for one year; the Commission postulated a one-year freeze prior to the beginning of sale. See 334 I. C. C., at 60 n. 2. But the Commission thereby assumed that during the one-year delay period nothing would happen; the trustees would sell no properties and enter into no contingent contracts for disposition of the debtor's assets. Absent Commission explanation, we cannot assume that the delay would have resulted in so total a suspension of the sales program during the first year, as well as a failure of the sale managers to expedite disposition of the properties and thereby shorten the contemplated six-year liquidation period. It is not for us to determine the extent to which imposition of a one-year pause at the outset would have enabled the trustees to accelerate the sale in the fifth and sixth years. But acceptance of the delay deduction in principle would compel a remand to the Commission for explanation of its tacit assumptions that the initial year would have been devoid of activity and the later years would merely have proceeded as before.

It is suggested that with the one-year freeze the delay concept may be viewed as a mere shifting of the valuation date to December 31, 1967. That date, it is said, is as rational as the date originally chosen. And so it may be. But the adjustments in value take into account only the expenses and depreciation attributable to a one-year pause, with no consideration to countervailing income and increases in capital value. The Commission says a comprehensive revaluation of the debtor's assets as of December 31, 1967, would produce a much greater loss than the $15,386,000 actually deducted. But in the absence of proof we again cannot assume that that would be the case. For authority to that effect we need look no further than to the Commission itself, which, as we have earlier noted, rejected Penn Central's request on the first round for a further allowance for the "constant diminution of N[ew] H[aven]'s assets" to reflect the occurrence of abandonment delay. On that occasion the Commission noted that "a large portion of N[ew] H[aven] assets consists of land," and added: "We cannot assume that these values will diminish. It is at least as reasonable to presuppose that the values will increase." 331 I.C.C., at 698. If the Commission could not assume diminution in realty values at the time of the Second Supplemental Report, we do not see how, without some explanation, it could assume it at the time of the Fourth.

assumption that the debtor would have to sell some of the property during the final year at vastly reduced prices, he made a further deduction of $8,178,000.

On the remand, the Commission ordered a further deduction from the liquidation value of the estate, based on a hypothetical sale in bulk of all the New Haven's land assets.

"The liquidation value urged by the creditors assumes not only the immediate right to abandon, . . . but also the right to break up the railroad and sell the parcels for their highest and best prices. We think such a right may be restricted when a buyer for the entire bulk of the N[ew] H[aven] properties appears who will continue the operation of needed services." 334 I.C.C., at 60. (Footnote omitted.)

The Commission calculated the deduction on the premise that "[t]he bulk-sale discount merely reflects a market appraisal of the risks that the estate avoids, and the bulk buyer assumes." *Id.*, at 61. The Commission then credited the evidence that Penn Central had presented through a realty expert with respect to a bulk sale of the New Haven land properties. The expert testified to the premium to be charged by a "single purchaser of property who would, in turn, sell off the property probably to many users and who would obtain his profit by reason of its purchase and resale." On the basis of this testimony, the Commission found that a bulk buyer would command at least a 10.5% return on his investment, calculated as the sum of a 75% borrowing at 9% and a 25% self-financing at an internal charge of 15%, and that such an investment rate required an additional 4.5% discount of the New Haven land values over and above the 6% by which they had already been reduced. This bulk-sale discount resulted in a further diminution of $6,695,000 in the valuation of the New Haven assets. 334 I.C.C., at 61–62.

On the second round of review the reorganization court rejected the bulk-sale deduction as "improper and without support in law or reason." 304 F. Supp., at 805.

"Value, under the circumstances of this case, can only be arrived at through the dismantling of the transportation plant and a piece by piece sale of the properties. It is clear from the record that a market existed for the disposition of the properties on this basis. Their value is the best price the market place will give the seller, less the costs and expenses relevant to the sale. . . . It makes no difference whether the purchaser wants to use the property as is, or to improve and develop it. The question is how much will the market place give for a particular item of property." *Ibid.*

The Court answered the argument that the discount merely reflected the risk of nonsale that the seller transferred to the bulk buyer by pointing to the Commission's prior deduction of over $8,000,000 for that purpose. Moreover, the deduction violated the requirement that the sale price meet the "fair upset" minimum imposed by § 77(b)(5) of the Bankruptcy Act. "That lowest price is what the market would pay, which is implicit in the standard used here, i.e., fair liquidation value. Neither a trustee nor an equity receiver could, with the court's approval, sell for less." 304 F. Supp., at 806.

Penn Central now protests that the reorganization court has erred in rejecting the bulk-sale discount. It says its expert witness duplicated no discounts previously taken; he proceeded on the basis of all previous deductions. In addition, it is argued, his analysis took into account the problem of market absorption caused by the mass marketing of some 1,700 sale parcels and the risk of further depression of land values occasioned by cessation of New Haven's operations—factors not considered by New Haven's witness. The hypothetical bulk sale, Penn Central says, was merely a construct for qualifying the risks that New Haven itself would have assumed in undertaking the sale of its realty: it afforded a means to determine "the minimum rates of return necessary to attract capital to the business of owning and disposing of the New Haven's land." Penn Central insists that the bulk-sale analysis thus constituted a "pricing out" of an additional cost of liquidation: it was "simply an analytical device for approximating risks that would occur if the land were retailed over time as promptly as possible. . . ."

We may assume that Penn Central's "pricing out" theory is a rational one. But the record demonstrates that the Commission rejected it as insufficient to justify application of the bulk sale theory. Penn Central's analysis, said the Commission, "overlooks what is necessarily the bondholders' position—namely that aside from principles of equity and fairness they have a fixed right to

sell off N[ew] H[aven] in parcels, so that even a bulk buyer must pay the per-parcel price. Our answer is that we may compel the bulk sale and the bulk sale discount as a condition of an abandonment certificate, and, therefore, as a reduction of the present price.

". . . We . . . might compel N[ew] H[aven], if it filed for abandonment, to sell in bulk and thereby make a bulk sale price appropriate." 334 I.C.C., at 61.

The Commission thus ruled that only by assuming an actual buyer in bulk who would take over the New Haven properties for continued railroad operations could price. Far from setting forth a theory of compulsory transfer "completely independent" of a "pricing out" analysis, the Commission concluded that only its power to compel the sale of the real estate to a single buyer for continued operation justified the bulk-sale discount.

We do not consider whether the Commission could lawfully impose such a bulk-transfer obligation on a railroad in liquidation at the cost of reducing the per-parcel valuation of its assets.[74] For the record before us is devoid of evidence that a bulk buyer would agree to take over the New Haven properties for continued service at any price. When a railroad has a lengthy history of deficit operations with no prospect of improvement, and a consequent operating value of zero or even a negative figure, the Commission cannot rationally assume that a *deus ex machina* will emerge to spend millions for the opportunity to lose millions more.

Penn Central's witness gave no testimony in support of any such theory. He was a professional developer of real estate, not a railroad operator. And he testified to what extra charges *he* would levy, after all previous deductions for the costs and risks of sale, to assume the risk of nonsale as well as the entrepreneurial activity of retailing the realty parcels. His testimony established nothing more than that he would not undertake the task of per-parcel sales that New Haven had assumed unless the company paid him a handsome fee. The Commission could hardly have compelled the New Haven trustees to turn over the assets of the debtor to such an entrepreneur, who would, on his own testimony, have proceeded *himself* to do just what the Commission said it was empowered to forbid the bondholders to do—dismantle the estate, rid himself of railroad-connected assets, and devote his talents to the disposition of the realty.

4. *The discount of liqudation factors.* In its Second Supplemental Report the Commission accepted the projection offered by the New Haven trustees that they could substantially complete a liquidation sale in six years. 331 I.C.C., at 663. Accordingly, the Commission discounted the estimated receipts of sale over the six-year period to reflect their present value—a deduction of $17,563,000. *Id.*, at 661. It did not, however, discount the estimated *expenses* of liquidation, although these, too, were projected to occur over the six-year period. The reorganization court was of the view that if future receipts were to be discounted to present value, future expenses should likewise be. 289 F. Supp., at 461; cf. *id.*, at 427–428. On the remand the Commission concurred. It noted that the parties were very close in their estimates of the proper discount, and it concluded that $3,800,000 represented the correct figure. *Fourth Supplemental Report*, 334 I.C.C., at 39–40.

On the second round of review the reorganization court observed that despite three valuation changes netting a $6,600,000 reduction in estimated worth, the Commission had failed to adjust the old, inapplicable discount figure. Accordingly, the court directed the Commission to file "a new formulation and computation of the discount for present value of the New Haven's liquidation proceeds, in accordance with generally recognized accounting principles and based upon the changes made in valuation items through and including those stated in the present opinion." 304 F. Supp., at 810–811. The court added that the Commission could submit its new formulation and computation in the form of a letter or short brief, and afforded other parties in interest one week to file their comments, as well as any formulations and computations of their own, also in a letter or brief. In accordance with this directive of the court, the Commission submitted its new calculations, and the

[74] The Commission frequently requires an abandoning railroad to sell its properties in bulk to a party (typically a public authority) that will undertake continued operation of the service, but typically sets the sale price at "not less than net salvage value of the property sought to be acquired." See, *e.g.*, *Rutland R. Corp. Abandonment*, 317 I.C.C. 393, 425; *Chicago N. S. & M. R. Co. Abandonment*, 317 I.C.C. 191, 200, aff'd *sub nom. Illinois* v. *United States*, 213 F. Supp. 83, aff'd *per curiam*, 373 U.S. 378; *Fort Dodge D. M. & S. R. Co. Abandonment*, 312 I.C.C. 708, 712; *Chicago A. & E. R. Corp. Abandonment*, 312 I.C.C. 533, 537; *Arkansas & O. R. Corp. Abandonment*, 312 I.C.C. 501, 505.

bondholders replied. In its order adjudging the price to be paid, the reorganization court ruled that "[t]he sum of $2,415,899 should be added to liquidation value inasmuch as it was improperly deducted in applying the discount to present value found by the Commission. . . . " 304 F. Supp., at 1137.

In its brief before this Court the Bondholders Committee states that the reorganization court's directive resulted from the Commission's continued failure to calculate discounts back to present value with respect to four items, three of them to the detriment of New Haven and one to the detriment of Penn Central. The first is the $8,177,633 deducted as the cost of hypothetical forced sales of New Haven realty during the last years of the liquidation. The Commission could have treated the item either as part of the value of the unsold land and then written it off as a cost of sale, with a discount back to present value for both sides of the balance sheet, or as a wash to be eliminated in computing both receipts and expenses. In fact the Commission did neither; it included the figure on both sides of the books, but discounted back only in the asset column. The result, says the Committee, is an error of $2,066,488. A similar shortcoming in determining the liquidation values of road property, such as ties and rails, added another error of $1,474,057. Third, says the Committee, the Commission erroneously spread the sale of certain realty over the full six-year period when the undisputed evidence showed that New Haven could sell the land in 12 to 18 months; this resulted in an overstatement of $118,000 in the discount attributable to the net proceeds. Finally, the Commission assumed that New Haven could sell off $47,121,400 in equipment, investments, and materials during the first year of the liquidation, but failed to spread the assumed receipts over the entirety of that year, with a consequent understatement of $1,372,646 in the applicable discount. A netting of the four items, together with an added correction of $130,000 made by the Commission, results in the $2,415,899 adjustment ordered by the reorganization court.

The Commission does not dispute that it made the errors as alleged by the Committee. Its sole reply is that the bondholders have waived their claims in this regard by failing to present them to the Commission. Penn Central concedes that "the first two errors asserted by the bondholders represent miscomputations" in Penn Central's favor. But it argues that the amount of the fourth error and the existence of the third were the subject of conflicting testimony before the Commission, and it joins in the Commission's contention that the bondholders have waived the right to a resolution in their favor by failing to press a timely objection before the Commission when the agency first made its alleged mistakes.

The record demonstrates that the bondholders have the better of this argument. It is undisputed that both the bondholders and Penn Central presented witnesses to the Commission on the remand who agreed that the Commission had erred in its discounts and who differed only in minor amounts. See *Fourth Supplemental Report*, 344 I.C.C., at 40. But the Commission simply bypassed the agreement, unpersuaded that it had erred in its prior opinion. *Id.*, at n. 17. The bondholders then carried the persistent discounting error to the reorganization court on the second round and won corrective relief. The submission of proposed adjustments by way of letter was not, as is suggested, an untimely filing of claims, but a proper presentation pursuant to the instruction of the court—an instruction made necessary by the Commission's failure to straighten out the discounts after two rounds of hearings and reports, with errors that the bondholders on one side and Penn Central on the other now frankly concede aggregate over $5,000,000. Of the four items advanced by the Committee, only the third is subject to any real doubt, and that $118,000 item can hardly be considered a substantial sum in the context of these cases. A further remand to the Commission to resolve the accuracy of such a figure would serve no useful purpose at this stage of the litigation. The reorganization court resolved the controversy in favor of the bondholders following extensive oral argument on the issue. We affirm its judgment on these issues as free from that degree of error that would require us to overturn its finding.

5. *The loan-loss formula.* In its Second Supplemental Report the Commission, projecting a three-year interim period between merger and inclusion and concluding that a short-term lease would not be appropriate, required Penn Central to extend $25,000,000 in loans to the New Haven in exchange for first-priority trustees' certificates. 331 I.C.C., at 702–706.[75] In addition, it

[75] In its Fourth Supplemental Report the Commission provided for payment of the trustees' certificates by cancellation against the price adjustments provided for in the Purchase Agreement. 334 I.C.C., at 70.

ordered Penn Central to share in New Haven's operating losses to the extent of 100% in the first year, 50% in the second, and 25% in the third, not to exceed $5,500,000 in any one year. *Id.*, at 718–719. On the first round of judicial review the sliding-scale aspect of the formula was disapproved as an improper deterrent to the bondholders' assertion of their legal rights, 289 F. Supp., at 444, pursuant to the suggestion of MR. JUSTICE DOUGLAS at an earlier stage of the proceedings, see *Penn-Central Merger Cases*, 389 U.S., at 557–558 (separate opinion), and on the remand the Commission abandoned it. 334 I.C.C., at 71–72.

The $5,500,000 annual ceiling derived from the assumption, based on calculations provided by the New Haven trustees and accepted by the Commission, that despite the massive cash drain in 1967, future annual New Haven operating losses would be unlikely to exceed $5,400,000 in succeeding years. 331 I.C.C., at 718–719. Coupled with the sliding-scale formula, the annual ceiling thus proposed that Penn Central absorb the entirety of New Haven's 1968 cash loss. On the first round the reorganization court expressed the opinion that even with the abrogation of the sliding scale, Penn Central's share of that loss "should be a substantial percentage." 289 F. Supp., at 464.

By the time the parties returned to the Commission on the remand, it was evident that the trustees' appraisal of their ability to contain the New Haven's deficits had been far too optimistic. From February through December 1968, the trustees had already drawn down $14,000,000 of the $25,000,000 loan that was supposed to last for three years; at that rate they would exhaust the loan in another six or seven months. 334 I.C.C., at 72. The cash loss was equally grim: the projected 1968 cash deficit stood at $15,672,000, with an estimated operating deficit of $8,200,000. Despite the $2,800,000 increase in the operating deficit over the trustees' initial prediction, the Commission adhered to its original ceiling and, prorating over the 11-month period from merger to inclusion, required Penn Central to pay $5,000,000. 344 I.C.C., at 74. On the second round of review the reorganization court affirmed without discussion.

The bondholders now urge that Penn Central be required to bear the entire operating loss from merger to inclusion. New Haven incurred that loss as an independent entity, say the bondholders, only because it remained outside of Penn Central after the merger, at Penn Central's request and for Penn Central's convenience. It is urged that the Commission's ceiling was originally calculated to place the entire loss of the first year on Penn Central, and that the original intention should be carried out.[76]

Penn Central denies responsibility for the fact that inclusion took place some 11 months after merger rather than along with it, and puts the blame at the door of the bondholders for their litigious insistence upon working out the terms of inclusion prior to the event. It also notes that it has been obliged to take over New Haven less than a year after its own formation, rather than at a later point in the three-year period originally envisaged by the Commission.

While the issue is not free from doubt, we cannot say the reorganization court committed error in letting the Commission's action stand. Without ascribing fault to any party, we note the unfairness to the bondholders in requiring them to bear whatever portion of the operating loss Penn Central does not pay due to the inability of Penn Central and the trustees to negotiate an interim lease. On the other hand, there is a countervailing unfairness to Penn Central in requiring it to bear the full burden of New Haven's losses while it lacked exclusive and assured control over the operations of the debtor. The $5,000,000 paid by Penn Central is no drop in the bucket; it amounts to 61% of the operating loss as figured by the Commission and nearly one-third of the entire cash loss for the interim period. In no sense did Penn Central's contribution represent a payment for assets received; on the liquidation hypothesis, the Commission could rationally have declined to require any

[76] In addition, the bondholders contend the calculation of the operating loss upon which the formula is based is itself unfair. Chase Manhattan and the Committee say the calculus excludes items such as rent for leased roads and interest paid during bankruptcy, aggregating some $2,600,000. The Commission refused to include such items because it thought them "more nearly capital charges, that is, costs of providing the railroad plant . . . ." *Second Supplemental Report*, 331 I.C.C., at 718. Chase Manhattan attacks the Commission's ruling on the ground that New Haven paid out the monies in question in 1968 only because it had not yet been included in Penn Central. But the test for an operating loss as opposed to a capital charge is not whether a cash disbursement took place; the Commission could properly limit Penn Central's liability to the former category.

payment at all. Chase Manhattan argues that "[e]ither there was no equitable obligation on the part of Penn Central to pay any of the New Haven loss during the period from the date of the Penn Central merger to the date of its acquisition of the New Haven assets or there was an obligation to pay the entire loss." We cannot agree that the Commission was obliged to adopt such an all-or-nothing approach. Under the circumstances, the Commission's final disposition represents a pragmatic compromise of the competing interests, and in the absence of a controlling contrary principle of law we do not disturb the reorganization court's acceptance of the Commission's judgment.

6. *New Haven investments.* The Bondholders Committee complains that New Haven has transferred its stock ownership in two concerns—the New York Connecting Railroad and the Railway Express Agency—with no value given in exchange. The Connecting Railroad was owned jointly by New Haven and Penn Central on a 50–50 basis, *Fourth Supplemental Report*, 334 I.C.C., at 44 n. 20, and is now presumably a wholly owned subsidiary of the merged company. REA is owned by various railroads; at the time of inclusion New Haven held about 4.5% of the outstanding stock.

In both instances the Commission valued New Haven's investment interest on the liquidation hypothesis. A witness presented by the New Haven trustees, whose testimony the Commission accepted, stated that because of Connecting Railroad's $18,000,000 funded debt its stock would have no liquidation value whatever. As to the REA, he said that its stock would have little or no value because of pending litigation over a tender offer for the stock[77] as well as recent legislation increasing the permissable size and weight of parcel post packages. *Second Supplemental Report*, 331 I.C.C., at 678.

The Bondholders Committee does not attack the Commission's finding of zero value for the Connecting Railroad and REA stock. Instead, the Committee says that if the shares were worthless, the Commission erred in requiring their transfer to Penn Central. Were the stock to have had no value on the liquidation of New Haven, the Committee argues, the reorganization court would, in the absence of bids for the shares, have ordered their distribution to the creditors to do with as they pleased. Accordingly, the Committee calls for the return of the stock to New Haven.

The Committee's request overlooks the fact that even though the shares in question might be worthless to a New Haven undergoing liquidation, the Commission could nonetheless order their transfer on the ground of their value to an on-going Penn Central required to take in New Haven as an operating entity. But entirely apart from that consideration, and without pausing to assess the correctness of the zero valuation placed on the stock, we agree with Penn Central that the Committee's request for the return of the stock is foreclosed by *res judicata*. For the Committee—as well as all the other bondholders—took no appeal from the order of the reorganization court directing the transfer of the New Haven assets subject to a later determination of value.[78]

7. *"Going concern" value.* The bondholders urge that Penn Central should pay an added amount to reflect the "going concern" value of the New Haven. This sum, it is stressed, would be calculated not as an alternative to liquidation value, but as a supplement to it. Since it is universally agreed that the New Haven was a losing operation in the form in which Penn Central was obliged to take it over, the bondholders display considerable temerity in pressing for inclusion of what could prove, in an ultimate analysis, to be only a substantial negative figure.[79]

The Commission rejected the notion that the New Haven had a going concern value over and above the liquidation value of its physical properties. In the Commission's view, the bondholders' estimate of $55,075,000 for such intangibles as organizational costs was premised on the replacement of a defunct railroad and overlooked the probability that no one would ever have rebuilt the New Haven in its present form. More fundamentally, the Commission correctly

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[77] See *Denver & R. G. W. R. Co.* v. *United States*, 387 U.S. 485.

[78] The Bondholders Committee raised the question in its petition for certiorari whether the reorganization court had erred in its assignment of zero value to certificates of contingent beneficial interest issued in connection with the reorganization of the Boston & Providence Railroad. See 304 F. Supp., at 810. The Committee has not revived the issue in its Brief, nor has it responded in its Reply Brief to the Government's contention that it has abandoned the claim. Accordingly, we do not consider the matter further.

[79] In 1968 the New Haven suffered an estimated operating deficit of $8,200,000. That figure, capitalized at 8%, amounts to more than $100,000,000.

repudiated the claims based on going concern value as antithetical to the liquidation hypothesis on which the appraisal of the New Haven's assets had proceeded. As the Commission said, "It is not realistic to assume that a potential buyer would pay the liquidated value of the N[ew] H[aven] assets and then pay additional amounts representing elements of going concern value in the face of N[ew] H[aven]'s past deficit operations and its bleak prospects for the future." *Second Supplemental Report*, 331 I.C.C., at 686–687.

The Bondholders Committee concedes that the intangible assets in fact acquired by Penn Central "would be worthless to the New Haven in an assumed liquidation. . . ." That is enough to end the matter. The bondholders are not entitled to treat the New Haven as a liquidating enterprise with respect to certain items and as an operating railroad with respect to others, depending on which approach happens to yield the higher value. Nothing could be more unfair or inequitable to Penn Central than to permit the New Haven bondholders, at its expense, to have the best of both worlds.[80]

8. *The "underwriting" plan for the Penn Central stock.* Thus far we have considered the disputes over the valuation of the New Haven assets transferred to Penn Central. We now reach the one issue raised in connection with the consideration given by Penn Central in exchange. The Purchase Agreement negotiated by Pennsylvania and New York Central on the one side and the New Haven trustees on the other provided that Penn Central should pay in part for the New Haven properties with 950,000 shares of its common stock.[81] As a New Haven trustee stated, "[O]ne of the principles for which we negotiated at considerable length was that the bulk of the consideration should be in the form of common stock or, failing that, should be debt instruments having either conversion rights or options which would permit the claimants to the New Haven's Estate to participate in the benefits of the merger." In confirming the terms of the agreement, the Commission accepted the testimony of a New Haven trustee that the value of the stock could range anywhere from $75 to $100 a share on the date of closing and that the average, $87.50, represented his estimate of market value at the time of inclusion. 331 I.C.C., at 688–689. The Commission adopted the $87.50 per share value placed on the Penn Central stock by the trustee as reasonable. *Id.*, at 689–690.

On the first round of review the reorganization court agreed that the $87.50 per share figure represented a fair value for the Penn Central stock, based on the Commission's calculation of the estimated future earning power of the new company and the testimony of the New Haven trustee, "a well qualified expert." The expert saw "no reason why recent fluctuations in the market value of these shares should change the disposition of the matter. . . ." 289 F. Supp., at 462.

On the remand, the bondholders challenged the Commission's stock valuation. The Commission cursorily rejected the attack on the ground that the bondholders' witness was unfamiliar with Penn Central's operating and

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[80] The decisions of the New York state courts relied upon by the bondholders are inapposite. In *In re City of New York*, 18 N. Y. 2d 212, 219 N. E. 2d 410, appeal dismissed condemned the Fifth Avenue Coach lines. The trial court treated the takeover as one of a going concern and fixed the award at reproduction cost new less depreciation. The Court of Appeals agreed that Fifth Avenue had demonstrated a capacity for profitable operations under reasonable rates, it was entitled to going concern value, but that the trial court had erred in excluding evidence of value of the "intangible going concern assets, that is, the component of value in the business which in addition to the value of the tangible assets reflects an efficient operation." *Id.*, at 220, 221, 219 N. E. 2d, at 412, 413. The opinion of the Court of Appeals does not disclose whether payment of liquidating value would have yielded a higher price. In *In re Port Authority Trans-Hudson Corp.*, 20 N.Y. 2d 457, 231 N.E. 2d 734, cert denied *sub nom. Port Authority Trans-Hudson Corp.* v. *Hudson Rapid Tubes Corp.*, 390 U.S. 1002, the Court of Appeals dealt with a public taking of railroad tunnels under the Hudson River owned by a company in reorganization and having only a "dim financial future . . . ." 20 N.Y. 2d, at 465, 231 N.E. 2d, at 736. The tunnels, which required only $88,000 to be put in working order, had cost $32,000,000 to build, and would have cost $400,000,000 to replace; their liquidating value was a negative figure, because of costs that would have been incurred in plugging them up. *Id.*, at 467 and n. 2, 470, 231 N.E. 2d, at 737 and n. 2, 739. Because the Port Authority was taking the tunnels for continued operation, the Court of Appeals held the proper valuation was depreciated original cost plus the value of intangible assets also attributable to the operation as a going concern. *Id.*, at 471–472, 231 N.E. 2d at 740. In neither of these cases did the New York courts require the taking authorities to pay *both* an operating and liquidating value. Rather, they awarded the owners the value reflecting the highest and best price for their properties—precisely the treatment accorded the New Haven here.

[81] At the time of the Second Supplemental Report, an issue of 950,000 Penn Central common shares to New Haven would have given the debtor 4% of the total shareholder equity in the new company. 331 I.C.C., at 689.

financial plans, gave undue weight to extraordinary past expenses, and generally neglected the future prospects of the company. 334 I.C.C., at 68 n. 40.

By the time of the second round of judicial review, inclusion had taken place and the Penn Central had given its consideration in exchange. The bondholders, renewing their charge that the Commission's prophecy had been erroneous, pointed to the actual market performance of the stock. As of the inclusion date, December 31, 1968, the market price stood at 63⅜, more than 20 points below the Commission's estimated value. If that date should be thought suspect because of year-end sell-offs, the bondholders noted that throughout 1968 the price had fluctuated between 53½ and 86½, with a mean price between February 1 and December 31 of 69½. Thus, the bondholders contended, the primary component of their bundle of consideration had turned out to be worth anywhere from $17,000,000 to $23,000,000 less than it was supposed to be.

On the second round the reorganization court rejected the bondholders' contention that the Commission had predicted an $87.50 value as of the closing date.

"[T]he Commission, presumably in an effort to assure fairness to Penn Central, did not use the market value of December 31, 1966 or an average of the values at or about December 31, 1968, the actual date of transfer. Instead, it adopted the theory that, after all, the purpose of using stock in payment was to tap the expected future economic benefit of the Penn Central merger which would come to full fruition seven to ten years after its effective date on February 1, 1968, but would be reflected in an upward trend of the stock at the time of closing or transfer of New Haven's assets to Penn Central, then estimated to be in 1970.

"[T]he theory of giving recognition to an intrinsic value in the shares, which will be realized when the full economic benefits of the merger have been achieved, not only assists the Penn Central by relieving it of the need to divest itself of a crippling amount of cash, which would be prejudicial to its merger program, but affords the New Haven an opportunity to participate in probable future profits." 304 F. Supp., at 808–809.

The court nonetheless recognized an element of unfairness to the New Haven bondholders in that the New Haven was compelled to accept the stock "at a substantial present loss on an assurance of future gain." As the court put it, "The nub of the unfairness and inequity is not the 87½ fixed for present calculations, but the fact that the purchaser is getting assets of sure present value while the seller is asked to gamble for its payment on the future of the Penn Central." *Id.*, at 809. The court concluded that this did not necessitate a change in price or an amendment to the valuations postulated by the Commission. "To be fair and equitable, however, it does require a supplemental provision fulfilling the implicit promise by the purchaser to pay $83.1 million as part of the price for the assets conveyed." Accordingly, the court provided that

"if at any time the market price of Penn Central common shares reaches and maintains 87½ per share on the New York Stock Exchange for a period of five consecutive days on which the Exchange is open and doing business (not counting days on which the Exchange is closed to trading) between the date of final consummation of the plan of reorganization and February 1, 1978, then and in that event it will be conclusively presumed that Penn Central has, in transferring the shares of the New Haven, made payment of the $83.1 million of the purchase price represented by the shares. If, however, the common shares of Penn Central do not reach and maintain the price as aforesaid, then the value of the shares will be determined by the average of the means between high and low prices of Penn Central shares on the New. York Stock Exchange for the 30 business days next preceding February 1, 1978, on which the Exchange is actually operating and there are sales of Penn Central shares. Penn Central will forthwith become liable to pay in cash to the New Haven, or its successor or successors, the difference between said mean market prices of those 30 days and 87½ for each share. . . ." 304 F. Supp., at 809–810.

The court provided that the benefit of Penn Central's underwriting of any difference between the mean market price and 87½ would inure only to the New Haven and would not follow the shares into the hands of third-party buyers.

In addition, the court afforded Penn Central the option of relieving itself of the 1978 underwriting obligation in the following manner:

"The Penn Central is granted an option, operative between the date of final consummation of the plan and February 1, 1978, to discharge its obligation to underwrite and pay the difference between such average price and the higher 87½ at the end of the ten year period by paying one or more blocks of 50,000 shares to the New Haven . . . the difference between the mean market prices for sales of Penn Central common shares and 87½ per share as of a specific day of sales on the Exchange which shall previously have been designated by Penn Central in a written notice delivered to the New Haven at least 5 days prior to such market date." *Id.*, at 810.

The underwriting plan of the reorganization court thus combined a series of essential findings and protective features. First, it ratified the Commission's determination that intrinsic value rather than market price should guide the appraisal of the worth of the Penn Central common stock; second, it predicted that that intrinsic value would be reflected in a market price of at least $87.50 per share by the time Penn Central fully realized the benefits of its merger; third, it provided that Penn Central would secure the New Haven estate against the risk that the market price of its stock would not reflect that minimum intrinsic value within the first nine years after inclusion; and fourth, it contemplated that New Haven would be left free to participate in whatever future appreciations in value Penn Central's stock might enjoy. In sum, the reorganization court devised a plan that added to its assessment of present worth both a reasonable assurance of realization of such worth and the opportunity of additional gain. In so doing, the reorganization court in effect determined that postponement of immediate realization of $87.50 per share was offset by the possibility of even greater future market price of the stock. and that the package constituted full compensation for the assets transferred to Penn Central.

On the basis of the record before the District Court at the time of its order, we would have no hesitancy in accepting its findings, conclusions, and proposed underwriting plan as consistent with the history of the reorganization proceedings and supported by substantial evidence. But we cannot avoid the impact of recent events in assessing the propriety of the decree that that court has entered. See *United States* v. *Aluminum Co. of America*, 148 F. 2d 416, 445. And those events make it possible that this aspect of the reorganization court's decree may be wholly unrealistic.

The fairness and equity that are the essence of a § 77 proceeding forbid our approval of a payment for the transferred New Haven properties that may be worth only a fraction of its purported value. And the same considerations of fairness and equity prevent imposing on Penn Central the burden of immediate payment in full, particularly when it is remembered that the New Haven bondholders have never objected to the receipt of Penn Central stock in exchange for the New Haven assets.

Accordingly, we set aside the order of the Connecticut District Court insofar as it determines that an intrinsic value of $87.50 inheres in the Penn Central common stock and implements an underwriting plan to secure payment of that sum. Further proceedings before the Commission and the appropriate federal courts will be necessary to determine the form that Penn Central's consideration to New Haven should properly take and the status of the New Haven estate as a shareholder or creditor of Penn Central.

V

We turn finally to the contention of the bondholders that quite apart from the specific items that together go to make up the price to be paid for the New Haven assets, the plan of reorganization itself is not only unfair and inequitable under the Bankruptcy Act but violates the Fifth Amendment as a taking of property without just compensation.

The purchase price that the Commission and the reorganization court have required Penn Central to pay to the New Haven estate is based upon the liquidation value of the seller's assets, appraised as of December 31, 1966. That price hypothesizes a shut-down of New Haven followed by a sell-off of its assets at their highest and best value. In the circumstances of this case, and for the reasons we have already set out at length, we agree with the reorganization court that it would be unfair and inequitable to allow Penn Central to take the properties for any lesser sum. Moreover, we today require a reassessment of the consideration that Penn Central is to give in exchange

for those properties. We thereby accord the bondholders the right to a liquidation and a per-parcel sale that is theirs by virtue of their mortgage liens. The Bankruptcy Act does not require that they be given more. Nor is it necessary to consider the bondholders' claim that anything less than full liquidation would amount to an uncompensated taking in violation of the Fifth Amendment.

But the Bondholders Committee presses another Fifth Amendment argument. It points to the Commission's own finding that from the inception of the New Haven reorganization through 1968 the debtor's estate had amassed more than $70,000,000 in administrative and prebankruptcy claims that take priority over the bondholders' liens. *Fourth Supplemental Report*, 334 I.C.C., at 126. The reorganization court itself noted that " 'losses reasonably incident to working out the solution most consistent with the public interest' [have] eroded the debtor's estate in excess of $60 million." 304 F. Supp., at 800. (Footnote omitted.) Although the extent to which the ongoing deficit operation has impaired the bondholders' security is unclear, it is undeniable that the continued operation of the railroad into the late 1960's, together with the legal uncertainties engendered by the doubtful future of the company, have greatly depressed the value of the bondholders' interests. Cf. *Penn-Central Merger Cases*, 389 U.S., at 509.[84]

A § 77 reorganization court may not, of course, disregard a claim that injurious consequences will result to a secured creditor from the suspension of the right to enforce his lien against the property of a debtor. That claim, however, "presents a question addressed not to the power of the court but to its discretion—a matter not subject to the interference of an appellate court unless such discretion be improvidently exercised." *Continental Illinois National Bank & Trust Co.* v. *Chicago, R. I. & P. R. Co.*, 294 U.S. 648, 677. Here the reorganization court recognized its duties under the Bankruptcy Act and the Constitution. In August 1968 it ruled as follows:

"In view of the history of this deficit operation from the time of the filing of the petition under § 77 and even before, the size of the losses, the long period of time necessarily involved in seeking to work out a solution, short of liquidation, through inclusion in the Penn-Central, the present condition of the Railroad and the rate of loss and outflow of cash in the recent past and in the foreseeable future, this court finds that the continued erosion of the Debtor's estate from operational losses after the end of 1968 will clearly constitute a taking of the Debtor's property and consequently the interests of the bondholders, without just compensation. It is therefore constitutionally impermissible, and obviously no reorganization plan which calls for such a taking can be approved." 289 F. Supp., at 459.

We do not doubt that the time consumed in the course of the proceedings in the reorganization court has imposed a substantial loss upon the bondholders. But in the circumstances presented by this litigation we see no constitutional bar to that result. The rights of the bondholders are not absolute. As we have had occasion to say before, security holders "cannot be called upon to sacrifice their property so that a depression-proof railroad system might be operated. But they invested their capital in a public utility that does owe an obligation to the public. . . . [B]y their entry into a railroad enterprise [they] assumed the risk that in any depression or any reorganization the interests of the public would be considered as well as theirs." *Reconstruction Finance Corp.* v. *Denver & R. G. W. R. Co.*, 328 U.S. 495, 535–536.

Only two Terms ago, when we last considered the Penn Central merger, we quoted approvingly the Commission's statement that "[i]t is a fundamental aspect of our free enterprise economy that private persons assume the risks attached to their investments, and the N[ew] H[aven] creditors can expect no less because the N[ew] H[aven]'s properties are devoted to a public use." *Penn-Central Merger Cases*, 389 U.S., at 510. We added:

"While the rights of the bondholders are entitled to respect, they do not command Procrustean measures. They certainly do not dictate that rail operations vital to the Nation be jettisoned despite the availability of a

[84] As previously noted, the holders of the Harlem River Division bonds have received satisfactory security by Penn Central's assumption of the mortgage. See n. 48, *supra*. We are informed that the right of the holders of the General Income bonds to participate in the reorganized company depends on the outcome of this litigation. The holders of the First and Refunding Mortgage bonds stand somewhere in between. See 289 F. Supp. at 442 n. 18.

feasible alternative. The public interest is not merely a pawn to be sacrificed for the strategic purposes or protection of a class of security holders . . . ." *Id.*, at 510–511.

In this context we appraise the bondholders' claim that the continued operation of the New Haven from the inception of the reorganization proceeding in 1961 to the inclusion in Penn Central in 1968 worked an unconstitutional taking of their property. There is no longer room for dispute that the bondholders will receive the highest and best price for the assets of the debtor as of December 31, 1966. That price of course reflects the depreciation of the properties and the losses incurred in the operation of the railroad from the commencement of reorganization proceedings under § 77 in the middle of 1961. But the Bondholders Committee does not tell us what the depreciation and losses attributable to the prevaluation period are. Moreover, no bondholders formally petitioned the reorganization court to dismiss the proceedings and thereby permit a foreclosure on the mortgage liens until April 1967—well after the 1966 valuation date.[85]

Nor can Penn Central be held liable for the further decline in New Haven's value from the valuation date to the actual inclusion. The new company did not even come into existence until midway through that period, and from the point of its own creation until it took in the New Haven, it contributed substantially to recompense the debtor for its operating losses. Moreover, the failure of the bondholders to press for early liquidation of the New Haven meant that their initial application for a dismissal of the reorganization proceedings came just as the objective of salvaging the New Haven appeared possible to achieve. As the reorganization court noted, only two of the several bondholder groups made that initial application; it was not joined by the trustees, nor was it endorsed by other representatives of the bondholders and creditors; and it came just as the Commission was about to certify a feasible plan of reorganization to the court. "To jettison everything achieved and turn back just as a glimmer of light begins to show at the end of a long dark tunnel," said the court, "not only carries with it an aura of unreality but borders on the fantastic." *In re New York, N. H. & H. R. Co.*, 281 F. Supp., at 68.

On the other hand, we must also reject any lingering suggestion by Penn Central that the price it must pay for the New Haven assets is unfair in either a statutory or a constitutional sense. At first glace there is a seeming anomaly in the requirement that Penn Central pay a liquidating value for property it must operate at a loss. But it is not correct to say that New Haven's right to liquidate is inconsistent with Penn Central's obligation to operate, or that if the New Haven's creditors had such a right, Penn Central must have it as well. The bondholders had the right by force of their state-created liens under the New Haven's mortgage obligations. Penn Central had no such right, because its merger was expressly conditioned on its assumption of responsibility for continued New Haven service. There was nothing inequitable in an arrangement that permitted the bondholders to recover the value of their liens on the property of the debtor at the same time that it required Penn Central to pay that value in exchange for the nearly $1,000,000,000 worth of benefits that the merger was then anticipated to produce.

As the Commission said at the time of its Second Supplemental Report, "Calling upon Penn-Central to pay more than the N[ew] H[aven] is worth as a going concern is not unreasonable within the meaning of section 5(2) . . . . The Penn-Central merger (which will bring substantial dollar savings to the merger applicants) was approved with the thought that some of the merger savings would be available specifically to ward off a liquidation and shutdown of the N[ew] H[aven] so that adequate transportation service would remain available to the public which now relies on the N[ew] H[aven]." 331 I.C.C., at 687–688.

The reorganization court made the point with clarity and force:

"The whole purpose of making the inclusion of the New Haven a condition of the merger was to require Penn-Central, which, in being permitted to merge, was granted the opportunity to realize tremendous economic benefits, to take over and operate a helplessly sick but still needed railroad,

[85] As late as October 1966 the reorganization court noted that the policy of preserving the New Haven as an on-going railroad "has been concurred in by the bondholders . . . ."

which it could well afford to do. It is part of the price Penn-Central is called upon to pay for the right to merge. The right to merge was granted, the merger has taken place, and the price should be paid." 289 F. Supp., at 465–466.

For the reasons stated in this opinion, the judgment of the United States District Court for the District of Connecticut, reviewed on writs of certiorari in Nos. 914, 916, 920, 1038, and 1057, is affirmed in part and vacated and remanded in part. The judgment of the United States District Court for the Southern District of New York appealed from in Nos. 915, 917, and 921, is vacated, and those cases are remanded with instructions to abstain pending the further proceedings before the Interstate Commerce Commission and the reviewing courts under § 77 of the Bankruptcy Act.

It is so ordered.

MR. JUSTICE DOUGLAS took no part in the decision of these cases.

MR. JUSTICE MARSHALL and MR. JUSTICE BLACKMUN took no part in the consideration or decision of these cases.

MR. JUSTICE BLACK, with whom MR. JUSTICE HARLAN joins, dissenting.

The central issue in these cases, easily lost I fear in the 98-page opinion of the Court, can in my judgment be briefly and simply stated. After this Court's decision in the *Penn-Central Merger Cases*, 389 U.S. 486, the Interstate Commerce Commission assumed its difficult statutory task of determining the liquidation value of the assets of the New Haven Railroad, a determination which if upheld by the courts would decide the purchase price Penn Central would have to pay for the bankrupt New Haven. The Commission made that valuation determination, and the question before this Court is whether, under the appropriate standards of court review, the Commission's valuation of the New Haven's properties should have been sustained or rejected by the reviewing courts. This question comes here from two federal district courts, both of which were called upon to review the Commission's valuation of the New Haven properties, (1) a bankruptcy court convened under § 77 of the Bankruptcy Act, 11 U.S.C. § 205, to consider the reorganization of the New Haven, and (2) a three-judge merger court convened under 28 U.S.C. §§ 1336 (a), 2321–25, to review Commission merger and inclusion orders. Both district courts had jurisdiction under these statutes to examine the Commission's valuation decisions. And the proper scope for each court's review was the same: were the Commission's findings supported by substantial evidence and consistent with applicable statutory requirements? Yet the reception the Commission's determination received from the two courts on the final round of review was dramatically different. The bankruptcy court took issue with several of the Commission's important findings as to the New Haven's liquidation value and, substituting its own ideas of the proper method of appraising the railroad's properties, increased by over $28,000,000 the value the Commission had placed on the assets of the New Haven. 304 F. Supp. 793. In sharp contrast, the three-judge merger court noted the "severe limitations" on the scope of its review of valuation matters, 305 F. Supp. 1049, 1053, and, after carefully examining the Commission plan, sustained the agency's determinations.[1] Judge Friendly, writing for the three-judge merger court, stated the fundamental reason for that court's disagreement with the bankruptcy court:

"Essentially, we think, our disagreements . . . reflect a difference in view concerning how far we are at liberty to substitute our own notions for the decisions the Commission has taken in what we regard as a sincere effort to comply with the tasks both courts assigned to it on remand." 305 F. Supp., at 1065.

I

Both district court decisions are now properly before this Court for our review, and contrary to the position taken by the Court today, it is my view that the Court has an obligation to pass upon both those judgments, not just one. As the quoted passage from Judge Friendly's opinion for the three-judge merger court indicates, the answer to the question whether this Court should follow the three-judge court and sustain the Commission's

[1] The three-judge merger court corrected the Commission's findings on minor valuation points which are not relevant here. The Commission has subsequently made findings consistent with the three-judge court opinion on these questions. 334 I.C.C. 528.

valuation of the New Haven properties turns largely on the proper scope of judicial inquiry into the agency determination. Our previous cases make it clear that the scope of judicial review of the Commission's appraisal of such properties is narrowly limited to ensuring that the agency findings are supported by material evidence and consistent with statutory standards. The federal courts, this Court included, should defer whenever possible to Commission expertise on complex questions of valuation. It is my position, elaborated in what follows, that the application of this test to the record before the Commission in these cases can only lead to the conclusion that the Commission did not abuse its discretion in valuing the New Haven and, accordingly, that the three-judge court was correct in sustaining its determinations and the bankruptcy court wrong in rejecting them. The three-judge court's excellent opinion is, in my view, compelling support for the idea that a reasonable reviewing court exercising the proper scope of review would find that the Commission acted wholly within its discretion. Moreover, I find myself in agreement with Judge Friendly that the bankruptcy court greatly exceeded its reviewing authority and in so doing improperly substituted its own views on valuation for those of the Commission.[2]

The Court today reaches conclusions completely at odds with those stated above and affirms the decision of the bankruptcy court. I do not think the Court could reach the result it does but for its mistaken assumption that the bankruptcy court was somehow the more appropriate of the two courts to review the Commission's valuation determinations and that, accordingly, the excellent opinion of the three-judge court could be simply ignored on the ground that that court should have abstained in favor of the bankruptcy court. Congress has granted jurisdiction to review the Commission findings to both courts under the peculiar circumstances presented in these cases, and the Court offers only make-weight arguments to support its holding that the three-judge court should have abstained from reaching the valuation questions. In my view, both courts were obligated to fulfill their statutory mandate to review the Commission valuation findings, and this Court has an obligation to treat with equal dignity the decisions of each of those courts. For this reason I cannot agree that the Court is justified in proceeding as if Judge Friendly's opinion for the three-judge merger court simply did not exist. Nor can I accept the Court's position that in reviewing the conclusions of the bankruptcy court it should apply a standard of review that attaches great weight to the conclusions of that court rather than to those of the Commission. Our prior cases indicate that the correct rule is just the opposite. In sum, the Court first disposes of the three-judge court's opinion by assuming that that court should have abstained, and it then adopts a deferential posture toward the conclusions of the bankruptcy court. In so doing the Court clears the way for its affirmance of the bankruptcy court. The Court's approach and the result it reaches are intimately related, and I regret that I cannot agree with either.

II

On the question of valuing the New Haven's assets, the tasks which the three-judge merger court and the bankruptcy court were called upon to perform in these cases were virtually identical, and for both courts that task was a narrowly circumscribed one. The statutes governing review in both courts provide the same flexible standard: under § 77(e) of the Bankruptcy Act the bankruptcy court was to determine if the terms for the sale of the New Haven's assets were "fair and equitable," and under §§ 5(2)(b) and (d) of the Interstate Commerce Act the three-judge court was to ensure that the terms of the merger and inclusion were "just and reasonable" and "equitable." More important, our previous cases leave no doubt that the two district courts and, accordingly, this Court are permitted only a limited scope for their review of the Commission's valuation findings. In *Ecker* v. *Western Pacific R. Co.*, 318 U.S. 448, 472, this Court emphasized that under § 77(e) of the Bankruptcy Act, "Valuation is a function limited to the Commission,

[2] Of course, the bankruptcy court and the three-judge merger court agreed on many of the issues that were presented to them, some of which were questions of valuation and some which were not. Apart from the question of the underwriting plan, *ante*, at 90–92, the Court today affirms both district courts on those issues on which both agreed, and I concur in that result. I differ with the Court, however, on its handling of all those questions of valuation over which the two district courts disagreed.

without the necessity of approval by the [bankruptcy] court." The Court elaborated its holding this way:

"The function of valuation thus left to the Commission is the determination of the worth of the property valued, whether stated in dollars, in securities or otherwise. One of the primary objects of the bill was the elimination of obstructive litigation on the issue of valuation and the form finally chosen approached as near to that position as seemed to the draftsmen legally possible. Judicial re-examination was not considered desirable . . . . The language chosen leaves to the Commission, we think, the determination of value without the necessity of a re-examination by the court, when that determination is reached with material evidence to support the conclusion and in accordance with legal standards." 318 U.S., at 472–473.

See also *Reconstruction Finance Corp.* v. *Denver & R. G. W. R. Co.*, 328 U.S. 495, 508–509; *Group of Institutional Investors* v. *Chicago, M., St. P. & P. R. Co.*, 318 U.S. 523, 536–542. These cases make it clear that Congress delegated the valuation function to the Commission and that the Commission's determinations can be reviewed by the federal courts under § 77(e) only to determine whether they are supported by substantial evidence and conform to the applicable statutory standards.

The scope of review of the three-judge merger court under § 5 of the Interstate Commerce Act is virtually identical to that of the reorganization court under § 77. The function of the three-judge court is only to determine if the Commission's actions "are based upon substantial evidence and to guard against the possibility of gross error or unfairness." *Penn-Central Merger Cases*, 389 U.S. 486, 524. If a court finds the Commission's "conclusions to be equitable and rational," it should not, as it seems to me this Court does today, "second-guess each step in the Commission's process of deliberation." *Id.*, at 524.

The reasons compelling such judicial restraint lie not only in the accumulated expertise of the Commission but also in the inherent uncertainty of the valuation process itself. "An intelligent estimate of probable future values . . . , and even indeed of present ones, is at best an approximation . . . . There is left in every case a reasonable margin of fluctuation and uncertainty." *Dayton Power & Light* v. *Public Utility Commission*, 292 U.S. 290, 310. These inevitable uncertainties of a complex valuation were greatly magnified in this case, for here the Commission was called upon to determine what values the New Haven properties would have, as the three-judge court put it, in "a liquidation that never happened, that in a world as we know it scarcely could have happened, and that, if it had happened, could have happened in any one of a number of equally imaginary ways. . . ." 305 F. Supp., at 1056. Given the extremely hypothetical context in which the Commission made its determinations, it is impossible for any reviewing court to know if the Commission's finding even approximated the true liquidation value of the railroad. Because of this enhanced uncertainty, the area in which the Commission was required to exercise its judgment in this case was unusually wide, and a reviewing court could probably upset its conclusions in only the clearest instances of abuse.

I indicated previously that when these criteria for judicial review are taken into account, it becomes impossible for me to believe that the Commission abused its discretion in deciding as it did the excessively complex and difficult valuation issues discussed at length in the Court's opinion. The three-judge merger court concluded that the Commission's findings in this regard were supported by substantial evidence and consistent with relevant principles, and, after reviewing the record and the opinion of the Commission, I find myself in wholehearted agreement with the three-judge court's conclusion. Judge Friendly's fine opinion leaves no doubt in my mind that the court for which he wrote was fully aware of both the limited scope of its reviewing power and also its obligation within those limits to scrutinize carefully each of the significant decisions of the Commission. Thus, the court assumed that "[i]f the Commission made demonstrable errors, it is our duty to correct these . . . ," but, unlike the Court today, it refused "to re-examine every judgment made by the Commission and to substitute our own whenever we think it better." 305 F. Supp., at 1056. The three-judge court's opinion sets out fully and adequately the reasons why the Commission should be affirmed on each of the disputed points, and there is nothing to be gained from my repeating those reasons here.

III

The Court's opinion affirming the bankruptcy court attempts to avoid the force of the foregoing considerations by first holding that the three-judge court should have abstained from reaching the valuation issue and then assuming for some reason which is not clear to me that this Court should apply a limited scope of review to the valuation findings of the bankruptcy court rather than to the Commission's findings. This approach is, I submit, premised on erroneous assumptions.

A

There can be no question but that under relevant federal statutes both the three-judge merger court and the bankruptcy court had jurisdiction to review the Commission's determination of the New Haven's liquidation value. See 11 U.S.C. § 205; 28 U.S.C. §§ 1336(a), 2321–25. The Court today does not really dispute this conclusion, but argues instead that the bankruptcy court might have had "primary jurisdiction" to decide the valuation issues, citing to support this idea several quite inapposite cases dealing with *in rem* jurisdiction, and, alternatively, that the three-judge court should have "abstained" because the only remaining issue was "the value to be accorded the assets transferred, and the resolution of those issues was the essence of the § 77 process." *Ante*, at 32. Actually, the only "primary jurisdiction" involved here was the primary jurisdiction of the Commission to decide questions of valuation. Moreover, the question of the New Haven's value may well have been central to the § 77 proceedings, but, in ordering the New Haven's inclusion in Penn Central, the Commission exercised authority under both § 5 of the Interstate Commerce Act and § 77 of the Bankruptcy Act. The question of the New Haven's value was equally central to the requirement under § 5 that the Commission determine before issuing an inclusion order that the terms of the inclusion are "equitable." 49 U.S.C. § 5 (2)(d). Review of the Commission's valuation was therefore as appropriate on the merger and inclusion side as on the bankruptcy side, and the Court's argument to the contrary is completely conclusory. Accordingly, I think the three-judge merger court was correct when it decided that, "unfortunate as the duplicitous system of review may be, we see no basis on which we can properly decline to exercise the jurisdiction conferred upon us. . . ." 289 F. Supp. 418, 424.

B

The Court also errs, I think, when it assumes that it should defer to the findings of the bankruptcy court rather than to those of the Commission. The reasoning behind this novel approach is never clearly stated. At times, the Court seems to take the view that the proper role of the bankruptcy court on valuation questions lies somewhere between that of a trial court charged with the responsibility of making a fair estimate of the value of the New Haven properties and an appellate court whose responsibility is limited to reviewing the Commission's valuation. The adoption of this hybrid role for the bankruptcy court is strenuously urged upon us in some of the briefs in this case. Such a theory arguably justifies a deferential attitude on the part of this Court toward the reorganization court's determinations and also provides at least a partial justification for the bankruptcy court's *de novo* valuation estimates. However, the notion that the bankruptcy court has special powers in reviewing Commission valuations and in weighing the public interest is completely untenable in light of *Western Pacific* and the cases following it. Those cases make it clear that while the bankruptcy court does have certain special functions in § 77 reorganizations, the role of the bankruptcy court in the areas of concern here is simply that of an appellate court. As we said in *Reconstruction Finance Corporation* v. *Denver, R. G. & W. R. Co.*, 328 U.S. 495, 508:

"[T]he experience and judgment of the Commission must be relied upon for final determinations of value and of matters affecting the public interest, subject to judicial review to assure compliance with constitutional and statutory requirements."

To like effect was the conclusion reached in *Chicago, R. I. & P. R. Co.* v. *Fleming*, 157 F. 2d 241, 245 (1946), a case following *Western Pacific*:

"The Commission is allowed wide discretion in reaching its conclusions, and if its findings are supported by substantial evidence and follow legal standards, they must be affirmed by the courts. . . ."

In my opinion these and other cases preclude the notions that the bankruptcy court has special factfinding and interest-weighing functions sufficient to justify this Court's viewing it as a quasi-trial court.

Alternatively, the majority's position might be that even though the reorganization court had no special review powers, this Court should still give weight to its conclusions concerning the Commission's price determinations. This position might have some force were there grounds for confidence that the bankruptcy court in this case applied the correct scope of review in examining the Commission determinations, but no such grounds for confidence exist here. This Court has an obligation to examine carefully the opinion of the bankruptcy court to determine if that court did in fact apply the correct scope of review. Such an inquiry necessarily involves the Court in determining if the agency's decisions are consistent with applicable law and supported by substantial evidence. As I indicated earlier, the record in this case simply does not support the conclusion that the reorganization court stayed within its proper scope of review of the Commission determinations. Since the reorganization court applied the wrong reviewing standard, there is no justification for this Court's giving any deference to the valuation determinations of that court.

The Court's opinion is thus poised between two equally unsatisfactory alternatives. Its conclusions must either rest on the theory that the reorganization court has extraordinary reviewing powers, a theory which I think is precluded by *Western Pacific* and the cases which follow it, or the Court must take the position that the reorganization court correctly applied the *Western Pacific* standard, a conclusion which seems to me untenable in light of the record in these cases and the opinion of the three-judge merger court.

IV

Today's decision will have the effect of greatly burdening the Penn Central by increasing the amount that company owes to the New Haven bondholders by an additional $28,000,000. The imposition of this additional burden can only bring about a further deterioration of the Penn Central's already seriously compromised financial position[3] and will further reduce the ultimate chances of success of this venture in which the public has a considerable stake. The public interest in these cases certainly lies in establishing and maintaining the Penn Central as a viable private enterprise with reasonable rates and efficient services. Here the Commission had a duty "to plan reorganization with an eye to the public interest as well as the private welfare of creditors and stockholders." *Reconstruction Finance Corp.* v. *Denver, R. G & W. R. Co.*, 328 U.S. 495, 535–536. See also the *Penn-Central Merger Cases*, 389 U.S. 486, 510–511. Because Penn Central's economic soundness will be vitally affected by the price it has to pay for the New Haven assets, the Commission had an obligation, which I think it fulfilled in these cases, to prevent an overvaluation of the New Haven assets which might unnecessarily jeopardize the newly merged Penn Central system. If the Commission resolved close and fairly debatable issues of valuation in favor of Penn Central rather than the New Haven bondholders, the agency's actions were wholly justifiable in terms of its statutory mandate to protect the public. Although the courts must review Commission determinations of value to guarantee that those valuations are "fair and equitable" to the bondholders, that reviewing authority does not permit a court to substitute its views for those of the Commission. Judicial review of Commission valuations must be exercised in light of the fact that "Congress has entrusted the Commission, not the courts, with the responsibility of formulating a plan of reorganization which 'will be compatible with the public interest.' § 77 (d)." *Group of Investors* v. *Chicago, M., St. P. & P. R. Co.*, 318 U.S. 523, 544. Here the Commission struck a balance between public and private interests that was clearly within its discretion, and I think it is both improper and unwise for this Court to upset that balance and place an additional $28,000,000 burden on the Penn Central, a burden that I fear may ultimately be borne by the consumers of the Penn Central's services or by the Federal Treasury.

[3] As the Court notes in its opinion, *ante*, at 2, the Penn Central Transportation Company has filed a petition for reorganization under § 77 of the Bankruptcy Act in the United States District Court for the Eastern District of Pennsylvania.

For the reasons stated above, I would affirm the judgment of the three-judge merger court on the valuation issue and would reverse the judgment of the bankruptcy court to the extent that it is inconsistent with the three-judge court.

Nos. 914, 915, 916, 917, 920, 921, 1038, & 1057

WHITNEY NORTH SEYMOUR, New York, N.Y. (HORACE J. McAFFEE, ALBERT X. BADER, JR., SELVYN SEIDEL and SIMPSON THACHER & BARTLETT, with him on the brief) for petitioner-appellant-respondent; LESTER C. MIGDAL, New York, N.Y. (LAWRENCE W. POLLACK and MIGDAL, LOW, TENNEY & GLASS, with him on the brief) for appellant-petitioner-respondent; JOSEPH AUERBACH, Boston, Mass. (JAMES WM. MOORE, JOHN N. WORCESTER, ROBERT G. BLEAKNEY, JR. and MORRIS RAKER, with him on the brief) for appellee-respondent; LEONARD S. GOODMAN, Associate General Counsel, ICC (ERWIN N. GRISWOLD, Solicitor General, RICHARD W. McLAREN, Assistant Attorney General, JAMES van R. SPRINGER, Deputy Solicitor General, JOHN H. D. WIGGER, Justice Dept. attorney, and ROBERT W. GINNANE, General Counsel, with him on the brief) for appellee-petitioner: HUGH B. COX, New York, N.Y. (ROSWELL B. PERKINS, ULRICH SCHWEITZER, SAMUEL E. GATES, ROBERT L. KING and HARVEY J. GOLDSCHMID, with him on the brief) for appellee-respondent-cross-petitioner; LOUIS J. LEFKOWITZ, Attorney General, State of New York, DUNTON F. TYNAN, Assistant Solicitor General, and WALTER J. MYSKOWSKI filed brief for State of New York, as appellee; ROBERT K. KILLIAN, Attorney General, State of Connecticut, SAMUEL KANELL, Special Assistant Attorney General, and JACK RUBIN, Assistant Attorney General, filed brief for State of Connecticut, as appellee.

STATEMENT OF SAMUEL PORTNOY, MANAGER, TRANSPORTATION, OCCIDENTAL CHEMICAL CO., HOUSTON, TEX.

My name is Samuel Portnoy—I am Manager of Transportation Research for Occidental Chemical Company, P.O. Box 1185, Houston, Texas 77001. I have been employed by Occidental Chemical Company for over four years. Practically all of my work after graduating college, has been in the traffic and transportation field for approximately thirty years.

I am presenting this statement as Chairman of the Legislative Sub-Committee of the Transportation Committee for the Fertilizer Institute, Washington, D.C.

The Fertilizer Institute is a trade association, with about 300 member companies which manufacture and distribute approximately 75 percent of the fertilizer used on the American farms. (Appendix 1 lists the Institute members.)

In 1969, 38.7 million tons of fertilizer was consumed by the farmers of the United States. Also an additional 18.6 million tons of fertilizer was exported. This tonnage is shipped thru 6,300 plants located throughout the United States. (Appendix 2 shows the various plant locations.)

As you can see from the above our group has a tremendous interest in obtaining necessary and satisfactory rail transportation equipment and service.

In reading the bill, we are convinced it will provide the railroads with the assistance it needs to provide the necessary car supply as well as maintain the facilities to promote safe and adequate transportation. The bill also has the necessary safeguards to make sure that the loans are not given to those railroads unable to make the necessary improvements.

The Fertilizer Institute needs a strong railroad industry under private ownership and management and this bill will help to keep our system strong as well as avoid failures.

During 1969 the fertilizer traffic contributed approximately $420,000,000 to the railroads freight revenues. In many cases the ton of fertilizer makes more than one railroad move.

The economy of our country is dependent on sufficient economical rail transportation services, and the fertilizer industry feels that its duty is to promote this.

It is respectfully submitted to your committee.

Samuel Portnoy, Manager Transportation Research
Occidental Chemical Company
Chairman, Sub-Committee
Legislative Transportation Committee
of the Fertilizer Institute—Washington, D.C.

Member Companies

A-A Fertilizer Co., Plainview, Minnesota
A.C.F. & Shirleys Fert., Brisbane, Australia
Acme Hamilton Mfg. Corp., Trenton, New Jersey
Acme Products Co., South Haven, Michigan
Adams Ammonia Co., Argos, Indiana
Adams Fertilizer Service, Bloomington, Illinois
Adams Hard-Facing Co., Guymon, Oklahoma
Ad-Craft Company, S. Sioux City, Nebraska
Agric, Anhydrous Ammonia Co., Ltd., Aylmer, Ontario, Canada
Agric. & Industrial Corp., New York, New York
Agrico Chemical Co., Div. of Continental Oil Co., Memphis, Tennessee
Agricultural Services, Inc., Grand Island, Nebraska
Agri-Serv., Inc., Santa Paula, California
Agri-Service, Inc., Lind, Washington
Agro Vita, Inc., Minneapolis, Minnesota
Agway Inc., Syracuse, New York
Paul Akers, Inc., Indianapolis, Indiana
Allied Chemical Corp., New York, New York
American Cyanamid Co., Princeton, New Jersey
American Fert. & Chem. Co., Englewood, Colorado
American Oil Company, Chicago, Illinois
American Zinc Company, St. Louis, Missouri
Ametalco, Inc., New York, New York
AMF Beaird, Inc., Shreveport, Louisiana
Amick Farm Supply, Papillion, Nebraska
Anco Chemicals, Ltd., Weston, Ontario, Canada
Anco Mfg. & Supply Co., Tulsa, Oklahoma
Arco Chemical Company, Fort Madison, Iowa
Assoc. of Mill & Elevator Mutual Ins. Cos., Chicago, Illinois
Atwood Vacuum Machine Co., Rockford, Illinois
Audrain Soil Service, Inc., Laddonia, Missouri
Australia Fert., Ltd., Sydney, Australia
Baer Ag. Supply Company, Waukee, Iowa
H. J. Baker & Bro., Inc., New York, New York
Barnard & Leas Mfg. Co., Inc., Cedar Rapids, Iowa
Bartlett & Company, Kansas City, Missouri
Bastian-Blessing, Div. of Astro Controls, Inc., Chicago, Illinois
Batman Farms Co., Inc., Grain Valley, Missouri
Beall Mfg. Div., Unit Rail Anchor Co., Inc., East Anton, Illinois
Thomas Beckett Company, Dallas, Texas
Bell Mfg. Company, Inverness, Mississippi
Roy & Lynn Benson, Stephen, Minnesota
The Blakely Peanut Co., Blakely, Georgia
John Blue Company, Huntsville, Alabama
Bluegrass Plant Foods, Inc., Cynthiana, Kentucky
Boettcher Enterprises, Inc., Beloit, Kansas
F. W. Bolgiano & Co., Washington, D. C.
Brandt Chemical Co., Inc., Pleasant Plains, Illinois
Bridgeton Marine Terminal, Bridgeton, New Jersey
Brockville Chemical Inds., Chatham, Ontario, Canada
Canadian Industries Ltd., Montreal, Quebec, Canada
Canadian Superior Oil Ltd., Calgary, Alberta, Canada
Carpenter Sales, Inc., Bondurant, Iowa
Central Farmers Fert. Co., Chicago, Illinois
Central Resources Corp., New York, New York
Champion-Farm Div., Koehring Co., Sand Springs, Oklahoma
Chemi-trol Chemical Co., Fremont, Ohio

Chemurgic Agricultural Chem., Inc., Turlock, California
Chevron Chemical Co., San Francisco, California
Chicago Bridge & Iron Co., Oak Brook, Illinois
Chilean Nitrate Sales Corp., New York, New York
Cia Paulista de Adubos Copas, Sao Paulo, Brazil
Cities Service Company, Atlanta, Georgia
Clarinda Elevator, Inc., Clarinda, Iowa
Clark Manufacturing Co., Atherton, Missouri
Clark Plant Food & Chemical Co., New York, New York
Clayton County Farm Serv. Co., Elkader, Iowa
Columbia Nitrogen Corp., Augusta, Georgia
The Columbiana Boiler Co., Columbiana, Ohio
Cominco American Inc., Spokane, Washington
Commercial Shearing & Stamping Co., Youngstown, Ohio
Commercial Solvents Corp., New York, New York
Continental NH_3 Products Co., Inc., Dallas, Texas
Co-Operative Elevator Co., Pigeon, Michigan
Co-Op, Inc., Ida Grove, Iowa
Cooperative Oil & Supply Assn., Shenandoah, Iowa
Corenco Corporation, Tewksbury, Massachusetts
Corken Pump Company, Oklahoma City, Oklahoma
Cotton Belt Liquid Gas Corp., Benoit, Mississippi
Cotton Producers Association, Atlanta, Georgia
Cox Grain & Feed Co., Tennant, Iowa
Walter Craft Fert. & Chem. Co., Malaga, New Mexico
Creighton Brothers, Warsaw, Indiana
Crop Builders, Inc., Edgewood, Iowa
CSBP & Farmers, Ltd., Perth, Western Australia
Daycon Nitrogen Company, Peterbsurg, Indiana
Deaton Ammonia Service, Eaton, Ohio
Decatur Foundry & Machine, Decatur, Alabama
Delevan Mfg. Company, West Des Moines, Iowa
Delta Tank Mfg. Co., Inc., Macon, Georgia
Dempster Industries, Inc., Beatrice, Nebraska
Denney Gin Company, Milan, Tennessee
Diamond R. Fertilizer Co., Winter Garden, Florida
Diamond Shamrock Oil & Gas, Amarillo, Texas
Bennie Dick & Sons, Silver Lake, Kansas
Dietrich Mfg., Inc., Goodfield, Illinois
Dimmitt 66, Inc., Dimmitt, Texas
Direct Nitrogen, Ltd., Wallington, Surrey, England
Dixie Chemical Corp., New Bern, North Carolina
Dixie Guano Company, Laurinburg, North Carolina
Dorchester Cotton Oil Co., St. George, South Carolina
Double "A" Fert. Ser. Ltd., Lethbridge, Alberta, Canada
Douglass Screen Printers, Inc., Lakeland, Florida
Dover Corporation, Blackmer Pump Div., Grand Rapids, Michigan
Dow Badische Company, Williamsburg, Virginia
Duesterhaus Farm Supply, Quincy, Illinois
Duval Corporation (Duval Sales Corp.), Houston, Texas
Eagle-Picher Industries, Inc., Joplin, Missouri
The Eckville Co-Op Assoc. Ltd., Eckville, Alberta, Canada
Electric Reduction Company of Canada, Ltd., Toronto, Ontario, Canada
Electric Wheel Co., Div. of Firestone Tire & Rubber, Quincy, Illinois
El Paso Products Co., Odessa, Texas
Elyria Farm Supply, Inc., Elyria, Nebraska
Emcee Industries, Inc., Findlay, Ohio (Teaneck, New Jersey)
Erny's Fertilizer Service, Walton, Indiana
Escambia Chemical Corp., Pensacola, Florida
Esso Chemical Co., Inc., New York, New York
Exley & Sponsler Nitrogen Service, Humeston, Iowa
Fairview Fertilizer Co., Inc., Fairview, Kansas
Farmers Coop. Association, Marathon, Iowa
Farmers Cooperative Co., Hooper, Nebraska
Farmers Co-Op Elevator Co., Garden Plain, Kansas

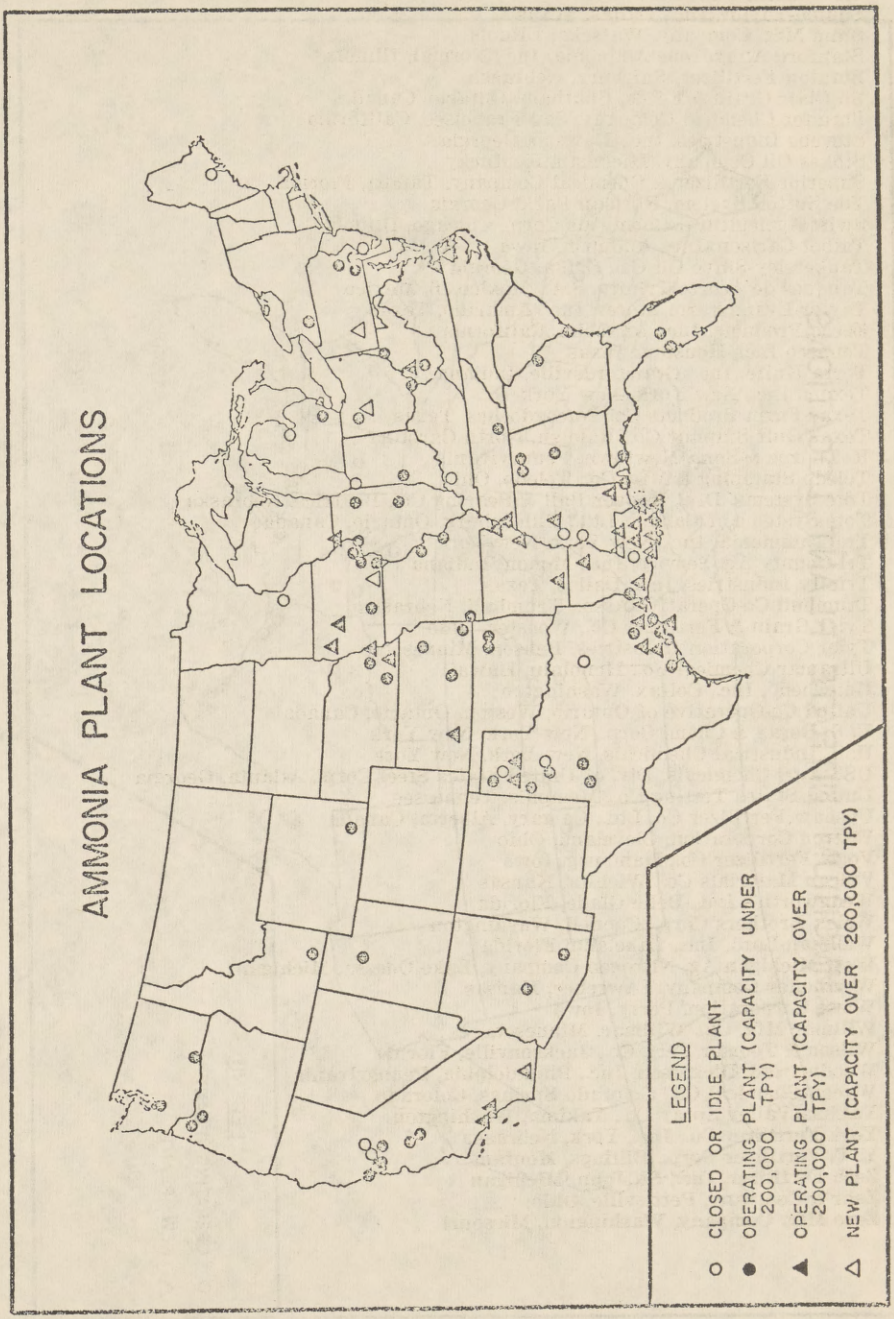
Farmers Co-Op Grain Assoc., Polk Nebraska
Farmers Co-Op Grain Co. of Yetter, Lake City, Iowa
Farmers Coop. Grain & Supply Co., Ensign, Kansas
Farmers Coop, Oil Assn., Winner, South Dakota
Farmers Elevator Mutual Ins. Co., Des Moines, Iowa
Farmers Fertilizer Co., Lawton, Iowa
Farmers Fertilizer Works, Inc., Elizabethtown, Pennsylvania
Farmers Service AAL, Tutwiler, Mississippi
Farmers Supply Company, Marvell, Arkansas
Farmers Supply Cooperative, Hutchinson, Kansas
Farmers Supply Coop. AAL, Greenwood, Mississippi
Farmers Union Central Exchange, Inc., South St. Paul, Minnesota
Farmland Industries, Inc., Kansas City, Missouri
Farmore Distributing Co., Pendleton, Oregon
Farmway Service, Columbia, Missouri
The Ferguson Company, Dawson, Georgia
Ferguson Industries, Dallas, Texas
Ferro Corporation, Cleveland, Ohio
Fertilizantes del Nordeste S.A., Mexico
Fertilizantes Fostfatados Mexicanos, S.A., Mexico
Fertilizantes Garza, S.A., Brownsville, Texas
Fertilizantes Liquidos, S.A. Celaya, GTO, Mexico
First Mississippi Corp., Jackson, Mississippi
Fisher Controls, McKinney, Texas
Fisons (Pty.) Limited, Johannesburg, South Africa
Five County Farmers Assn., Clarksdale, Mississippi
Lily Flagg Gin, Huntsville, Alabama
Florida Favorite Fertilizer, Lakeland, Florida
Fox Farm Supply Corp., Wever, Iowa
Fox Valley Hicksgas, Inc., Plainfield, Illinois
Freeport Sulphur Company, New York, New York
French Potash & Import Co., New York, New York
FS Services, Bloomington, Illinois
Fuller Seed Company, Lincoln, Illinois
Amos J. Funk, Inc., Gridley, Illinois
Gas Equipment Supply Co., Atlanta, Georgia
E. B. Gee Cotton & Grain Co., Blytheville, Arkansas
Geigy Agricultural Chemicals, Yonkers, New York
General American Trans. Corp., Terminals Div., Chicago, Illinois
General Bottle Gas Corp., Logootee, Indiana
Gigstad Fertilizer Co., Nortonville, Kansas
Giltner Grain & Supply, Inc., Giltner, Nebraska
Goodall Rubber Company, Trenton, New Jersey
Goodpasture, Inc., Brownfield, Texas
W. R. Grace & Co., New York, New York
Graphics Mfg. Company, Chicago, Illinois
Great Salt Lake Minerals and Chemicals Corp., Atlanta, Georgia
Green Butane Company, Leoti, Kansas
Green Hills Service, Inc., Linneus, Missouri
Greenlife Products Co., Inc., West Point, Virginia
Green Valley Farm Supply, Island, Kentucky
Greenwood Fertilizer Co., Farley, Iowa
Grow-Green Chemicals, Inc., Bethel, North Carolina
Gulf Central Pipeline Co., Chicago, Illinois
Gulf Interstate Eng. Co., Houston, Texas
Gulf Oil Company-U.S., Kansas City, Missouri
Gulf & Western Indus., New York, New York
Hagie Manufacturing Co., Clarion, Iowa
Hamilton Farm Bureau Co-Op, Hamilton, Michigan
Hancock Farm Chemicals, Findlay, Ohio
Harmon Grain Storage, Inc., Trumbull, Nebraska
Harper & Bowers, Inc., Estill, South Carolina
Harris Rim & Wheel, Inc., Atlanta, Georgia
L. Harvey & Son Co., Kinston, North Carolina
Hawkeye Chemical Co., Clinton, Iowa

Haycock Soil Service, Delavan, Illinois
Hercules, Inc., Wilmington, Delaware
Herrick Feed & Produce, Westboro, Missouri
Herrin Fertilizer Co., Buffalo, Illinois
Hewitt-Robbins, Inc., Div., Litton Inds., Buffalo, New York
Highview Cooperative, Webster City, Iowa
Hill Chemicals Inc., Dallas, Texas
Hi-N Corporation, Stanley, New York
Hoover's Inc., Greenleaf, Kansas
Howe Hilliard Grain Co., Mayfield, Kentucky
Howe Incorporated, Minneapolis, Minnesota
J. M. Hunt & Son, Ackley, Iowa
Hydrocarbon Products Co., Stamford, Connecticut
Imperial Chemical Industries of
Australia & New Zealand, Limited, Melbourne, C. I., Australia
Inject-O-Meter Mfg., Inc., Clovis, New Mexico
Inland Chemical Co., Wilder, Idaho
International Commodities Export Corporation New York, New York
International Minerals & Chemical Corp., Skokie, Illinois
Jannusch Ferfitilizer Ser., McLean, Virginia
Kaiser Agri. Chem. Div. Kaiser Alum. & Chem. Corp., Savannah, Georgia
Kalium Chemicals Limited, Atlanta, Georgia
The KBH Corporation, Clarksdale, Mississippi
K. C. Soil Service, Inc., Pecatonica, Illinois
Kelsey Hayes Company French & Hecht Div., Davenport, Iowa
Kerr McGee Chemical Corp., Oklahoma City, Oklahoma
Kershaw Oil Mill, Kershaw, South Carolina
Kewanee Farmers Co-Op Elevator Co., Kewanee, Illinois
King Gas Products Co., Blue Earth, Minnesota
Klein Fertilizers, Inc., Fowlerville, Michigan
Kohout Mfg. Co., Orange City, Iowa
Kokomo Grain & Feed Co., Kokomo, Indiana
Krantz, Robert A., Hutchinson, Kansas
L'Ammoniac Agricole L'Orangerie, Wattignies (Nord), France
Landmark Farm Bureau Coop. Assn., Inc., Columbus, Ohio
Laverty Elevator, Inc., Indianola, Iowa
Lebanon Chemical Corp., Lebanon, Pennsylvania
Lein Oil Company, Janesville, Wisconsin
Leipsic Agri. Supply Co., Leipsic, Ohio
The Lemm Corporation, Memphis, Tennessee
Liberty Manufacturing Co., Inc., Red Spring, North Carolina
Lindsay Brothers Co., Minneapolis, Minnesota
Linn Cooperative Oil Co. Marion, Iowa
Gabe Logsdon & Sons, Inc., Wayland, Missouri
Thomas J. Maas & Son, Waterford, Wisconsin
Madison Cooperative Creamery, Madison, Nebraska
Madison Fertilizer, Inc., Tallulah, Louisiana
Madison Fert. Service, Inc., London, Ohio
The Man-An-So Corporation, Nevada, Iowa
Mapco, Inc., Athens, Illinois
Marcelo Steel Corp., Manila, Philippines
March Liquid Fertilizer Co., Warren, Minnesota
Marsh Instrument Company, Wilmette, Illinois
Cliff Martin Milling Co., Wrens, Georgia
The McGregor Company, Colfax, Washington
Alexander M. McIver & Son, Charleston, South Carolina
Ralph McKay, Ltd., Melbourne, Victoria, Australia
Meacham's Nitrogen Serv., Morganfield, Kentucky
Meiners Farm Service, Inc., Colfax, Illinois
Melroe Mfg. Company, Gwinner, North Dakota
Melvins, Streator, Illinois
MFA Plant Food Division (Missouri Farmers Assoc.), Columbia, Missouri
Midwest Nitrogen Inc., Niota, Illinois
Midwest Plant Food, Inc., Napoleon, Ohio

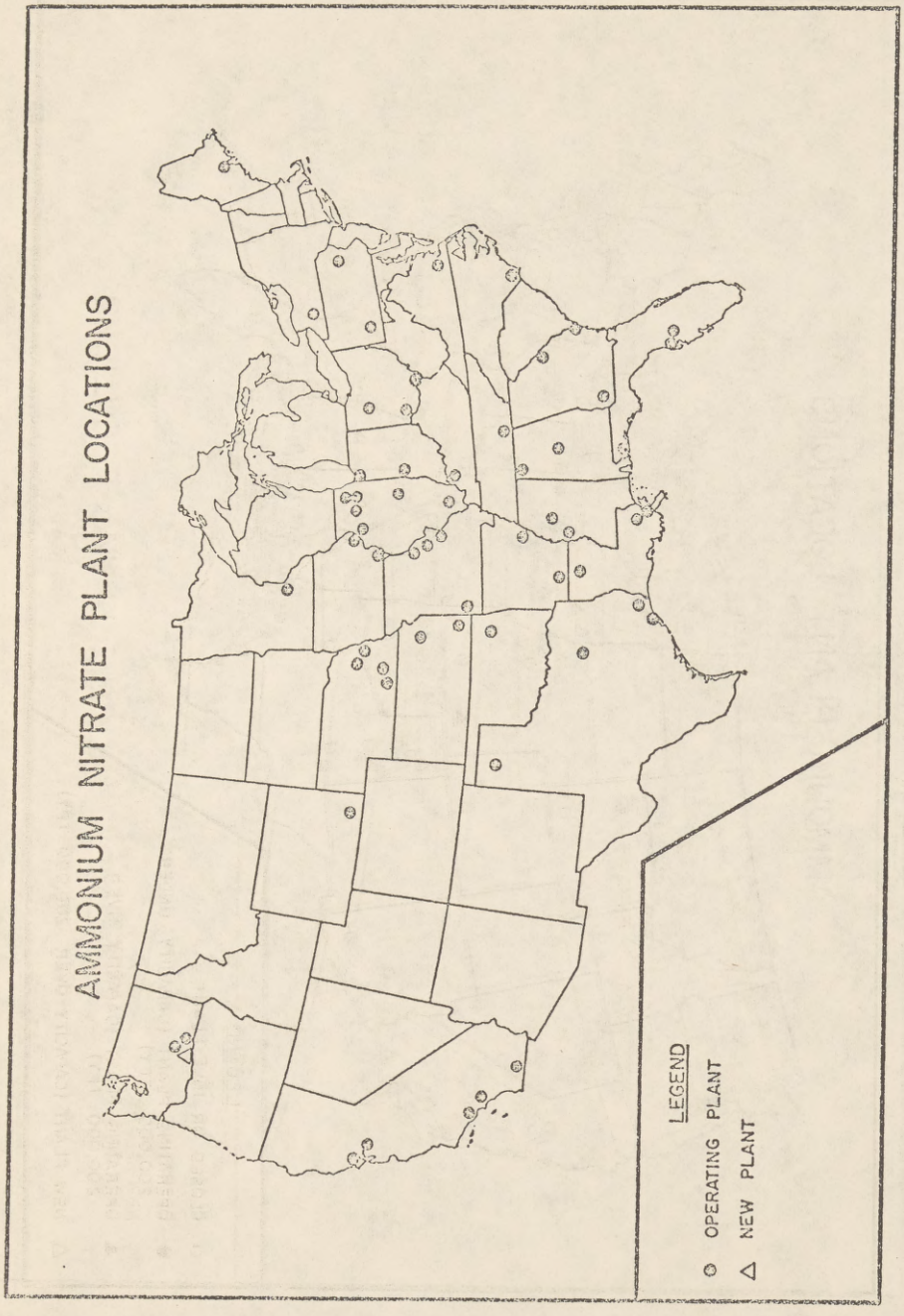
Midwestern Chemical Co., Inc., Belleville, Illinois
Milford Fertilizer Co., Milford, Delaware
Minnesota Liquid Fert. Co., LeSueur, Minnesota
Ouachita, Fert. & Grain Co., Monroe, Louisiana
Owens-Corning Fiberglas, Toledo, Ohio
Parish Fertilizers, Canton, Illinois
Parker Fertilizer Co., Inc., Sylacauga, Alabama
Parker Hannifin Corp., Minneapolis, Minnesota
Peacock Corporation, Scotch Plains, New Jersey
Penta Farm Supply, Inc., Tulia, Texas
Peterson Propane Company, Hampshire, Illinois
P&H Mfg. Company, Shelbyville, Illinois
Philipp Brothers Chemicals, New York, New York
Philipp Brothers Division of Englehard
Minerals & Chemicals Corp. New York, New York
Phillips Petroleum Co., Bartlesville, Oklahoma
Piester Grain Company, Minden, Nebraska
Potash Company of America, Denver, Colorado
Potash Company of Canada, Toronto, Ontario, Canada
Potash Import & Chemical Corporation, New York, New York
PPG Industries, Inc., Pittsburgh, Pennsylvania
Planters Chemical Corp., Albany, Georgia
Planters Fert. & Soybean Co., Pine Bluff, Arkansas
Prior Products, Inc., Dallas, Texas
Pro-Chem Company, Inc., Middlesex, New Jersey
Propane Gas Coop., Eagle Grove, Iowa
Pugh Gin & Fertilizer Co., Tillar, Arkansas
Raybestos-Manhattan, Inc., Passaic, New Jersey
Reading Bone Fertilizer Co., Reading, Pennsylvania
Richmond Guano Company, Richmond, Virginia
Hardin Richter Anhydrous Co., Kampsville, Illinois
Rickel, Inc., Manufacturing Div., Kansas City, Missouri
Riverside Industries, Marks, Mississippi
Robin Jones Phosphate Co., Nashville, Tennessee
Rochester Gauges, Inc., of Texas, Dallas, Texas
Rocket Supply Corporation, Roberts, Illinois
Rockwell Mfg., Company, Pittsburgh, Pennsylvania
I. G. Rosenberger, Inc., Silverdale, Pennsylvania
Rural NH_3 Service, Liberty, Mississippi
Rutherford Equipment, Inc., Lithonia, Georgia
San Diego Fertilizer Co., San Diego, California
Schmidt's Chemicals, Waterloo, Illinois
Schroeder's Fert. Service, Inman, Kansas
A. R. Scoones & Co., Kyabram, Victoria, Australia
Seaboard Seed Company, Bristol, Illinois
Selstad Soil Service, Great Falls, Montana
Service Fert., Grain Co., Iola, Kansas
Service Gas, Inc., Morris, Illinois
Shell Canada Limited, Toronto, Ontario, Canada
The Sherwin-Williams Co., Cleveland, Ohio
Sierra Chemical Company, Newark, California
Simonsen Mill-Rendering Plant, Inc., Quimby, Iowa
J. R. Simplot Company, Pocatello, Idaho
J. F. Sloan Co., Salinas, California
Smith Chemical Company, Grand Junction, Colorado
Smith Company of Uvalde, Uvalde, Texas
Smith-Douglas Div. of Borden Chemical, Norfolk, Virginia
Smith Oil Corporation, Rockford, Illinois
Soil & Crop Service, Inc., Othello, Washington
Southern Agricultural Spreaders Pty. Ltd., Moss Vale, N.S.W. Australia
Southwest Chemical Corp., West Memphis, Arkansas
Southwest Potash Corp., New York, New York
Southwest Sprayer & Chem. Co., Waco, Texas
Spatz Paint Industries, Inc., St. Louis, Missouri

Sprague Grange Supply, Inc., Sprague, Washington
S.P.S., Inc., Onawa, Iowa
Squibb-Taylor, Inc., Dallas, Texas
Stam Mfg. Company, Watseka, Illinois
Stanford Anhydrous Ammonia, Inc., Normal, Illinois
Stanton Fertilizer, Fairbury, Nebraska
St. Clair Grain & Feeds, Chatham, Ontario, Canada
Stauffer Chemical Company, San Francisco, California
Stevens Industries, Inc., Dawson, Georgia
Stokes Oil Company, Hickman, Kentucky
Superior Fertilizer & Chemical Company, Tampa, Florida
The Sutton System, Norman Park, Georgia
Swift Agricultural Chemicals Corp., Chicago, Illinois
Talbot-Carlson, Inc., Audubon, Iowa
Tankersley-Shive Oil Co., Ocilla, Georgia
Tanques de Acerto Trinity, S.A., Mexico 16, Mexico
Taylor-Evans Farm Stores, Inc., Amarillo, Texas
Teeco Products, Inc., Anaheim, California
Tenneco Inc., Houston, Texas
Terra Knife, Inc., Crawfordsville, Indiana
Texaco Inc., New York, New York
Texas Farm Products Co., Nacogdoches, Texas
Texas Gulf Sulphur Co., Raleigh, North Carolina
R. Thorpe & Sons, Newtown, Pennsylvania
Toledo Stamping & Mfg. Co., Toledo, Ohio
Tote Systems, Div., Hoover Ball & Bearing Co., Beatrice, Nebraska
Tote Systems of Canada Ltd., Tillsonburg, Ontario, Canada
Transammonia, Inc., New York, New York
Tri-County Ag. Service, Inc., Monon, Indiana
Trinity Industries, Inc., Dallas, Texas
Trumbull Co-Operative Assn., Trumbull, Nebraska
Tyler Grain & Fertilizer Co., Wooster, Ohio
Tyler Corporation Industries, Benson, Minnesota
Ultramar Chemical Co., Honolulu, Hawaii
Uni-Chem., Inc., Colfax, Washington
United Co-Operative of Ontario, Weston, Ontario, Canada
U. S. Borax & Chem. Corp., New York, New York
U. S. Industrial Chemicals, New York, New York
USS Agri-Chemicals, Div. of United States Steel Corp., Atlanta, Georgia
United States Testing Co., Memphis, Tennessee
Upshaw Fertilizer Co. Ltd., Calgary, Alberta, Canada
Vistron Corporation, Cleveland, Ohio
Vogel Fertilizer Co., Hamburg, Iowa
Vulcan Materials Co., Wichita, Kansas
Wedgworth's Inc., Belle Glade, Florida
Welch Brothers Corp., Connell, Washington
Wellman-Lord, Inc., Lakeland, Florida
West Michigan Ag. Nitrogen Company, Lake Odessa, Michigan
Westheffer Company, Lawrence, Kansas
Wiese Corporation, Perry, Iowa
Willmar Mfg. Co., Willmar, Minnesota
Wilson & Toomer Fert. Co., Jacksonville, Florida
Woodward & Dickerson, Inc., Philadelphia, Pennsylvania
Wycon Chemical Co., Colorado Springs, Colorado
Yakima Valley Spray Co., Yakima, Washington
York Fertilizer Co., Inc., York, Nebraska
Y. V. Fertilizer Corp., Billings, Montana
Zeeb Fertilizer, Inc., St. John, Michigan
Zehr & Company, Pettisville, Ohio
Zero Mfg. Company, Washington, Missouri

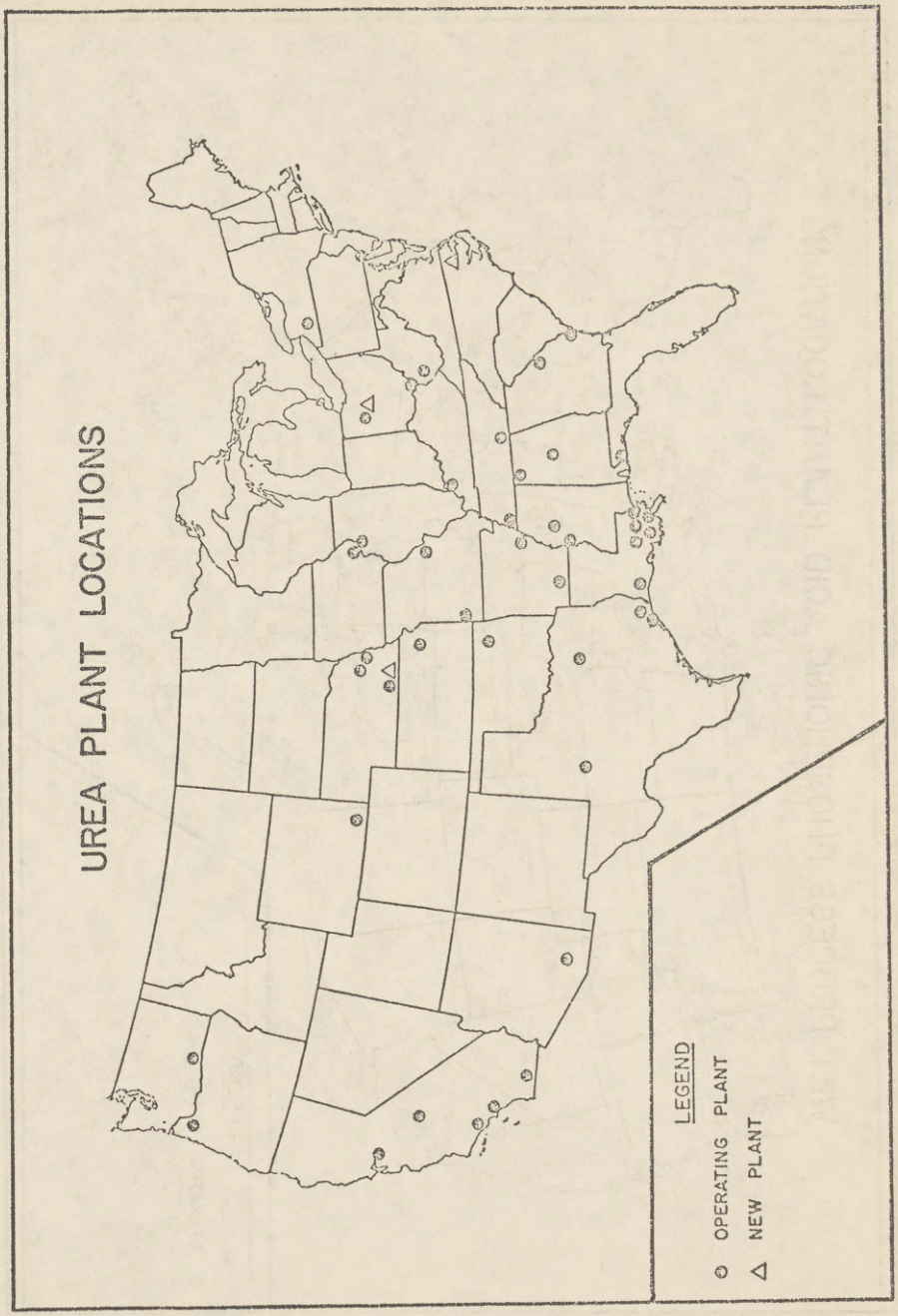
APPENDIX 2


AMMONIA PLANT LOCATIONS
LEGEND
○ CLOSED OR IDLE PLANT
● OPERATING PLANT (CAPACITY UNDER 200,000 TPY)
▲ OPERATING PLANT (CAPACITY OVER 200,000 TPY)
△ NEW PLANT (CAPACITY OVER 200,000 TPY)

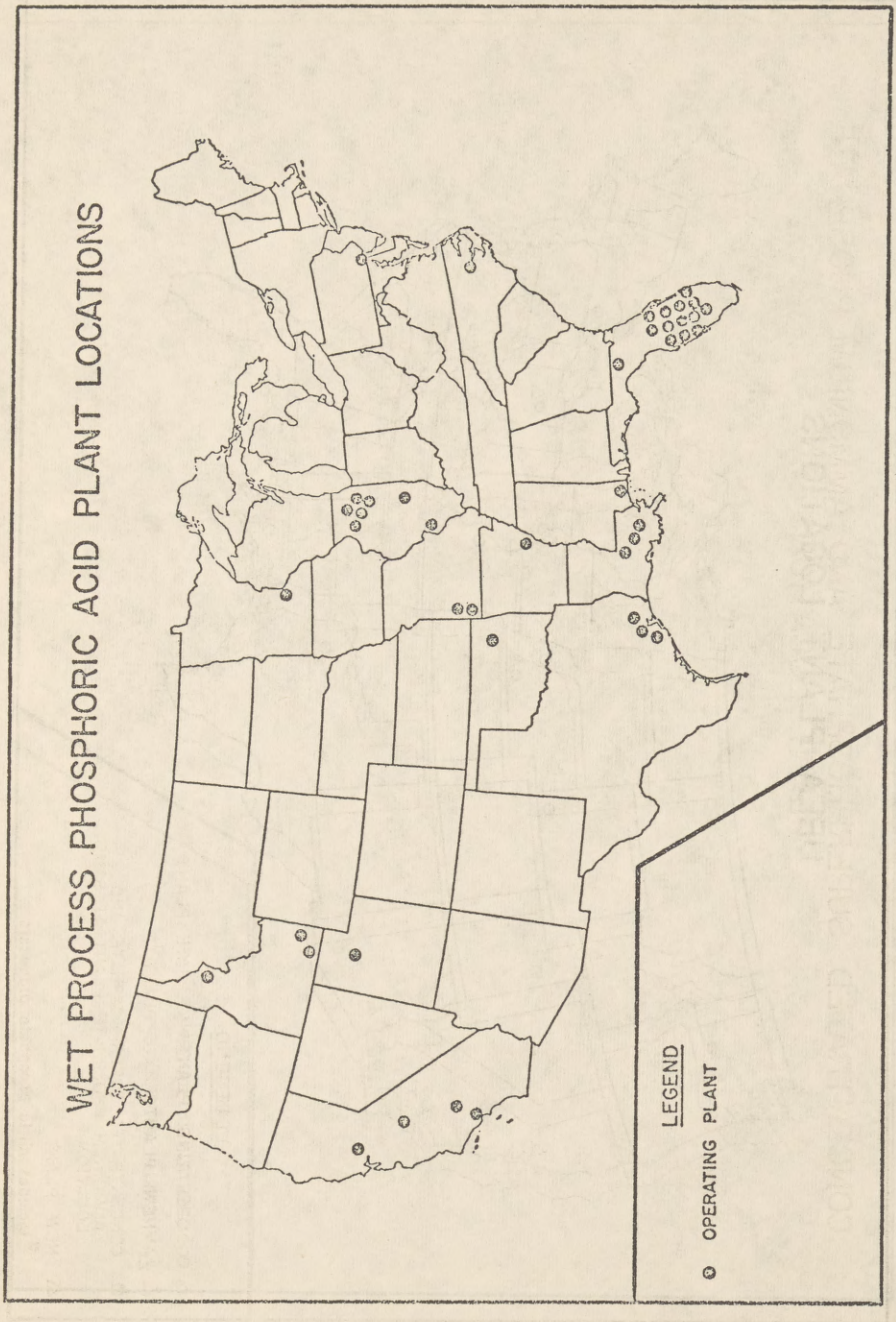
APPENDIX 2


AMMONIUM NITRATE PLANT LOCATIONS
LEGEND
OPERATING PLANT
NEW PLANT

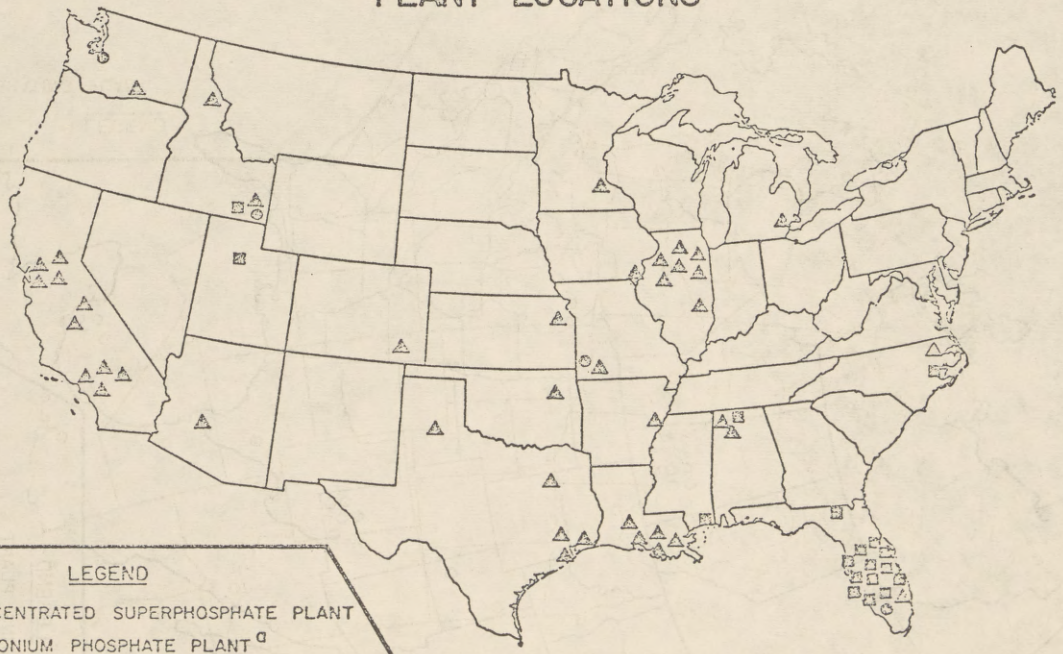
APPENDIX 2



APPENDIX 2


WET PROCESS PHOSPHORIC ACID PLANT LOCATIONS
LEGEND
OPERATING PLANT

CONCENTRATED SUPERPHOSPHATE AND AMMONIUM PHOSPHATE PLANT LOCATIONS

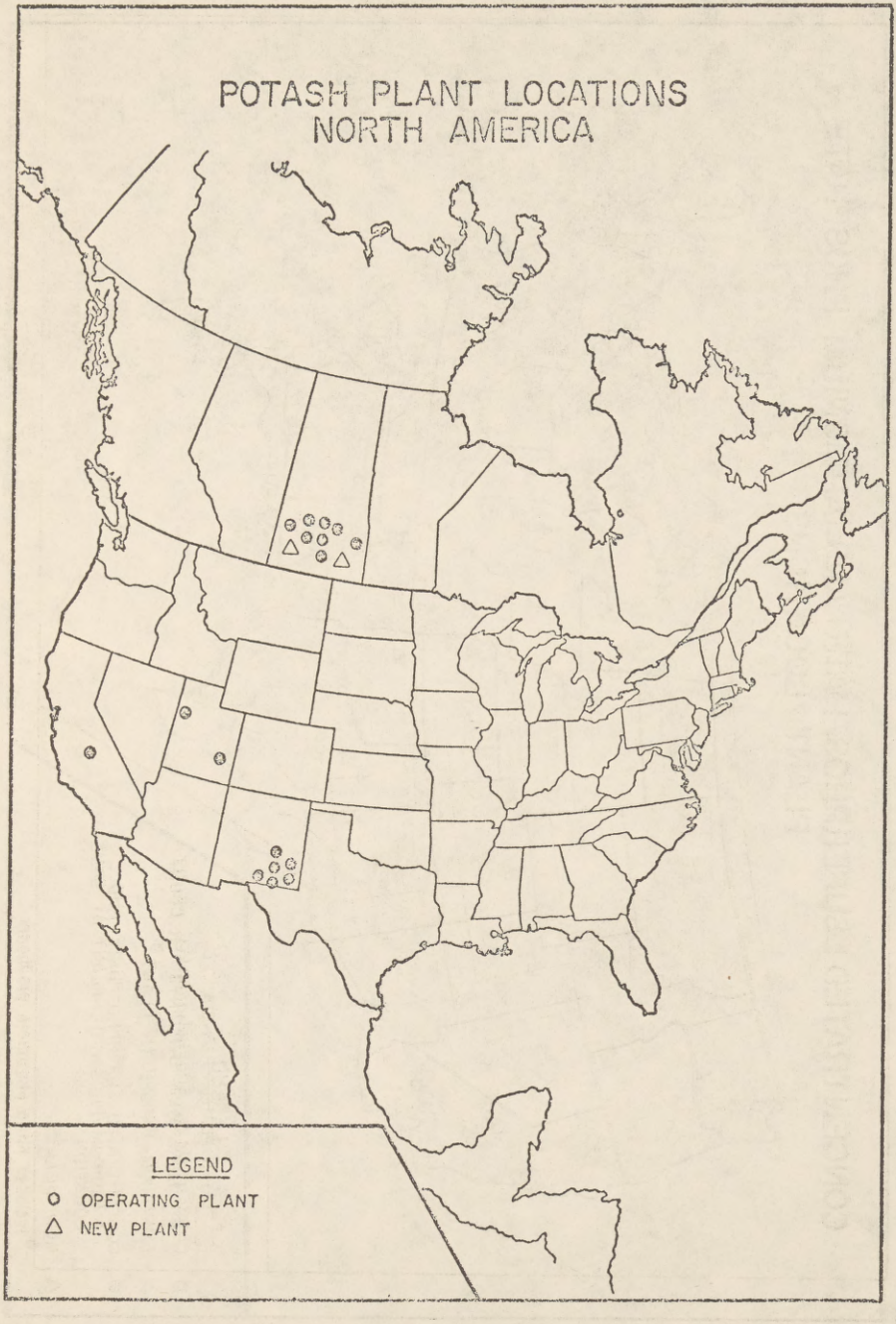


LEGEND

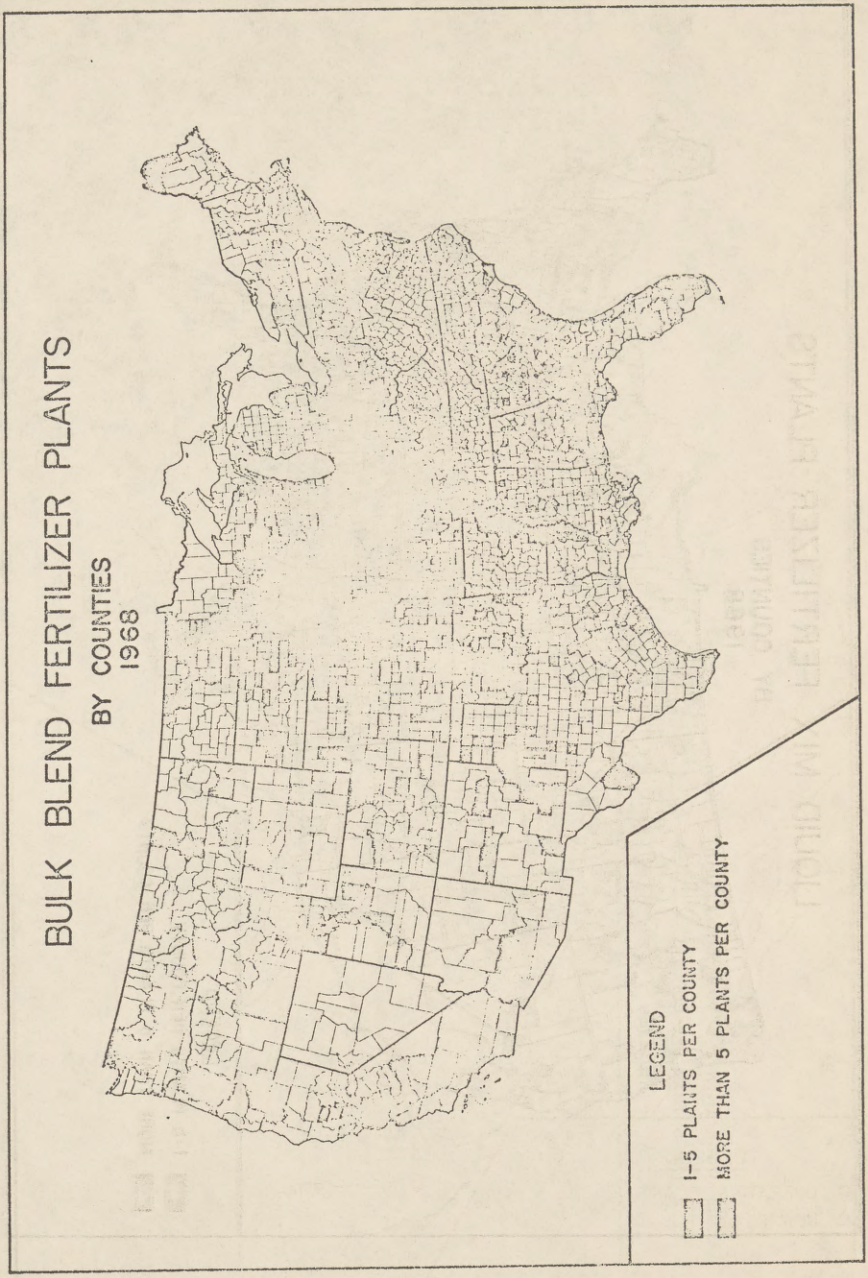
- ⊙ CONCENTRATED SUPERPHOSPHATE PLANT
- △ AMMONIUM PHOSPHATE PLANT[a]
- ⊡ CONCENTRATED SUPERPHOSPHATE AND AMMONIUM PHOSPHATE PLANT AT SAME LOCATION
- △ NEW PLANT

[a] Includes nitric phosphate producers

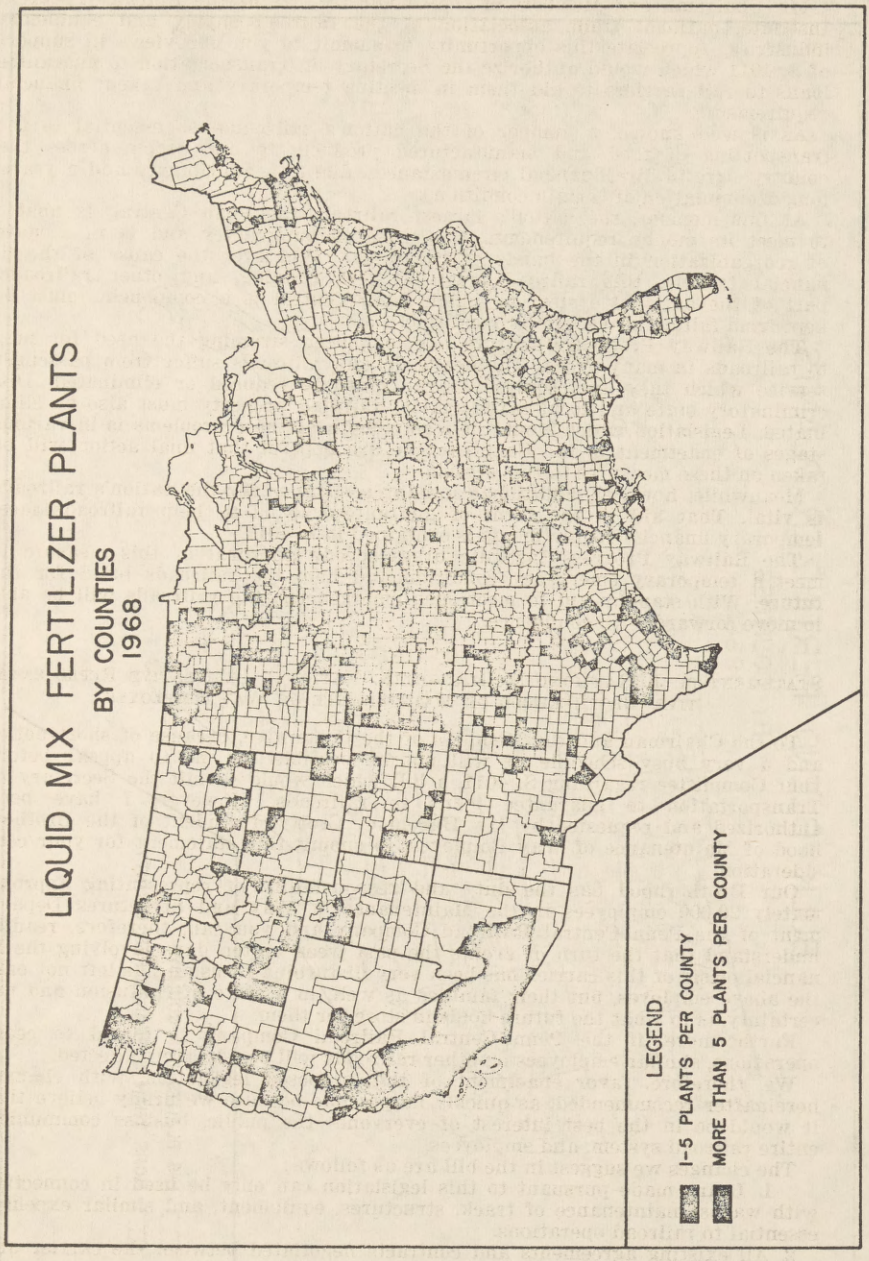
APPENDIX 2


POTASH PLANT LOCATIONS
NORTH AMERICA
LEGEND
OPERATING PLANT
NEW PLANT

APPENDIX 2


BULK BLEND FERTILIZER PLANTS
BY COUNTIES
1968
LEGEND
1-5 PLANTS PER COUNTY
MORE THAN 5 PLANTS PER COUNTY

APPENDIX 2


LIQUID MIX FERTILIZER PLANTS
BY COUNTIES
1968
LEGEND
1-5 PLANTS PER COUNTY
MORE THAN 5 PLANTS PER COUNTY

STATEMENT OF NILS A. LENNARTSON, PRESIDENT, RAILWAY PROGRESS INSTITUTE

Mr. Chairman and Members of the Committee, We at the Railway Progress Institute, national trade association of the railroad supply and equipment industries, appreciate this opportunity to submit to you our views in support of S. 4011 which would authorize the Secretary of Transportation to guarantee loans to rail carriers to aid them in meeting temporary and urgent financial requirements.

As is well known, a number of the nation's railroads—so essential to the transporting of food and manufactured products to our people across the country—are in dire financial circumstances, due to a multiplicity and a years-long accumulation of certain conditions.

At this moment, the nation's largest railroad, the Penn Central, is unable to meet its money requirements, has declared bankruptcy and is in a state of reorganization in the hands of the courts. Whatever the cause of the financial trouble, this railroad must be kept running, and other railroads, part of the national system in which Penn Central is a component, must be kept from falling into a similar condition.

The Railway Progress Institute has long been stressing the need for help to railroads in many areas. The heavy deficits railroads suffer from passenger service which they are required to run must be reduced or eliminated. Discriminatory state and local taxes against railroad property must also be eliminated. Legislation which would help solve both of these problems is in various stages of enactment in the Congress. We are hopeful that final action will be taken on these measures in this session.

Meanwhile, however, additional standby assistance for the nation's railroads is vital. That aid in the form of guaranteed loans to help railroads meet temporary financial requirements is contained in S. 4011.

The Railway Progress Institute urges speedy approval of this measure to meet a temporary emergency condition and help the railroads build for the future. With standby aid to meet such emergencies, the railroads will be able to move forward with confidence.

STATEMENT OF J. RAYMOND MCGLAUGHLIN, NATIONAL LEGISLATIVE REPRESENTATIVE, BROTHERHOOD OF MAINTENANCE OF WAY EMPLOYES

To the Chairman and the Members of the Committee, because of short notice and a very busy schedule, it will not be possible for me to appear before your Committee regarding S. 4011, a bill which would permit the Secretary of Transportation to guarantee loans to railroads. However, I have been authorized and requested by Mr. Harold C. Crotty, President of the Brotherhood of Maintenance of Way Employes, to submit this statement for your consideration.

Our Brotherhood has the duty and responsibility of representing approximately 20,000 employees in the Maintenance of Way and Structures Department of the Penn Central Railroad Company and you can, therefore, readily understand that the turn of events the past week or ten days involving the financial crisis of this carrier has been very disturbing to us an has left not only the above employes, but their families as well, in a state of confusion and uncertainty as to what the future holds in store for them.

Furthermore, if the Penn Central Railroad Company is forced to cease operations, similar employees on other railroads will be adversely affected.

We, therefore, favor enactment of this proposed legislation, with changes hereinafter recommended, as quickly as possible because we firmly believe that it would be in the best interest of everyone—the public, businss community, entire railroad system, and employees.

The changes we suggest in the bill are as follows:

1. Loans made pursuant to this legislation can only be used in connection with wages, maintenance of track, structures, equipment, and similar expenses essential to railroad operations.

2. All existing agreements and contracts negotiated between the carrier and employees involving hours of service, rates of pay, working conditions, and pensions plans continue uninterrupted.

3. Maintain prevailing wage rates and other working conditions in the railroad industry.

Your early and favorable attention to S. 4011, together with the amendments we have suggested, will be greatly appreciated.

RAILWAY LABOR EXECUTIVES' ASSOCIATION,
Washington D. C. June 26, 1970.

Hon. WARREN G. MAGNUSON,
Chairman, Senate Commerce Committee, U. S. Senate, Washington, D.C.

Dear Mr. Chairman: This is to inform you that the Railway Labor Executives' Association, representing 14 standard railway labor organizations as follows:

American Railway Supervisors' Association
American Train Dispatchers' Association
Brotherhood of Locomotive Engineers
Brotherhood of Railroad Signalmen
Brotherhood Railway Carmen of the United States and Canada
Brotherhood of Sleeping Car Porters
International Association of Machinists and Aerospace Workers
International Brotherhood of Boilermakers and Blacksmiths
International Brotherhood of Electrical Workers
International Brotherhood of Firemen and Oilers
International Organization Masters, Mates, and Pilots of America
National Marine Engineers' Beneficial Association
Railroad Yardmasters of America
Sheet Metal Workers' International Association

heartily supports the declared purpose and the general principles of S. 4011, the Emergency Transportation Assistance Act of 1970, but we also feel that the bill should be amended to include certain protective provisions.

Railroad employes are not only aware but are much concerned over the fact that while many railroads systems are thriving and prosperous, certain others are in temporary financial difficulties. S. 4011 would offer strong and helpful relief for such difficulties. At the same time, more basic legislation is urgently needed to deal with the railroad industry's problems. Two bills of this kind that deserve prompt action by the Congress are the National Rail Passenger Corporation bill, S. 3706, and the broad railroad safety bill, S. 1933, both recently passed by the Senate.

To protect the interests of the taxpayers and the railroad employes, we suggest that the Committee amend S. 4011 in the following ways:

1. Any federally guaranteed loan to a rail carrier should be used only for payment of wages, purchase of equipment and/or materials and supplies needed to operate and maintain the railroad. No rail carrier receiving a federally guaranteed loan shall expend such loan money or any revenues received from its railroad operations to diversify outside the railroad industry.

2. Any profits distributed by a subsidiary or affiliated company of any carrier benefitting from a guaranteed loan should go only to liquidate the guaranteed loan and/or to operate and maintain the railroad.

3. Any carrier with a guaranteed loan should be required to maintain wages, rules and working conditions at least equal to those on the majority of Class I railroads, and should be required to honor all its existing labor agreements.

4. Any carrier with a guaranteed loan which has agreed to set aside funds to meet its obligations under any labor agreement, including labor merger agreements, shall be forbidden to spend such funds for other purposes.

With these amendments, we believe S. 4011 would be a measure strongly in the public interest and would deserve prompt favorable action by this Committee and the Congress.

Very truly yours,

J. TAYLOR SOOP,
Executive Secretary.

UNITED TRANSPORTATION UNION
Cleveland, Ohio, August 25, 1970.

Hon. VANCE HARTKE,
Chairman, Surface Transportation Subcommittee,
Senate Office Building, Washington, D.C.

Senator HARTKE: We appreciate your invitation as outlined in your letter of August 20, 1970, to submit our views on the proposal Mr. C. L. Dennis presented to the Senate Committee on Commerce during the course of his testimony on S. 4011, S. 4014, and S. 4016.

From our statement submitted for the record of these hearings you will note that the United Transportation Union endorses the concept of Federally guaranteed loans to assist the individual railroads which find themselves in financial difficulties without recourse to lending institutions on the same basis as business establishments in other industry.

The record high interest rates prevailing in the last several months have had an unduly harsh impact on transportation companies, particularly the railroads. The Penn Central receivership, of course, compounded the problem by adversely affecting the borrowing ability of railroads whether they are in financially good shape or on the brink of receivership. At present it is not uncommon for financially sound railroads to find lending institutions demanding as high as 13% interest.

Mr. Dennis' proposal is attractive for both economic and psychological reasons. Economically, the set-aside of $1 billion from the Railroad Retirement Account for Federally guaranteed loans to the railroads at ½% above the prime rate would make available to railroad companies desperately needed funds at realistic, rather than usurious, interest rates. At the same time, funds from the Railroad Retirement Account would be invested at interest rates yielding a substantially higher rate of return than those invested under present investment policy. On the psychological side, such a program would have the virtue of ensuring the availability of cash needed to re-vitalize the railroads while using as a source, monies contributed by the employers and employees of the industry.

The administration of the program, conceivably, would have an added benefit in that it would take from the lending institutions and transfer to the Department of Transportation the element of control that follows when they negotiate the conditions attaching to such loans. The Department of Transportation should be more vitally interested in and perhaps more knowledgeable in the needs of the railroad industry than are the lending institutions which presently are the only source for borrowed funds. We also support the idea that the Department of Transportation's administrative activities in such a program would be subject to review by the Department of the Treasury and a Special Committee of Congress.

It is our view that such guaranteed loans should be available only for meeting payroll, maintaining track, equipment and those items directly related to operations. Such loans should not be used to meet interest payments and debt retirement.

The labor-management draft bill dated July 31, 1970, contains what we believe to be adequate safeguards with respect to the use to which such loans could be put. Other provisions we feel essential to safeguarding the public and employees' interests are set forth in our statement to the Committee.

In summary, we wish to reiterate our strong support of the concept of applying One Billion dollars as proposed, and further offer our wholehearted support to the committee in working out appropriate language for a Bill.

CHARLES LUNA,
Chairman, Congress of Railway Unions.

BROTHERHOOD OF RAILROAD SIGNALMEN,
Chicago, Ill., September 2, 1970.

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

DEAR MR. CHAIRMAN: This is in response to your letter of August 30, with which you transmitted copy of a prepared statement recently presented to your Committee in behalf of Mr. C. L. Dennis, and containing the proposal, "that $1 billion should be taken from the Railroad Retirement Trust Fund and loaned to those railroads which are in need." Your letter asked for our comments on this proposal.

We have review the proposal, and in our opinion, it does not merit serious consideration by any Committee of Congress. The proposal represents a complete departure from the sound principles that have been followed from the beginning of the Railroad Retirement System thirty-five years ago.

If our government is to lend money to railroads or other corporations allegedly in distress, or is to guarantee loans made to them by others, it surely can do so without involving this or other trust funds that exist for the payment of pensions to aged or disabled workers and their survivors. The difficulties and complexities that would be encountered, and the inevitable controversies that would occur if and when a railroad would go under and the guarantee by the government would come into play, seem so formidable that we doubt if those who propose such a scheme have given it the careful thought or the responsible study that the subject deserves.

Of course, implementation of such a program would require extensive amendment of the Railroad Retirement Act, as well as the enactment of entirely new legislation. We would assume and expect that the Senate Committee on Labor and Public Welfare would hold extensive hearings on any bills which would so drastically affect the Railroad Retirement System. We are confident that many organizations and other vitally concerned would wish to vigorously present their views.

As you know, a recently enacted public law increased Railroad Retirement benefits and also made certain changes in the interest income of the trust fund. This legislation also provided for a study commission to review the Railroad Retirement System and report its recommendations by June 30, 1971.

No doubt the study commission's report will include recommendations to insure future solvency of the Railroad Retirement System for its present and future beneficiaries. Additionally, for this reason, consideration of the instant proposal before your Committee would certainly appear to me to be inappropriate.

I appreciate receiving the opportunity to comment on this most important matter.

Respectfully yours,

C. J. CHAMBERLAIN,
President.

[From the Washington Post, June 26, 1970]

A PENN CENTRAL DIRECTOR'S VIEW: '. . . POOR AND INEPT MANAGEMENT'

This story was written by Frank C. Porter of The Washington Post with the collaboration of Ronald Kessler, Robert J. Samuelson and William H. Jones, staff writers.

"The could determine whether they were making money or losing it. They didn't seem to have a clear idea of how much commercial paper they had out. They had no controls on cash; they didn't know if it was coming or going."

Thus does a director of the Penn Central Co. describe what he calls the "terribly poor and inept management" of the world's largest transportation company before its bankruptcy last Sunday shocked financial markets worldwide.

The same view comes from a high Nixon administration official privy to the elaborate negotiations that preceded the government's abortive effort to bail out the railroad. (The effort was abandoned when what he called the "political risks" loomed as too great.) The company's officers—even its president and newly appointed board chairman, Paul A. Gorman—had no clear picture of the firm's finances when the discussions took place, the official said.

Implications of its failure go far beyond the far-flung boundaries of Penn Central's own empire. They call into question the health of the whole railroad industry, the wisdom of conglomerate mergers, the liquidity of American corporations in general in the face of tight money and declining business, and government transportation and economic policy.

What went wrong? How did it happen?

Ever since the merger of the New York Central and the Pennsylvania Railroad in February, 1968, the combined operation had been plagued by expensive labor agreements, tight money conditions, spiraling debt, major breakdowns in service, a drop in freight shipments, increasing passenger deficits and—more recently—unusually bad winter weather and a general business slowdown.

But by many insiders' accounts, the key problem was a civil war within the company—and consequent mismanagement.

"It was one of those incompatible situations you find in business from time to time where you have so much friction and lack of authoriyt, it's just a mess," says Robert S. Odell, a San Francisco businessman who was a Penn Central director until May 2.

If there is such a thing as glittering names in American railroading, they belonged to Stuart T. Saunders and Alfred E. Perlman. And the industry was stunned when they were fired as board chairman and vice chairman, respectively, on June 8—the day before the government's plan of an immediate $200 million loan to be followed by legislated funds was presented to congressional leaders.

Saunders, the perfect picture of the Virginia aristocrat, headed the rich Norfolk & Western, then controlled by the Pennsylvania, before becoming board chairman of the Pennsy, itself and then chief executive officer of the Penn Central. His influence extended well beyond railroads. He had close ties with the Kennedy and Johnson administrations (whom he served as a kind of unofficial ambassador to the business community), was an influential member of the prestigious Business Council, was the recipient of a long string of honorary degree and joined clubs in 11 different cities.

Perlman was more a man of the people and a protege of the late Robert R. Young, the "Populist of Wall Street," who installed him as head of the New York Central after gaining control in a bitter proxy fight in 1954. An M.I.T. graduate and intellectual in an industry not known for its intellectuality, Perlman earlier had won a reputation as an operating genius by building the Denver & Rio Grande into a prosperous road after it had been in bankruptcy four times.

On paper this was the dream team for any American corporation—Saunders as the perfect front man with is impeccable legal, political and social credentials; Perlman as the brilliant and innovative operating man.

But it didn't work out that way. It was apparent from the beginning that Saunders and Perlman could never pull together in harness. (Perlman had served as president and chief administrative officer of the merged company before being moved to vice chairman when Gorman took over as president last December. Gorman also assumed the chairmanship when Saunders was fired earlier this month.)

"Saunders has a lot of talent as a lawyer, but he just didn't know how to run a railroad," former director Odell recalls. "He took the position that the Pennsylvania had purchased the Central, rather than merging with it, and there was continual conflict between the men from each road. On top of that, they had two men for every job—with the Pennsylvania man usually on top." (Other sources point out that many of the Central's most able executives quit.)

One incident is illustrative.

A year ago Perlman's own estimates indicated that the $81 million that had been projected as the annual savings to be realized from merger economies would be wiped out by labor and capitalization costs of the merger.

When he was reminded by a visitor that Saunders had just predicted even higher savings from the merger than oriignally estimated, Perlman turned slowly in his chair and looked out a floor-length window of his oak-paneled office on New York's Park Avenue.

"I never comment on anything the chairman says," he finally muttered.

A year later, Perlman puts major blame for the bankruptcy on the growth of competitive means of shipping freight—trucks, oil pipelines, inland waterways, air transport—and the unexpected slowdown in the economy with increasingly tight money conditions.

But he concedes "differences of philosophy of management" between himself and Saunders.

"The Pennsylvania wanted volume regardless of profitability," Perlman told The Washington Post in New York. "We looked at profitability more closely. We wanted to put more money into the railroad, but they invested in real estate and developed it."

Perlman was typical of most officers of the merger company in the use of "we" and "they" to distinguish between Central and Pennsy personnel.

"I was supposed to be in charge of operations," Perlman says, "but I didn't have a full control. There was too much fragmentation of authority."

Whether the merger actually plunged Penn Central into bankruptcy can only be the subject of speculation. Many believe that circumstances would have been even worse without it, that the Central would have gone under anyhow. It had been in a precarious position off and on ever since World War II and faced bankruptcy when Young won control in 1954, although he was unaware of it.

At any rate Perlman was convinced that the Central couldn't make it alone in the face of the merger of other Eastern roads, and he had grave doubts about a merger with the Pennsy.

Joseph Borkin, another Young protege and special counsel for the Central and the merger railroad until last year, writes in his biography of Young that Young and Perlman made overtures to the Pennsy about merger in 1957. A different version comes from James M. Symes, former Pennsy chairman, who told The Washington Post that "I proposed the merger; he (Young) hadn't thought about it, but he was very enthusiastic."

Perlman changed his mind about the desirability of a Pennsy merger, particularly when the faltering Baltimore & Ohio came up for grabs a few years later. He waged an unrelenting proxy fight for the B & O but lost to the Chesapeake & Ohio.

What Perlman wanted was an end-to-end or complementary, merger as opposed to a parallel merger in which both parties serve primarily the same area and markets and thus could dispose of duplicate facilities. For years, railroad theoreticians had envisaged a series of mergers that would create three competing systems in the east, based on a major northeastern carrier oriented largely to miscellaneous freight and passengers (such as the Pennsy or Central) in combination with a mid-Atlantic bulk carrier serving the coal regions (such as Norfolk & Western, the C & O and the B & O). In general, the coal roads are big money makers.

"When the C & O and the B & O merged, leaving out the Central, it was the Central's last gasp," says Charles T. Ireland, still another Young protege and former president of Alleghany Corp, Young's holding company. Ireland is now senior vice president of International Telephone & Telegraph.

It was then that Perlman resumed merger discussion with the Pennsy, knowing full well that it would be a marriage of weakness.

"It's not a good merger," he is said to have told the late Sen. Estes Kefauver (D-Tenn.), "but it's the only one we can get."

As chairman of the Senate Subcommittee on Antitrust and Monopoly, Kefauver was considered the biggest impediment to merger. An associate recalls that Perlman so charmed Kefauver that the senator withdrew his opposition. After some five years of hearings and litigation, the merger was ultimately consummated in 1968.

If most of the investment community and the general public took the roseate predictions of the merging parties at their word—Pennsy stock had sold as low as 12 in the early 1960s; stock in the combined operation hit a high of 86½ in 1968—one person didn't.

That was Ireland. Young's vehicle for industrial conquest, Alleghany Corp., had been the Central's largest stockholder with 14 per cent of the road's outstanding shares. As president, Ireland sold off 85 per cent of these holdings in 1966, nearly two years before the merger was effected. "This should have been the tipoff that it wasn't going to be a viable merger," a longtime Young associate observes.

The vaunted $81 million in merger economies were more than offset by what economists like to call diseconomies.

Ireland and others, for example, point out that some trouble with reconciling the computer systems of the two roads was anticipated but nothing on the scale of what developed.

As it turned out, computers of the two lines were incompatible for months. Whole freight cars and shipments were lost. Perishable goods frequently spoiled before they could be found. Shippers diverted business to other lines or trucking firms.

Perlman notes that the cost of altering locomotives so that they could be used on both carriers was $750,000. An agreement with labor unions to assure

that no jobs would be lost through merger—it permits maximum cut in the work force of only 5 per cent a year—was expensive and no one had anticipated the current 8 or 9 per cent annual wage increases that stem from inflation.

And then there were the big mistakes about the money market. S. Scott Nichols Jr., railroad analyst with W. E. Hutton & Co., notes that two years ago the Penn Central weighed the possibility of a blanket mortgage on its extensive real estate holdings. (The company for examples, owns many of the larger buildings in the area bounded by Madison and Lexington Avenues and 40th and 50th streets in New York.)

"But interest rates were climbing—they were up to 6 to 6½ per cent—and they decided to wait until they went down," Nichols remembers. "They kept going up and the more they went up the more Penn Central felt they would go down. (The irony is that Penn Central was unable to sell a $100 million bond issue at 10½ per cent last month. They were able to get away with selling commercial paper until it became obvious that they were losing money and gimmicking consolidated earnings."

As an example of the latter, Nichols points out that the $20 million of annual earnings from a real estate subsidiary, Great Southwest Corp., are carried on the books as earnings of Penn Central although the latter only receives the $2 million a year Southwest pays in dividends.

It was against this background that Penn Central finally asked the U. S. government to bail it out.

The subject was first broached when Board Chairman Saunders met Secretary of the Treasury, David M. Kennedy in Hot Springs, Va., the first part of May during the spring meeting of the Business Council.

The first real involvement occurred on May 28 when Saunders met in secret with a group of the Nixon admistration's highest officials: Kennedy, attorney General John N. Mitchell, Commerce Secretary Maurice H. Stans, Defense Secretary Melvin R. Laird and Peter Flanigan, assistant to the President.

Saunders reportedly told the group that Penn Central faced the prospect of bankruptcy soon, possibly within the week. The Cabinet officers were understandably nervous. The stock market hit an eight-year low that day with the Dow Jones industrials dropping 10 points to 631. The omnipresent fear was that the bankruptcy of a giant corporation could possibly turn the stock market plunge and moderate recession into panic and depression.

Saunders came prepared with a plan and it won an immediate informal commitment from the government. Under a section of the Defense Production Act designed to help little and medium-sized military suppliers, the government (in this case the Navy would guarantee a $200 million loan to be supplemented later when Congress passed a bill permitting $750 million in Federal loans to ailing railroads.

One administration official theorizes that this early commitment was a tactical error, in that it foreclosed alternative solutions. He also speculates that without government assistance Penn Central might have been bailed out by private lenders; the banks, insurance companies and other institutions had already sunk so much money in the railroad that a little bit more might have been worth it to protect their investment.

At any rate, the plan was unveiled to congressional leaders June 9 in the office of Senate Minority Leader Hugh Scott (R-Pa.), who was worried about what a bankrupt Penn Central might do to employment in his state.

A government source says the immediate Congressional response was "generous" and included pledges of speed up passage of the railroad loan bill.

Similar legislation was passed during the 1957-58 recession, when many railroads were in financial trouble. It granted the Interstate Commerce Commission authority to make loans to ailing roads and under it the shaky New York Central actually got $24 million. But the law expired in 1963 and was not renewed.

After the legislators had time to think it over, however, they had second thoughts. Penn Central's Gorman conceded that the $200 million alone wasn't enough to keep the company from going broke. And the trains would continue to run even with Penn Central in bankruptcy.

Chairman Wright Patman (D-Tex.) became the symbol of this resistance, and company and administration officials sought in vain to win him over.

Some critics contended that Patman wanted to see a big company go broke to dramatize his complaint that high interest rates and scarce credit are ruining the economy.

There were doubts in the Executive Branch also. Defense Under Secretary David M. Packard, although he worked hard to dissuade Patman from his opposition, feared that such a commitment might lead other companies, particularly giant and ailing Lockheed Corp., to line up for government aid. Some questioned the applicability of the Defense Production Act to the rescue of a railroad. And if Congress failed to pass the follow-on loan authority, President Nixon could be accused of throwing $200 million down a rathole.

But in the end the dominant factor appeared to be political, stemming from what one congressional investigator called the "clubby atmosphere" existing between Penn Central and the Nixon administration.

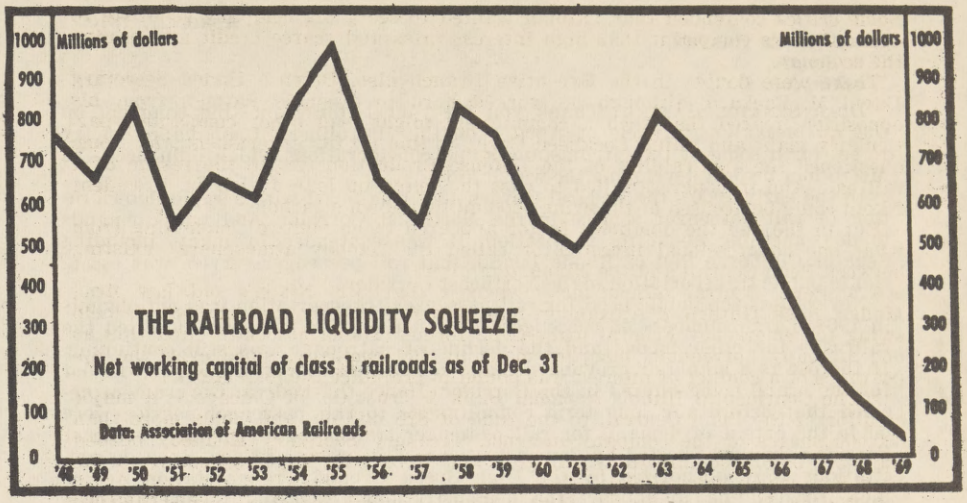
- A Penn Central official acknowledged that Mr. Nixon's old law firm, Mudge, Rose, Guthrie & Alexander, had been retained by the company to help swing the emergency Federal loan. (One former Young associate cited this as one of many horrendous bloopers made by the company, since even the appearance of a conflict of interest was bound to prejudice the loan effort.)
- The Continental Illinois National Bank & Trust Co. of Chicago is a major creditor of the Penn Central, to the tune of $26 million, and holds more than 300,000 shares of the company in trust. Treasury Secretary Kennedy headed the bank before coming to Washington and Robert P. Mayo, counselor to the President, was a high official.
- Walter H. Annenberg, a former Penn Central director, owned 180,000 shares in the firm before he was appointed Ambassador to Great Britain by Mr. Nixon.

Even among Mr. Nixon's critics, there was no suggestion of impropriety in these connections. But had the $200,000 loan been granted—particularly if it failed to fend off Penn Central's bankruptcy—Democrats might have been able to make political hay over them.

So last Friday the administration withdrew its support of the loan guarantee and two days later Penn Central, believing it had exhausted all remedies and fearful that creditors might successfully sue for a tougher form of bankruptcy, filed a petition for receivership.

"At first we felt we had to do something," says a high administration official who notes government concern for the repercussions of Penn Central's bankruptcy on the money markets (particularly commercial paper), on the rest of the railroad industry, on investor confidence and on the economy as a whole.

"But we just decided there were more political risks in doing something than not doing anything at all," he said.


Millions of dollars
Millions of dollars
1000
900
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700
600
500
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300
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0
THE RAILROAD LIQUIDITY SQUEEZE
Net working capital of class 1 railroads as of Dec. 31
Data: Association of American Railroads
'48 '49 '50 '51 '52 '53 '54 '55 '56 '57 '58 '59 '60 '61 '62 '63 '64 '65 '66 '67 '68 '69

APRIL 27, 1970.

HON. VANCE HARTKE,
U.S. Senate,
Washington, D.C.

DEAR SENATOR HARTKE: Thank you for your letter requesting comment on the *Business Week* article of April 4 on the Metroliners. I am happy to try to set forth some of the circumstances and considerations which influenced the Metroliner project developing the way it did.

In the early 1960's the Federal Government was faced with a rapid deterioration of rail passenger service in the Northeast Corridor, and with demands to do something about its restoration. It was contended by many, including Senator Claiborne Pell of Rhode Island, that rail passenger service was essential to public transportation in the Northeast Corridor.

Neverthless the public need for rail passenger transportation was not obvious in 1964. Large numbers of passengers had in the prior ten years deserted the railroads for other modes and the decline of patronage was still continuing. If there was a stable or growing demand for rail passenger service, it was not for the brand being offered in the Corridor. Hence the Federal Government decided that before any long term commitments to rail passenger service were made the extent of demand for rail passenger transportation in the Northeast Corridor should be tested by demonstrations of improved service. Such demonstrations were authorized by the High Speed Ground Transportation Act of 1965. In deciding to support the demonstrations the Federal Government—both Congress and the Administration—made wholly clear that the purpose was to obtain information for public policy formulation. *The demonstrations were not to constitute long-term commitments to rail passenger service improvements* per se. The distinction may be a fine one, but it is amply borne out in the legislative record and it is important to an understanding of the way in which the Government regarded the demonstrations as compared to the views of the Pennsylvania Railroad.

In mid 1964 representatives of the railroad approached the Government with a proposal for the establishment of a test track on its main line in central New Jersey and for the design and construction of prototype electrically powered passenger cars to operate between Washington and New York. The cost to the Federal Government of the test track, the prototypes, and the testing was to be between $30 and $50 million.

This proposal was rejected by the Federal Government in favor of a two-year demonstration which could test much sooner the attractiveness to passengers of rail service in the Northeast Corridor. It is probably accurate to say that the railroad never really abandoned the idea that a prototype and testing program was the better approach. Indeed, for the long run, it may have been. It could not, however, provide timely answers to the Government on the important questions of whether and under what conditions of service and patronage rail passenger service would be desirable.

I am strongly of the opinion that if in the early summer of 1966 instead of starting on the Metroliner fleet the railroad had embarked with Federal financing on a program of building and testing one or two prototype cars, there would today be no new equipment running between Washington and New York on the Penn Central Railroad, and the Federal Government would have spent many times more than it will spend on the Washington-New York demonstration, if it is carried out according to the contract. (About $4 million already spent—the Federal Government's total obligations for the demonstrations being about $12 million.) Furthermore, the Federal Government would not now have the important knowledge about passenger demand which has resulted from operation of the Metroliners.

For the Government's purposes in the demonstration the Metroliners were overdesigned and overengineered. At one time we were considering building new Silverliners (the commuter cars operated by the Penn Central around Philadelphia) and re-gearing them for 10 mile-per-hour service. This would have permitted meeting, with four intermediate stops, a three-hour Washington-New York schedule required by the terms of the Government's contract with the Penn Central Railroad. When the railroad made a decision to build cars with a 150 mile-per-hour capability for longer term service (the Government was not a party to the contract for car acquisition), the more modest but tested Silverliner design was discarded. I acquiesced in this action upon receiving assurances from the suppliers that a fleet of 50 modern cars could be built in a year to eighteen months.

This turned out not to be a good decision despite the fact that it cost the Government nothing more than delay. If a simpler yet adequate design for the Metroliners had been followed, the cars would probably have been running sooner, and more smoothly as shown by the Department's research cars—regeared Silverliners with Budd trucks. (They have been operated many miles at over 150 miles per hour.)

Even so, Metroliners have now been running for 15 months and have produced a very great deal of information about passenger behavior and wants. Although the Government-supported Washington-New York demonstration has not yet begun because the Penn Central has not been able to meet the scheduling requirements and the standards for track alignment (the Penn Central's own for up to 80 miles per hour) imposed by the contract with the Government, the essential purposes of the Government in sponsoring the demonstration have been satisfied. We now know with considerable precision that trip time coupled with schedule reliability is of great importance in passengers' choices of mode; we know that terminal to terminal rail time does not have to equal trip time by air to attract passengers so long as rail consistently meets schedules; and we are now much better able to predict the levels of patronage that would in the future use improved rail passenger service and the service of other modes. This information is invaluable to investment policy for transportation in the Northeast Corridor.

Considering the value already received by the Government from the operation of the Metroliners and the difficulties the Penn Central is having in meeting the contract requirements for carrying out the demonstration, it is my judgment that the demonstration contractt should now be terminated by the Government and a settlement reached on the $9.6 million (the entire amount) which the Government would have paid the Penn Central Railroad for carrying out the demonstration. Statistical surveillance should be continued as a matter of course but results already indicate the steps that should now be taken.

The Metroliner experience and studies carried out by the Northeast Corridor Transportation Project indicate that money spent on improvements to rail roadbed which reduce passenger trip time in the Northeast Corridor will pay very handsome returns in the next few years. The Metroliner operation is no longer needed as a demonstration, but rather as regular service. We need now to begin to realize the benefits—both to the traveling public and to the railroads—of reductions in trip time realized through improvements of rail roadbed.

The *Business Week* article states that the Penn Central Railroad has spent $57 million on the Metroliner project so far while the Federal Government has committed $11 million to the project and to this point spent only $2 million. The article seems to imply that such a ratio between private and public expenditure is, to say the least, disproportionate.

At the time of negotiations in 1965–66 on the terms of the contract between the Pennsylvania Railroad and the Government the railroad estimated that 50 new cars would cost about $20 million and extra improvements to track would be on the order of $10 million. Mr. Saunders in testifying on the high speed transportation bill on June 30, 1965 before the Subcommittee on Transportation and Aeronautics of the House Committee on Interstate and Foreign Commerce stated that:

"We will have to spend something over $10 million in order to put our track in condition to operate trains at schedules of over one hundred miles an hour. And this is not money we would spend anyway."

Mr. Saunders also testified at the hearing on June 30 that:

"Furthermore, our New York-Washington line is in good physical condition for the type of service currently performed. In the past 4 years we have spent $25.5 million in maintaining and improving it. We have laid 25,000 tons of new rail, renewed 400,000 crossties, put in some 850,000 tons of stone ballast, rehabilitated main line bridges, and overhauled the catenary system."

On July 16, 1969 the Penn Central Railroad stated by letter to the Federal Rail Administration that through May 31, 1969 it had spent $31.7 million for road and structure on the line between Washington and New York for the "Northeast Corridor Demonstration Program". Since the $31.7 million appears to have been spent on road and structure between 1965 and June 1969 it is not evident that the Penn Central has spent more on its main line between Washington and New York than it would normally have spent in a four-year period. If this is the case additional costs (for car acquisition) incurred by the railroad in preparing for the demonstration are closer to $25 million than to $57 million.

This is not to denigrate in any way Mr. Saunders' sincere efforts to comply with the terms of the Penn Central's contract with the Federal Government.

The railroad in the period 1965–69 embarked on one of the largest mergers in the history of American business which brought adjustment problems of severe intensity. Also, more important, because of inflation the railroad found its costs of capital increasing sharply. Unfortunately, perhaps, for the Penn Central there were no escalation clauses in the contract with the Government.

I appreciate very much your interest in this background and I hope my comments will be useful to the Committee in its consideration of public policy for railroad passenger service. I know that it is not an easy problem to deal with.

Sincerely yours,

ROBERT A. NELSON,
Federal Executive Fellow, formerly Director of Office of High Speed Ground Transportation, U.S. Department of Transportation

STATEMENT OF JAMES R. NELSON

My name is James R. Nelson. Since 1951, I have been Charles E. Merrill Professor of Economics at Amherst College. I was for two years the Chairman of the Board of Economic Advisors to the Governor of the Commonwealth of Massachusetts, and in 1967–68 I was Director of the Office of Economics in the United States Department of Transportation.

Anyone who discusses railroads is likely to develop the least-attractive qualities of Cassandra and Jeremiah. So I will do my best to avoid second guessing and hand wringing, except to the extent that it may be required in the course of discussing the legislation before you. To focus immediately on the matter at hand, my doubts with respect to the proposed legislation center on Section 4. In the draft submitted to the Houses of Congress by Secretary Volpe on June 16, this reads:

"SEC. 4. *Guarantees.* (a) 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. Before making a guarantee under this section, the Secretary must find, in writing, that:

"(1) The loan is necessary to carry out the purposes of this Act;

"(2) The loan is not otherwise available on reasonable terms and conditions; and

"(3) The general financial condition of the rail carrier, upon obtaining the loan to be guaranteed, would be such as to hold out a reasonable assurance of its ability to meet its obligations as they become due, and to continue the performance of satisfactory transportation services.

"A loan guaranteed under this section may not bear interest at a rate exceeding such per centum per annum as the Secretary deems reasonable, taking into account the range of interest rates prevailing in the private market for similar loans and the risks assumed by the Federal Government. . . ."

I would also call your attenton to the penultimate paragraph of Secretary Volpe's covering letter of June 16, the first sentence of which reads:

"Present financial circumstances are such that without legislation of this kind there is a serious risk of carrier insolvencies or other cases of severe financial hardhip which could cripple the Nation's transportation. . . ."

To take up the last quotation first: to assume that "carrier insolvencies" by themselves "could cripple the Nation's transportation" is to confuse the financial and the economic. Insolvency is financial, in the basic sense of inability to pay one's bills. In the past, railroads which were operating in bankruptcy because of previous insolvency often used the respite from past obligations to modernize their plant and improve their operations generally. So, economically speaking, failure to repay debt incurred to buy facilities which are now obsolete, or which was used for injudicious purposes at the outset, may be the first necessary step toward uncrippling the nation's transportation. Moreover, the case may be even worse for government loan guarantees which are provided in an atmosphere of "serious risk of carrier insolvencies". The net effect of new money under these conditions may simply be to permit the railroad to pay interest to its creditors for a little longer—as occurred with loans made by the Interstate Commerce Commission to the New Haven Railroad under the 1958 Transportation Act—and to lead to a deferral of necessary corrective measures and a more resounding crash once it occurs.

These comments lead us back to Section 4 of the proposed legislation. The basic difficulty in this section emerges from a comparison of sub- paragraphs

(2) and (3). The former requires the Secretary of Transportation to determine that "The loan is not otherwise available on reasonable terms and conditions", whereas the latter stipulates that "The general financial condition of the rail carrier, upon obtaining the loan to be guaranteed, would be such as to hold out a reasonable assurance of its ability to meet its obligations as they become due, and to continue the performance of satisfactory transportation services."

As with all proposed governmental loan guarantees, this proposal runs the danger of falling between two stools. *If* the borrower has such a poor credit rating that he cannot obtain new or renewed loans in the private market, how can there be any "reasonable assurance" that he can repay the government? With reference to Penn Central and cases like it, the dichotomy appears at an even more fundamental level: *if* there is genuine concern about the adequacy of cash flow even to meet current payrolls, how can a borrower in this marginal position ever hope to service new debt?

If these questions can be answered at all, the answers must obviously lie either in temporary and exceptional economic conditions which impair the borrower's "normal" creditworthiness, or in exceptional gains in profitability which an emergency loan may make possible. Even the latter of these two possible answers is not entirely convincing, for the question still arises: how can the government have "reasonable assurance" that such gains will eventually materialize if they are beyond the range of vision of private lenders?

The first question deserves careful examination, however. So it will be repeated:

Are there temporary and exceptional conditions which impair the "normal" creditworthiness of railroad borrowers?

The first possibility which comes to mind is that of conditions such as those of the Great Depression of the 1930's. The Reconstruction Finance Corporation performed a valuable public service during that era by tiding over many businesses which were solvent by any normal criteria but had been plunged into financial difficulties by depression—induced loss of profitable business. Some of the RFC's most spectacular rescues were in the field of railroading. *But economists are now arguing whether there is even a "recession" of 1970; and 1969, which was a year of difficulty for the Penn Central and several other railroads, was a boom year of record proportions.* Secretary Volpe remarked, on the first page of his letter of transmittal of June 16, that "The railroad industry is inherently vulnerable to unexpected changes in the economy." He should, perhaps, have referred specifically to *downward* changes, because this seems to be what he meant. With this one addition, Secretary Volpe's statement is entirely correct. But the conclusion to be drawn from it would seem to be the precise opposite of the conclusion that Secretary Volpe himself draws. If a railroad is in desperate trouble in the best of times, what can a lender expect of it in the worst of times?

A second possible abnormality may be found in the very high interest rates which have prevailed for the last year or so and still prevail. Companies with excellent credit ratings are now forced to pay 9% or more on new issues of long-term debt. Before its financial collapse, the Penn Central apparently tried and failed to market such an issue at more than 10%; it was reported at the time that an interest rate of 11.5% would have been required to reflect the general credit position of the borrower, and this interest rate in turn would place any loan beyond the bounds of financial plausibility.

This financial abnormality may provide more grounds for a government guarante that the cyclical "abnormality" which was considered first. Lord Keynes once said that high interest rates may not only *reflect* uncertainty as to the borrower's creditworthiness; they may be a *source* of such uncertainty, because of the high profitability required if the borrower is to pay them. Moreover, there may be a certain money illusion among lenders: an interest rate which is 25% above the rate on AAA bonds may cause no comments about creditworthiness, beyond the fact of the higher rate itself, when triple-A rates are around 4%, and yet produce damaging second thoughts from lenders if triple-A rates are around 9%.

So the possibility of financial abnormality cannot be dismissed out of hand. But, at the same time, it does not go very far toward justifying a loan-guarantee program of the type proposed. To take the specific case of the Penn Central: its common stock was selling in the 80's as recently as last year; moreover, both

major predecessor companies were very large corporations and very well-established. In periods of credit stringency, the main problem for borrowers is not likely to be high interest rates so much as credit rationing. Money may not be available to him at any interest rate. Larger and better-established borrowers are likely to stand at the head of the line. And there can be no question that the average railroad borrower is both large and well-established. If the government would like to single out groups which are really being hurt by present money conditions, it could find plenty of deserving claimants long before it reached the railroads.

The third possible abnormality has to do with possible bad management.

As any baseball fan knows, the prime requirement for a good manager is an array of talented players. Therefore the first question must be: what is there to manage? And here the railroad record must be viewed realistically. It shows that passenger losses per train tend to mount at about the same pace as the rate of train discontinuance, leaving total passenger deficits at a stubbornly high figure. It shows freight traffic which is growing at all only in those parts of the country which are both growing most rapidly and are most remote from previous centers of industrial activity. It shows that even piggy-back traffic, which has been hailed as a possible source of long-run salvation for the industry, was lagging behind the previous year even before labor difficulties in the trucking industry arose to obscure year-to-year comparisons. It shows that practically all of these problems are worst in the northeastern part of the country. With stagnation and economic difficulty on almost every horizon, the hallmark of a really able manager might be his desire to avoid employment with the railroad industry.

But, in the short-run, there are probably a number of cases where bad management has complicated the woes that individual railroads would have had anyway. In general, railroad managements are reluctant to face one of the most obvious facts of economic life: *that firms which cannot effect large technical economies with increases in scale are bound to be penalized by the diseconomies inseparable from large groups of employees.* Economies of scale are a product of the physical world, if they exist at all; diseconomies of scale are the universal and all-encompassing byproduct of the human world. Railroads have their employees scattered all over the map, and are therefore prime candidates for exceptional diseconomies of scale. Mergers involving the combination of two such large and far-flung employers are likely to uncover new diseconomies of scale even when they were previously unknown. This appears to be what may have happened to the Penn Central merger.

But:

(*a*) The confusion and diseconomies of scale created by a merger may take a long time to correct, or may last in diminished form indefinitely; in any event, they defy scientific analysis or prognosis.

(*b*) In a field like railroading, one of the worst by-products of post-merger confusion is likely to be a decline in service standards. In the case of the Penn Central, passengers have been voluble on this subject. Freight does not talk; but those responsible for routing it have been moving it away from the merged railroad. A diverted freight shipment may never come back.

(*c*) For a number of quite different reasons, railroad personnel policy contains built-in features which are highly resistant to rapid change. A new broom may sweep clean, but it cannot reach very far.

Therefore, on balance, anyone who hopes to come out whole on a loan guarantee of a change from bad to good management is likely to be guilty of a devil theory of history. Conversely, good management which might have prevented an avalanche may be helpless if brought on the scene as it is already roaring down the slope.

Fourth, and finally, there is the special problem of rail passenger service. Federal policy with respect to rail liability for such began to change when less-stringent rules for train discontinuance were written into the Interstate Commerce Act in 1958. The Railpax proposal now before Congress is a further step in the direction of removing some of the weight of this albatross from the neck of the railroads. All levels of government are involved in various programs which are designed to shift the burden of losses on commuters from railroads to the general public. The Penn Central has already announced an intention to discontinue passenger service west of Buffalo and Harrisburg. In short, there is reason to believe that the rail passenger deficit, or at least the railroad share of it, will decline quite soon and quite substantially.

So far, so good. But, even assuming that a good deal of rail passenger service is to be preserved, a loan guarantee program is an awkward and illogical way of handling interim deficits on passenger service. If the final intention is to abandon the service, then a loan guarantee program amounts to shoeing a dead horse—and then billing the horse's owner.

This search for temporary railroad difficulties which might just go away if time could be bought with government-guaranteed loans has produced a number of candidates. But none can make a convincing case. To summarize:

1. The prosperity-and-depression argument tells strongly *against* a loan guarantee. Any railroad which was in trouble, or on the verge of it, in the piping times of 1969 was in desperate trouble, indeed.

2. The tight-money argument at least helps to support the idea behind the loan guarantee. But, in view of the strong and extensive financial connections of American railroads, it cannot be maintained that this support is worth very much. If lenders refuse to lend to railroads, or will lend only subject to ruinous conditions, the reason is not likely to be ignorance of the industry or contempt for the small size of the borrower. The trouble lies in both the level and the trend of the earnings of many railroads.

3. To the extent that the bad-management argument is true, as it may often be, the result may be a further ground for pessimism rather than optimism. Without question, the biggest error in judgment involved in the Penn-Central merger was the decision to proceed with the merger itself. But even the best of chefs cannot unscramble a bad omelet.

4. Many American railroads may finally be seeing daylight ahead as they proceed through their long tunnel of passenger losses. But other railroads are already in deep trouble even though they have given up passenger service; and even those who stand to gain most, on paper, from reorientation of the passenger financial burden may have a long way to go before they realize their paper gains.

In view of the pessimistic character of most of the remarks made above, it may be useful to go beyond the immediate legislation at hand to consider some possible attributes of a genuinely constructive governmental policy toward railroads.

Even a constructive policy has a negative side, in the sense that it does *not* do certain things. In this case, two prime candidates for non-feasance would be loan guarantee programs (as in the proposal now before the Congress), and—if non-feasance may be stretched to include non-non-feasance—schemes for complete deregulation. The former buys time in the face of the prospect that it will not be used properly. The *laissez-faire* proposal of complete deregulation would doubtless be in the short-run interests of many users of rail service, and it might be in the long-run interests of all. But, unless one either believes that the railroads could survive under conditions of complete deregulation or that their survival is a matter of no particular consequence, then deregulation *as the only program* is too one-sided. It may, of course, have an important place in a larger program.

Government subsidies have a certain abstract charm which begins to vanish once they are looked at carefully. American railroads have two attributes which are of basic interest to the American public: they are a *transportation system*, and they control large stretches of contiguous real estate which may be of the highest value for future urban development and general land-use planning. The system aspect and the landownership aspect must remain in the background as long as subsidies are doled out on particular occasions for special purposes. Moreover, the major beneficiaries of the subsidies may be neither the railroads nor the public in general but such non-indigent groups as commuters who choose to live in certain of the older and more affluent suburbs. Finally, an across-the-board national subsidy to private owners and operators would appear to be open to very fundamental practical objections. It is hard to see how a long-range, consistent, and constructive general subsidy policy for rail transportation could ever be devised.

Any national policy which preserves the railroads in the long run must face the fact that the present system now has subnormal earning power, and that there is no assurance that any further system will have normal earning power. Yet they have some positive economic value, even on a commercial evaluation of their role in transportation. Their additional value as controllers of continuous strips of real estate is incalculable. So a viable answer to the problem of constructive government policy toward railroads must probably lie in the direction of some extension of *direct government participation* (not necessarily

"nationalization" as that word is usually understood). This direct government participation might take one or more of a number of forms: acquisition of the Penn Central, and operation as a yardstick railroad in competition with the privately-owned Norfolk & Western-Chesapeake & Ohio (on the pattern of the Canadian National and Canadian Pacific); government purchase of railroad way and structure, with or without government railroad operation or direct government investment and maintenance; establishment of a central agency to own, lease, and otherwise control rolling stock; etc. The list of possibilities could be greatly extended. But they would all have to face two facts: (1) the present rail network of the United States has subnormal earning power, and will continue to display the symptoms of major illness as long as the underlying disease continues; (2) whether the final owner is public or private, the prime question to be faced is—*what level of railroad plant, and of railroad operations, is in the public interest*? If the answer is "no plant", then that is that. If the preference is for some positive level, then the next question must relate *directly* to financing. It cannot be put off, or evaded, by diversionary tactics such as support for loan guarantees.

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