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DEPARTMENT OF TRANSPORTATION AND RELATED AGENCIES APPROPRIATIONS

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HEARINGS

BEFORE A

SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS HOUSE OF REPRESENTATIVES

NINETY-FIFTH CONGRESS

SECOND SESSION

SUBCOMMITTEE ON THE DEPARTMENT OF TRANSPORTATION AND RELATED AGENCIES APPROPRIATIONS

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UNITED STATES RAILWAY ASSOCIATION FISCAL YEAR 1978 SUPPLEMENTAL REQUEST

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MONDAY, FEBRUARY 27, 1978.

UNITED STATES RAILWAY ASSOCIATION
FISCAL YEAR 1978 SUPPLEMENTAL REQUEST

WITNESSES

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CARY W. DICKIESON, GENERAL COUNSEL AND VICE PRESIDENT
ALAN L. DEAN, VICE PRESIDENT FOR ADMINISTRATION
W. J. ANDERSON, ACTING VICE PRESIDENT FOR FINANCE
FREDERIC W. YOCUM, VICE PRESIDENT FOR OPERATIONS
WILLIAM H. BOZMAN, COMPTROLLER

Mr. McFALL. The Subcommittee will come to order. Today we will receive testimony on the fiscal year 1978 supplemental budget request of the United States Railway Association. Testimony will be given by Mr. Donald C. Cole, President of the United States Railway Association, and members of his staff. We will discuss the status of your pending litigation and Conrail financial problems in more detail at our regular fiscal year 1979 budget hearing. I think, however, it would be appropriate if we could have a brief update on both of these issues at this time since they are the primary reasons for your rather large supplemental request. We will be glad to hear your statement at this time, and we will insert in the record your supplemental budget justification.

GENERAL STATEMENT

Mr. COLE. Thank you, Mr. Chairman. We are very pleased to have an opportunity to be here this morning to discuss our 1978 supplemental request for \$13 million for administrative expenses of the Association.

First, I would like to emphasize the urgent nature of our request for a supplemental appropriation in the current fiscal year. As we indicated in our submission to you last December, we have apportioned 80% of our available funds in the first half of the fiscal year. Without additional funds prior to June, we will have to sharply curtail our preparation for the valuation case and will be unable to meet the time schedule directed by the Special Court which was set up to hear this massive corporate restructuring case. Also, any delay beyond June 1 would destroy our ability to proceed with our assessment of Conrail's performance and funding requirements on a timetable that would permit Congress to consider solutions as part of the 1980 budget process. We desperately need action by the Congress on our supplemental request prior to the first of June.

The Association transmitted to the Speaker of the House, the President of the Senate, and the Office of Management and Budget, on December 23, 1977, its appropriation request of \$27.2 million for Fiscal Year 1979. The President's Budget for FY 1979 includes the entire amount of our request as well as a proposed supplemental appropriation of \$13 million for FY 1978. This supplemental would bring our total appropriation for FY 1978 to \$23 million, the amount approved in the authorizing legislation enacted last fall.

These funds are required to permit the Association, in cooperation with the Departments of Justice, Transportation and Treasury, to conduct the litigation on behalf of the Government which has arisen from the reorganization of the bankrupt railroads and which involves transferor claims amounting to billions of dollars. The authorization will also enable USRA to administer the investment of public funds in Conrail for working capital, rehabilitation and other purposes; to monitor the railroad's performance and use of funds; to assess the need for any further Federal action that might be needed to move Conrail toward the goal of financial self-sufficiency; and to administer Section 211(a) loans to the Delaware & Hudson (D&H) and the Missouri-Kansas-Texas (Katy) railroads.

Approximately 80 percent of our authorization will be used in the litigation efforts, and 20 percent will be used in administering the financing of Conrail, monitoring its operations, and monitoring the loan to the D&H and Katy.

Early in 1977 we had forecast a decline in Association activity for Fiscal Year 1978. Our appropriations request reflected this. But the events of the past nine months have dramatically changed our plans for the current fiscal year and have substantially increased our requirements over the original estimates for FY 1978 for both litigation support and Conrail monitoring. In the litigation support area, the need for concentrated field work in asset valuation has increased sharply. The Special Court, in addition, has indicated that it will consider alternative methods of valuation.

The Association's budget estimate of one year ago underestimated the resources that would be required to effectively monitor Conrail and the Delaware & Hudson. Until January 1977, Conrail not only met the goals set forth in the Final System Plan but exceeded them. The situation today is much different. Conrail is having considerable difficulty in achieving the results it forecast for itself less than a year ago. Similarly, the D&H is having severe financial difficulties. The Association is analyzing both situations and will report to Congress on them, as required by law, at the end of May.

LITIGATION

The Association is involved in three major areas of litigation:

The main valuation case before the Special Court governed by Section 303 and 306 of the Act. (This three-judge Special Court was set up to determine the amount of compensation owed to railroads in reorganization for rail property conveyed under the Act.)

Questions relating to loans made to Conrail under Section 211(h) of the Act.

General litigation including actions attempting to force the transfer of rail properties not conveyed or to return certain rail properties already conveyed.

METHODS OF VALUATION

On October 12, 1977, the Court issued its most significant opinion on the main valuation case. It accepted the Association's argument that value to the transferors, not to the Government, is the appropriate measure of just compensation. Thus, the market value of the conveyed properties, whether sold for scrap or for continued rail use (if the transferors can prove such a likelihood), is the central valuation theory adopted by the Court. However, the Court expressed its intention to consider, in limited circumstances, other methods of determining constitutional minimum values and suggested an alternative—original cost less depreciation and deterioration.

The Court ruled that the transferors will be entitled to submit evidence of possible preconveyance sales to prospective purchasers including governmental bodies, but it also ruled that the United States would not be considered a prospective purchaser.

LITIGATION SUPPORT

Although the Association is performing a large portion of its legal work in-house, it will continue to employ two law firms with special expertise to augment its own staff. The firms have been used at a combined monthly rate of approximately \$150,000. This rate is expected to increase next year when major evidentiary proceedings occur in the valuation case.

The Association has developed and is installing an automatic storage and retrieval system for the enormous number of documents connected with the case; more than one million pages of documents have already been processed. Operating this system, including reimbursing the Justice Department, is expected to cost approximately \$500,000 during fiscal year 1978.

The Association has engaged a panel of senior real estate appraisal experts to direct a substantial field project of site appraisal. The work will extend into next fiscal year. Extensive work will also be done on valuation of equipment, facilities and other assets.

The Court has indicated that it will consider valuations asserted by the transferors based upon continued use of specific assets for rail transportation. This spring, the transferors will put forward their assertions and the Association will respond to them. Until proffers are made, it will not be possible for the Association accurately to plan and staff for its response. This is a complex problem involving projections of traffic, revenues, and costs for individual segments of railroad, as well as assessment of the willingness and ability of potential purchasers to make offers.

The bulk of the general litigation in which the Association has been involved consists of 40 lawsuits naming the Association as a defendant and challenging its actions in designating or failing to designate certain rail properties for conveyance under the Act. The Court places a deadline of July 1, 1977, on all such conveyance-related lawsuits. Since then, the Association, as a nominal defendant, has been instrumental in mediating compromises in several of the suits.

Financial requirements for litigation support in FY 1978 can be summarized as follows:

| | <i>(Thousands)</i> |
|----------------------|--------------------|
| General Counsel..... | \$4, 916 |
| Asset Valuation..... | 10, 853 |
| Operations..... | 225 |
| Other Support..... | 2, 069 |
| Total..... | 18, 063 |

MONITORING

The Association must be capable of independently and comprehensively assessing the finances and operations of Conrail because of the heavy public investment in the railroad and the urgent need for it to meet statutory goals with respect to service and financial self-sufficiency. USRA staff must have the resources to be able to collect and analyze information on the major factors which contribute to revenues, costs and capital requirements, and be capable of preparing comprehensive projections. These projections should provide the Federal Government with timely information concerning present and future problems of the railroad.

As this Committee is aware, the Association has already invested \$1.3 billion in Conrail with an additional \$0.7 billion appropriated. The railroad has continued to incur substantial operating losses, and our attention must be focused and impact on issues that are critical to turning the railroad into an efficient, viable operation that is meeting the rail transportation needs of the region and the nation. The major "turn around" areas as we view them include:

- Attracting sufficient revenue
- Cost effective capital programs
- Improved equipment utilization
- Improved management systems
- Integration and consolidation savings
- Improved productivity

Monitoring efforts of the Association will include the review and analysis of the various reports required under the Financing Agreement between the Association and Conrail. This material consists of an extensive set of monthly and quarterly reports plus the data in the Five-Year Business Plan which is updated each year. The Association also needs to be able to conduct specific studies of critical problem areas so that we can be sure that the Board of Directors receives an independent assessment of the carrier's operating and financial problems.

The Association also will apply similar monitoring capacity to the Delaware & Hudson and the Katy railroads although this will be secondary to the main task of monitoring Conrail.

FINANCIAL MONITORING

Turning to financial monitoring, it is clear that the remaining portion of the \$2.026 billion previously appropriated for Conrail will be advanced in FY 1979. The Association must monitor Conrail's use of

these funds to assure compliance with the Financing Agreement, to identify deviations from the financial projections of the Final System Plan and to determine the extent to which additional funds will be needed if Conrail is to become financially self-sustaining.

Financial monitoring will focus on the current financial and cash positions of all three railroads, comparing performance with projections. Staff will prepare comprehensive projections and assess the adequacy of the financial management programs of the railroads. Since the Association depends upon the railroads to furnish much of the data used in the monitoring process, it is desirable to check the reliability of the accounting and management systems furnishing that data. In the case of Conrail, the Association will monitor the progress being made in improving the reliability and accuracy of its accounting and inventory control systems.

In pre-Conrail days, I can remind the Committee, the lack of accuracy and reliability was very evident. Conrail is working to improve the situation, but its accounting and inventory systems are still not completely in place.

The D&H and the Katy will require continued financial monitoring to protect the Association's loans to these rail carriers. The Association has agreed to advance an additional \$2 million to the D&H above the \$28 million approved earlier and foresees the need for \$6 and \$7 million more during fiscal year 1978. Just recently, the Federal Railroad Administration approved loan guarantees of \$7.9 million to enable the D&H to refinance 20 locomotives purchased in 1976, and, in accord with action by our Board of Directors, the D&H will receive draw-downs on the amount now through the end of July. The D&H has a new president who is aggressively taking hold and working to improve the carrier's financial and operational posture. But we also realize that the D&H suffers even more than Conrail does from the changed economics of the Northeast. We intend to analyze the entire economic situation closely in order to be able to deal better with the railroad's and the region's rail transportation problems and needs.

OPERATIONS MONITORING

During the past year, the Association has strengthened its monitoring capabilities, particularly in the major "turn around" areas of marketing, equipment utilization, rehabilitation cost-effectiveness, management systems and customer service.

The Association has re-established the position of Vice President of Operations and it has set up certain organizational units in the operations area to strengthen monitoring capabilities.

A number of special studies are being started in fiscal year 1978 to appraise realistically Conrail's need for capital.

Financial requirements for monitoring support in fiscal year 1978 can be summarized as follows:

| | (Thousands) |
|----------------------|-------------|
| General Counsel..... | \$119 |
| Finance..... | 1,531 |
| Operations..... | 2,597 |
| Other support..... | 1,112 |
| Total..... | 5,359 |

Mr. Chairman, I would like to submit for the record a copy of our budget justification for fiscal year 1978. I would also like to suggest that the Committee insert a provision in the proposed legislation which would permit our appropriations to be made available through fiscal year 1979. We have had great difficulty in estimating the timing and amount of our future need for administrative expense appropriations. Our major expenses are for litigation support and this activity is dependent upon actions by the Special Court. We believe the additional flexibility as to the timing of certain actions, and, therefore, the timing of obligations, would be very desirable.

Mr. Chairman, I would be glad to answer any questions that the Subcommittee may have on our supplemental request.

[The justification material follows:]

UNITED STATES RAILWAY ASSOCIATION

FY 1978 SUPPLEMENTAL
BUDGET SUBMISSION
FOR
ADMINISTRATIVE EXPENSESGENERAL STATEMENTI. Introduction

The Association is proposing a supplemental appropriation for \$13 million in FY 1978. Since we presently have had appropriated \$10 million for FY 1978, our supplemental budget estimate of \$13 million is based on the belief that appropriations totaling \$23 million will be required to meet our needs for the current fiscal year. An authorization for FY 1978 administrative expenses in the amount of \$23 million was approved by the President on November 23, 1977. Both the authorization and the requested appropriation contain language that would continue the availability of the supplemental funds through September 30, 1979.

Our fund requirements for both litigation support and financial monitoring have increased substantially over the estimates made one year ago. In the litigation support area, we did not foresee the need for asset valuation work during FY 1978 which would involve extensive field work as well as consideration of alternative valuation methodologies. In addition, we had no knowledge at the time that a fairly extensive title quality project would be required or that so many apparently relevant documents would be produced so quickly by the estates and other parties, and, therefore, be available for document processing. Our staffing plans of one year ago have had to be substantially revised because of the heavy asset valuation program contemplated in FY 1978 and because our need for in-house attorneys and paralegals has substantially increased.

Our budget estimate of one year ago also seriously underestimated the staff effort needed to monitor not only Conrail but also the Delaware & Hudson Railway Company and the Missouri-Kansas-Texas Railroad Company. As of September 1976, the Association's staff had had very little experience with Conrail monitoring and that which we did have was gained during a period when Conrail was not only meeting the goals set forth in the Final System Plan but exceeding them. Likewise, the Delaware & Hudson Railway Company seemed to be enjoying reasonably good operating results. The situation today is vastly different; both Conrail and the Delaware & Hudson are experiencing considerable difficulty in achieving the results which they themselves had forecast less than a year ago. As we will describe in the following paragraphs, additional studies and data processing support will be needed if the Association is to do an effective job of monitoring the activities of the three railroads to which it has loaned substantial Federal funds.

The Association has received a \$10 million administrative expenses appropriation for FY 1978. We obligated \$14.3 million in FY 1977, and \$23.4 million is now estimated to be our FY 1978 requirement. The following table summarizes by major activity, obligations for FY 1977, the FY 1978 amounts presently available, the additional funds requested and the totals now proposed for FY 1978. The presently available column sets forth our estimate of how the \$10.4 million available will be obligated. We have been obligating these funds on the assumption that our request for a supplemental will be approved by Congress.

REQUIREMENTS BY PROGRAM
(\$ in thousands)

| | FY 1977 <u>Actual</u> | <u>Available</u> | FY 1978 | |
|---------------------|--------------------------|------------------|--------------------------------|--------------|
| | | | <u>Additional Required</u> | <u>Total</u> |
| <u>Litigation</u> | | | | |
| General Counsel | \$ 4,986 | \$ 1,920 | \$ 2,996 | \$ 4,916 |
| Asset Valuation | 3,897 | 4,800 | 6,053 | 10,853 |
| Operations | 223 | 225 | -- | 225 |
| Other Support | <u>1,883</u> | <u>1,055</u> | <u>1,014</u> | <u>2,069</u> |
| Total | \$10,989 | \$ 8,000 | \$10,063 | \$18,063 |
| <u>Monitoring</u> | | | | |
| General Counsel | \$ 62 | \$ 50 | \$ 69 | \$ 119 |
| Finance | 1,054 | 630 | 901 | 1,531 |
| Operations | 1,415 | 1,312 | 1,285 | 2,597 |
| Other Support | <u>792</u> | <u>430</u> | <u>682</u> | <u>1,112</u> |
| Total | \$ 3,323 | \$ 2,422 | \$ 2,937 | \$ 5,359 |
| TOTAL | \$14,312 | \$10,422 | \$13,000 | \$23,422 |
| <u>Percentages:</u> | | | | |
| Litigation | 77% | | | 77% |
| Monitoring | 23% | | | 23% |
| Total | 100% | | | 100% |

II. Litigation Support

A. Status of Litigation

Early in 1977 the Special Court held arguments concerning methodology to be used in valuing rail properties conveyed to Conrail on April 1, 1976. The Special Court's opinion on the basic constitutional issues involved in valuation theory was issued in October. The Special Court's opinion was basically favorable to the Government and a number of valuation theories put forward by the estates, such as "reproduction cost" or "trended original cost", were rejected by the Court. These methods of valuing the properties could have increased the Government's exposure to a figure as high as \$14 billion.

The proceeding before the Special Court has been described by the Court as "probably the most gigantic task ever confided to a court." Many billions of dollars are involved and there are scores of parties to the proceedings. The size of the case and the complexity of the issues are staggering.

The Penn Central Trustees by themselves have the resources to mount a litigation effort appropriate to the enormous stakes involved and are represented by two large and prestigious law firms. In addition to devoting their own substantial internal resources to the case, they have retained the services of numerous consultants on a wide range of subjects. Similarly, the Erie Lackawanna Trustees are represented by one of Wall Street's largest law firms and have had the assistance of numerous expert consultants. Other transferors and creditors are also active litigants in the proceedings.

The Association is primarily responsible for representing the Government's interests in the case. It is represented by its internal legal staff and by two Washington law firms, Wilmer, Cutler & Pickering and Hogan & Hartson. Because of the economies involved, the Association has sought increasingly to carry the burdens of the litigation internally. Nonetheless, the two law firms retained by the Association unquestionably contribute to the Government's litigation effort. They provide talent and experience that are essential for proper representation of the Government's interests and which the Association itself does not possess. Active participation in the litigation by the Association's two law firms will, therefore, presumably continue for the duration of the entire case.

The 1978 fiscal year will be devoted primarily to preparation for evidentiary proceedings on property valuation which are presently expected to begin either late in calendar year 1978 or early in calendar year 1979. This preparation will include a substantial amount of pre-trial discovery and numerous depositions. We expect

the Court to consider the basic issues raised by a number of liquidation factors which impact significantly on asset values. The schedule outlined by the Court indicates that another major effort required during the current fiscal year will involve the preparation of Association responses to suggested sales for rail use which will be put forth by the estates.

The October opinion from the Special Court included a strong statement urging the parties to settle the case through negotiation instead of litigation. This course could potentially benefit the Government by shortening the period during which very substantial costs are incurred for preparation and trial of the case. However, the information now being collected on asset valuation is as essential for negotiating a fair settlement as it is for litigation.

If serious negotiation ensues, it will probably begin within a few months and it will take at least a year to settle the complex issues that are involved. It is the unanimous view of the concerned Government interests (and apparently of the Court and the Estates as well) that trial preparation must proceed simultaneously with negotiation. To do otherwise would weaken the Government's negotiating posture and leave it unprepared if negotiations failed to produce agreement.

The Special Court also suggested in the October opinion an additional valuation approach that it wished to have considered. Specifically, the Court suggested testimony regarding the use of original cost less depreciation and deterioration as a valuation method. Preparation for such testimony on this major new issue will require a substantial investment in staff time and contract support.

B. Legal Support

At the end of the 1977 fiscal year, the Association's in-house, full-time legal staff consisted of 22 attorneys and 16 paralegals. There was also a support staff of 17. This in-house group has conducted a substantial amount of the legal research required to prepare for litigation, and it has permitted us to reduce our reliance on outside counsel. In FY 1978, we will continue to expand our in-house staffing by adding four attorneys, five paralegals and three secretaries.

USRA's use of outside counsel is expected to cost \$2 million in FY 1978. During fiscal year 1977, the use of outside firms averaged approximately \$150,000 per month. During the period when we were preparing a brief for the April Special Court proceeding, the monthly level was approximately \$200,000. During the summer and

fall, the monthly billings of the two firms fell to about \$100,000 but this level will increase to about \$160,000 per month as the Association prepares for the hearings which are expected in the course of fiscal year 1978.

We are estimating that document processing will continue at a substantial volume during FY 1978. However, we hope to do more of this work in-house in the future, thereby reducing costs. The basic system of processing was set up and operated for us by an outside firm in FY 1977 at an approximate cost of \$1 million. During that period we identified, catalogued, and microfilmed about 100,000 documents comprising about 500,000 pages. In the final stage of the process, this information is entered into an automated retrieval system. Document processing costs for FY 1978 are expected to be \$490,000. This level of effort will be required to process the documents generated during discovery, deposition, and trial proceedings. These funds support a sophisticated and comprehensive data system which utilizes the Justice Department's JURIS system for computer storage and retrieval.

During FY 1978, a special project is being mounted by the General Counsel's office to check the title quality on real estate parcels transferred in the conveyance process. A preliminary review has indicated that much of the property conveyed did not have clear title and some parts of it can be used only for rail purposes. Such title limitations obviously affect significantly the value of these properties if considered for non-rail use. The title quality staff, which is located in Philadelphia, will consist of approximately twelve recent law school graduates plus supervisors. Contract funds are needed for a real estate lawyer and for the purchase of maps.

The General Counsel's legal support staff will contain 67 full-time positions and expenses for the office in FY 1978 (excluding the Office of Asset Valuation and \$119,000 of personnel related costs for Conrail monitoring support) are as follows:

| | | (\$ in thousands) |
|-------------------------|------------|-------------------|
| Personnel Related Costs | | \$2,001 |
| Contracts: | | |
| Outside Counsel | \$2,000 | |
| Document Processing | 365 | |
| Title Quality | 300 | |
| Other | <u>210</u> | |
| Subtotal, Contracts | | 2,875 |
| Computer Support | | 40 |
| TOTAL | | <u>\$4,916</u> |

C. Asset Valuation

USRA has assigned values to the conveyed assets on the assumption that, in the absence of a restructuring, the rail properties of the estates would have been liquidated and sold for non-rail use. The Special Court has indicated that it will also consider an alternative valuation model based on the sale of the rail properties to profitable railroads for rail use. Although it is presently impossible to be certain of the manner in which the Special Court will decide to proceed with respect to these valuation models, it has instructed the estates to submit proffers describing the possible sale of assets for rail use early in calendar year 1978. The Association believes it is also essential to be prepared for hearings on values for non-rail use before the end of 1978.

The Association expects the Special Court to consider during fiscal year 1978 the value of properties disposed of for non-rail use as part of a liquidation procedure. The first set of questions to be considered involve "cut-across" issues which are common to most properties. Later hearings will be held on specific properties. These hearings will review such matters as the sale of individual parcels of real estate for its highest and best use as well as the net return that might be obtained by selling assets such as cars, locomotives, track and work equipment from the inventory of facilities and equipment of the bankrupts.

The Office of Asset Valuation has responsibility for research and valuation studies of real estate, facilities, equipment and other assets, assuming that assets will be sold for rail as well as for non-rail use. The Office of Asset Valuation will have a staff of 51, and a summary table for FY 1978 obligations follows:

(\$ in thousands)

| | | |
|-------------------------------|---------|----------|
| Personnel Related Costs | | \$1,547 |
| Contracts: | | |
| Real Estate | \$5,292 | |
| Equipment, Facilities & Other | | |
| Assets | 1,740 | |
| Rail Use | 800 | |
| Litigation Assistance | 110 | |
| Documentation & Control | 100 | |
| Subtotal, Contracts | | 8,042 |
| Computer Support | | 1,264 |
| TOTAL | | \$10,853 |

1. Real Estate

During the past fiscal year, the Association has developed a detailed program for establishing values for the huge amount of real estate conveyed to Conrail which will be sufficiently documented to be presented and defended in Court. There are some 18,000 miles of right-of-way, involving thousands upon thousands of land parcels of varying width, a significant portion of which is located in urban areas. We have selected some 300 properties which are considered to be of high value and which because of their location and characteristics, are likely to be controversial in the valuation proceedings. Detailed narrative reports will be prepared on each of these major properties. The remainder of the right-of-way will be reviewed in a less detailed fashion but a report form will be completed by an appraiser on each parcel.

This program involves site visitation by an appraiser and the preparation of a standard appraisal report citing the characteristics of the property, its highest and best use, and the prices of similar property sold in the vicinity over the past few years. These initial reports must be reviewed and adjusted in terms of certain general considerations which are peculiar to our theory of net liquidation value. These include absorption factors, appreciation rates, discount rates, liquidation costs and the probable liquidation schedule. Fiscal year 1978 will see this work substantially completed along with the special studies that are required to define the impact of the general liquidation factors cited above.

For most of fiscal year 1977, our real estate valuation staff consisted of less than 5 people. As we have more clearly defined this program, it has become apparent that the staff must be expanded if we are to have the capacity to determine policy, to prepare manuals, to monitor appraisal contracts, to review appraisal reports for consistency, and to organize and file for ready retrieval the thousands and thousands of reports that will be produced. This staff is expected to expand to 26 during fiscal year 1978.

Expenses for real estate valuation are summarized as follows:

| | | (\$ in thousands) |
|-----------------------------|------------|-------------------|
| Personnel Related Costs | | \$ 842 |
| Contracts: | | |
| Site Appraisal Work | \$3,025 | |
| General Liquidation Factors | 565 | |
| Engineering Studies | 350 | |
| Title Quality Check | 600 | |
| Other | <u>330</u> | |
| Subtotal, Contracts | | <u>4,870</u> |
| TOTAL | | \$5,712 |

2. Equipment, Facilities and Other Assets

Valuation of these assets is the responsibility of the Special Studies division. A detailed program has been developed in these areas over the past year. Involved are all of the conveyed assets other than real estate and buildings. This includes equipment, materials and supplies, facilities, intangible assets, and other benefits. This division also conducts or contracts studies for the development of the economic and methodological framework within which all valuations are made.

In the equipment area, funds are required in FY 1978 to update the valuations contained in the FSP, to respond to discovery requests and participate in deposition activity. In the facilities area, a review and update of the FSP valuations is needed to incorporate inventory refinements and modifications of methodology and to verify and as necessary correct early engineering reports. A special study is required to review and assess the bridge dismantling costs which were incorporated in our original valuations. Less work has been done on intangible assets than on other areas and completion of the first detailed reports in this area will be accomplished during FY 1978.

A staff of 10 is projected to provide guidance and direction to contractors, to review and revise valuations based upon contractor inputs and to provide support to attorneys preparing for litigation in the facilities, equipment and intangible assets valuation proceedings. The 1978 fiscal year expenses for valuation of equipment, facilities and other assets are summarized as follows:

| | | (\$ in thousands) |
|-------------------------|-----------|-------------------|
| Personnel Related Costs | | \$ 285 |
| Contracts: | | |
| Facilities | \$ 650 | |
| Equipment | 270 | |
| Economic Issues | 570 | |
| Intangible Assets | 200 | |
| Other Benefits | <u>50</u> | |
| Subtotal, Contracts | | <u>1,740</u> |
| TOTAL | | \$2,025 |

3. Rail Use

The Special Court has given indications that it will consider valuations asserted by the transferors based upon continued use of specific assets for rail transportation. Up to

this point the Association has done little to prepare for responding to transferors' assertions concerning rail use values which they will put forward this spring in response to the Special Court's instruction. It can readily be seen that this is a complex problem involving projections of traffic, revenues, and costs for individual segments of railroad, as well as assessments of the willingness and ability of potential purchasers to make offers. Our efforts in 1978 will involve developing a general approach to guide the analysis of proffers when they are put forward by the transferors.

The Association must assemble an expert team to prepare the analysis and testimony that will be required. We must also amass a vast body of factual data and review all existing studies which are relevant to rail use values. We expect to assemble an in-house staff of 10 people who will cover three general areas of expertise: rail acquisition planning, acquisition financing, and ICC practices and policies. In addition, we expect that contractual services of \$800,000 in 1978 will be required. Studies will probably involve, in addition to the analysis of specific proffers, many of the more difficult economic factors of the sort that were considered in preparation of the Final System Plan such as the condition of assets and the economic viability of light density lines.

Fiscal year 1978 expenses for the Office of Rail Use Valuation are summarized as follows:

| | | (\$ in thousands) |
|-------------------------|-------|-------------------|
| Personnel Related Costs | | \$ 290 |
| Contracts: | | |
| Preparatory Projects | \$650 | |
| Discovery | 50 | |
| Proffer Analysis | -- | |
| Defense Strategy | 100 | |
| Testimony | -- | |
| Subtotal, Contracts | | 800 |
| TOTAL | | \$1,090 |

4. Data Processing Support

The Asset Valuation area will be placing heavy demands on USRA's data processing services. The major use will be for real estate where it is expected that data processing costs will be \$368,000 in 1978. This is in addition to placing demands for almost four man years of in-house analysts' time. These funds will be required for management and control of the real estate operation for data entry, edit and reporting on the vast volume of appraisal reports and for documentation of the computer effort. The next largest use of data processing effort

will be in the rail use area which is expected to require \$240,000 of computer time in 1978. The development of basic information on traffic flows and financial results for various rail segments will require substantial computer support. A summary of the computer support requirement for asset valuation follows:

(\$ in thousands)

| | Personnel Related Costs | Computer | Equipment & Supplies |
|-----------------|-------------------------------|--------------|-------------------------|
| Facilities | \$ 40 | \$ 52 | \$ 5 |
| Equipment | 16 | 6 | -- |
| Real Estate | 145 | 368 | 35 |
| Summary System | 48 | 160 | 16 |
| General Support | 20 | 44 | 3 |
| Rail Use | 43 | 240 | 23 |
| TOTAL | <u>\$312</u> | <u>\$870</u> | <u>\$82</u> |

5. Direction and Supervision

The Assistant Vice President for Valuation Planning has a staff of five and utilizes contractual services to assist him in establishing basic strategy and policy for valuation and to provide resources for quality control and documentation.

(\$ in thousands)

| | | |
|-------------------------|------------|--------------|
| Personnel Related Costs | | \$130 |
| Contracts: | | |
| Litigation Assistance | \$110 | |
| Documentation & Control | <u>100</u> | |
| Subtotal, Contracts | | <u>210</u> |
| TOTAL | | <u>\$340</u> |

III. Monitoring

The Association must be capable of independently assessing the financial viability of Conrail, the Delaware & Hudson Railway and the Missouri-Kansas-Texas Railroad. USRA staff must have the resources to collect and analyze information on the major factors which contribute to revenues, costs and capital requirements and be capable of preparing independent projections. These projections should provide the Federal Government with early information concerning future problems and assist in the development of alternative courses of action should it appear that any of the railroads are unlikely to achieve financial stability.

The major railroad, of course, is Conrail in which the Government has already invested \$1 billion with an additional \$1 billion appropriated. Attention must be focused on the "turn around" efforts of the railroad through special reports and meetings with Conrail officials to assess progress. The major "turn around" areas as we view them include:

- o Attracting sufficient revenue
- o Implementation of the rehabilitation program
- o Cost effective capital programs
- o Improved equipment utilization
- o Profit margin analysis
- o Effective marketing programs
- o Improved management systems
- o Adequate subsidy levels for passenger and low density lines
- o Integration and consolidation savings
- o Improved productivity

The monitoring efforts of the Office of Finance will relate primarily to the review and analysis of the various reports required by the Financing Agreement between the Association and Conrail. These include:

- o Monthly, quarterly, and annual financial statements
- o A Business Plan concerning the use of financing proceeds as well as anticipated revenues and expenses
- o Interim projections indicating the extent to which Conrail is tracking its Business Plan
- o Quarterly maintenance reports which will cover maintenance-of-way expenditures and indicate progress on the facilities rehabilitation program
- o Comparison and variance analyses which will assist the Association in understanding the reasons for differences between actual results and the Conrail Business Plan
- o Copies of reports to SEC, security exchanges, lenders, ICC and shareholders
- o Daily cash receipts and disbursements and two-week forecasts of the same

All of this information will provide the data on which the staff will base its recommendations concerning the financial viability of Conrail.

A. Finance

Financial monitoring will focus on the current financial and cash position of the three railroads, comparing performance with projections, preparing independent projections, and assessing the adequacy of the financial management programs of the railroads. Since the Association depends upon the railroads to furnish most of the data used in the monitoring process, it is desirable to check the reliability of the accounting systems furnishing that data.

In the case of Conrail, the Association will monitor the progress being made in improving the reliability and accuracy of its accounting and inventory control systems.

In order to maintain the integrity of the forecasts contained in the Final System Plan, it is necessary to restate FSP financial forecasts periodically to incorporate changes in accounting rules, regulations and policies so that the FSP pro forma financials will be comparable to Conrail's actual accounting structure. The staff must continue to assess the financial impact on Conrail and the other railroads receiving financial aid of changes in general inflation rates, real economic growth, and rate increases particularly when these factors differ from those assumed in the FSP and other more recent projections.

During fiscal year 1978, the \$350 million current limit authorized by Section 211(h) of the RRR Act will be reached. This section authorizes USRA to make loans to Conrail for use in paying off obligations of the bankrupt railroads which were received after conveyance. Conrail acts as agent for the estates. When the lending limit is reached, it will be necessary to implement the revolving feature of the Penn Central settlement which the U.S. Government reached with the Trustees and under which additional 211(h) obligations can be met.

A major new effort to be initiated in FY 1978 involves the review of Conrail's capital structure. Various alternatives will have to be considered concerning the types of securities Conrail will issue as experience is gained and new information becomes available concerning the total capital requirements of the Corporation. A staff of two will be employed and \$200,000 in contractual services will be utilized to obtain the services of an investment banking firm during FY 1978.

The final portion of the \$2.026 billion appropriated for Conrail will be advanced in FY 1979. Continued close monitoring will be required since Conrail is expected to need additional funding. It is reasonably certain that additional appropriations will not be made until the existing funding is nearly exhausted and only after extensive studies have been completed. In addition to the capital structure review previously noted, an update of the Final System Plan will be undertaken based on developments since 1975, and an assessment made of Conrail's traffic and revenue forecasts.

The Delaware & Hudson Railway Company and the Missouri-Kansas-Texas Railroad Company will require continued financial monitoring to protect the Association's loans to these railroads. The D&H in particular will face a very tight cash situation in 1979, since it

was originally scheduled to receive a \$2 million advance from the Association in that year but that loan amount has now been advanced to 1977.

The staff required for proper monitoring of the financial aspects of the three railroads is 18 people for both FY 1978 and 1979. Contractual needs include funds for employing consultants to assist in analysis of Conrail's five-year projections, a final audit of the Section 211(h) program (which begins in 1978 and extends into 1979) and investment consulting services. The fiscal year 1978 expenses for financial monitoring are summarized as follows:

| | | (\$ in thousands) |
|----------------------------------|------------|-------------------|
| Personnel Related Costs | | \$ 703 |
| Contracts: | | |
| Analyze 5-Year Projections | \$250 | |
| Review Conrail Accounting System | 75 | |
| 211(h) Audit | 30 | |
| Investment Consulting Services | <u>200</u> | |
| Subtotal, Contracts | | 555 |
| Computer Support | | <u>273</u> |
| TOTAL | | \$1,531 |

B. Operations

The Association now believes that it reduced resources in the Operations area far below the level needed for effective monitoring, particularly of Conrail. During the past fiscal year, the Association was not able to monitor activities adequately in most of the major "turn around" areas. This is particularly true in marketing and equipment utilization.

Separate organizational units have been set up for operations review, local rail service and manpower, operations and cost analysis, marketing analysis, and facilities and equipment. Staff is being added in each area to establish an independent forecasting capability so that we can assess Conrail's plans for the short term as well as the five-year period covered in the Business Plan. These assessments will permit the Association to keep the Board of Directors informed on a monthly basis with respect to each of the major "turn around" areas. The current staff of 19 will be increased to 32 during FY 1978.

Special reviews are planned during FY 1978 in the following areas of Conrail activity:

- o Adequacy of service
- o Equipment utilization and condition and the need for new acquisitions
- o Elimination of unprofitable traffic

- o Operating practices at yards, terminals, and line-haul facilities
- o Extent of penetration into existing and new profitable transportation markets
- o Rate of return on and timing of road and yard improvements
- o Maintenance-of-way cost controls
- o Priority among competing demands for investment funds
- o Intermodal competitive factors in the Northeast with emphasis on New England
- o Impact of foreign purchases by Conrail on the U.S. economy

Expenses for the Office of Operations (excluding \$225,000 of personnel related costs estimated for litigation support) are as follows:

(\$ in thousands)

| | | |
|-------------------------------|------------|----------------|
| Personnel Related Costs | | \$ 891 |
| Contracts: | | |
| Local Rail Service & Manpower | \$ 50 | |
| Operations Review | 347 | |
| Operations & Cost Analysis | 250 | |
| Marketing Analysis | 175 | |
| Facilities & Equipment | <u>325</u> | |
| Subtotal, Contracts | | 1,147 |
| Computer Support | | <u>559</u> |
| TOTAL | | <u>\$2,597</u> |

C. Data Processing Support

USRA's data processing support activities are organizationally located with the Office of Finance & Operations; however, system development, supervision and facility management costs have been allocated to the section of the justification where the basic program is discussed. For instance, costs associated with Asset Valuation have been included under II Litigation Support. Our estimate of computer support for monitoring costs (Finance and Operations) are as follows:

(\$ in thousands)

| | Personnel Related Costs | Computer | Equipment & Supplies |
|--------------------------------|-------------------------------|--------------|-------------------------|
| Financial Analysis | \$149 | \$110 | \$14 |
| Marketing | 28 | 23 | 2 |
| Operations & Cost Analysis | 119 | 194 | 16 |
| Manpower & Local Rail Services | 18 | 10 | 1 |
| Equipment & Facilities | <u>85</u> | <u>58</u> | <u>5</u> |
| TOTAL | <u>\$399</u> | <u>\$395</u> | <u>\$38</u> |

IV. Executive Direction and Administrative Support

Expenses for executive direction and administrative support provide for staff and administrative services obtained by contract. Executive direction includes the Office of the Chairman, the Office of the President and Chief Executive Officer, and expenses relating to the functions of the Secretary of the Corporation and Public & Governmental Affairs. Administrative support includes management systems, budget and accounting, personnel, administrative services, audit and procurement. The following table summarizes staff and contractual services in this area:

| | | |
|---------------------------|------------|-------------------|
| Full-time positions: | | |
| Executive Direction | | 12 |
| Administration | | 35 |
| Personnel Related Costs: | | (\$ in thousands) |
| Executive Direction | | \$ 461 |
| Administration | | 1,140 |
| Other Services: | | |
| Rents and Communications | \$788 | |
| Printing and Photographic | 235 | |
| Supplies | 175 | |
| Equipment | 100 | |
| Contractual Services | <u>265</u> | |
| Subtotal, Other Services | | 1,563 |
| Computer Support | | 17 |
| TOTAL | | <u>1/ \$3,181</u> |

1/ \$2,069,000 is prorated to litigation support and \$1,112,000 to monitoring.

A. PROPOSED FULL-TIME PERMANENT STAFFING LEVELS

| | <u>12/31/77</u> | <u>3/31/78</u> | <u>6/30/78</u> | <u>9/30/78</u> |
|-----------------------------------|-----------------|----------------|----------------|----------------|
| Chairman | 2 | 2 | 2 | 2 |
| President/Chief Executive Officer | 10 | 10 | 10 | 10 |
| <u>General Counsel:</u> | | | | |
| Litigation Assistance | 60 | 65 | 67 | 67 |
| Asset Valuation | 40 | 51 | 51 | 51 |
| Subtotal | 100 | 116 | 118 | 118 |
| <u>Administration:</u> | | | | |
| Vice President | 2 | 2 | 2 | 2 |
| Management Systems | 4 | 4 | 4 | 4 |
| Comptroller | 10 | 11 | 11 | 11 |
| Support Services | 9 | 9 | 9 | 9 |
| Personnel | 5 | 5 | 5 | 5 |
| Audit | 4 | 4 | 4 | 4 |
| Subtotal | 34 | 35 | 35 | 35 |
| <u>Finance:</u> | | | | |
| Vice President | 7 | 7 | 7 | 7 |
| Financial Analysis | 8 | 9 | 9 | 9 |
| Computer Services | 16 | 21 | 24 | 24 |
| Capital Structures | 2 | 2 | 2 | 2 |
| Subtotal | 33 | 39 | 42 | 42 |
| <u>Operations:</u> | | | | |
| Assistant Vice President | 2 | 2 | 2 | 2 |
| Local Rail Services & Manpower | 4 | 4 | 4 | 4 |
| Operations Review | 2 | 2 | 2 | 2 |
| Operations & Cost Analysis | 9 | 9 | 9 | 9 |
| Marketing Analysis | 2 | 4 | 6 | 7 |
| Facilities & Equipment | 5 | 8 | 8 | 8 |
| Subtotal | 24 | 29 | 31 | 32 |
| TOTAL | 203 | 231 | 238 | 239 |

B. REQUIREMENTS BY OBJECT CLASS

(\$ in thousands)

| | FY 1977 <u>Actual</u> | 1978 | | |
|-------------------------------------|--------------------------|------------------|--------------------------------|--------------|
| | | <u>Available</u> | <u>Additional Required</u> | <u>Total</u> |
| Personnel Costs | \$ 4,373 | \$ 3,225 | \$ 3,968 | \$ 7,193 |
| Travel | 193 | 150 | 210 | 360 |
| Transportation of Things | 74 | 100 | 88 | 188 |
| Rents, Communications, Utilities | 547 | 400 | 388 | 788 |
| Printing & Reproduction | 189 | 50 | 185 | 235 |
| Supplies | 148 | 75 | 100 | 175 |
| Equipment | 40 | 50 | 50 | 100 |
| Contracts | 8,446 | 6,192 | 7,926 | 14,118 |
| Administrative Services | <u>302</u> | <u>180</u> | <u>85</u> | <u>265</u> |
| TOTAL | \$14,312 | \$10,422 | \$13,000 | \$23,422 |

12/7/77

C. PROGRAM BY FISCAL YEAR (\$ in thousands)

| | FY 1977 | | | | FY 1978 | | | |
|----------------------------|-------------------------------|-----------|---------|----------|-------------------------------|-----------|---------|----------|
| | Personnel Related Costs | Contracts | Other | Total | Personnel Related Costs | Contracts | Other | Total |
| <u>Litigation Support:</u> | | | | | | | | |
| General Counsel | \$1,392 | \$3,594 | \$ -- | \$ 4,986 | \$2,021 | \$ 2,895 | \$ -- | \$ 4,916 |
| Asset Valuation | 547 | 3,350 | -- | 3,897 | 1,824 | 9,029 | -- | 10,853 |
| Operations | 200 | 23 | -- | 223 | 225 | -- | -- | 225 |
| Other Support | 1,025 | 24 | 834 | 1,883 | 1,045 | 8 | 1,016 | 2,069 |
| Total | 3,164 | 6,991 | 834 | 10,989 | 5,115 | 11,932 | 1,016 | 18,063 |
| <u>Monitoring:</u> | | | | | | | | |
| General Counsel | 62 | -- | -- | 62 | 119 | -- | -- | 119 |
| Finance | 533 | 521 | -- | 1,054 | 803 | 728 | -- | 1,531 |
| Operations | 500 | 915 | -- | 1,415 | 1,141 | 1,456 | -- | 2,597 |
| Other Support | 381 | 19 | 392 | 792 | 563 | 2 | 547 | 1,112 |
| Total | 1,476 | 1,455 | 392 | 3,323 | 2,626 | 2,186 | 547 | 5,359 |
| TOTAL | \$4,640 | \$8,446 | \$1,226 | \$14,312 | \$7,741 | \$14,118 | \$1,563 | \$23,422 |
| Percentages: | | | | | | | | |
| Litigation Support | | | | 77% | | | | 77% |
| Monitoring | | | | 23% | | | | 23% |
| Total | | | | 100% | | | | 100% |

12/6/77

D. SUMMARY OF COMPUTER SERVICES REQUIREMENTS BY ORGANIZATION

(\$ in thousands)

| | FY 1978 | | | | |
|-----------------|------------------|--|-----------------|-------------------------------------|--------------|
| | <u>Positions</u> | <u>Personnel Related Costs</u> | <u>Computer</u> | <u>Equipment & Supplies</u> | <u>Total</u> |
| General Counsel | 1 | \$ 20 | \$ 20 | \$ -- | \$ 40 |
| Asset Valuation | 10 | 312 | 870 | 82 | 1,264 |
| Subtotal | 11 | \$332 | \$890 | \$ 82 | \$1,304 |
| Finance | 4 | 149 | 110 | 14 | 273 |
| Operations | 9 | 250 | 285 | 24 | 559 |
| Administration | -- | 7 | 10 | -- | 17 |
| TOTAL | 24 | \$738 ^{1/} | \$1,295 | \$120 | \$2,153 |

^{1/} Includes contract consultants.

9/19/77

SETTLEMENT NEGOTIATIONS

Mr. McFALL. Mr. Cole, most of your budget request is for litigation support. As you have indicated, in October the Special Court issued an opinion on the basic Constitutional issues involved in valuation theory. At that time, the Court also issued a statement urging the parties to settle the case through negotiation instead of litigation. What steps have been taken during the past four months to settle the case and what are the prospects of a negotiated settlement?

Mr. COLE. I would like Mr. Dickieson to handle this question.

Mr. DICKIESON. Right after the Court issued its October opinion and made the suggestion, this topic was discussed at a meeting of the Liaison Committee that represents all the parties. There we agreed to pursue settlement negotiations to see where they might lead. In the time since the October opinion, the Government parties have addressed the question of how they would organize themselves to negotiate a settlement.

There has been a Policy Committee established containing representatives of the various executive branch agencies and USRA. That Committee is intended to resolve the kinds of policy questions that would arise during any settlement negotiations.

We also have had at least one meeting with each of the bankrupt estates. They have indicated a preference to conduct the negotiations separately and we are meeting separately with each of the estates. I think we are making some progress. It is quite early. Frankly, it is far too early to say whether anything will come out of this.

The ability to move forward in the negotiations is impacted by the fact that, at the same time and with the same people with whom you are trying to discuss a settlement, you are also in court with them and trying to meet the court-imposed deadlines in terms of trying a case. But, I think we have moved forward.

As I say, these discussions are in an early stage and I would not expect any prompt resolution, but I think there are hopeful prospects.

SPECIAL MASTERS

Mr. McFALL. Well, good luck.

About a year ago, when Mr. Lewis testified on your fiscal year 1978 budget he indicated that you expected the Special Court to issue instructions to special masters to begin the process of fact finding throughout the region. He also indicated that if you had 15 hearings rather than 10 hearings going simultaneously it would increase your costs over the next few years but compress the case into a shorter period. How many special masters are going to be involved and what impact will this have on the length of the case?

Mr. DICKIESON. This, I think, helps to illustrate the problems we have in trying to estimate how much litigation is going to cost. The Special Court has not yet appointed any special masters. We don't know how many are going to be involved. What has occurred in the case over the past year has been different than we expected. The Court took several months longer than we expected to issue its major opinions. There was more time spent on discovery and trial preparation.

The Court's October opinion did start the clock running with respect to the transferors' basic case, namely, their efforts to demonstrate they could have sold their lines for rail use. But these demonstrations do not presently involve hearings and there is no schedule set for hearings on that side. For our part, we have filed a motion trying to establish a schedule for addressing the major basic issues that affect all the asset categories with respect to the scrap model, scrap liquidation approach that we advocate.

That schedule would have hearings starting in the fall, and on just those issues, may involve four or five masters. Those are the tip of the iceberg. At the present time we don't know how many special masters are going to be involved. We are not expecting any factual, evidentiary hearings to take place before the fall, at least no significant ones.

We now are not really anticipating that the evidentiary aspects of the case will be underway until the early part of fiscal year 1979.

EXTENDED APPROPRIATION AVAILABILITY

Mr. McFALL. Your original fiscal year 1978 appropriation is available only until the end of the current fiscal year. Why do you feel you need an extra year of availability of your supplemental?

Mr. COLE. We have had great difficulty in estimating the timing and amount of our future needs for administrative expenses. Our major expenses are for litigation support and this activity is dependent upon actions by the the Special Court. We believe the additional flexibility as to the timing of certain actions, and, therefore, the timing of obligations, would be very desirable.

Mr. McFALL. Is this extended availability specifically authorized?

Mr. COLE. Yes. It was authorized under Public Law 95-199.

PRIVATE LAW FIRMS

Mr. McFALL. On page 3 of your justifications you indicate that there are also two private law firms representing the Government in your litigation. With the large number of lawyers in the Justice Department and the Department of Transportation, why do you feel you need assistance from these firms?

Mr. DICKIESON. This is an unusual litigation that requires some specialized expertise that is not readily available among the lawyers of the Justice Department or the Department of Transportation. It is also a very enormous case.

In addition to the two law firms, we have internally at USRA more than 20 lawyers currently working only on the valuation litigation. These lawyers have all been hired since conveyance, since April of 1976.

They have had the desired impact upon the cost, the amount of money, we are spending on outside counsel. During calendar year 1976, for example, the combined payments to the two law firms were running at a monthly average of \$198,000 a month. As we got more lawyers on the USRA staff and were able to take over more and more of the routine aspects of the valuation case, these payments declined. During the first six months of calendar 1977, the monthly average dropped to \$156,000, and during the last half of 1977 it fell to \$82,000 a month. And it has been holding at that level or slightly above so far this year.

We do expect the monthly cost of the outside law firms will tend to increase when we get into evidentiary hearings. While we have a large legal staff at the Association, we are not staffed to handle the peaks of the litigation which you get when involved in actual evidentiary hearings. At that point, we will rely more heavily on the outside law firms than we will in the preparation phases.

Mr. McFALL. On what basis were these firms selected?

Mr. DEAN. These two contracts go back to the days preceding the founding of USRA when the Department of Transportation, knowing of the need for legal assistance, did undertake a competitive review of possible law firms, eliminating some significant ones that were already involved in litigation on behalf of the potential adversaries. So there was a competitive approach to the selection of both law firms. Since then, there have been extensions of the contracts.

These extensions come before our Board of Directors for regular review, but it is clear that the expertise of these law firms must be retained on a sustained basis.

Mr. McFALL. On page 5 you indicate that you will be paying \$2 million for outside counsel in fiscal year 1978. Does this all go to these two law firms?

Mr. DEAN. About \$1.8 million is for the two law firms.

Mr. McFALL. Are your outside contracts subject to the normal Federal Government contracting regulations? If not, can the GAO audit these contracts?

Mr. DEAN. We have in our law, Mr. Chairman, a specific exemption from the provisions of the U.S. Code which deal with competitive bidding. We do, however, have an internal policy order which calls for maximum competitive bidding and we do use competitive procedures wherever possible. But we are not required to do this by law. We have provision in our contracts for GAO audit, that is, any contract over \$100,000 which is not a fixed price contract. So there would be access, yes, sir. We also have an internal audit staff.

TITLE QUALITY

Mr. McFALL. On page 5 you indicate that you are checking the title quality on the real estate transferred in the conveyance process. What percentage of this property did not have clear title?

Mr. DICKIESON. We do not yet know what that percentage will be. We do think it could have a significant impact on the result in the valuation case. Basically much of this land was acquired by the railroads in the last century and was subject to various defects in title or to reversionary clauses that had the property revert to its original owners in the event the railroads ceased rail operations. And it is well known that railroads do have title problems when they go to sell an abandoned rail line for non-rail uses.

The purpose of our study is to get that factor into our valuation effort. This is a very complex task which we are doing internally in our office in Philadelphia with law students and other temporary people we have hired.

VALUATION METHODS

Mr. McFALL. Nearly half of your fiscal year 1978 budget is for asset valuation. Specifically, what valuation approaches, other than net liquidation value, has the Special Court indicated it will consider?

Mr. COLE. On October 12, 1977, the Court issued its most significant opinion on the main valuation case. It accepted the Association's argument that value to the transferors, not to the Government, is the appropriate measure of just compensation. Thus, the market value of the conveyed properties, whether sold for scrap or for continued rail use (if the transferors can prove such a likelihood), is the central valuation theory adopted by the Court. However, the Court expressed its intention to consider, in limited circumstances, other methods of determining constitutional minimum values and suggested an alternative—original cost less depreciation and deterioration.

The Court ruled that the transferors will be entitled to submit evidence of possible pre-conveyance sales to prospective purchasers including governmental bodies, but it also ruled that the United States would not be considered a prospective purchaser.

SELLING OF PENN CENTRAL PROPERTIES

Mr. McFALL. With respect to having the assets sold for rail-use, didn't former Secretary Coleman propose that some other railroads buy the Penn Central?

Mr. COLE. Mr. Chairman, this was a proposal which Secretary Coleman put forward. The only offers we knew that were involved were in the Three Systems Plan. The Chessie was to pick up the Erie Lackawanna and the Reading. That, as you know, did not occur. Primarily because of labor negotiation problems, Chessie backed out.

Secretary Coleman had some proposals but we were not privy to the discussion of controlled transfer that went on within the Administration. In fact, it was a year and half later, during discovery for litigation, that we came across the documents and memos that flowed between the Department of Transportation, OMB and others during that period. We were never asked to comment on these proposals at any time.

It was completely in the hands of the Secretary of Transportation. We were surprised at how much work had been going on without USRA comment.

Mr. McFALL. At our hearings on your fiscal year 1976 budget Mr. Jordan said that the Trustees of the Penn Central expressed substantial interest in selling their properties to other railroads. How many offers did they receive for their property?

Mr. DICKIESON. The Penn Central Trustees, after the passage of the Rail Act, did make an effort to see whether Western and Southern carriers might be interested in buying some of their lines.

They were able to generate from those railroads a number of expressions of interest, primarily in the lines west of Buffalo and west of Pittsburgh. None of those discussions ever went beyond that point. While some of the railroads did express some interest, none of the discussions ever involved price.

RAIL USE ASSETS

Mr. McFALL. On page 6 you indicate that you will have an \$800,000 contract for rail use asset valuation. How much of your fiscal year 1978 asset valuation effort will involve rail use as compared with nonrail use assets?

Mr. DICKIESON. Estimated expenditures for FY 1978 rail use effort total \$1,396,000. This represents approximately 13 percent of our total budget estimate of \$10,853,000.

We will submit a table to illustrate the pro-rated by category planned rail use effort.

[The table follows:]

| FISCAL YEAR 1978 | | | | | | |
|------------------------------|----------|---------|-------------|---------|---------|---------|
| (In thousands of dollars) | | | | | | |
| Item | Rail use | Percent | Nonrail use | Percent | Total | Percent |
| Personnel related costs..... | \$290 | 19 | \$1,257 | 81 | \$1,547 | 100 |
| Contracts..... | 800 | 10 | 7,242 | 90 | 8,042 | 100 |
| Computer support..... | 306 | 24 | 958 | 76 | 1,264 | 100 |
| Total..... | 1,396 | 13 | 9,457 | 87 | 10,853 | 100 |

ASSET VALUATION COST FOR FSP

Mr. McFALL. As I recall, Congress appropriated about \$40 million to enable you to develop the Final System Plan for Conrail. One of the chief components of that Plan was determining the value of the rail properties conveyed to Conrail. Your valuation method assumed that these properties would not be used for rail use, and in September, 1975, you testified that: "The Association believes that its work in connection with the foregoing (asset valuation) to be thorough and complete. . . ." If you did such a good job in connection with the Final System Plan, why do you need additional money now?

Mr. DICKIESON. Of the \$40 million that was used to develop the Final System Plan, only approximately \$2.75 million of those dollars was spent on asset valuation. The problem with asset valuation during the preparation of the Final System Plan was that the basic approaches to valuation were arrived at by the Board of Directors in November of 1974 and, of course, the final dollar figure had to be produced in time for inclusion in the Final System Plan by July, 1975.

So it was within that very short time frame that the work to value the assets had to be done. As we said then, and as I would still agree now, the work that was done was good and we think the number that it produced on the theories that were then being employed was accurate.

However, there is a considerable difference between producing a number that is appropriate for inclusion in a plan such as the Final System Plan and having the detailed, extensive backup data, the availability of expert witnesses to testify and the like that you need for litigation.

What we have been doing since then is to expand the work that has been done so that what we will be able to take to court will be of

evidentiary quality. As I say, we are still quite satisfied with the answers produced in the Final System Plan. The only things we have discovered in our efforts to prepare the work for the court that have led to changes in the numbers have been situations where the court has, in effect, ruled against our legal theories.

REAL ESTATE INSTRUCTIONAL MANUALS

Mr. McFALL. On page 7 with respect to real estate valuation, you refer to preparing manuals. Why do you feel these are essential?

Mr. DICKIESON. The Association's real estate valuation program involves a multi-State appraisal of over 300,000 acres of land located in urban, suburban, and rural surroundings. Approximately 100 real estate appraisers from throughout the Northeast are involved in the project. The use of instructional manuals in a project of this size is essential to ensure accurate dissemination of both the legal and methodological information needed by the appraisers. Furthermore, manuals ensure consistent application of the valuation methodology and provide a means to ensure that all data gathered in the field is reported back to the Association in a consistent format compatible to the Association's data retrieval systems.

VALUATION OF EQUIPMENT

Mr. McFALL. On page 8, how do you determine the value of equipment that was conveyed to Conrail nearly two years ago?

Mr. DICKIESON. Two principal factors enter into the valuation of equipment conveyed to Conrail. The first is identification of the equipment conveyed and the second the condition of the equipment.

USRA has an intensive effort underway to stipulate to the inventory of equipment conveyed to Conrail. As a part of this process, USRA is coordinating with both Conrail and the transferors to assure that all parties agree as to the equipment inventoried. The inventory of rolling stock is identified by car initial and number. Using the estates' car movement and maintenance records, supplemented by the inspections made by USRA's equipment valuation consultants, it should be possible to determine both the existence of and the general condition of the equipment as of 1976.

The valuation of the equipment in the Retrieval Model relies in part on the condition of the equipment. For example, some equipment, such as non-rebuilt freight cars and locomotives less than sixteen years of age, would be sold for reuse at a price dependent upon this condition.

SECTION 211(h) LOANS

Mr. McFALL. You state that during fiscal year 1978 the \$350 million limit in Section 211(h) loans will be reached and when the lending limit is reached, it will be necessary to implement the revolving feature of the Penn Central settlement. How does this revolving feature work?

Mr. DICKIESON. Our authorization for Section 211(h) loans only permits loans in the amount of \$350 million to be outstanding at any one time. The actual amount of Section 211(h) eligible claims exceeds \$350 million.

When the Government parties were addressing the questions brought to them by the Penn Central Trustees, whether the Government would be prepared to settle a variety of its claims against the Penn Central estates, one of the primary claims of the Government was the section 211(h) claim. Under 211(h) we, in effect, loan money to Conrail as agent to pay off claims by shippers, suppliers and labor against the bankrupt estates. These claims are, in effect, administration claims, very high priority claims.

We were able to persuade the Penn Central Trustees to agree as part of that settlement and plan of reorganization that to the extent the \$350 million ceiling was reached, the Penn Central Trustees would commence repaying those claims to us so we, in turn, could re-loan the money to pay additional claims.

This process, in effect, sets aside \$107 million of the 211(h) money to pay the claims attributable to the smaller states and \$243 million to pay claims to Penn Central, with Penn Central paying claims against it that exceed the \$243 million as they are incurred.

Mr. McFALL. Why are we still paying off preconveyance obligations of the estates of the bankrupt railroads?

Mr. COLE. As contemplated when the 211(h) legislation was originally drafted, certain obligations incurred prior to April 1, 1976 do not require payment for several years thereafter. Damage claims, personal injury claims, and employee wage claims historically can take a few years to settle in cases of disagreement and litigation. Also, certain reorganization courts delayed the normal payment of bills until certain legal issues and appeals to various courts had been completed. Certain amounts are still in dispute, including the payment of retirement, health and welfare insurance premiums of the Erie Lackawanna railroad.

Mr. McFALL. How much longer do you feel you will have to pay these obligations?

Mr. COLE. We anticipate that 211(h) obligations will continue to be paid through at least 1979.

LISTING OF 211(h) LOANS

Mr. McFALL. Would you provide a listing of the loans made to date under this section?

[The information follows:]

LOAN FUNDS BY ESTATE AS OF FEB. 14, 1978

[In millions of dollars]

| | Drawdowns | Additional loan commitments |
|--------------------------------------|--------------|-----------------------------------|
| Penn Central Transportation Co. | \$236.8 | \$25.5 |
| Erie Lackawanna | 23.1 | 21.4 |
| Lehigh & Hudson River | .1 | ----- |
| Lehigh Valley | 5.8 | 5.6 |
| Reading | 18.4 | 8.7 |
| Central of New Jersey | 16.2 | 6.1 |
| Ann Arbor | .1 | ----- |
| Total | 300.5 | 167.3 |

¹ Includes loans approved subject to availability of funds \$17,800,000.

SECURITY FOR LOANS

Mr. McFALL. What security do you have for these loans and what are the repayment prospects?

[The information follows:]

The Outline of Settlement of December 17, 1976 is an agreement between Trustees of the estate of the Penn Central Transportation Company and the United States Government, in which the Penn Central acknowledges as administrative claims the Section 211(h) obligations paid on behalf of the Penn Central with loan funds. The Outline of Settlement prescribes the method by which the reorganized Penn Central Company will repay to the Association the loan funds used to pay its Section 211(h) obligations.

Under the terms of the Outline of Settlement the new Penn Central Company will issue Series B, first secured notes to the United States in the amount of the outstanding loans made by USRA to Conrail pursuant to Section 211(h) of the Rail Act for payment of Penn Central obligations. Such Series B notes will be general obligations of the New Company and will be secured by the proceeds of the Valuation Case and by first lien on the assets of the New Company, including the common stock of the Pennsylvania Company. We believe the assets of the New Company will be more than sufficient to consider the 211(h) loans for the Penn Central to be fully secured.

The method of repayment and the security underlying the Section 211(h) loans made to pay the obligations of the other estates has not yet been determined. The Government and the Association are negotiating with several of the estates on these issues, but it is difficult to assess at this time the prospects for ultimate repayment of the loans made to the other estates. It should be noted that the Rail Act states that Conrail and the Association shall have direct administration claims against the estates for the loans made to pay the Section 211(h) obligations of the estates. This status should assure us that the Section 211(h) loans will be treated as a very high priority claim in the reorganization proceedings of the other estates.

[Following is a copy of the Penn Central Outline of Settlement which sets forth in detail the procedures for the repayment of the Section 211(h) loans made on behalf of the Penn Central.]

DECEMBER 17, 1976.

OUTLINE OF SETTLEMENT

1. On plan consummation date (start up of New Co.), which it is now estimated will occur between March 31, 1977 and January 1, 1978, the outstanding trustee certificates (hereinafter TC's) due in 1976 now held by the United States will be paid in full in cash. This will include \$50 million principal, plus interest accrued from January 15, 1976, to the date of payment computed at a rate to reimburse the Treasury's actual interest cost, whatever it may be, but now estimated at about \$5 million, plus the guarantee fee and interest thereon, if any, pursuant to the terms of the guarantee. The cash needed for this payment will be obtained from New Co. cash, property sale proceeds expected to be available to New Co., or, to the extent needed, will be provided by the private sector's purchase from New Co., of Series A, First Secured Notes of New Co., due and payable in 3 or less annual installments beginning in 1978, with interest as fixed by New Co. and the purchaser or purchasers, secured by a first lien on the valuation case proceeds and on the assets of New Co., including the common stock of the Pennsylvania Company, which lien will nevertheless authorize liquidation of the assets other than said stock. Payments on and the lien of the Series A Notes will have priority over payments on the General Mortgage Bonds (estimated to be \$600 million) and other indebtedness of New Co. but the Series A Notes will be subject to the priority of the payments on and lien of the TC's due 1986.

2. On plan consummation date, New Co. will issue Series B, First Secured Notes to the United States in the amount of the then outstanding loans made by the United States Railway Association (herein after referred to as "USRA") to ConRail pursuant to Section 211(h) of the Regional Rail Reorganization Act of 1973, as amended (hereinafter referred to as "the RRRRA") for the payment of

obligations of the Trustees of the estate of the Penn Central Transportation Company (hereinafter referred to as the Trustees), plus accrued interest thereon. As additional such loans are made, New Co. will issue additional Series B Notes to the United States. Subject to the present \$350 million statutory limitation or higher statutory limitation if any that may at any time be imposed on 211(h) loans by USRA to ConRail, USRA will make a sufficient amount of 211(h) loans to ConRail to enable it to make all payments hereinafter described arising under 211(h). The plan of reorganization to be submitted by the Trustees to the reorganization court, a draft copy of which has been delivered to the representatives of the United States, (hereinafter referred to as "the plan") will provide that, to the extent such loans are made:

(1) for payments by ConRail pursuant to the Agency Agreement in effect from time to time between the Trustees and ConRail with respect to obligations described in Section 211(h)(1)(A)(i)-(v); or

(2) for payments by ConRail to which the Trustees (or New Co. after plan consummation date) have agreed or as may be approved by the reorganization court or other court of competent jurisdiction as a proper obligation of the estate:

(a) pursuant to Sections 504(e) and 504(g) of the RRRRA (except that with respect to vacation pay obligations under Section 504(e) of the RRRRA the provisions of paragraph 3 of this Outline of Settlement shall be deemed an agreement by the Trustees); or

(b) pursuant to Sections 211(h)(1)(A)(vii), (viii), (ix) and (x) of the RRRRA; or
 (3) for payments by ConRail with respect to obligations of the estate under Section 303(b)(6) of the RRRRA, the amount of which has been agreed to by the Trustees (or New Co. after plan consummation date), or has been determined by a court of competent jurisdiction; such loans are made in respect of valid claims of administration of the PCTC estate.

3. The Trustees will compromise, and New Co., will meet with Series B Notes claims for vacation pay paid ConRail with loans made by USRA pursuant to Section 211(h) of the RRRRA (hereinafter referred to as "211(h) loans") in respect of former PCTC employees in the amount of \$60 million. The Trustees, ConRail and USRA will seek to defer the appeal pending before the United States Court of Appeals for the Third Circuit insofar as it pertains to liability for vacation pay, and to dismiss the appeal when a plan including provisions disposing of the vacation pay issue as aforesaid is consummated.

4. The Series B Notes will be general obligations of New Co. and will be secured by the Valuation Case proceeds and by a first lien on all the assets of New Co., including the common stock of the Pennsylvania Company, which lien nevertheless will authorize liquidation of the assets other than said stock. The lien of the Series B Notes will be subject only to that of the Series A Notes and the outstanding TC's due in 1986. New Co. shall continue to be liable for principal and interest on the Series B Notes regardless of any decision which may be reached in the Special Court or other proceedings on the issue of whether the obligations paid by the proceeds of 211(h) loans constitute compensable unconstitutional erosion.

5. The Series B Notes will carry a rate of interest, fixed at the date of issue, equal to the Treasury's cost of borrowing rate on 10-year direct obligations issued within 30 days prior thereto if any were so issued, or, if not, at the yield rate to the purchaser of 10-year U.S. Government direct obligations then selling in the public trading markets, plus $\frac{1}{8}$ of 1%. Interest on the Series B Notes will compound semi-annually.

6. All the Series B Notes with accrued interest will mature and be redeemed in cash at the time the certificates of value mature or prior thereto when and if the certificates of value are redeemed prior to their maturity, or at the time final judgment in a Tucker Act action is satisfied, whichever occurs first, but may be prepaid at the option of New Co. at their principal amount plus accrued interest. If such Tucker Act judgment is insufficient to redeem all the Series B Notes, the Tucker Act judgment shall be applied to payment, first on principal and second on interest, on the Series B Notes to the fullest extent possible, and any Series B Notes not redeemed after the entire amount of the Tucker Act judgment is applied as required by this sentence will remain outstanding and will mature and be redeemed as provided in the preceding sentence as though no final judgment in a Tucker Act suit had been satisfied. If the General Mortgage Bonds are retired in full before the Series B Notes mature, then New Co.'s asset liquidation program will be continued and any future proceeds from the program will be used to make

payments on the Series B Notes, which payments shall be applied first on principal and second on interest, unless there is then a default in payment in respect to the TC's due 1986, in which case future proceeds will first be used to retire the TC's.

7. Within 90 days after New Co. shall have received a request from USRA, New Co. will make whatever payment on the principal of the Series B notes as shall be required to reduce the principal balance thereof then outstanding in respect of 211(h) loans to such amount (but not to less than \$243 million) as shall be necessary to enable USRA to make 211(h) loans (within the \$350 million statutory limitation, or higher statutory limitation, if any, that may at any time be imposed) to ConRail for 211(h) payments on behalf of the PCTC or New Co., as the case may be, or on behalf of other railroads in reorganization, provided that the principal amount to be outstanding in respect of such other railroads in reorganization will not be in excess of \$107 million. In the event that payment of the principal of the Series B notes is necessary to permit USRA to make 211(h) loans to ConRail in respect of obligations of PCTC and the unpaid principal balance of Series B notes then outstanding in respect of 211(h) loans is \$243 million then, notwithstanding the preceding sentence, New Co. at its option:

(1) will make whatever payment on the principal of the Series B notes as shall be required to reduce the unpaid balance thereof then outstanding in respect of 211(h) loans to such amount as shall be necessary to enable USRA to make 211(h) loans to ConRail for 211(h) payments on behalf of PCTC and at the same time USRA shall make a commitment to make a 211(h) loan to ConRail in respect of such obligations of PCTC;

(2) will pay directly to ConRail as agent an amount in cash sufficient to pay such obligations of PCTC; or

(3) will itself promptly discharge the PCTC obligations.

The aggregate amount of all payments on Series B notes required from New Co. prior to maturity shall not, in any event, be less than the following cumulative amounts on the following dates:

| | <i>(Millions)</i> |
|--------------------|-------------------|
| Dec. 31, 1978..... | \$20 |
| Dec. 31, 1979..... | 40 |
| Dec. 31, 1980..... | 60 |
| Dec. 31, 1981..... | 80 |

The obligation to make said payments shall have priority over all other obligations to make payments then due on any other indebtedness of New Co., except any payment then due on any Series A notes then outstanding and any interest due on the TC's of 1986. New Co. will recognize that the Government's right to receipt of such payments on the Series B notes is an absolute obligation of New Co. and not subject to availability of cash. Therefore, should New Co.'s asset liquidation program fail to generate the cash necessary to make any one or more of said payments, New Co. will take any and all steps as may be required to obtain the required cash.

Pending the consummation of a Plan, the Trustees will reimburse USRA for 211(h) loans by such amount (but not to reduce the principal balance thereof then outstanding in respect of 211(h) loans to less than \$243 million) as shall be necessary to enable USRA to make 211(h) loans (within the 350 million statutory limitation, or higher statutory limitation, if any, that may at any time be imposed) to ConRail for 211(h) payments on behalf of the PCTC or on behalf of other railroads in reorganization, provided that the principal amount to be outstanding in respect of such other railroads in reorganization will not be in excess of \$107 million.

In addition to Series A, First Secured Notes referred to in paragraph 1, New Co. may obtain cash needed for making principal payments on Series B Notes referred to above issued in respect of 211(h) loans, by issue and selling in the private sector Series A, First Secured Notes maturing within 24 months from date of issue, but not later than December 31, 1982, with interest to be payable at and before maturity at such times and rates as may be agreed upon by the New Co. and the purchasers of such Series A First Secured Notes. These Series A Notes shall be secured and be entitled to the same priority and rank as provided for the Series A Notes described in paragraph 1.

8. Current interest on the TC's due in 1986 will continue to be paid as due and the principal as well as any accrued interest will be paid at or before maturity, and New Co. will also pay the Government its guarantee fee when due.

9. The net proceeds of the liquidation of New Co.'s assets will be applied solely to payments on its indebtedness and expenses of operations and maintenance (including improvements needed to maintain the competitive position of operating properties pending disposition), and will not be diverted to other uses such as new capital acquisitions or major improvements.

10. New Co. will not assert as a set-off against any of its payments obligations to the United States in this Outline of Settlement its claim against the United States in respect of the reorganization, including erosion claims, but may pursue them without prejudice. Any settlement of state and local tax claims will, for purposes of any erosion claim, be deemed a settlement *pro rata* for the period from the date of filing of the petition for reorganization under Section 77 (June 21, 1970). No part of this settlement shall be deemed a waiver by the United States of any available defense to the erosion claim of the Trustees or their successors in interest.

11. The Trustees (or New Co. after plan consummation date) shall be free to claim that the obligations paid by the proceeds of the 211(h) loans constitute compensable unconstitutional erosion. Likewise, the estate shall be free to claim that the interest paid on any such 211(h) loans is also such erosion, but only (1) for interest paid or payable up to the date of plan consummation, or (2) if the principal of such 211(h) loans constitutes compensable unconstitutional erosion, to the extent that it is necessary to take into account such interest paid on any such 211(h) loans to insure that the estate receives, pursuant to Section 306 of the RRRRA, such compensation as shall be constitutionally required for any erosion. The Trustees (or New Co. after plan consummation date) will not assert, however, if the principal of the 211(h) loan does not constitute compensable unconstitutional erosion, that any part of the interest paid on the Series B notes is an item of such erosion.

12. The Trustees will, to the maximum extent possible, settle, using now escrowed funds, proceeds of future sale of assets, or borrowed funds, outstanding State and local tax claims (estimated at present to be approximately \$400 million). The plan will provide that liquidated personal injury prebankruptcy claims (approximately \$12 million liquidated, plus an estimated \$10 million for liquidation of remaining claims) and small claimants against the PCTC having claims aggregating \$1,000 or less shall be paid in cash on plan consummation date or, in the case of personal injury pre-bankruptcy claims exceeding \$5,000, the excess over \$5,000 shall be paid in installments of 15 per centum per quarter year thereafter. The Trustees, ConRail and USRA will seek to defer the appeal pending in the United States Court of Appeals for the Third Circuit insofar as it pertains to the escrow accounts, and to dismiss the appeal when a plan including the provisions of this paragraph is consummated.

13. To the extent other claims of the United States are, by agreement or adjudication, given priority status as administration claims, Series B notes will be issued in the agreed or adjudicated amount. The Trustee will attempt to settle all such other claims. Any such other claims not settled will be treated in the plan in accordance with the priority to which they are entitled. This agreement shall not be interpreted as in any way governing or restricting the rights of the Secretary of Treasury under §77(e) of the Bankruptcy Act and E.O. 7263 with respect to federal tax and customs claims against the PCTC, nor shall it operate to preclude the United States from asserting any priorities to which it may be entitled, nor from contesting the propriety of the treatment accorded to such claims by the plan.

14. The plan will provide for the waiver of any and all defenses to any payment to the United States pursuant to the foregoing payment obligations which are of the type described in *In re Penn Central Transportation Company*, 494 F.2d 270 (3rd Cir. 1974), commonly referred to as "Columbus Option" defenses.

15. The \$50 million sum which was segregated in 1975 and 1976 for the payment of the TC's due 1976 shall be available for use in payment of compromised State and local tax claims. Upon substantial completion of such tax compromise program, said \$50 million sum shall again be segregated from available unencumbered or other free funds so as to be available for use in retiring the TC's due 1976. In any event, if the TC's due in 1976 are not previously paid pursuant to the plan, the amount thus again segregated shall be paid to the United States on July 1, 1978, and to the extent that any amount then remains due on the TC's due 1976, available unencumbered or other free funds shall be paid on such TC's as they become available until all amounts due on them have been paid. Should payment on the TC's be made pursuant to this paragraph, the full amount of principal, interest and guarantee fee shall be paid, and no reduction shall be made or pursuant to any alleged defense of the type described in paragraph 14 hereof.

16. So long as any Series A or B Notes or the TCs due 1986 are outstanding, New Co. will not permit the Pennsylvania Company to pay cash dividends on its common stock in the period from and after the plan consummation date in an aggregate amount exceeding 50% of the consolidated net income during said period (computed in accordance with generally accepted accounting principles) of the Pennsylvania Company and its subsidiaries, but there shall be excluded from the computation of said aggregate amount of dividends any such dividends of the Pennsylvania Company used by New Co. to make payments of interest on or principal of the TC's due in 1986, or to make any payment on the Series B, First Secured Notes as provided in this agreement.

17. Until the TC's due in 1986 and the Series B Notes have been paid, the United States shall be supplied with New Co.'s annual certified financial statements prepared by independent certified public accountants of recognized standing selected by New Co. and acceptable to the United States as soon as such annual certified financial statements become available to the management of New Co., and shall have full access to such accountants and their work papers, and may, at its own expense, itself conduct an audit of New Co. at any time. Each such set of annual certified financial statements delivered to the United States shall be accompanied by a letter from the independent certified public accountants who prepared the certified financial statements which letter shall state that in making their examination of New Co.'s books of account and in preparing their certified financial statements of New Co. the accountants did not obtain any knowledge of any failure by New Co. to comply with any provision of the Outline of Settlement, or, if such accountants shall have obtained knowledge of any failure to comply with any provision of the Outline of Settlement, such knowledge shall be set forth in such letter. The United States shall also be supplied with all other reports and statements supplied to creditors and stockholders of New Co., including, but not limited to, quarterly reports and proxy statements. The United States shall also be supplied with timely quarterly reports on the asset liquidation program of New Co. in sufficient detail to monitor the historical and projected asset liquidation program. The United States may also, at any reasonable time and from time to time, and at its own expense, examine and make copies of the records and books of account of New Co. and discuss its affairs with its officers and directors, with the understanding that any information thus obtained shall not be publicly disclosed.

18. The United States reserves the right to withdraw its support for the plan if by reason of changes made in the provisions thereof it determines that its interest has been materially and adversely affected thereby, in which event this settlement, except with respect to the obligations of the Trustees under paragraphs 7 and 15 hereof, shall be null and void and the parties shall at that time be free to assert any and all positions which may have been available to them prior to this settlement. In particular, the United States reserves the right to withdraw its support of the plan if the plan finally approved by the reorganization court treats personal injury prebankruptcy claims and small claims under \$1,000 in a manner substantially less favorable to such claimants than the manner of treatment agreed to in the Outline of Settlement, or if the plan has not been consummated by December 31, 1978. The United States also reserves the right to withdraw its support for the plan if the plan as submitted to the reorganization court or as finally approved by the reorganization court treats other creditors of the PCTC estate in a manner substantially different from that contained in the plan as delivered to representatives of the United States on December 17, 1976, and if the United States determines that its interests have been materially and adversely affected thereby.

ACCRUED VACATION LEAVE

Mr. McFALL. Last year we discussed your court case involving accrued vacation pay. Has this case been decided?

Mr. COLE. Of the major bankrupt railroads against which Conrail and USRA had disputes on the issue of vacation pay liability, settlements have been negotiated with the Penn Central, the Lehigh Valley and the Reading. Negotiations are in progress with the Erie Lackawanna. The appeals of the rulings of the reorganization courts have been deferred while the settlements have been negotiated.

D&H AND M-K-T LOANS

Mr. McFALL. You refer to loans to the Delaware & Hudson and the Missouri-Kansas-Texas (Katy) railroads. How much have you loaned to these railroads and what is the status of these loans?

Mr. COLE. The Missouri-Kansas-Texas (MKT) Railroad was loaned \$19 million, of which \$4 million has already been repaid under the tax allocation payment. The railroad is continuing to perform better than forecast.

The United States Railway Association originally approved a loan to the Delaware & Hudson of \$28 million in March 1976. In December 1977, this was increased to \$30 million, all of which was loaned by January 1978.

In February 1978, D&H obtained a loan from the Federal Financing Bank, guaranteed by the Federal Railroad Administration, to finance certain locomotives for which the United States Railway Association had paid in the spring of 1976. This amount, \$7.5 million, was repaid to the Association, who in turn repaid its loan to the Federal Financing Bank. USRA then entered into an agreement to re-borrow these funds. As of the end of February 1978, the Association had loaned \$1,750,000 of this, making a total indebtedness presently outstanding by the D&H of \$24.2 million. USRA will loan an additional \$5.8 million during the fiscal year ending September 30, 1978.

Mr. McFALL. Do you still have authority to make loans under Section 211(a)? If so, how much?

The information follows:]

The Association still has the statutory authority granted by Section 211(a): to make loans to the Corporation [Conrail], the National Railroad Passenger Corporation, and other railroads (including a railroad in reorganization which has been found to be reorganizable under section 77 of the Bankruptcy Act pursuant to section 207(b) of this title) in the region, for purposes of achieving the goals of this Act; to a State or local or regional transportation authority pursuant to section 403 of this Act; and to provide assistance in the form of loans to any railroad which (A) connects with a railroad in reorganization, and (B) is in need of financial assistance to avoid reorganization proceedings under section 77 of the Bankruptcy Act (11 U.S.C. 205).

However, Section 210(b) restricts the aggregate principal amount of obligations which the Association may issue to carry out the purposes of the Act:

The aggregate principal amount (exclusive of interest or additions to principal on account of accrual of interest) of obligations issued by the Association under this section which may be outstanding at any one time shall not exceed \$395,000,000. No obligations or proceeds thereof shall be issued or made available after the date of enactment of the Railroad Revitalization and Regulatory Reform Act of 1976 except—

(1) to meet existing or potential commitments for loans under section 211 of this title made or applied for prior to January 1, 1976; and

(2) for the purpose of providing loans pursuant to subsections (g) and (h) of section 211 of this title.

The Association has, in effect, committed itself to issuing \$395 million in obligations to finance the following loans:

| | <i>(Millions)</i> |
|----------------------------|-------------------|
| Conrail..... | \$350 |
| Delaware & Hudson..... | 30 |
| Missouri-Kansas-Texas..... | 15 |

These loans have been granted pursuant to both Sections 211(a) and 211(h). (Section 211(h) provides for loans to meet certain outstanding pre-conveyance obligations of the railroads in reorganization.) Thus, at this time, the Association is precluded from making further loans under Section 211(a).

It should be noted that on October 1, 1978, the M-K-T is expected to pay back \$2 million of its loan to the Association. This would reduce the amount of the Association's outstanding obligations and consequently would permit the Association to loan up to \$2 million under Section 211(a).

USRA STAFFING

Mr. McFALL. On page 16 you indicate that, as of December 31, 1977, you had a permanent staff of 203 employees. Last year Mr. Lewis testified that your current staff at that time was 146 and would decline to 132 by the end of the year. Most agencies do not alter the budget approved by the Congress without either a reprogramming or subsequent Congressional action. Is it your position that the Association can hire as many employees as current funds permit you to pay?

Mr. DEAN. There is no question but that we encountered a significant shift in the need for both personnel and contract money, and with it, funds, and that this happened not long after consideration was given to our 1978 fiscal year appropriations. This came out of two parallel developments.

One was demand arising from the litigation side, particularly the valuation of assets on which much of the key court decisions will hinge. The largest single chunk of additional money that we have now requested, both in the supplemental and for the 1979 fiscal year is in this asset valuation area, and this money is crucial to the litigation function.

We had to strengthen the monitoring capability which we candidly concede was, after the planning phase, cut down excessively. And as Conrail's prospects began to look less promising, it became obvious we had to have more capacity to understand and to penetrate how Conrail was doing.

Under our budget procedures, as soon as we decided to go for a supplemental and formally submitted it before the President's budget came down, we are required to submit directly to this Committee the new budget request and the supplemental request.

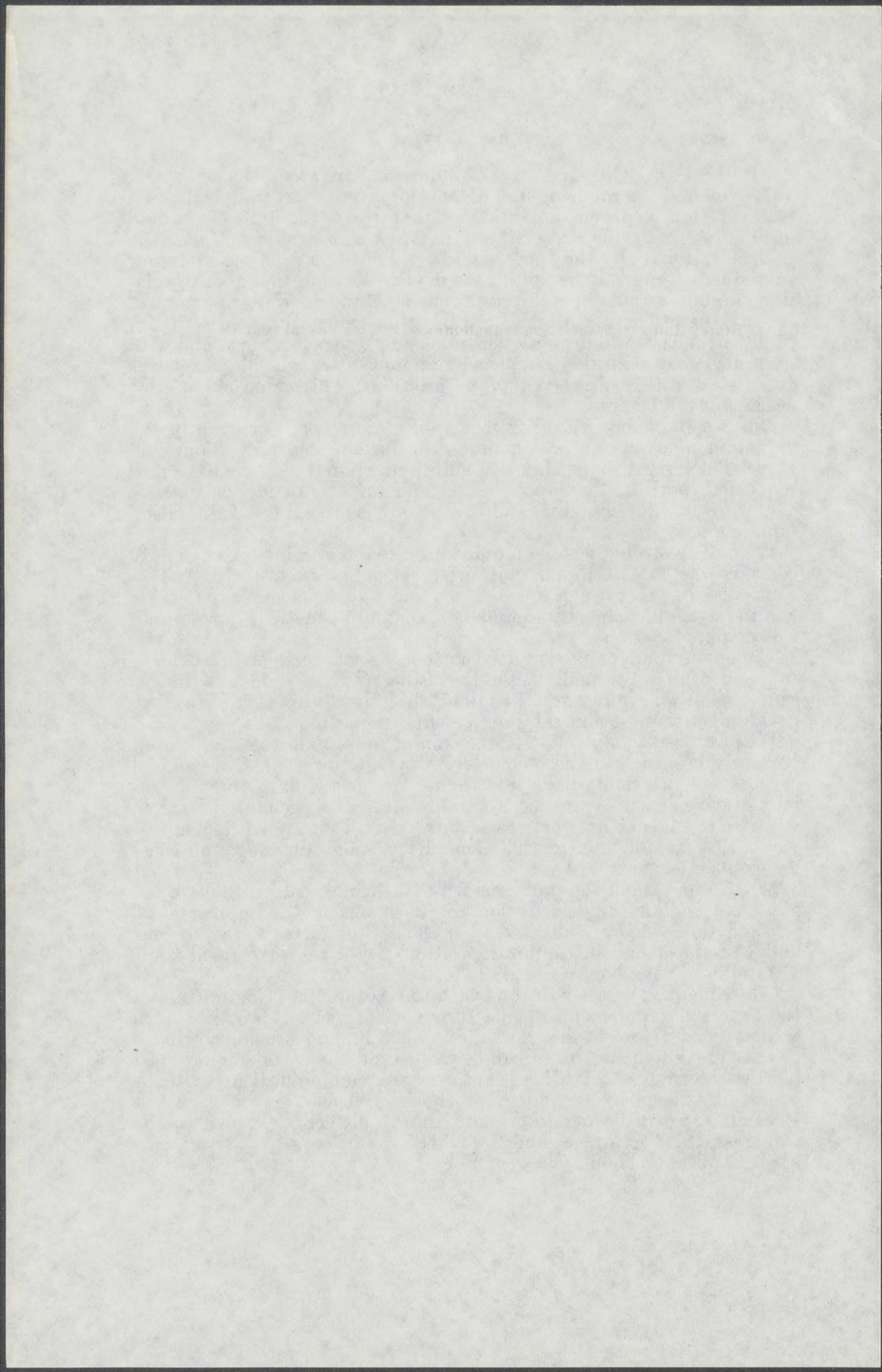
We also tried to stay close to the staff of the Committee and keep it currently informed of these changes. As you know, as a Government corporation, we don't have line items. We get a lump sum for administrative expenses and the Committee has always counted on us to adjust our expenditures between contracts and internal personal services. But we did inform the Committee some time ago of these developments.

Mr. COLE. One of the problems with the timing here is that we did not have adequate authorization to cover this in the supplemental referred to, I believe, in November. The Committee acted on our budget request and in the appropriations for fiscal year 1978; some \$10 million. Yet, there was still no authorization.

Consequently, we were dealing with the Authorizing Committees at the time the supplemental came through last year. It was not until the very end of the session that the full \$23 million was authorized.

This prevented us from dealing with a supplemental request last fall. At the time, as Mr. Dean said, we were communicating with the staff and as soon as we had the authorizing legislation in place last December, we made our interest in the supplemental known to the Congress, this Committee and the OMB.

Mr. McFALL. Thank you very much.



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