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MILWAUKEE RAILROAD BANKRUPTCY

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HEARING

BEFORE THE

SUBCOMMITTEE ON TRANSPORTATION AND COMMERCE

OF THE

COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE

HOUSE OF REPRESENTATIVES

NINETY-FIFTH CONGRESS

SECOND SESSION

ON

THE MATTER OF THE CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD'S PETITION FOR REORGANIZATION UNDER SECTION 77 OF THE FEDERAL BANKRUPTCY ACT

JANUARY 5, 1978

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MILWAUKEE RAILROAD BANKRUPTCY

THURSDAY, JANUARY 5, 1978

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON TRANSPORTATION AND COMMERCE,
COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE,
Washington, D.C.

The subcommittee met at 10 a.m., pursuant to notice, in room 2322, Rayburn House Office Building, Hon. Fred B. Rooney, chairman, presiding.

Mr. ROONEY. We are here today to consider the matter of the Chicago, Milwaukee, St. Paul & Pacific Railroad's petition for reorganization under section 77 of the Federal Bankruptcy Act. It is always distressing to discuss the bankruptcy of any organization. The causes and solutions may be viewed with certain cold objectivity, but there also is the human element of the adverse effects that it inevitably has on many parties. I hope that in our deliberations we do not lose sight of this human suffering.

Unfortunately, the Milwaukee Railroad has a certain familiarity with bankruptcy. The Milwaukee Railroad was chartered in 1863 as the Milwaukee & St. Paul Railway, and ironically commenced operations by purchasing the bankrupt Milwaukee & Prairie de Chien Railway. Shortly after the turn of the century, it was decided to expand this Wisconsin Railroad to the west coast. Subsequently, it developed that the anticipated traffic failed to materialize, precipitating the filing for bankruptcy on March 17, 1925. The railroad was purchased in 1926 but the Great Depression adversely affected this railroad, as it did many other business organizations, and the railroad again went bankrupt in 1935. It remained in bankruptcy until 1947, when as a result of the prosperity created by World War II, it was able to reorganize.

The primary purpose of these hearings is to determine the causes for the present bankruptcy of the railroad and elicit proposals for solutions to this dilemma with a view of hopefully preventing future instances of this nature. In this regard, we want to determine the condition of the other midwestern railroads, and the effects the bankruptcy will have on these railroads and on midwestern and other industries. In addition, we will want to ascertain whether additional bankruptcies cascading from this bankruptcy are anticipated. Everyone recognizes that one of the paramount concerns is the continuation of essential services. At the same time, admittedly it is not always an easy task to ascertain what constitutes essential services.

I am aware that the trustees for the reorganization and to carry out the ordinary operations of the railroad have not been appointed by the court. Such appointment is not expected until later on

this month. In no way do I want these hearings to interfere with the orderly procedures of the court. I believe that the segregation of the responsibilities of Congress and the court is such that we can proceed prior to the appointment of trustees, just as was done in the case of the Rock Island Railroad bankruptcy 3 years ago. As I mentioned, we must consider all viable proposed solutions to the problems. In this regard, we will want to examine the feasibility of accelerating the redeemable preference shares and loan guarantee programs provided in title V of the Railroad Revitalization and Regulatory Reform Act of 1976. Similarly, we would want to examine whether proposals by the Secretary for mergers, consolidations, reorganizations and other unification or coordination projects for rail services, provided in section 401 of the act, would be a preferable solution. Although these appear to be two distinct solutions, consideration must be given to a combination of these programs and to any other new programs which I understand will be suggested today.

I am also aware that the Federal Railroad Administration has scheduled public hearings on this matter later this month. I do not believe that these hearings and the FRA hearings will be duplicative. The FRA hearings are an integral part of the process established by section 401 of the 4R Act and as such are clearly distinctive from the responsibility of this subcommittee.

Before calling the first witness, I would like to request that, as is customary for this subcommittee, testimony be limited to 15 minutes. Written statements will, of course, be included in the record in their entirety but as I am sure you understand oral testimony must be limited to summations. In this regard I would like to comment that I have already read a summary of Mr. Ingram's testimony in an article by Steve Aug in last night's Evening Star. Mr. Aug has written many fine articles about railroad matters and this subcommittee is grateful for his interest. I would like to say that I have always enjoyed the articles and believe him to be the leader in this field in this country.

Our first witness will be Hon. John M. Sullivan, Administrator for the Federal Railroad Administration.

Mr. Sullivan, we welcome you once again to this committee.

STATEMENT OF HON. JOHN M. SULLIVAN, ADMINISTRATOR, FEDERAL RAILROAD ADMINISTRATION, DEPARTMENT OF TRANSPORTATION, ACCOMPANIED BY ROBERT E. GALLAMORE, DEPUTY ADMINISTRATOR; CHARLES SWINBURN, ASSOCIATE ADMINISTRATOR FOR FEDERAL ASSISTANCE; AND RAY JAMES, CHIEF COUNSEL

Mr. SULLIVAN. Mr. Chairman, I have with me this morning Mr. Robert Gallamore, my Deputy; Mr. Charles Swinburn, my Associate Administrator for Federal Assistance; and Mr. Ray James, my Chief Counsel.

I appreciate your listing me first among your witnesses in such a serious matter. I would like to say that, to tie into your opening remarks, that I would like to talk about the action of the Department as a result of the Milwaukee and Midwest railroad situation. Immediately after learning on December 19 of the Milwaukee's intention to declare bankruptcy, Secretary Adams instructed me to organize a meeting to discuss the problems of the Midwest rail-

roads. He took this action under section 401 of the 4R Act. A notice was published in the Federal Register yesterday, and a meeting will be held in Chicago on January 18 and 19.

Mr. Chairman, it is the Secretary's opinion and mine that a solution for the problems of the midwestern railroads must come from the private sector. The best thing the Federal Government can do to help the industry find the answers, and where possible, help implement them, is a meeting such as the meeting called by the Secretary and the Federal Railroad Administration in Chicago. This will give us a chance, and everyone in the industry a chance, to discuss the whole problem instead of pieces of it, or as it relates to just one railroad or a few railroads.

When talking is done, we hope they will begin working to make the system healthy and viable over the long term. I might say it probably is an unusual opportunity for the private sector to step forward and see what they can do to manage their industry. The alternative to work beginning immediately on solutions from the industry itself is continuing deterioration of the system, the failure of more railroads, and finally a solution imposed by the Federal Government as was done following the collapse of the northeastern railroads.

I know of no one who thinks that that would be good for the railroad industry or for the Nation. We think that the failure of the Milwaukee can be the catalyst for changes in attitudes and actions that will lead to the rebuilding of the midwestern railroads, and we hope the Chicago meeting will be the start of the process.

Mr. Chairman, I have a prepared statement that gets into considerable financial detail which, in effect, shows you what we have, and what we have compiled from published statistics on the Milwaukee Railroad, and I think to save time I would like to submit that for the record.

Mr. ROONEY. Without objection, it will become part of the record.

Mr. SULLIVAN. We will be happy to answer any questions.

[Testimony resumes on p. 12.]

[Mr. Sullivan's prepared statement follows:]

TESTIMONY OF FEDERAL RAILROAD ADMINISTRATOR JOHN M. SULLIVAN BEFORE THE SUBCOMMITTEE ON TRANSPORTATION AND COMMERCE OF THE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE, U.S. HOUSE OF REPRESENTATIVES, JANUARY 5, 1978

Mr. Chairman, members of the Committee, I appreciate the opportunity to discuss the bankruptcy of the Chicago, Milwaukee, St. Paul and Pacific Railroad Company. Appearing with me today is Robert E. Gallamore, my Deputy, who will play a major role in our review of the problems of the Midwest rail network.

In describing the conditions surrounding the bankruptcy of the Milwaukee, I will discuss the extent of its physical plant, its recent traffic history, and its financial performance.

Extent of the Milwaukee's Physical Plant

The Milwaukee Railroad operates over 10,000 route miles in 16 states from Kentucky across the northern tier to the Pacific Northwest, with over 7,700 miles concentrated in the Granger Region of Illinois, Iowa, Minnesota, North Dakota, South Dakota, Montana, and Wisconsin. The region is generally characterized by more rail capacity than is needed to move the existing traffic. An example of this problem at its worst is the small town of Albert Lea, Minnesota, which is served by four separate railroad companies operating six rail lines through the town. In a recent filing with the Interstate Commerce Commission, pursuant to section 802 of the 4R Act, the Milwaukee Railroad identified 3,708 miles of line which were either pending or prospective candidates for abandonment. This represents approximately 37 percent of the Milwaukee's system. The excess capacity problem is not limited to light density lines. With one exception, every Corridor of Consolidation Potential (CCP) identified in the Department's report under section 503 of the 4R Act lies in or is connected to this region. These CCPs include five of the mainlines between Omaha and Chicago and the eight mainlines between Chicago and Kansas City.

Recent Traffic History

The principal commodities handled by the Milwaukee are farm products, food or kindred products, lumber or wood products, pulp and paper, and transportation equipment. In 1976 these commodities represented 54 percent of the railroad's total carloads, 48 percent of revenue tons, and 60 percent of railway revenues. During the period 1966-1976 the number of carloads of these principal commodities carried by this railroad decreased 25 percent while the number of tons decreased 7 percent. Farm products, the most important commodity to the Milwaukee, decreased 37 percent on a tonnage basis during that period, from 8.1 million tons carried in 1966 to 5.9 million tons carried in 1976. Even during the 1973 Russian grain movement, the Milwaukee never achieved the level of 8 million tons of grain that it handled in 1966. Caught between a stagnant traffic base and escalating costs, the Milwaukee has survived by deferring maintenance and injecting funds from subsidiaries. Last month it reached the point where its management decided it should no longer operate in that manner.

Financial Performance

An examination of the railroad's financial performance in recent years confirms management's judgment. Our analysis examined the financial aspects of the railroad in terms of revenues, profitability, and expenses.

Revenues

For the six year period covering 1970 through 1975, the railroad was able to increase its revenues by 37 percent from $277.5 million in 1970 to $381.1 million in 1975. This increase tends to mask the reality of the Milwaukee's traffic picture, which is at best stagnant, as indicated below:

TABLE I

TRAFFIC INDICATORS 1/
(In millions of tons and ton-miles)

Year	Total Tons	Revenue Ton-miles
1970	45.2	17.7
1971	41.9	16.6
1972	43.2	17.9
1973	46.8	19.7
1974	45.8	18.9
1975	42.6	17.4
6 yr. avg.	44.3	18.0

SOURCE: ICC R-1 Reports

1/ Includes non-revenue freight of nominal amounts.

What these figures indicate is that the company was paid substantially more in current dollars to provide approximately the same amount of service in 1976 as it did in 1970. But the increased revenues reflect almost entirely the effects of inflation through ex parte rate increases.

Profitability

Table II presents the Milwaukee's profit and loss statements in a general accounting format for the years 1970-1975 using financial information from the Milwaukee's R-1 reports filed with the ICC. The Table indicates that the railroad experienced cumulative pretax losses over the six year period totaling $90.7 million.

On a consolidated basis, that is, after adding other income (net) of $61.2 million from sources outside of the railroad's operations, the company did show small profits in two of the last six years. The overall effect of using other income to subsidize rail operations over the period was to reduce the $90.7 million pretax loss to $32.1 million.

Expenses

The declining profitability of the Milwaukee in the face of a significant current dollar increase in revenues points to difficulties in expense control

TABLE II

PROFIT & LOSS STATEMENT

CHICAGO, MILWAUKEE, ST. PAUL & PACIFIC RAILROAD COMPANY
(Industrial Basis, in Mil's $)

	1970	1971	1972	1973	1974	1975	SIX YEAR Totals	% Inc/Dec.
Revenues:								
Freight	248.7	273.9	292.2	329.8	362.9	350.1		
All Other	28.8	21.9	20.6	25.6	31.8	31.0		
Total Revenues	277.5	295.8	312.8	355.4	394.7	381.1	2,017.3	37%
Expenses:								
Maint. of Way	45.3	49.1	57.8	58.7	60.8	59.0		
Maint. of Equip.	45.3	49.7	51.2	49.6	53.8	54.8		
Taxes	24.9	24.6	26.4	30.6	38.5	37.4		
Transportation	121.3	118.6	128.8	147.4	167.2	171.5		
Traffic	7.6	8.1	8.6	9.8	10.3	10.2		
Misc. & General	17.9	17.5	19.0	19.8	21.4	23.0		
Equip. Rents	23.1	25.6	27.8	37.5	42.9	55.0		
Total Operating Expenses	285.4	293.2	319.6	353.4	394.9	410.9	2,057.4	44%
Net Operating Inc.	(7.9)	2.6	(6.8)	2.0	(0.2)	(29.8)		
Less: Fixed Chg's.	10.2	9.5	6.7	7.6	8.5	8.1		
Rail Income-Pretax	(18.1)	(6.9)	(13.5)	(5.6)	(8.7)	(37.9)	(90.7)	(109%)
Add: Other Inc. (Net)	9.9	3.0	4.9	9.0	21.9	12.5	61.2	
Consol. Income-Pretax	(8.2)	(3.9)	(8.6)	3.4	13.2	(25.4)	29.5	
Less: Fed. Inc. Tax	-0-	-0-	-0-	-0-	1.8	4.4	2.6	
Ordinary Inc. (ICC-R-1)	(8.2)	(3.9)	(8.6)	3.4	11.4	(21.0)	26.9	
Add: Deprec. & Ret's.	18.9	18.9	18.7	17.0	16.0	16.8	106.3	
Total Cash Inc. (Rail Only)	0.8	12.0	5.2	11.4	7.3	(21.1)	15.6	

SOURCE: ICC-R-1

Key: ( ) indicates a deficit or a negative number

as a major cause of the company's bankruptcy. In order to highlight what has happened to the Milwaukee's operating expenses, we have reformatted its income statement on a more functional basis, as depicted in Table III.

This Table first sets forth total revenues and then subtracts from them expenses grouped into three basic categories: (1) fixed cash expenses, defined as the noncontrollable expenses of taxes and fixed charges that have to be paid even if the railroad does not operate a single train; (2) variable expenses, which comprise cash expenses related to train operations and maintenance; and (3) the non-cash expenses of depreciation and retirements.

This Table indicates the tremendous escalation in the cost of train operations (i.e., payroll, fuel, and equipment costs), which,when combined with the fixed expenses, has left little cash available for materials and supplies to be used in the maintenance of plant and equipment.

Our analysis indicates that since 1970 alone, the railroad has been able to install on an annual basis only about 50 percent of the ties required to maintain a normalized condition. In fact, in 1975 and 1976 the railroad was able to install only 30 and 40 percent, respectively, of its annual requirements.

TABLE III

PROFIT & LOSS STATEMENT

CHICAGO, MILWAUKEE, ST. PAUL & PACIFIC RAILROAD COMPANY
(Functional Basis, in Mil's.$)

	1970	1971	1972	1973	1974	1975	SIX YEAR %Inc.
Total Revenues:	277.5	295.8	312.8	355.4	394.7	381.1	37%
(1) Fixed Cash Expenses							
State & Local Taxes	24.9	24.6	26.4	30.6	38.5	37.4	50%
Fixed Charges	10.2	9.5	6.7	7.6	8.5	8.1	(21%)
Sub Total	35.1	34.1	33.1	38.2	47.0	45.5	30%
(2) Variable Expenses							
Payroll & Fringes	156.0	168.6	191.7	210.6	227.7	223.8	43%
Fuel Costs	10.6	10.4	11.1	14.2	26.3	27.5	159%
Materials & Supplies	51.9	45.1	43.9	43.5	43.5	51.0	(3%)
Equip.-Rents	23.1	25.6	27.8	37.5	42.9	55.0	138%
Sub Total	241.6	249.7	274.5	305.8	340.4	344.2	42%
(3) Non-cash Expenses	18.9	18.9	18.7	17.0	16.0	16.8	(11%)
Total Oper. Exp. & Fix. Chg's.	295.6	302.7	326.3	361.0	403.4	419.0	38.0%
Rail Income-Pretax	(18.1)	(6.9)	(13.5)	(5.6)	(8.7)	(37.9)	
Avg. No. of Employees	15,745	15,004	14,811	14,396	14,400	13,038	(17.0%)
Avg. Wage per/Employee	$ 9,909	$11,237	$12,946	$14,628	$15,811	$17,164	73.0%

SOURCE: ICC

Key: (indicates negative number or a Deficit)

The deferred maintenance problem on the Milwaukee Railroad is not limited to its branch lines alone. The Milwaukee's mainline routes across the Northern tier to the Pacific Northwest and south from Chicago to Louisville, Kentucky, suffer from considerable deferred maintenance with numerous slow orders that reduce operating speeds to 10 miles per hour. These slow speeds render the company unable to offer adequate, reliable, competitive service to shippers, causing yet further erosion of their traffic base, further reducing already insufficient revenues, and increasing operating expenses.

As the right hand column in Table III indicates, overall payroll costs over the period increased 43 percent (although the number of employees dropped 17 percent and the average wage per employee increased 73 percent); fuel costs increased 159 percent. In contrast, expenditures for maintenance materials and supplies decreased 3 percent, resulting in the inability to maintain plant and equipment, and forcing per diem payments and leasing charges for equipment to rise 138 percent.

The decrease in depreciation and retirements of 11 percent reflects the company's inability to acquire new equipment, a fact corroborated by the already-cited and dramatic 138 percent increase in equipment charges.

Finally, the fixed cash expenses, which have traditionally been the focus of attention in bankruptcy, do not offer much comfort in this instance since, despite the overall increase of 30 percent over the six year period, the fixed charges actually decreased by 21 percent. Thus, all of the increase reflects state and local taxes that would likely have to be paid in case of

a reorganization. This analysis indicates that the basic problem of the Milwaukee is its lack of sufficient traffic to economically utilize its plant. These problems cannot be met by the typical debt type of reorganization.

***

I think you will agree, Mr. Chairman, that the above analysis makes it clear that an inability to borrow--whether from private capital markets or from the Federal Government--was not the cause of the bankruptcy of the Milwaukee. Nor would massive Federal assistance to fix track necessarily insure the Milwaukee a new and sufficient traffic base. Our conclusion is that the long-term remedy of the Milwaukee's problems is not simply the provision of of assistance under Title V of the 4R Act. Indeed, use of Title V without effecting substantial improvements in the overall rail system in the region would offer only temporary relief while delaying the essential process of coming to grips with the basic causes of the marginal railroad problem.

In order to start that essential process, the Secretary has decided to call a public meeting in Chicago on January 18 and 19, 1978, to discuss the problems of the rail system in the Midwest, under the authority of section 5 of the Department of Transportation Act, as amended by section 401 of the 4R Act. We are inviting railroads,labor organizations, state agencies, shipper organizations, and other affected parties to participate.

Mr. Chairman, that concludes my formal remarks. I hope the Committee concurs with the thrust of our analysis and supports the initiative we are taking in Chicago, for your support would be most helpful. I will be happy to answer any questions you or other members of the Committee might have.

Mr. ROONEY. I had the opportunity to read the rough draft of that statement last night. It seems any time anybody from DOT comes before this committee, they give the rhetoric of the past and how the problem was caused and so forth, but no firm solutions.

You state in your testimony that the problem ought to be solved in the private sector. I agree but I question, why did we establish the 4R Act, and particular why do we have title V and section 401 of the act? I believe in the private sector. I believe all industries should rely on the private sector, not Government's involvement, but in this instance a solution that cannot be made overnight, and the railroad needs some Government assistance.

Mr. SULLIVAN. Well, I guess the way to answer that, Mr. Chairman, would be to say that I am from the private sector.

Mr. ROONEY. I know you are. You come from a very profitable private sector.

Mr. SULLIVAN. Well, sir, in my case very small profits but nevertheless they did feed a very large family. The point I would like to make is that we are getting to a point, due to the farsighted legislation that the Congress put together with the 4R Act, of being able to implement the provisions of that act, and hopefully have the private sector step forward in a posture and at a point in time that will be without match really as you go back in history. The 4R Act gets into 504, 901, 902 studies, which will be coming out and available to the public at the end of this month. The hard and extensive work that has gone into that is going to prove to be invaluable in going out and taking the results of the input we get from these public hearings, and putting some concrete solutions together, not in the sense of we, the Federal Government, saying to the private sector "Here is what we figure you should do, because we have been sitting there in Washington and we know; we have read that act over and over and the reasons you should do it are."

Rather, we see that we now have the tools provided by the legislation, and provided by beefing up of my own staff, and I make it clear that I am very proud of the people that I find with me in the Federal Railroad Administration, because I think we will bring to this problem the best brains in the country, with a backlog of research into problems like this, and be able to act as a facilitator, to absorb what is being said, and separate the self-interest where we find it from what is best for providing rail service to the area, and of course ultimately to the Nation itself.

I think in the terms of the private sector, the 401 provisions give an unusual opportunity to even discuss some of the possible solutions that they can entertain. Again it becomes a provision of the 4R Act that is going to be tested for the first time. I think the worst thing we could possibly do would be to go out there with a mind set that would say that the Federal Government now has to dig down ever deeper, to suddenly throw money at a problem before we really know what the proper solutions are and what the proper process is, to allow the private sector to put their house in order, and in effect go out and make money, and provide services.

Mr. ROONEY. I have heard considerable criticism that the FRA is not implementing the title V financial program in an expeditious

manner. I wonder whether or not you agree with this criticism, and what can be done to expedite the commitment of funds.

Mr. SULLIVAN. Well, sir, I will say this: I have heard the criticism. I think I understand the criticism. I don't agree with the criticism. Certainly during my briefing period the final regulations weren't even in place to put out moneys under the 4R Act. I think our first year appropriation was $70 million and we have quickly got out $62 million of that. In the current fiscal year we have put out additional moneys, and there are additional applications pending.

We are aggressively working to get these moneys out in a fashion that would comply with the law in every respect and still keep in mind that the desirable thing is to improve service and put it on a solid basis in the private sector.

Mr. ROONEY. Mr. Sullivan, do you have any preliminary timetable as to how long you expect your section 401 program for these midwestern railroads will take?

Mr. SULLIVAN. Our discussions with the Secretary have been very much in the formative stage, and we aren't in a position to prejudge or even anticipate all of the comments that will be forthcoming in the hearings in Chicago. We guess that what we are talking about is not going to be a rapid overnight solution. We think that the attention regionally and nationally will be there, so that we can lead the way and provide some real momentum towards a processing solution that may take several years. These are answers that we will certainly have more definite feelings about after the Chicago hearings.

Mr. ROONEY. I recognize the gentleman from Illinois who has been talking to the chairman about this matter ever since it was brought to public attention. I would like to say that he has made a very substantial contribution to this subcommittee. I now recognize Mr. Russo.

Mr. RUSSO. Thank you, Mr. Chairman.

Mr. Sullivan, I have several questions that deal with section 511, which is part of an amendment that I had introduced when the act was adopted at the last session of Congress. I was wondering what is your feeling in the FRA, in support of the provisions of section 511. Do you have any problem in dealing with that particular provision?

Mr. SULLIVAN. No, sir, we don't. We are very supportive of the legislation, in fact have asked ourselves internally why the initial preferences went toward section 505 assistance, and what remedy or what inducement could we offer, say, to encourage more applications and more implementation of section 511 assistance. I think I would ask Mr. Swinburn, who is our Associate Administrator for Federal Assistance, to get into some detail on that for you, sir.

Mr. SWINBURN. Mr. Congressman, I believe that your primary interest in asking the question was directed to the amendments that you proposed last fall, which were adopted into section 511. I do not believe that we have any problems interpreting the amendments and implementing the amendments, particularly vis-a-vis security, as you intended them. We have not yet had a specific case where we have had to interpret those amendments and come to

any conclusions which might differ from what you intended the amendments to do.

Mr. RUSSO. So you are saying that if a railroad applied to you for funds to rehabilitate leased equipment, and if they met the earnings test in section 511, they would have no problem getting the money from the FRA?

Mr. SWINBURN. You mean the earnings test which deals with the earning power of the project?

Mr. RUSSO. Earning power of the project rather than the earning power of the corporation, and also the value of the asset for which the loan guarantee is made. For example, if it were to cost $5,000 or $7,000 to repair that leased equipment, and the revenue that it generates is about $15,000; in other words a loan, a preference loan of about $3,000, would you have any problem making that loan under section 511?

Mr. SWINBURN. Taking it from the general to the specific, in that specific situation, I don't believe so. The other amendments which you sponsored say that we have to have the lease as our security. If we had the lease as our security, in the event we had to take recourse to that lease, then we would also have recourse to the earning power of that piece of repaired property, and the difference between the value in earning power of that property and what we had put up would then serve as security for us, and we would have no problem accepting that as security.

Mr. RUSSO. What is the attitude, Mr. Sullivan, of the FRA on the question of prospective earning power of a company as compared with the value-of-the-security-pledged test that is in the guarantee loans under section 511?

Mr. SULLIVAN. I think it goes beyond attitude, Congressman Russo. I think in some cases we are actually going to be faced with court tests rather than tests of our attitude. Our attitude is very supportive. We want to get these moneys out. We want to help the essential segments of the industry to get their properties in a moneymaking status. When you get into the elements of a court test, where these things are concerned, I think I would ask Ray James, our Chief Counsel, to get into a little of the detail of what we run into in actually administering the law, and finding our security in either corporation earnings or, on the other hand, project or equipment earnings.

Mr. James.

Mr. JAMES. Mr. Russo, we try to implement the law as faithfully as we can.

Mr. RUSSO. My concern, Mr. James, is that you interpret the law as it was written, not as you think it should have been written.

Mr. JAMES. Absolutely. We try very hard to do that, but when we get down to concrete situations, it is sometimes difficult to apply the written words.

Mr. ROONEY. Will the gentleman yield?

Mr. RUSSO. I yield.

Mr. ROONEY. You talk about the quick manner in which you committed $62 million or $63 million in redeemable preference shares, and we authorized and I think appropriated $70 million last year. What are you going to ask for this year?

Mr. SULLIVAN. Actually it would be the balance of what is appropriated, what was authorized. We want to get the moneys out as authorized.

Mr. ROONEY. In other words, you are going to get the additional $530 million out in this next fiscal——

Mr. SULLIVAN. I don't believe all of that comes in this fiscal year, Mr. Chairman.

Mr. SWINBURN. Our existing appropriation for this fiscal year, Mr. Chairman, is $260 million, and that leaves, with the $60 million already spent, $280 million out of the $600 million authorization, which presumably we will have in the next fiscal year for spending.

Mr. ROONEY. What would you do if we authorized more?

Mr. SWINBURN. If you authorize more?

Mr. SULLIVAN. Mr. Chairman, if I may say, of course we are in that point in the budget cycle that certain things are still to be determined and put forward by the administration, so I could say that if we could leap ahead in time and see that there was an increase or perhaps there would be any increase available in the moneys that we have to assist the industry with, our posture would be supportive of assisting the industry within the funds that are authorized and appropriated, and certainly in the real world of what can be spent realistically, what amount of work can be done realistically, to accomplish projects that are supportive of better health for the railroad industry.

Mr. SWINBURN. Mr. Chairman, if I may add one point there, existing applications for preference share funds total $390 million. We know of one other application which will be coming in the vicinity of $100 million, which puts us at around $500 million. We do not know of any planned applications by the railroads above that $500 million figure right now, so that to authorize additional funds over $600 million we might not receive any applications in the near future.

Mr. RUSSO. Isn't it last year, rather than being $70 million, actually $120 million because of the Conte amendment? You authorized what, $62 million out of a possible $120 million?

Mr. SULLIVAN. I think if we were to look into the date it became available, and the work seasons involved, even if we had wanted to and had processed the proper applications, we wouldn't have been able to get it out in time. This is my recollection of the additional $50 million.

Mr. RUSSO. Based on the information you have at the present time, how much do you anticipate allowing in the next fiscal year?

Mr. SULLIVAN. $260 million this fiscal year.

Mr. RUSSO. $260 million, and do you know if the Milwaukee has applied for any of those funds at all?

Mr. SULLIVAN. There are existing Milwaukee applications, and of course there will be a trustee for the Milwaukee, and he will decide whatever course he sets out on, we would certainly react——

Mr. RUSSO. How many dollars are in for Milwaukee?

Mr. SWINBURN. They originally filed an application for $91 million in preference shares. We funded $9 million worth of that in the season. The railroad was in the process of redoing the remainder of the application to submit to us in the next few months when

the bankruptcy occurred. We expect that management will consult with the trustee and the courts as soon as they are able to consider the question of resubmitting that application. If the answer is yes, then we will deal with the Milwaukee in its bankruptcy.

Mr. RUSSO. What was the problem with only authorizing $9 million out of $91 million? Was there certain data that wasn't available? Was that the reason why?

Mr. SULLIVAN. Congressman Russo, what the Secretary did and instructed us to do, which of course we wholeheartedly agreed with, was to expedite those portions of a project where we could get people to work, and actually soak up some of the unemployment out there, and in this case that was the portion of their application that we could immediately identify and approve and get going to get those people to work.

Mr. RUSSO. Is that the same philosophy that you use when it comes to handling the Rock Island applications?

Mr. SULLIVAN. The Rock Island applications are a whole different world. Without trying to go into the detail of it, I guess it is one that I have been involved with even from the briefing stage forward, because we have had correspondence with the Rock Island on assistance as far back as March of 1977. In fact, there was a letter of March 1, 1977, in which we laid out very specific details that we felt were needed, financial details that were needed, to enable us to make findings that would enable us to get money out to them.

Mr. RUSSO. That was March of what year?

Mr. SULLIVAN. Last year.

Mr. RUSSO. And have you received that information?

Mr. SULLIVAN. That information came in on December 28 of last year.

Mr. SWINBURN. We did, Mr. Congressman, give the Rock Island the same treatment as the Milwaukee Railroad, in offering to fund a project during the 1977 work season, without complete information, because of the incentives provided by the Economic Stimulus Act and the Secretary's directive to get some money out for jobs last summer. Unfortunately, in the case of the Rock Island, because it is a bankrupt railroad, the act specifically requires a security finding that it does not require for solvent railroads and we and the Rock Island were unable to come to terms that would allow us to make that security finding, and the Rock Island was therefore not able to draw down or have us obligate the funds for their interim project.

Mr. RUSSO. Do you have enough information now from the Rock Island to be able to expedite the applications that they have before the FRA?

Mr. SWINBURN. I think the literal answer to that is no, but as I understand it from the Rock Island staff people with whom we are working, the rest of the information is virtually put together and here.

Mr. RUSSO. Would you say that the typical processing time for an application would take several months—7, 8, 9 months—in the application for both 505 and 511 programs?

Mr. SULLIVAN. If I may answer that, not as the technical expert involved, I think they vary. These things vary considerably with

the amount of detail that is required and the level of expertise available to the management of a particular corporation in putting together the financial details that are required, so you could have a considerable variance.

Mr. RUSSO. Mr. Sullivan, in implementing the 511 programs, what criteria do you set up? What guidelines have the FRA set up in order for the railroad to be able to get this money? If they come to you and they know exactly what they have to apply for, what information they have to give you, they submit it to you, you review it, then you take over and make the loan?

Mr. SULLIVAN. Our regulations, Congressman Russo, are quite specific and very detailed, and in fact have been subjected to some criticism because of that. I think it is worth pointing out that we are really not administering a grant to a private corporation here. We are administering assistance wherein we anticipate the return of that assistance to the Federal Government.

Now I would like Mr. Swinburn to get into some of the detail that answers your question directly on section 511.

Mr. SWINBURN. Mr. Sullivan is correct that we have published regulations as to the information that must be provided. The regulations basically focus on the information that we need to make the findings under 511(g), and I guess in large part deal with, No. 1, the efficiency of the investment, the demand for the investment in terms of traffic and ability to serve shippers, the ability to repay the investment, the value of the project and any other security that might be provided by the corporation.

Mr. RUSSO. Let me read a section of a letter I received from Brock Adams, which I may add was in response to a letter I had sent him on June 7. My initial response from the Secretary was on June 10 indicating that he would get back to me as soon as he possibly could on what guidelines were being used by the FRA in handling 511(g) programs, and after about four or five telephone calls from the time of the June 10 letter, I finally received a letter from Brock on August 3 which I find a little insulting having to wait that long for him to answer my letter.

> We have interpreted these statutory findings primarily as making approval of a particular application for an obligation guarantee dependent upon, one, the economic merits of the project, the borrower's ability to repay the obligation, and the adequacy of the security pledged to the government.

Are those the guidelines you operate under?

Mr. SWINBURN. Yes, sir.

Mr. RUSSO. Are you acquainted with the letter sent to Secretary Adams from Senators Magnuson, Long, and Danforth?

Mr. SULLIVAN. Yes, sir, we have all seen that.

Mr. RUSSO. I am especially concerned about the third paragraph of that letter which indicates that they feel that the regulations imposed upon the applicant railroads are more stringent than those normally found in the private financial marketplace.

Would you say that was a fair assessment of the regulations that are coming out of the FRA?

Mr. SULLIVAN. No, sir, I wouldn't say that. I think we had a subsequent meeting with the staffs involved that got into a great amount of complex detail. I can tell you, as a small businessman, that when I went hat in hand to see my banker, I didn't always get

friendly treatment, and yet as I review what is being done within the FRA, it is certainly complying with the law. We are administering the law as written and in a supportive frame of mind. In other words, we actually had Woody Price, who is the Secretary's special assistant, Mr. James, Mr. Swinburn, sit down for 2 solid days going over our regulations, shortly after I was sworn in, to simplify them and be sure we were carrying that supportive frame of mind out as completely as possible within the regulations and to soften those regulations wherever we could under the law. That has been done and that facilitated our getting out the moneys that have been gotten out.

Mr. RUSSO. If I may go on and read a couple of more sentences:

> Congress created this program because normal banking practices limit the availability of funds to marginal railroads, and it was clearly our intention that the government assume some risk in administering them. Attempting to act as a commercial lender in this context may work to defeat the very transportation objectives that the program sought to achieve.

I think it pretty much states exactly how not only the Senators feel but those of us on this subcommittee who helped draft this legislation.

Mr. SULLIVAN. Let me just say this, if I may, Congressman Russo. If I were the hardnosed banking officer that had just lent $9 million to the Milwaukee Railroad, I think I would be in talking to the president and the chairman of the board right now about being too lenient, so that I really can't see—I think the subsequent discussions that we had with the staffs brought out how complex the situation is and provided a better understanding for everybody involved as to what the thrust of our efforts are.

Mr. RUSSO. Let me ask you; under 511 guarantee dollars, how long do you think it will take to put that program into operation full swing?

Mr. SULLIVAN. Let me have Mr. Swinburn, who is on top of those details, give you some idea where we are as to applications and how soon we would hope to have agreements on them in relation to how much money is available in the current fiscal year.

Mr. SWINBURN. We have $141 million worth of applications under 511 now, Mr. Congressman. We have obligated $12 million. We expect in the next quarter to obligate a significant amount of that for equipment purposes with most, if not all, of our applicant railroads. We expect from the Chicago & Northwestern an additional, very large application, which has been reported in the newspapers, and we have been talking to several more profitable railroads about the possibility of some applications for coal-related transporation. I think that during this next quarter that money is going to start flowing very quickly under the existing applications, and over the next 6 to 9 months we should be getting a significant number.

Mr. RUSSO. How many applications do you have right now on 511?

Mr. SWINBURN. Number of applications, sir?

Mr. RUSSO. Yes.

Mr. SWINBURN. It is about five.

Mr. SULLIVAN. We can supply for the record the exact detail as of the end of the year.

Mr. RUSSO. Would you do that?

[The following information was received for the record:]

Section 511—Obligation guarantee applications—December 31, 1977

	Million
Chicago, Milwaukee, St. Paul & Pacific Railroad Co	$17.8
Chicago & North Western Transportation Co	16.0
Chicago, Rock Island & Pacific Railroad Co	88.2
Missouri-Kansas-Texas Railroad Co	12.0
Delaware & Hudson Railway Co	7.5
Total	141.5

Mr. RUSSO. Has the Rock Island made any application for section 511?

Mr. SWINBURN. Yes, sir, they have.

Mr. RUSSO. For how much?

Mr. SWINBURN. $82 million worth of equipment financing, and I believe it is about $7 million worth of maintenance-of-way financing, track financing.

Mr. RUSSO. And how far along are they in that particular application? Is there going to be a point in time, is there a point in time that you can tell me now when that application will be approved or disapproved or are there too many things pending to give that kind of a statement?

Mr. SWINBURN. The equipment application is actually composed of three different, and you could even say more than that, smaller applications, because it includes new equipment, rebuilt equipment, leased equipment, et cetera. We are the closest, because it is the easiest, to a decision on the new equipment. I would anticipate that decision coming very quickly, probably within a month, and the other equipment following right after.

Mr. RUSSO. Let me ask you this: In that 505 program, in which position in the Rock Island's debt structure is the FRA willing to place the Government? Is it going to be between the secured debt and the unsecured debt or what position in that structure are you placing the Government?

Mr. SWINBURN. For the interim application during the 1977 work season, we offered to the Rock Island a Federal position behind secured debt, behind administrative claims, and ahead of unsecured debt and equity.

Mr. RUSSO. You talk about work season. You have indicated your interest in completing your agreements by the time that that work season starts. Why wouldn't it make more sense to do it prior to that, several months ahead of time, so they can plan ahead for the work season?

Mr. SULLIVAN. I think the context that Mr. Swinburn is referring to there is the money that we got out to the Milwaukee, and a similar effort we made to get money out to the Rock Island, the $2 million to the Rock Island, which floundered on the rocks of the security question. Unfortunately, we can try to do these things, but the applications don't arrive or the analysis of extensive financial information doesn't always allow us to complete each and every application when we would like to, but we certainly are working very hard to accommodate ourselves to the work season and getting people to work out on the railroads.

Mr. RUSSO. Getting back to the Rock's problem, one of the things that is going on right now as I understand from talking to representatives of the Rock Island is that there is an independent consultant's study going on right now; is that correct?

Mr. SWINBURN. Yes, sir.

Mr. RUSSO. As to the valuation of the assets in the event the Rock were to be liquidated. Is there any particular reason why it took so long to get an independent consultant in there, or why wasn't it done sooner rather than so late?

Mr. SWINBURN. As you know, Mr. Congressman, there was a very large disagreement between the Rock Island management and ourselves as to the value of those assets. We simply didn't know we were going to have the need for getting a consultant in until we found out that there was such a wide disagreement between us, and as soon as we realized that, we felt the need to get an independent appraisal to sort of mediate between the parties on the question.

Mr. SULLIVAN. Congressman Russo, that question gets into an area that I suppose I feel some sort of familiarity with, having lived with and made judgments from so many different sets of financial figures. I think the situation where the Rock Island is concerned is a tough one. You have a trustee who took over a bankrupt property. Perhaps there was momentum involved, deterioration underway that is ongoing, a need to assemble management effort and at the same time cut management costs. There are a number of difficult problems that they are obviously working with, that would lead into the elements of a financial statement, but these various elements, when they total out, when they actually total out, and they come out to the Rock Island valuing the liquidation value of their assets of $473 million and the Federal Railroad Administration taking a reasonably objective view of liquidation value of those same assets and coming up with $273 million, it obviously gets into the need, the sudden need, for an independent interpretation.

Mr. RUSSO. When did that disagreement arise, Mr. Sullivan?

Mr. SULLIVAN. October of last year.

Mr. RUSSO. In December it was decided that the best thing to do was to have an independent consultant come in and make their own determination.

Mr. SULLIVAN. Again, I might add that with all of the business with the Rock Island, we are trying not to be the hardnosed banker. We have been very supportive. We have retained a highly respected Wall Street financial analyst whose area of expertise is the railroad industry, Mary DeSapio by name, and she has spent a considerable amount of time working with the Rock Island, trying to lead them from our regulations into generating the kind of financial information we need to reconcile these differences, other than just the security findings. The analysis by Mary herself, on our payroll, helping the Rock Island get us the information we need, demonstrates to me that we are employing substantial resources to help them and help us get to a point where we could make the necessary findings and get them the money.

Now so far we have obviously not reached that point, and we think that one other area to reach that point would be independent

financial analysis that would perhaps, who knows what they will come up with. They are doing this in direct consultation with the Rock Island on information supplied by the Rock Island but they will then come to us with: This is the liquidation value of this property."

From that, we hopefully could make some positive findings.

Mr. RUSSO. So it really doesn't matter whether the Rock is applying for loan guarantees for the rehabilitation of leased cars, or new cars. The basic problem is whether or not there is enough security. If they were to come in to you, assuming that this independent analysis was very favorable to the Rock, and then they came in and applied for leased equipment—because they have as I understand it, such a tremendous demand for freight and they just don't have the cars to ship the freight on, and the quickest way of doing that would be to upgrade and rehabilitate these leased cars—you wouldn't have any problem with the fact that they were looking for leased cars or new cars?

Mr. SULLIVAN. That is correct.

Mr. RUSSO. As long as they had the security. So in the application of the amendment that was adopted at the last session of Congress you have absolutely no problem.

Mr. SULLIVAN. No problem.

Mr. RUSSO. In implementing amendment.

Mr. SULLIVAN. No problem.

Mr. RUSSO. You don't see any language in section 511 that would cause you a problem that ought to be straightened out, to make it clear exactly——

Mr. SULLIVAN. I would like Mr. Swinburn to address that.

Mr. RUSSO. OK, because I want to be sure there is no problem. If there is a legislative change we can make I want to make it clear.

Mr. SWINBURN. I should make one thing clear for the record, Mr. Congressman. The administration, in the last session, had proposed a change to the 511(g) security amendment. The administration is bothered by the direction to disregard the earning power of the corporation in the event that the asset value or earning value of the project exceeds the amount of money being obligated toward the project. The problem that the administration has is that even if we knew a railroad were going bankrupt next week, knew it as a certainty, or even if we knew that a railroad would be liquidated next week and knew it as a certainty, under certain conditions we might still have to grant the obligation. The administration feels that is not good precedent for Federal lending practices, has suggested an amendment to eliminate that feature. In the meantime, we are interpreting and administering the law exactly as written.

Mr. RUSSO. So, in other words, it is the administration's position that you would rather look at the earning power of the corporation rather than the project itself?

Mr. SWINBURN. We like the ability to look at all three, and I think we will find that the ability to look at all three in some combinations will enable us in certain circumstances to get money out in this program.

We do not like the idea of disregarding totally earning power, particularly in a situation where we know a corporation is going to go belly up next week.

Mr. RUSSO. But assuming that if the value or the prospective earning power of the equipment or facilities is far greater than the money going to be secured by them, do you have a problem there?

Mr. SWINBURN. In cases where we had direct access to that earning power, I don't think we would. I could think of cases where that earning power relationship might exist, but the Federal Government would be barred from having access to that earning power. Those are the cases which bother us.

Mr. RUSSO. Well, maybe we should sit down and see if we can draft language that can alleviate the major problem, but, at the same time, keep the intent and spirit of the law, which is to help these marginal railroads that have big shipper demands, meet the demand by rehabilitating cars so that they can get them in 2 or 3 days rather than waiting 4 or 5 months. That is my concern. That is the purpose of the amendment.

Mr. SWINBURN. I would be happy to do that. I should say the real problems we have with that amendment probably would arise in the case of track-related projects, not equipment-related projects.

Mr. RUSSO. But the application that you have approved under 511(g), I think, the one you have approved, has been on tracks, hasn't it?

Mr. SWINBURN. That is correct. The Katy Railroad was a track investment. The management came forward and offered security to the Government combined with measurement of the earning power of the corporation, and it was deemed to be adequate to make the loan guarantee, so we had no interpretation problems at all.

Mr. RUSSO. As far as the leases of that particular equipment, you have no problem accepting the fact that the lease would be used as collateral either, do you?

Mr. SWINBURN. No, sir.

Mr. RUSSO. I have no further questions.

Mr. ROONEY. Thank you very much.

I would like to follow up on that. I think under title V, didn't we authorize $1 billion, and you claim that there are only five applicants for $140 million?

Mr. SWINBURN. That is correct; $141 million.

Mr. ROONEY. Why are there not more applicants?

Mr. SWINBURN. I think there are several reasons for that, Mr. Chairman. One, the universe of railroads who over the last 2 years have wished to deal with the Federal Government in a financial relationship, is limited, and those railroads devoted most of their management attention at the beginning of the title V program to the preference share program because the money is very, very cheap, is the 2-percent money. A loan guarantee costs the railroad essentially Treasury borrowing rates plus a slight increment. The same railroads are now becoming interested in the loan guarantee program. As I said, the North Western is going to give us a $275 million application for loan guarantees, and we have other more profitable railroads talking to us about coal-related projects and the loan guarantee program.

Mr. ROONEY. Mr. Sullivan, in your prepared statement, and I will quote:

> It is simply foolish to expect that railroads can survive in the private sector bearing the full cost of ownership, operation and maintenance for their fixed facili-

ties in rolling stock while public policy towards the highways and waterways still reflect the wage of unbridled development and expansion of those modes without either adequate repayment by them or effect controls on them. These issues must be faced soon, or we will lose our options as time and the course and trend of events erode them.

My question is, do you believe that if the Federal Government were to modify its support of competing modes, a greater share of the Midwest rail system would become viable, and how should we modify the support?

Mr. SULLIVAN. These answers, I think, Mr. Chairman, will be part of what is forthcoming from the hearings that are starting in Chicago on the 401 process. I think it is obviously something that can't be oversimplified. If I were to make the gross error of doing that, somebody could say we have too many railroads, too much track, and not enough business on these railroads and tracks.

Competitive equality for the industry is a major problem. I don't think there is anyone who denies that. We have a highway system with billions of dollars invested in it. We have a waterways system built, compliments of the Government; we have an airline industry that is founded on Government investment in research and development of military aircraft at untold billions of dollars.

Somehow, through all of this, the railroads have survived. I think in our conversation the other day I learned there has never been a class I railroad liquidation in bankruptcy.

I guess what we are trying to say is that we think one of the things that will be offered out of the Chicago hearings is the possibility of looking at what logical remaining business there is for a viable private sector railroad industry, and if we have two centers of population and production and consumption, do we really need five railroads fully signaled between those two centers? It probably will turn out that we need much less in the way of physical plant which constitutes a drain on the assets and resources of the corporations involved.

We want to stay away from the idea that any favored corporation, as such, is the right solution, in that keeping a given corporation or numbers of corporations alive with grants from the Federal Government is not a solution that we see as any solution at all, but we do think that the process started by the Secretary in Chicago to meet this emergency out in the field, as the President had promised the Nation, will be a very important beginning to what we hope will lead to some constructive long-lasting solutions.

Mr. ROONEY. Thank you very much.

Mr. RUSSO. Mr. Chairman, could I follow up so I can clarify a few more things on the record?

Just so I have it clear that you understand the purpose of section 511, let me go over some of my ideas on the 511 earning power. First of all, the first thrust is to clarify the congressional intent that the FRA is not to give priority to credit worthiness of specific corporate but rather make judgment on the worth of the particular project. It also gives the Secretary flexibility, I feel, in administering the program.

In the letter from Senators Magnuson and Long and Danforth, I think they set forth that that is particularly their idea, that:

It has always been reported to this committee that the Federal Railroad Administration continues to judge the worth of any application by the credit worthiness of

the applicant railroad as a whole rather than by the worth of the specific project in question. The Railroad Transportation Improvement Act amended Title VI in order to direct the department to consider the credit worthiness of the specific project instead. It is for this reason the committee will not favorably consider a prospective earning power amendment to Title VI, which has been suggested by the department.

In section 505, there is a key provision that says, "The probable value of the assets of the railroad in the event of liquidation provides reasonable protection to the United States." Should that be amended to allow you more flexible standards so you can implement the program to section 505? Do you find that particular provision restrictive?

Mr. SULLIVAN. Congressman Russo, I wouldn't want to be the one to oversimplify your reading of what you intended and how the legislation was enacted, but what I would like to do is have the proper members of my staff come and have a thorough discourse with you to be sure that we are capturing any differences in our interpretation and administration of the act and your understanding of what the intent of your amendment was, and I think——

Mr. RUSSO. I would certainly be more than happy to lay that out. This way, the criticisms that I receive will probably stop if we both understand exactly what the intent of the law is. I would hope in the coming years that you implement section 511. I wonder whether or not there is an obsession in the FRA to hold back the program, and I hope that is not the case; that the philosophy is not to implement the program and put up enough barriers so people don't apply.

Mr. SULLIVAN. I suspect that the barriers there are probably corporate judgment rather than failure in the legislation, itself. If I am the board of directors or the management of a corporation, I am always taking a hard look at my debt structure and our debt-to-equity ratio, and whether or not there is $1 billion or $80 billion of Federal debt guarantees available is nice to know, but basically I am making the management decisions for my corporation based on our needs and resources, ability to spend the funds generated, and the ability to service that debt and repay it eventually.

Mr. RUSSO. The answer to the question I raised a second ago about section 505, the provision that requires the protection of the United States, do you find that to be restrictive in implementing the program? Should we change it to make the standards more flexible so we can get the dollars out to the railroad as soon as we can?

Mr. SULLIVAN. I think that gets into the area of administering grants versus administering assistance under the law. I would ask Mr. James if he has comments he wants to make on any difficulties we perceive with that.

Mr. JAMES. Mr. Russo, it is a restriction; whether it restrains our giving assistance is something we haven't yet determined. We would be glad to look at it in the context of the purpose and the program and the other provisions of the program to see whether it should be modified and make a recommendation.

Mr. RUSSO. You know, I am concerned that you authorize $120 million and only $62 million is actually spent, and we know the problems that we face in this country with upgrading our railroad system. The slower we take, the more problems we will have in the

future, and the more railroads will be put on the marginal list, and that is something we don't want to happen.

Mr. SULLIVAN. If I may make one comment, private sector is oversimplification. If the railroad industry has one basic problem, it is that they are not earning enough money. When an entity does not earn money, they can't hire as many people; they can't buy new equipment when they should; they can't attract equity investment from the private capital markets. There is just a whole spinoff of items that flow out of the industry not making the right amount of money. Making money, at best, in the business world is not easy. In the case of the railroads, as figures will show you, with, I think, 1.49-percent return on investment, it is a life and death affair, and I think that the Federal Government, certainly this administration, and what I have read about the new leadership at the ICC, is aware of this problem and wants to do those things that would be supportive of allowing the industry to make more money.

If there turns out to be short-term interim assistance to carry through a turnaround, fine, but I don't think the amounts of money are even available to the Federal Government to get into the amount of total dollars that would be necessary if somebody decided by the stroke of a wand to nationalize the industry and run out for 200,000 miles of track, and renovate it; you can't count that high as to the needs that are there.

So we think that the posture of enabling the industry, itself, to go out and do the things that management has to do to earn money is the very best thing that the Federal Government could do in this instance.

Mr. RUSSO. I have no further questions, Mr. Chairman.

Mr. ROONEY. That will conclude our questions. Thank you, gentlemen for appearing before the committee.

Mr. SULLIVAN. Thank you, Mr. Chairman.

Mr. ROONEY. Our next witness is Hon. A. Daniel O'Neal, Chairman of the Interstate Commerce Commission. I would appreciate your introducing your colleagues for the record.

STATEMENT OF HON. A. DANIEL O'NEAL, CHAIRMAN, INTERSTATE COMMERCE COMMISSION, ACCOMPANIED BY VIRGINIA MAE BROWN, COMMISSIONER, JAMES B. THOMAS, JR., DIRECTOR OF THE BUREAU OF ACCOUNTS, AND ALAN M. FITZWATER, DIRECTOR, RAIL SERVICES PLANNING OFFICE

Mr. O'NEAL. Thank you, Mr. Chairman. On my right is Commissioner Brown from the Commission. On my far right is Jim Thomas, the Director of the Bureau of Accounts at the Interstate Commerce Commission, and on my left is Alan Fitzwater, who is the Director of the Rail Services Planning Office.

I appreciate this opportunity to comment on the financial situation of the Milwaukee Railroad and its future prospects. I do have a longer prepared statement, and I would like to submit it for the record [see p. 29].

Mr. ROONEY. Without objection, it will become part of the record.

Mr. O'NEAL. I will summarize with this shorter statement.

At the outset, I would like to say that while the bankruptcy of the Milwaukee Railroad comes as a disappointment, it does not

come as a surprise to the Commission. The financial condition of this carrier has been precarious for some years because it is unable to generate sufficient cash flow to support its physical plant. Like other weak railroads, it has been faced with ever-increasing costs, declining traffic volume, strong competition in certain areas, severe weather, and other difficulties. Back in December 1974, the Early Warning Branch of the Commission's Bureau of Accounts began a series of reports that showed the Milwaukee to be in a marginal and worsening condition. Just this past November, the Early Warning Branch concluded that without some increased financial aid and system rationalization, reorganization would follow. My prepared statement contains statistics which illustrate why this very thing occurred. Basically, carloadings were way down because of weather, decreased demand for forest products, and fewer, shorter grain movements.

During this period, a wholly owned subsidiary, Milwaukee Land Co., provided substantial loans, keeping the railroad afloat. However, worsening economic conditions, and the adverse settlement of a $4.3 million lawsuit, precipitated a railroad management decision that a bankruptcy petition be filed.

The Milwaukee has attempted to continue maintenance and rehabilitation during its difficult times. It has used title V of the 4R Act funds to increase road maintenance over the like period in 1976, has utilized FRA preference-share financing available to it, and has been seeking $100 million in additional FRA funds for main line rehabilitation and equipment repair. Unfortunately, these efforts could not prevent a petition for reorganization.

Turning now to the ICC's role regarding rail service in general, and the Milwaukee situation in particular, I would say that the agency's primary concern regarding any railroad is the maintenance of necessary service to the public. To accomplish this, the Commission performs a number of different tasks:

1. Constant monitoring of regulated carriers (for instance, the Early Warning Branch).

2. Close watch on the availability of freight cars, the lack of which can result in revenue losses.

3. Constant evaluation of the effect weather has on a carrier's operations—the Milwaukee experienced severe weather problems in late 1977, not to mention the devastating winter of 1976.

4. Ratemaking relief in the form of a special exemption from the requirement that 7 percent of a 10-percent rate increase granted in 1974 be applied to deferred maintenance and capital improvements. A December 1975 order allowed the Milwaukee to use the entire 10-percent increase for operating expenses.

Fundamental to our concern at this point should be the issue of just what is the best way to insure that the important service provided by the Milwaukee is not lost. One alternative is traditional reorganization under section 77, which would undoubtedly involve the abandonment of unprofitable branch lines and possibly even redundant main lines. The Milwaukee has already submitted a system diagram map to the Commission, filed under section 1a of the Interstate Commerce Act, which proposes to abandon 37 percent of its physical plant.

Traditional reorganization is not assured of success. The Milwaukee is not a strong carrier, and has keen competition from other railroads in the area (BN, UP, C&NW, and the Soo Line). Moreover, the Milwaukee main line between Minneapolis-St. Paul and Washington State is largely paralleled by the BN and the UP, and much of it originates and terminates little traffic on that segment of the line. Therefore, additional funding seems necessary for successful section 77 reorganization.

The Commission will be ready to do its part should a traditional reorganization be attempted. We already have 11 Milwaukee abandonment applications, which are being expeditiously processed, and we will give prompt attention to any reorganization plan filed under section 77.

The Commission has also begun to analyze the Milwaukee's financial prognosis under section 77, including the need for and the cost of directed service operations under section 1(16)(b) of the Interstate Commerce Act. My prepared statement contains such an analysis by our Bureau of Accounts. Even with deferrals allowed by section 77, and $5.1 million from federally guaranteed trustee certificates under the Emergency Rail Services Act of 1970, it is estimated that continued operations would require another $5 million from other sources for the first 9 months of 1978. I should make it clear at this point, however, that we are not now recommending that this or any other specific amount be authorized or appropriated for this purpose.

In addition to considering whether the Milwaukee can be reorganized under section 77, we must look at whether this railroad should, over the long run, become part of a larger integrated system. This raises the question of the Milwaukee's previous efforts to be included in the Burlington Northern system, and my prepared statement contains an analysis of the attempt by the Milwaukee to become part of the Burlington Northern system.

Looking to the future, present law offers several options for possible rationalization of the Milwaukee's system with that of other area railroads. Section 401 of the 4R Act provides a planning process which could result in the merger or controlled transfer of all or a part of the Milwaukee with other railroads. We understand that the Milwaukee is cooperating with the FRA in this regard. The Commission encourages this process and will cooperate with the FRA as fully as we can.

Of course, the Milwaukee Road is not the only railroad in the Midwest region which is experiencing financial difficulties, and I would expect that any thorough planning process would have to encompass the financial and operating conditions of all railroads in the region. My prepared statement contains a brief rundown of our view of the situation of some of the other railroads in the area, particularly the weaker ones.

Although we do not believe it possible now to predict accurately what the outcome for the Milwaukee and other railroads in the Midwest should be, it is encouraging to note that a viable planning process is apparently under way. At this juncture, it appears that existing planning legislation is adequate, although it may be necessary to provide a higher level of funding under the Emergency Rail Services Act, and possibly other acts as well. In general, however,

what remains to be done is to implement fully existing legislation. We at the Commission will cooperate in every way possible to achieve that important goal.

We appreciate again the opportunity to testify on behalf of the ICC and will be happy to try to answer any questions you might have.

[Testimony resumes on p. 44.]

[Mr. O'Neal's prepared statement and attachments follow:]

STATEMENT OF
A. DANIEL O'NEAL,
CHAIRMAN, INTERSTATE COMMERCE COMMISSION
BEFORE THE SUBCOMMITTEE ON TRANSPORTATION AND COMMERCE
OF THE HOUSE COMMITTEE ON INTERSTATE AND
FOREIGN COMMERCE ON THE PETITION BY THE
CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC RAILROAD
COMPANY FOR REORGANIZATION UNDER THE
FEDERAL BANKRUPTCY LAW

January 5, 1978

Mr. Chairman, Members of the Subcommittee:

I appreciate this opportunity to be here today to discuss a subject of concern to all of us: the recently filed petition for reorganization under section 77 of the Bankruptcy Act of the Chicago, Milwaukee, St. Paul and Pacific Railroad (the Milwaukee Road). You have indicated your interest in exploring the reasons for the Milwaukee Road's bankruptcy as well as proposals for solutions to the problem. With respect to solutions, you have stressed that we must look into the need for additional Federal legislation, acceleration of the redeemable preference shares and loan guarantee programs under Title V of the Railroad Revitalization and Regulatory Reform Act of 1976 (4-R Act), and other possibilities. In addition, you have emphasized the need to consider not only the problems of the Milwaukee but also the condition of other railroads in the Midwest, both solvent and bankrupt. I hope that my comments today can be of assistance to the Subcommittee in appreciating and responding to this situation.

At the outset I would like to say that, while the bankruptcy of the Milwaukee Road comes as a disappointment, it does not come as a surprise to the Commission. The financial condition of this carrier has been precarious for some years. I would like at this point to provide some perspective by discussing the situation as the Commission has observed it over the years, by indicating some of the Commission's actions in response to it, and by outlining what the future may hold.

Like other railroads experiencing financial difficulty, the problem of the Milwaukee Road has been that it is unable to generate sufficient cash flow from its operations to support its physical plant. Faced with ever-increasing costs, declining

traffic volume, strong competition, severe weather, and other difficulties, this railroad has been in a state of difficulty for a number of years. Back in December 1974, the Early Warning Branch of the Commission's Bureau of Accounts reported that the Milwaukee was in a marginal condition, and that a continued decline in the nation's economy would cause the carrier's performance to drop to poor. A series of later reports essentially confirmed that analysis.

In the most recent report issued only last November, it was once again concluded that the Milwaukee Road could not generate sufficient cash flow from its operations to support its plant, and that without greater financial aid or a major system rationalization through coordination of track with other competing roads, the Milwaukee could soon be forced into reorganization. Unfortunately, this is exactly what came to pass.

It may be helpful at this point to take a look at some statistics. In the third quarter of 1977, the Milwaukee's operating loss amounted to $16.7 million, bringing the total loss for the first nine months of 1977 to $20.7 million. However, carloadings were down 5.8 percent in the third quarter of 1977 compared to the same quarter of 1976, largely as a result of both shorter and fewer grain movements and a decreased demand for forest products. For the first nine months of 1977, total carload traffic was 4.4 percent less than the same period of 1976.

To sustain the Milwaukee's operations during this period of financial difficulty, a wholly-owned subsidiary of the railroad, the Milwaukee Land Company, has provided the railroad with substantial loans. Most recently, Milwaukee Land advanced $14 million between January 1, 1977, and the first week of November 1977 of which $12 million was advanced after August 1977. The fact that the Milwaukee filed for bankruptcy appears to illustrate a management decision that there was simply a point beyond which Milwaukee Land could not go in supporting the operations of the railroad.

An additional liability which affected the Milwaukee's condition was a $4.3 million settlement of a series of class action lawsuits involving certain debt securities of the railroad, which was required to be paid by February 3, 1978. The railroad's officers have told the Commission's staff that this was a contributing factor in deciding to petition for bankruptcy, since the obligation could not be met with railroad funds.

Despite these problems, it appears that the Milwaukee has made every effort to continue maintenance and rehabilitation of its physical plant during its period of financial stress. Third quarter 1977 road expenditures were $9 million higher than in the same period of 1976, due both to programmed maintenance and aid under Title V of the 4-R Act. Through December 13, 1977, the Milwaukee had received $9.1 million of a $9.3 million preference share financing agreement with the Federal Railroad Administration. These funds served to rehabilitate the Milwaukee-to-Chicago corridor. We understand that the Federal Railroad Administration is presently considering the Milwaukee's request for an additional $100 million in aid under the 4-R Act to be used primarily for main-line rehabilitation and equipment repairs. However, it is evident that such aid which has been provided thus far both from internally-generated and outside sources was not enough to stave off bankruptcy.

At this point I would like to discuss with you some of the Commission's responses to the situation of the Milwaukee Road over the years. As you know, the agency's primary concern regarding any railroad is service to the public -- to insure that the nation's shippers and the general public are receiving the quality of railroad service which the public requires. To accomplish this, the Commission performs a number of different tasks. First and foremost, we constantly monitor the condition of the carriers subject to our regulation. With respect to the Milwaukee, I have already described to you the activities of the Early Warning Branch of our Bureau of Accounts, and its constant assessment of the financial condition of financially stressed railroads. As indicated, the

activities of this Branch have alerted us for some time to the fact that the Milwaukee has been in serious financial condition.

In addition to monitoring the financial condition of the Milwaukee, we have also kept a close watch on the availability of freight cars. It is important to have this information since severe freight car shortages can result in revenue losses to a railroad. Over the past several months, the Milwaukee, along with other railroads in the area, has reported some shortages of cars. While some indeterminate revenue loss probably was incurred by this turn of events, it does not appear that this factor standing alone was significant. Rather, it was the general loss of traffic, particularly grain traffic, which had a more significant impact on revenues. Also, there were frequent situations where the Commission was unable to help by expediting movements of cars because other railroads in the area were experiencing similar problems.

Another problem is weather. All of the railroads in the Milwaukee's area have had extreme operating problems because of early winter storms this year. The Milwaukee was plagued with snow, mud slides and wash-outs to a degree uncommon for this time of year. During the period from November 3, 1977, to December 15, 1977, it was necessary to plow the Milwaukee's main line six times in order to keep operating. There is no question but that these extreme weather conditions have contributed to the Milwaukee's overall revenue problems, although the extent of this is difficult to determine at the present time. In any case, this is another kind of situation which we constantly monitor and assess.

We have also attempted to assist the public interest with respect to the Milwaukee Road in the area of ratemaking. As you may be aware, the Commission in 1974 granted a 10 percent rate increase to the nation's railroads which was based upon the industry's need for increased revenues at that time. For the most part the increase was justified on the basis of a need to make substantial contributions to deferred maintenance and capital improvements. Accordingly, the Commission con-

ditioned the granting of the increase upon a commitment from the carriers to apply 7 percent of the 10 percent increase for these purposes -- thereby making only 3 percent available for increased operating costs. However, the Commission provided that railroads which could demonstrate a clear need to apply the full measure of the increase to operating costs could apply for special permission to do so. The Milwaukee, because of its difficult cash situation, was one railroad in such a position, and by an order issued in December 1975 the Commission authorized the Milwaukee to use the full rate increase to meet operating expenses. The Commission has kept a close watch on the Milwaukee to determine whether this relief continues to be necessary, and we are convinced that, despite apparent strong efforts by the carrier to improve its operating expense situation, the relief from the spending conditions continues to be justified. This relief is still in effect as of this date, and we anticipate that it will be for the foreseeable future. We will, of course, maintain our close supervision over this situation.

The question which concerns all of us now, of course, is what we can expect to come of the situation now that the Milwaukee Road has filed its formal petition for reorganization. For the immediate future the questions are of the procedural type which accompany the commencement of any reorganization proceeding. This includes such matters as the appointment and ratification of a trustee, which has not yet occurred but which can be expected shortly, and the handling of the carrier's finances during the course of the bankruptcy proceeding. A brief summary of the court proceedings thus far is attached as Appendix A to this statement.

Fundamental to our concern should be the issue of just what is the best way to insure that the important service provided by the Milwaukee is not lost. One alternative is to attempt to reorganize the railroad under section 77 in the traditional manner, which would undoubtedly involve the abandonment of unprofitable branch lines and possibly even redundant main lines. The Milwaukee has already proposed that its physical plant be reduced by 37 percent -- from its

present 10,000 miles to about 6,400 miles. The possible outline of such a plant reduction has already been submitted by the Milwaukee on its System Diagram Map, filed under section 1a of the Interstate Commerce Act, indicating projected future abandonments.

Whether a traditional reorganization of the Milwaukee would work is a question which cannot be answered at this time, although it must be recognized that the Milwaukee is not a strong carrier. The Milwaukee serves areas which are also served well by other carriers, notably the Burlington Northern, the Union Pacific, the Chicago and North Western, and the Soo Line. Further, over much of its main line route between Minneapolis-St. Paul and Washington State, the Milwaukee originates and terminates little traffic. This long main line parallels to a significant extent competing lines of the Burlington Northern and the Union Pacific from the Midwest to the Pacific Northwest. Therefore, if conventional reorganization is attempted, it is quite possible that financing would have to come from Title V funds under the 4-R Act.

Should traditional reorganization of the Milwaukee be attempted, the Commission will be ready to do its part of the job. Applications for abandonment of branch lines and other relief designed to improve the structure of the railroad will be handled as expeditiously as possible. The Commission already has 11 such applications for abandonment from the Milwaukee, which are being processed as quickly as time allows. When and if the time comes to consider a reorganization plan under section 77, the Commission will give the matter its closest attention.

The Commission has also begun to analyze the Milwaukee's financial prospects under section 77, including the need for and the cost of directed service operations under section 1(16)(b) of the Interstate Commerce Act. A recent report of our Bureau of Accounts, which is included in full as Appendix B to this statement, estimates that the Milwaukee will continue to incur substantial losses in 1978. Despite an ability under the bankruptcy laws to defer payments on property taxes, interest and certain debts, it is estimated that cash

flow from operations will be a negative $13 million during the first nine months of 1978. This analysis presupposes a substantial need for funding from outside sources. The Milwaukee is eligible to receive $5.1 million for general operations from the issuance of Federally-guaranteed trustee certificates. This is the balance of loan funds available under the Emergency Rail Services Act of 1970 for railroads in reorganization. Even with financing from this source it is estimated that the railroad would need another $5 million in funds from other sources in order to maintain operations for the first nine months of 1978.

In addition to considering whether the Milwaukee can be reorganized under section 77, it must be considered whether this railroad, or parts of it should over the long run become part of a larger integrated system. Since this raises the question of the Milwaukee's previous efforts to be included in the Burlington Northern system, I would like to go back and give some background on why the inclusion of the Milwaukee into the Burlington Northern system did not come about.

In 1967, the Commission approved the Northern Lines merger creating Burlington Northern and imposed numerous conditions upon its approval. Several of these conditions were designed to enhance the competitive position of the Milwaukee Road, and in fact one of the underlying rationales for approving the merger was that east-west competition along the Northern tier, between the Midwest and the Pacific Northwest, would still be maintained. This has been of particular importance to the users of transportation in the Seattle-Portland area, who over the years have relied upon the Milwaukee to provide such competition.

One relevant condition of the BN merger -- Condition 33 -- basically provided that the Commission would retain jurisdiction over the proceeding for five years following consummation of the merger for the purpose, among others, of considering petitions requesting inclusion in the merger.

The Northern Lines merger was consummated March 2, 1970, and on April 2, 1973, the Milwaukee filed a petition for inclusion in the BN pursuant to Condition 33. Basically, the Commission's reason for denying the Milwaukee's petition for

inclusion was that the railroad failed to establish that its proposal came within the limited purposes behind the adoption of Condition 33. This condition was imposed to provide a degree of protection for railroads operating in the territory covered by the Northern Lines merger proposal from the effects of that merger. Also, to the extent that it provided for the imposition of additional protective conditions, it was intended to protect competing carriers from certain possible effects of other then-pending merger applications. However, it was not intended to be invoked to solve a railroad's general financial problems or to improve the position of its shareholders. Further, to construe Condition 33 to warrant subsequent inclusion of Milwaukee in the BN would have run counter to one of the basic purposes behind the Northern Lines merger approval; namely, to strengthen the Milwaukee to enable it to become a more effective competitor with BN in the Northern tier States. Clearly, the conditions imposed in the Northern Lines case were not intended to operate at cross purposes, fostering the competitive position of the Milwaukee while at the same time authorizing its elimination as a competitor through inclusion in the BN. Also, I should mention that the merger partners did not want the Milwaukee to be included, and resisted it strongly. For these reasons, the Commission denied the Milwaukee's attempts to be included in the BN system.

Looking at the future, there are several options under present law by which the possible rationalization of the Milwaukee's system with that of other railroads in the area can be assessed. Section 401 of the 4-R Act provides a planning process which could result in the merger or controlled transfer of all or a part of the Milwaukee with other railroads. It is our understanding that the Milwaukee is cooperating with the Federal Railroad Administration in initiating a Section 401 planning process. The Commission encourages this process and will cooperate with the FRA as fully as we are able. We will also, as we have done previously, continue to provide FRA with all pertinent information regarding the situation.

As you suggest in your letter of December 22, 1977, to me, the Milwaukee Road is not the only railroad in the Midwest region which is experiencing financial difficulties, and I would expect that any thoroughgoing planning process would have to consider the financial and operating conditions of all railroads in the region. I would like at this point to give you a brief rundown of our view of the situation of some of the other railroads in the area, particularly the weaker ones.

As you know, there is already one railroad in the Midwest which is in bankruptcy, the Rock Island. The Rock Island's situation remains difficult, although it has made much progress in its efforts to reorganize and rehabilitate and the probability for success of these efforts has improved considerably. Yet due to excess capacity of lines throughout the Midwest and the condition of Rock Island's plant, much remains to be done.

For the first nine months of 1977 the Rock Island reported a net loss of approximately $29 million while carloadings increased by 1.3 percent compared to the same period of 1976. The cash position has weakened recently due to the sluggishness of grain traffic and the railroad remains vulnerable to possible service disruptions due to increasing deferred maintenance. The Rock Island will depend upon government assistance to provide the bulk of its maintenance funds for plants and equipment and has applied for approximately $160 million in 4-R Act assistance. The railroad has been drawing down funds from a $17.5 million loan received under the Emergency Rail Services Act of 1970.

Another carrier in the region which has been experiencing difficulty is the Chicago and North Western Transportation Company. The North Western's financial condition, although improving, remains weak.

A loss of $2.6 million was suffered by the North Western during the third quarter of 1977 as a result of a 4.3 percent decline in carloadings from the same quarter in 1976. The carrier reported a $3.2 million net profit for the first nine months of 1977 compared to a $570,000 net loss in the same period in 1976. Statistics for the fourth quarter of 1977 are not yet available but earnings are not expected to reach last year's levels because of increased maintenance work planned.

The North Western's management is nonetheless confident that a combination of factors will enable the railroad to provide better service and attract new traffic. These include the continuation of a management policy to abandon unprofitable lines, increased efforts to rationalize the railroad plant with competing railroads, and assistance under the 4-R Act to rebuild the plant. In connection with assistance under the 4-R Act, the Department of Transportation in September agreed to provide the North Western with $24.6 million for rehabilitation of its main line track under a preference share financing agreement.

Another railroad in the Midwest which has been experiencing difficulty is the Illinois Central Gulf. Profitable operations of this carrier in the first half of 1977 were more than offset by a $7.4 million loss reported for the third quarter. This loss resulted in a $463,000 loss for the nine months ended September 30, 1977 compared to an $11.3 million net income for the same period in 1976. While these figures were in part brought about by vastly increased expenditures for maintenance of plant and equipment, the Illinois Central Gulf is not in as desirable a position as it would like to be.

Other railroads in the area are in considerably better condition, including the Burlington Northern, the Union Pacific, and the Soo Line. These generally profitable carriers have good access to traffic and have been able over the years to generate sufficient revenues to maintain and improve their physical plant.

Although we do not believe it possible at this time to predict accurately what the outcome for the Milwaukee and other railroads in the Midwest should be, it is encouraging to note that the planning process is under way. At this juncture it appears that existing legislation regarding planning is adequate, although it may be necessary to provide a higher level of funding under the Emergency Rail Services Act, and possibly other acts as well. In general, however, what remains to be done is to implement existing legislation fully. We at the Commission will cooperate in every way possible to achieve that important goal.

Thank you for this opportunity to testify on this matter. I will be glad to attempt to answer any questions you may have.

Commissioner Murphy was absent and did not participate.

APPENDIX A

SUMMARY OF MILWAUKEE REORGANIZATION PROCEEDINGS

The Milwaukee Road filed for reorganization on December 19, 1977, in the U. S. District Court for the Northern District of Illinois in Chicago. The case is docketed as No. 77B 8999.

Order No. 1 of the reorganization court, dated December 20, 1977, authorizes and directs the Milwaukee Road to continue to operate its railroad properties, while relieving the railroad from payments on its funded or fixed debt and protecting it from court proceedings instituted by creditors. The railroad is to open new books of account as of December 19, 1977 and to file a statement of assets and liabilities as of December 18, 1977, with the Court no later than January 19, 1978. A hearing is ordered for January 18, 1978, in Chicago, when the Court will appoint one or more trustees of the Debtor's property.

The order enumerates a wide variety of obligations which are to be paid by the railroad. Among these are per diem charges, or amounts owing to other railroads for the use of their rail cars. The Commission has objected to that part of the order which distinguishes between per diem charges arising prior to February 1, 1978, and those arising after that date. The order appears to permit the Milwaukee to delay payment of the earlier charges while requiring immediate payment of the latter when due. We contend that this distinction between post and pre-reorganization per diem accounts is contrary to the decision of the United States Court of Appeals for the Seventh Circuit in Chicago, Rock Island and Pacific Railway Company v. Atchison, Topeka and Santa Fe Failway Company, et al., 537 F. 2d 906, 907 (7th Cir. 1976), cert. denied., _____ (1977), and that public policy favors prompt priority payment of past per diem balances.

APPENDIX B

BUREAU OF ACCOUNTS
Section of Financial Analysis

12/29/77

PROSPECTS FOR MILWAUKEE UNDER SECTION 77 REORGANIZATION
AND ESTIMATED COST OF DIRECTED SERVICE
OPERATIONS UNDER SECTION 1(16)b

Highlights

... We estimate that the Milwaukee will continue to incur substantial losses in 1978.

... Despite an ability under the bankruptcy laws to defer payments on property taxes, interest and certain debt, we estimate that cash flow from operations will be a negative $13 million during the first nine months of 1978.

... The Milwaukee is eligible to receive $5.1 million for general operations, from the issuance of Federally guaranteed Trustees Certificates. This is the balance of loan funds available under the Emergency Rail Services Act of 1970 for railroads in reorganization.

... Assuming the acquisition of the above financing, we estimate that the railroad will need at least $5 million of funds from other sources, in order to maintain operations for the first nine months of 1978.

... We estimate directed service operations under Section 1(16)b would cost the Government almost $50 million for the statutory 8 month period.

Details follow:

Projected Operating Results

We have prepared a projection of operating results for the Milwaukee Road for the fourth quarter of 1977 and the first three quarters of 1978. Our forecast assumes the following: (a) the recent lower level of carloadings will continue because of possible traffic diversion to other carriers as a result of the railroad's filing for reorganization on 12/19/77, (b) a reduction in the maintenance effort through a decline in maintenance personnel levels - although the current deferred maintenance of the carrier does not allow for any substantial maintenance reduction, (c) a 7 percent wage increase as of 1/1/78, as the final settlement will be retroactive to this time, (d) an inflation factor projected by Data Resources, for operating expenses other than wages: and (e) a 5 percent rate increase effective in the third quarter to offset the wage increase although no increase has been applied for yet.

Our projections reflect third quarter results with and without this rate increase. In our subsequently shown estimates as to the effects of reorganization and the application of Section 1(16)b, the 5 percent rate increase is assumed.

	4th Qtr. 1977	1st Qtr. 1978	2nd Qtr. 1978	3rd Qtr. 1978 1/	3rd Qtr. 1978 2/
Gross Revenues	$113.0	$110.7	$121.0	$117.8	$123.2
Ordinary Loss	10.9	12.9	6.0	10.0	4.6

1/ Assuming no rate increase.

2/ Assuming a 5 percent rate increase, effective 7/1/78.

NOTE: These estimates also assume that no contingent interest will be payable.

Estimated Cash Flow From Operations

Under reorganization, the railroad will be able to defer payments on property taxes, interest and certain debt. Despite these deferrals, we anticipate that cash flow from operations will result in a cash drain of about $13 million for the first nine months of 1977.

The railroad will be eligible to receive $5.1 million for general operations from the issuance of Federally guaranteed Trustees Certificates. This is the balance remaining from the Emergency Rail Services Act of 1970. Assuming the receipt of these funds and a year end cash balance of $4 million at 12/31/77, we estimate that the railroad will need at least $5 million from other sources in order to keep operating during the first nine months of 1978. Possible sources of additional funds include sale of assets, aid from subsidiaries, withdrawals from mortgage trustees and government funds. We were informed that 4P Act financing is designed to be applied to specific projects, not for general operations.

Our estimate of cash flow, under reorganization status, is shown in the following table. Earnings are based upon the previously discussed forecasts. The following projection also assumes no expenditures for capital improvements.

Estimated Source and Application of Funds
1978
(millions)

	1st Qtr.	2nd Qtr.	3rd Qtr.
Source			
Ordinary Loss	$(12.9)	$ (6.0)	$ (4.6)
Less Non-Cash Items 1/	5.0	5.0	5.0
Cash Flow (Drain) Generated from Operations	$ (7.9)	$ (1.0)	$ 0.4
Applications			
Equipment Maturities	$ 1.2	$ 0.7	$ 2.3
Net Cash (Decrease)	$ (9.1)	$ (1.7)	$ (1.9)
Cumulative (Decrease)	$ (9.1)	$(10.8)	$(12.7)

1/ Represents the total of depreciation and retirements, property taxes and certain fixed charges which are deferred under Section 77, and equity in undistributed earnings of affiliates.

Estimated Cost of Section 1(16)b Directed Service Operations

Should another carrier be forced to operate the Milwaukee for 8 months under the directed service provisions of Section 1(16)b, we project the cost to the government to be about $50 million for the statutory 8 month period. A schedule follows:

Estimated Cost to U.S. Government of Directed Service Operations
1978
(millions)

	1st Qtr.	2nd Qtr.	2 mos. 3rd Qtr.1/
Projected Ordinary Loss	$(12.9)	$ (6.0)	$ (3.1)
Add Back Depreciation & Retirements	4.5	4.5	3.0
	$ (8.4)	$ (1.5)	$ (0.1)
Assume Rental to Milwaukee Equal to Depreciation	3.8	3.8	2.5
	$(12.2)	$ (5.3)	$ (2.6)
Add Fixed Charges for Which Direct Carrier is not Responsible	1.0	1.0	0.7
	(11.2)	(4.3)	(1.9)
Deduct Other Income (Net) and Equity in Earnings of Affiliates	5.0	5.0	3.3
Out of Pocket Costs for Which Carrier may Make Claim	$ 16.2	$ 9.3	$ 5.2
Add Profit to Directed Carrier at 6 Percent of Freight Revenues	6.0	6.7	4.5
Net Cost to Government	$22.2	$ 16.0	$ 9.7

1/ Section 1(16)b is operative for only 8 months. Therefore, only two months of the third quarter would be applicable. These two month estimates were computed by taking two-thirds of our third quarter projections.

NOTE: The total estimated cost to the government over 8 months approximates $50.0 million. This assumes that no debt obligations including conditional sales agreements are to be honored by the directed carrier. However, equipment interest over the 8 month period would approximate $1 million, and equipment maturities over the period would approximate $4.0 million.

Mr. ROONEY. Thank you, Mr. Chairman.

In what role do you see the Commission with respect to the section 401 process?

Mr. O'NEAL. Well, we don't at this stage plan to testify at the hearings in Chicago, but we do have available a large amount of data that the Commission has had submitted to it by the carriers. I think we have some expertise at the agency and are certainly willing to, and interested in, working with the FRA in providing whatever information they feel they need.

Mr. ROONEY. The Commission must ultimately approve most of the actions to be implemented pursuant to the section 401 process; is that correct?

Mr. O'NEAL. Well, if they involve a merger or consolidation, we would have to be involved; that is true.

Mr. ROONEY. Mr. Russo?

Mr. RUSSO. I don't have any questions of the Chairman.

Mr. ROONEY. In your full statement submitted for the record, and I will quote:

> The Milwaukee is eligible to receive $5.1 million for general operations, from the issuance of federally guaranteed trustees certificates. This is the balance of loan funds available under the Emergency Rail Services Act of 1970 for railroads in reorganization.

Even with financing from this source, it is estimated—that the railroad will need another $5 million of funds from other sources, in order to maintain operations for the first 9 months of 1978.

Mr. Chairman, in your opinion, or the opinion of your colleagues, do you think that this subcommittee should increase the authorized funding available under the Emergency Rail Services Act?

Mr. O'NEAL. I think it is very difficult to be precise about just how much money this particular carrier would need, and I want to add a caveat to what we have said in the statement.

The carrier generates about $500 million in revenue, and the $13 million deficit in cash flow that we foresee is a rather small amount of that. It is difficult to say for certain that they would need that precise amount of money. That is our best estimate at this time.

But I think it is important to keep in mind we are dealing with a large amount of cash, $500 million in revenue at least, and it is hard to be precise about what might happen 9 months from now. If their traffic picks up, the situation could change dramatically. So I am really hesitant to urge an additional amount of money for that particular act at this stage.

Mr. ROONEY. In another part of your full statement, you suggest, on page 15, and I quote:

> Another railroad in the Midwest which has been experiencing difficulty is the Illinois Central Gulf. Profitable operations of this carrier in the first half of 1977 were more than offset by a $7.4 million loss reported for the third quarter. This resulted in a $463,000 loss for the 9 months ended September 30, 1977 compared to an $11.3 million net income for the same period in 1976.

Then I see from the ICG industries statement for the 10 months ending in October that earnings were up 48 percent, transportation group earnings pretax in October were $4.2 million and the investment analysts were told that the ICG transportation group had

pretax income for the first 10 months of 1977 of $8.5 million compared with the loss of $6.1 million for the same period in 1976.

The ICG Railroad strong performance resulted in $4.6 million as pretax income for the period and continued the earnings improvement which began earlier this year.

I just can't comprehend how your figures and those of ICG are so different. Is it a matter of accounting methods?

Mr. O'NEAL. I think it may be a matter of time frame. I will ask the director of the Bureau of Accounts to respond.

Mr. THOMAS. You mentioned that the figures were up to October and the month of October was a very strong month. We don't have any data on that, so we don't know how strong that month was in comparison with the preceding 9 months. It is also possible there could be an accounting difference.

Mr. ROONEY. Well, in my original quote, I said primarily the Illinois Central Gulf had a pretax income for the first 10 months of $8.5 million compared with a loss of $6.1 million for the same period in 1976. Do you have those figures?

Mr. THOMAS. No, sir, I think our figures go up through September 30 of 1977. I think the next sentence that you read shows that a heavy October 1977 made a substantial impact on ICG's financial situation.

Mr. ROONEY. Thank you, gentlemen, for your testimony this morning.

Our next witness is Mr. Fred H. Uhlig, chief, Bureau of Legislation, Illinois Department of Transportation.

STATEMENT OF FRED H. UHLIG, CHIEF, BUREAU OF LEGISLATION, ON BEHALF OF THE GOVERNOR OF ILLINOIS AND THE SECRETARY, ILLINOIS DEPARTMENT OF TRANSPORTATION

Mr. UHLIG. Mr. Chairman, and members of the subcommittee, I would like to thank you for the opportunity of appearing here today and would request, if I may, I have a brief statement which I would like to read in the record, the contents of which will take no longer than 5 minutes.

Mr. ROONEY. Without objection.

Mr. UHLIG. I first want to thank you for the opportunity to appear here today to present the views of the State of Illinois regarding the voluntary petition for reorganization filed by the Milwaukee Road on December 19, 1977. I might add, I spoke with Governor Thompson yesterday, and he does concur with all the comments made in this statement.

You and the members of this subcommittee are to be commended for responding so quickly to this event which, as you know, has caused great concern in Illinois and the Midwestern and Western parts of our country. The Milwaukee Road is a great railroad, a 10,000-mile system serving thousands of shippers in hundreds of communities, and its bankruptcy is a matter of major transportation significance, not only to the region that it serves but to the Nation as a whole.

Mr. Chairman, we in Illinois are especially concerned with the future of the Milwaukee Road, since the city of Chicago forms the hub of this railroad. The four main spokes of the Milwaukee

system to Seattle, Council Bluffs, Kansas City and Louisville come together in Chicago.

This provides direct, single-line service to customers in Chicago who wish to ship to points along those spokes. Moreover, the Milwaukee provides service to shippers and communities located on 680 route miles in Illinois, in many cases providing the only rail service available to these shippers and communities.

Despite its recent financial difficulties, the Milwaukee Road is generally well regarded by its Illinois customers, and the service it provides is valued by our State.

The Milwaukee Road is, in addition, a valuable corporate citizen in Illinois. In 1976, it provided employment to an average of 2,847 of our citizens and, during the same year, it paid in excess of $50 million in wages to those employees. These wages have, in turn, created thousands of jobs in other sections of the Illinois economy.

A corporation with a payroll in excess of $50 million is not lightly regarded in our State. Moreover, the Milwaukee Road has contributed financially to the government of Illinois, incurring tax accruals of $1,400,000 in 1976.

Finally, and I think this should be considered carefully, the Milwaukee Road has been a conscientious corporate citizen of our State. For example, it has cooperated fully in providing quality passenger service, both commuter and intercity, to our people.

Despite its financial condition, and in sharp contrast to some of its wealthier counterparts, it has always shouldered its fair share of the burdens created by the public's need for rail passenger service.

It has maintained some of the highest average speeds and best ontime performances in the Amtrak system, and it has been a leader in providing quality commuter services to the people of the Chicago area. Even in bankruptcy, its passenger trains continue to run on time. As you know, that has not always been the case in other parts of the country.

Clearly, Mr. Chairman, the State of Illinois and the Illinois Department of Transportation has not come here today to ponder the demise of the Milwaukee Road because, in our views, there has been no demise. And there must not be one.

The management of the Milwaukee Road has assured us that it will do everything within its power to provide quality service to its customers, and we believe that is exactly what it should do. The first task confronting the new trustee, when he is appointed later this month, will be to determine whether reorganization can be achieved on an income basis.

We believe he should be given ample time to make that determination, free from calls for dissolution of the railroad, decisions on behalf of the Federal executive branch that presume the railroad should be dissolved, or premature calls for merger, whether clothed in section 401 of the Regional Rail Reorganization Act of 1976 or not.

We in Illinois are proud of the example set by the Rock Island Railroad, which has shown how innovative management can turn a property around, just as we are encouraged by the talented efforts of the managements of many of the smaller railroads of our State.

We strongly believe the Milwaukee Road trustee should be given an opportunity to show what can be done on his railroad.

However, Mr. Chairman, all of us know that good wishes and breathing room may not, by themselves, be enough to completely restore the Milwaukee Road to the health it once enjoyed.

Clearly, more is required, and this is where we believe that the provisions of section 401 that deal with measures other than mergers, combined with timely and sufficient infusion of public assistance, can be of assistance.

After giving the new trustee time to familiarize himself with the Milwaukee Road, we believe the Federal Railroad Administration, in concert with rail planners in those States directly affected, should assist the Milwaukee Road and those other Midwestern carriers that wish to participate in vigorous search for economics that can be achieved through such measures as terminal consolidation, joint facilities and other measures outlined in section 401.

This search should be accompanied with timely and fully adequate commitments of public assistance to make possible the implementation of those projects voluntarily agreed to by the railroad involved.

We believe that, through this process and the innovations we anticipate will be undertaken by the new trustee, the Milwaukee Road should emerge as a healthy and important private sector carrier serving the Midwest.

We would like to make one further point, Mr. Chairman. The process contemplated in section 401 may well cause some facilities to be shunted aside, away from the main flow of public assistance.

These facilities, which include such entities as main lines downgraded to secondary mains on local service lines, branch lines required to bring traffic to the renovated main stems and local yards needed to assist in originating and terminating traffic to or from those main stems will also require some public funding if they are to remain as viable parts of the rail system providing adequate service to the shippers they serve.

We in Illinois strongly believe that such assistance should be provided as part of the total effect, and that legislation similar to the preabandonment proposals that were considered by this subcommittee last fall are the best vehicle for providing such capital assistance.

We believe such capital assistance to lesser lines is clearly in the public interest because it would maintain the integrity, usefulness and financial contributions of large portions of our national rail system, and would also expedite achievement of the improvements to the main stems necessary to bolster the health of midwestern carriers by alleviating the fears of those shippers and communities not located in the main stems.

Once again, Mr. Chairman, I want to thank you for the opportunity to appear here today and commend you and this subcommittee for your sensitivity and quick reaction to the problems that have come upon the Milwaukee Road and rail users in our section of the Nation.

Mr. ROONEY. Thank you, Mr. Uhlig.

Is your agency involved in the development of highways and other modes of transportation as well as railroads?

Mr. UHLIG. Yes, sir.

Mr. ROONEY. Does your department believe that government support for other modes has adversely affected the railroads in your area?

Mr. UHLIG. There is no doubt, Mr. Chairman, that the emphasis on interstate highway supplemental freeways, secondary systems, and waterways has had an impact on the financial condition of the railroads. This is why the State of Illinois has recognized this, and we have taken some steps and are prepared to take more in the future to try to help the problems of the railroads.

We have expanded our staff in the Bureau of Railroads to more adequately provide the assistance to the railroads needed in our State, and we have also sought and passed State legislation increasing the assistance to the railroads in Illinois.

Mr. ROONEY. Certainly there are going to be several abandonments in the State of Illinois, and I wonder whether the local communities and the State, itself, is prepared to meet these abandonments with some financial help to keep them from going?

Mr. UHLIG. Yes, sir, with our expanded staff we are reviewing all the abandonments by every carrier in Illinois and do petition either for or against the railroad in certain cases on every abandonment and do try to provide any assistance we can to help the railroad during this difficult period.

Mr. ROONEY. Mr. Russo?

Mr. RUSSO. Thank you, Mr. Chairman.

Under the 401 conferences, has the FRA ever invited any of your State agencies to participate in those 401 conferences?

Mr. UHLIG. To my knowledge, sir, they have not.

Mr. RUSSO. Do you think it would be important that the State railroad agencies be involved in those conferences?

Mr. UHLIG. Yes, sir. As we state in our statement, we are prepared to meet and assist, and that we believe we should be a part of the planning process involved in section 401 because of our closeness to the individual rail lines involved.

Mr. RUSSO. Has Governor Thompson been in touch with the Governors of other States involved in the Midwest to see whether or not they are going to get involved in solving the problems?

Mr. UHLIG. Yes, sir, the State of Illinois today is hosting a meeting of the National Conference of State Railway Officials in Chicago, and we understand that they will be submitting to this committee a statement concerning this particular problem for your review.

Mr. RUSSO. Thank you very much.

Mr. ROONEY. I want to say, Mr. Uhlig, I appreciate your appearance before the committee today and the only sad part about your department is the fact that Kevin McCarthy left you and is now with this committee staff.

Mr. UHLIG. Yes, sir, and we do miss him.

Mr. ROONEY. Thank you.

Our next witness will be Mr. William G. Mahoney, attorney representing the Railway Labor Executives' Association, Washington, D.C.

STATEMENT OF WILLIAM G. MAHONEY, ON BEHALF OF RAILWAY LABOR EXECUTIVES' ASSOCIATION

Mr. MAHONEY. Thank you, Mr. Chairman. I would like to express my appreciation to you and to Chairman Quinn of the Milwaukee for the kindness in permitting me to be advanced on the schedule, due to a previous commitment which I must make.

If I may, Mr. Chairman, I would like to read the statement. It is very short.

Mr. Chairman, and members of the committee, my name is William G. Mahoney. I am a partner in the law firm of Highsaw, Mahoney & Friedman with offices in Washington, D.C. I am here today to present the views of the Railway Labor Executives' Association with regard to the situation confronting its members and the employees they represent as a result of the filing by the Chicago, Milwaukee, St. Paul & Pacific Railroad of a petition for reorganization under section 77 of the Bankruptcy Act. The RLEA appreciates this opportunity to express to you its views on a topic of such importance to its members and, indeed, to the country.

The Milwaukee Railroad employs some 11,400 people in 16 States from Louisville to Seattle and Portland, Oreg. These employees, along with those of the Chicago, Rock Island & Pacific Railroad and perhaps one or two other Midwestern railroads, find themselves in precisely the same position as did the employees of the Penn Central, the Reading, the Lehigh Valley and the Erie Lackawanna in 1971 and 1972. The railroads by which they are employed are confronted by perilous situations which they cannot overcome without substantial Government assistance. These railroads are far too important to the present and future economic needs of this country to be permitted to cease to operate. They should not be broken up and parcelled out to their competitors as was once abortively attempted to be done to the Rock Island. They should not be decimated in the name of rationalization, a term which is often merely a euphemism for abandonment of service to the public in the quest of a rail system consisting of but three or four main lines east and west and north and south, and nothing else.

It is clear that the Congress now faces in the Midwest a situation very similar to that which it faced when the Penn Central was collapsing before our eyes. That is not to say that either the Milwaukee or the Rock Island is in the condition the Penn Central found itself when Congress came to the rescue, but we must recognize that such a condition may well confront us in the near future, and we must be prepared for that contingency.

The RLEA respectfully urges the Congress to insure the financial and physical integrity of these and other Midwestern railroads pending consideration and enactment of legislation which will insure rail transportation adequate for the future needs of this Nation. Whether such legislation should take the form of the establishment of another ConRail, purchase and leaseback of right-of-way; purchase and leaseback of rolling stock or motive power; or, inclusion of the Milwaukee and the Rock Island in the existing ConRail, cannot be determined without study and consideration. That study and consideration should begin now and be pursued vigorously. Whatever form the resulting legislation may take, we trust that the Congress will pay no less heed to the needs and the

sufferings of the employees of the midwestern railroads than they did to those of the northeastern railroads in the enactment of the law which created ConRail.

The association stands ready to cooperate with the members and staff of this committee in any way the committee may desire in an effort to secure the best possible solution to this problem.

Again, thank you for this opportunity to express the views of the association and for your kind attention to our remarks.

Mr. ROONEY. Thank you. You say the association stands ready to cooperate with the members and staff of this committee in any way the committee may desire in an effort to secure the best possible solution to the problem. I wonder whether or not labor is going to participate in Secretary Adams' 401 hearings later this month?

Mr. MAHONEY. We will participate in those hearings.

Mr. ROONEY. Have you been invited?

Mr. MAHONEY. I have been told that an invitation was sent to the Railway Labor Executives Association yesterday.

Mr. ROONEY. Mr. Russo?

Mr. RUSSO. I have one comment, Mr. Mahoney. I am concerned with various problems that have arisen in front of our subcommittee in dealing with the abandonment of the railroads, and the problems of assuming the collective bargaining agreements of a railroad that goes into trouble.

Do you see the labor movement being able to satisfactorily work out the agreement with those individuals who take over that particular track right in order to keep the railroad running properly?

Mr. MAHONEY. Sir, I believe you may be referring to the situation in which a line is abandoned and another operator comes in on that line. We should have no problem with working out those matters. Some experience that we have had is that when some of these operators come in, they do not wish to even speak to the unions, and they would seek to run the rolling stock that they have with as few people as possible. They have very often no rolling stock of their own. They lease it from some other railroad, perhaps, and the same thing with motor power. They do not have anyone to maintain their tracks, so they would hire somebody from the outside to do that, and so they really are operating their railroad with maybe, say, a 30-, 40-, 50-mile railroad with one or two people.

Mr. RUSSO. Don't you think it would be important in settling some of the difficulties to make sure, when you do accept the various contracts that are in existence, that they don't cause that particular line to be in financial——

Mr. MAHONEY. I understand. You are talking about the labor cost, and one of the elements to try to be reduced, and we can appreciate that. There is no question about that. We can appreciate the need for that sort of thing at times. It depends on the situation, in a particular case.

Mr. RUSSO. Thank you, Mr. Mahoney.

Mr. ROONEY. One final question, Mr. Mahoney: what is the posture of the RLEA with regard to the section 401 process proposed by Secretary Adams and Administrator Sullivan for dealing with the problems of the Milwaukee and other railroads in the Midwest?

Mr. MAHONEY. It is our view that the studies are fine things to have. But we feel that they cannot take the place of aid which was

intended, we feel, to come through the 4R Act, which has not come through the 4R Act. We believe that there is no reason why these railroads should go to the FRA for money when they know that they are going to have to present themselves as a viable carrier that can pay back the money and the project they have in mind doing is absolutely sound and is going to make money and enable them to pay back the loan. Confronted with that type of situation, they are not going to go to the FRA. That is why many haven't been going.

I don't think that is what the 4R Act was for in the first place, and I think it was a mistake on the part of the FRA to impose that type of regulation on the carriers who are applying. The 401 studies are only studies. Originally, you will recall, the Secretary of Transportation, Mr. Coleman, wanted a controlled transfer at his discretion, after study, under 401, and that the Congress decided not to give him that power, so all he has is the power to make studies and make recommendations. Of course, we think this should be done.

We think that nothing should be done with these railroads which will reduce their capacity, their lines or anything else, at least until those studies are completed and Congress has a chance to look at them.

Mr. ROONEY. You mentioned Secretary Coleman. Is there any comparison between this present administration and the past administration, or would you rather not comment?

Mr. MAHONEY. Well, I have personal views as to that situation, Mr. Chairman.

I think it is understandable because when you begin a program under a statute with an expert staff as large as is in the Department of Transportation and that staff remains the same, I think the program is pretty much going to remain the same, with some changes, I suppose, brought in from the top, but basically unless something drastic is done, which, as far as I can tell, hasn't been done, the programs which are initiated under the new statute will remain the same, and I think they do remain the same pretty much.

Mr. ROONEY. Thank you very much.

Now we have the star witness of the day, Mr. William J. Quinn, chairman of the board and chief executive officer of the Chicago, Milwaukee, St. Paul & Pacific Railroad, Chicago, Ill.

Mr. Quinn, I would appreciate it very much if you would introduce your colleagues for the benefit of the record. You may proceed.

STATEMENT OF WILLIAM J. QUINN, CHAIRMAN OF THE BOARD AND CHIEF EXECUTIVE OFFICER, CHICAGO, MILWAUKEE, ST. PAUL & PACIFIC RAILROAD, CO., ACCOMPANIED BY RAYMOND K. MERRILL, VICE PRESIDENT—LAW

Mr. QUINN. Mr. Chairman, my name is William J. Quinn. I am chairman of the board and chief executive officer of the Milwaukee Road and I am accompanied here this morning by Mr. Raymond K. Merrill, who is the vice president—law, of the railroad.

I have filed my statement with the subcommittee staff and I will just highlight that [see p. 54].

Mr. ROONEY. Without objection, your statement will become part of the record.

Mr. QUINN. Mr. Chairman, it was certainly not a short-range circumstance which brought the Milwaukee to the necessity of filing for a voluntary reorganization on December 19. The underlying reasons have been plain to see in the railroad industry for many years. We have simply not had sufficient dollars to reinvest in our fixed plant and rolling equipment, despite intermittent increases in freight rates, nor has the Milwaukee Road alone been the victim of the long-term marginality. What happened to us simply demonstrates that the complex set of circumstances which, over time, has undermined the economic vitality of much, if not in reality all, of the railroad industry are still on the march. They are headed west and they have reached the Pacific coast.

We in the railroad industry, and I particularly, have not watched this trend occur unremarked. Many times, to congressional committees, in industry circles, to our own stockholders, and in public statements and published articles, I have warned that there is no way that the status quo in railroading can remain. With much help from Government we must find innovative solutions and apply innovative thinking or we face the possibility of a nationalized rail industry.

With all the resources at our command, we on the Milwaukee have been doing battle with the long-term problem of economic marginality. I believe that we have been making some progress but for some relatively short-term reasons, which my written statement describes in detail, we simply ran out of time.

The Milwaukee was using all of the resources of Government that we could find available to forestall or circumvent the necessity for seeking reorganization. Every avenue available to us through the Railroad Revitalization and Regulatory Reform Act of 1976 was in use and still is. I doubt that any other railroad has tried as much or began trying as early, as the Milwaukee.

We have had some success, which my statement describes. We have some thoughts about how the process might go more smoothly.

The subcommittee should understand that while the Milwaukee is now in reorganization, it is still an operating railraod. Our trains run every day just as they did prior to December 19. We do not expect to shut down. We believe, despite the reorganization, that our railroad is essentially viable or that it will be once it is slimmed down and rehabilitated with the help of the various Federal programs which my written statement reviews.

I parenthetically say here that the importance of the Milwaukee Road and the whole railroad industry's viability should also be judged from the point of view of the necessity nationally to conserve energy, as the President and Government leaders are so eloquently warning the country.

The energy efficiency of the railroads in the handling of the Nation's freight does not have to be belabored before this subcommittee.

Further, looming large as a solution in part of the country's energy problems is the increased utilization of the Nation's vast coal reserves. Inherent to this expanded utilization is the need to

be able to efficiently and timely transport such coal. The railway system network throughout the country, of which the Milwaukee is a part, is a national resource that must be preserved rather than wasted, which is, I feel, a danger under present policies.

Yet we also believe that the Government must help the railroads more. The industry is not in an economic posture in which it can safely remain. The same forces which brought the Milwaukee to reorganization, I remind the subcommittee, are still at work.

Government must create a climate of competitive equality, railroad versus intercity truck and river barges. The Government must find ways to apply existing laws, notably the 4R Act, to encourage the elimination of redundant or economically wasteful railroad plants; and, finally, the Government must find new ways to encourage mergers among railroads, mergers which preserve the essential portions of the marginal midwest carriers, including the Milwaukee.

I believe, and have said so in the past, that perhaps Government can do so by financing the cost of rehabilitating the marginal carriers, which the viable carriers, for good and proper reason, will not be likely to undertake, and by assuming the cost of labor protection in future mergers.

In what has transpired in recent years to culminate on December 19, the Milwaukee has found itself in an interesting dilemma. It cannot make enough money at its business to meet its obligations, but under the law it cannot go out of business. Is that, I would ask, what we want the result of national transportation policy to be? I think not and I certainly hope not.

I thank you.

[Testimony resumes on p. 67.]

[Mr. Quinn's prepared statement follows:]

Statement of
WILLIAM J. QUINN
Chairman of the Board and Chief Executive Officer
Chicago, Milwaukee, St. Paul and Pacific Railroad Company

Mr. Chairman, my name is William J. Quinn. I am Chairman of the Board and Chief Executive Officer of the Milwaukee Road. Thank you for giving me the opportunity to be here today.

As you requested, I have filed 75 copies of my statement with the staff of the Subcommittee.

Since filing our voluntary petition for reorganization under Section 77 of the federal Bankruptcy Act on December 19, 1977, all of us in the Milwaukee Road's management have been occupied full time with the multitude of new problems and questions that arise under such circumstances. I did not receive Chairman Rooney's letter of December 22, 1977, requesting that I testify at this hearing, until December 27; and aside from the shortness of time for preparation, I have had to consider that on January 18, 1978, the federal Court will appoint a Trustee or Trustees. I don't know what the views of the Trustee or Trustees will be with respect to matters under consideration here today. I do not want to influence or prejudice any position the Trustee or Trustees might take by testimony of mine during the period in which management, under Court order, is in a caretaker position.

Chairman Rooney's letter indicates that it is the intention of the Subcommittee, among other things, to explore the reasons for the Milwaukee Road's bankruptcy.

The primary point that I would make in that inquiry is that the basic trends of marginality affecting the Milwaukee and certain other companies in the railroad industry -- the lack of sufficient dollars to reinvest in the plant to overcome deferred maintenance and the resultant growing weakness compounded by the inflationary spiral -- have all been present for many years. They did not show up, on the Milwaukee or on any other marginal carrier, or for that matter in the entire railroad industry, just in the past few months.

During the time when inflation was not the significant factor in this country that it is now -- that is, up to perhaps the late 1960's, -- the average percentage of growth of revenue and growth of the economy in the territory we serve, along with occasional rate increases, enabled the company to hold its own somewhat, although even then some amount of deferred maintenance was building up.

What really accelerated and compounded the problem was the inflationary spiral through all of the 1970's and in particular the tremendous increase since 1973. This, it seems to me, is the story told by the following table:

Fuel and Other Material Price Indexes
Western District (1967 = 100)

Year	Fuel	Material Other than Fuel
1967	100.0	100.0
1968	103.2	102.5
1969	108.1	105.9
1970	113.4	109.4
1971	116.2	114.1
1972	118.7	118.1
1973	138.6	123.5
1974	281.1	145.0
1975	328.9	192.8
1976		
Jan. 1	354.6	203.1
Apr. 1	354.0	206.9

Source: Association of American Railroads Economics and Finance Department Indexes of Railroad Material Prices and Wage Rates - Class I Railroads.

Simply stated, these figures demonstrate that the cost of everything we buy, whether it be fuel or other materials, has gone up several times faster than the combination of rate adjustments and business volume could increase revenues. Of course, labor costs have also increased markedly.

During this period, annual carloads of revenue freight on our railroad remained relatively flat until 1974, when late in the year the recession began making itself felt, reaching its low point as far as carloads were concerned in mid-year 1975. The generally disappointing year 1976 and the disappointing second half of 1977, when coupled with

the increased costs for everything we purchased, compressed the time span we thought we had in which to work something out -- the result was, we basically ran out of time.

Associated with this is the fact that the revenue per mile of road on the Milwaukee, while it has increased in recent years due largely to rate increases, has always lagged behind that of the other roads with which the Milwaukee Road is compared. This is the fundamental problem of our plant. The total plant has lighter density than most of its neighbors. This fact underscores the statement we have made many times that the size of our plant cannot be supported by the revenues it generates. Our coverage is thin; when there is a down-turn in the economic base we have done the only thing we could do: reduce expenses wherever possible. That is why there has been a steady, and I think dramatic, decrease in the number of people employed by the Milwaukee.

The problem gets to be this: A point is reached where the attempt to reduce expenses cuts into service capability and, in effect, becomes counterproductive. It is the breaking of this poverty cycle which is the crucial problem to be addressed, I believe, in the national transportation policy. It is the failure to understand this poverty cycle, or the unwillingness to deal with it, that has resulted in fundamentally no national transportation policy at all.

This brings us to the second half of 1977. Beginning late in June and evidencing itself dramatically in July, we experienced a marked lack of ability to meet our revenue projections. While August results were fairly close to forecast, September was again off. Extreme steps had to be taken early in September to meet the coming revenue-expense crunch. The straw that really broke the camel's back was the dislocation of revenues and the attendant increased costs which resulted from the series of early winter weather disruptions in the upper plains and the floods in the state

of Washington. This, of course, further compressed the time span and in effect removed one more opportunity to try and work out a better solution to fundamental ills and an attempt to reverse basic unfavorable trends.

Now, during all this time we did not stand idly by and wring our hands. We attempted to do something about the situation in every way available to management.

We sought additional revenues and discovered that additional revenues were not to be found in sufficient quantity.

We sought each and every remedy which is available to prudent businessmen engaged in railroading, considering the heavily regulated nature of the railroad industry. We sought help within the private sector and in the public sector as well.

It has hardly been an unfamiliar refrain for the Milwaukee to warn that its own solvency, and perhaps that of other railroads as well, might be short-lived unless imaginative departures from the status quo among all railroads were to take place soon.

I myself testified on this subject before this Subcommittee's Senate counterpart in September of 1975 at a hearing on S.2265, the "Rail Services Act of 1975." I have spoken out on the point many other times as well -- with the goal always in mind of getting something started that would avoid the ultimate nationalization of many, if not all, of the nation's railroads.

More particularly, from the point of view of the Milwaukee and its position in the railroad industry, I have frequently said that the Milwaukee is not alone in the problems confronting western railroads. I have said that there is too much railroad in the West and that, looking down the road, I didn't believe it to be realistic to expect that the Milwaukee operating in an area which does have a handful of stronger roads would be able to be a "core"

railroad -- a key road around which a system could be built -- though parts of it clearly will be included in any essential railroad system of the future. I have added that it only reflects business prudence to believe that the Milwaukee's future is tied necessarily to an alliance with greater strength.

I have said many times, and I say it again, that the railroad business has reached such a crisis point that we can no longer just say, "Let's hope things will get better." Maintaining the status quo, even if we eliminate the effects of the recent recession in the economy, will not result in a material change in the trends in this industry, including in the West.

Clearly, the concept of an imaginative and immediate restructuring of the national railroad system is embodied in the Railroad Revitalization and Regulatory Reform Act of 1976, the so-called 4R Act, and so is the concept of interim federal financial assistance to those railroads which require it.

I doubt that any railroad has explored the avenues of assistance offered by federal statutes as thoroughly as has the Milwaukee Road over the past two or three years. We have walked all the corridors of the federal law, the new ones and the old ones as well. We have knocked on all the doors behind which, we assumed from our study of the national intent, lay help. We have believed in, and have acted in accordance with, the mandate of Congress as it is expressed in Title I of the 4R Act.

I think the Subcommittee will be interested in our experiences with the 4R Act. Generally, we have been disappointed with the length of time it takes to gain acceptance for and to implement activities and programs under the provisions of Title V, including Section 505, dealing with Preference-Share financing, and Section 511, dealing with government guarantee of loans.

The Milwaukee Road was the first railroad to schedule a meeting with the Federal Railroad Administation staff, in the latter part of October, 1976, to talk about how to proceed with the developing of an application. In the weeks that followed we did develop a basic Section 505 application for plant rehabilitation between Milwaukee and the Twin Cities. We secured the approval of our Board of Directors and filed the initial application with the Federal Railroad Administration before year-end 1976.

We were also the first company to get any kind of program implemented under Section 505. The program, which was carved out of our initial application as a one-year project, began in mid-year 1977 and was completed on time. It was designed to cover track rehabilitation work which could be completed in what was left of the work season available for track work in our territory in 1977. The program and work received favorable comment from FRA field inspectors as to its professionalism and the manner in which it was organized and carried out. We have been engaged in completing the balance of the Section 505 application.

While we were not the first to submit Section 511 programs for approval, we do have significant programs under application to rehabilitate our fleet of locomotives and cars. These programs will have a substantial beneficial impact on both revenue and cost-reduction. They will permit us to avoid or postpone future capital expenditures, especially for locomotives between now and 1981. These programs were submitted in September, 1977. We have been informed that the best we can hope for is approval by May 1, 1978.

At the end of ~~September~~ February, 1976, immediately following the signing of the 4R Act by President Ford, we were the first railroad to attempt to progress activity under Section 517, which deals with financial assistance to railroads for the purpose of improving intercity rail passenger service on any

lines located outside the Northeast Corridor. Because we handle Amtrak passenger trains between Chicago and Milwaukee and Chicago and the Twin Cities, a program under this section was discussed with FRA staff and Amtrak personnel. We were disappointed to learn that while this section reads very well in the 4R Act, for all intents and purposes its has no substance to it.

I applaud and agree with the stated purpose of the 4R Act, which is to rehabilitate and restructure the essential parts of the national railroad system. The intent of the Congress is clear. I am fully in accord with it. We believe that the Act grants broad powers to the Secretary of Transportation and if we are disappointed with our experience under the Act to date, it is because of the myriad of detail and lengthy negotiations which one must undergo in order to gain acceptance for programs encompassed within the Act. We suggest that, given the desire to implement the intent of the Congress, the Act is basically sound -- although conceivably there could be some beneficial changes to make the conditions for working under the Act less onerous, along with expediting the procedures.

The Milwaukee has, as is widely known, the most ambitious program of any railroad in the country under Title VIII of the 4R Act for the abandonment of light-density lines. This program came about because of a rigorous analysis started fifteen months ago to define the profitable core of the plant in order to prepare to take advantage of the Title VIII proceedings when the timetable upon which we could do so began to unfold. We met the timetable beginning May 1, 1977, with the publication of our Title VIII map; in the past three or four months we have been vigorously pursuing the development of data and the filing of applications for the abandonment of 36 lines or segments of lines.

We also indicated in response to an inquiry from the Secretary of Transportation in the Spring of 1977 that we would be willing to assist in providing data to make a study under Section 901 looking at mergers of midwestern railroads. Since we have long been in the public forefront arguing that there must be a corporate restructing of the number of western railroads, this was an entirely consistent and appropriate action.

We have been prepared to engage in Title IV studies dealing with mergers and coordinations. At this time we do not know just how the Secretary of Transportation proposes to implement the Title IV authorities which he has, but he should find the Milwaukee responsive and in a position to offer constructive alternatives to solving an extremely difficult but obviously pressing and critical problem facing the users of transportation, particularly in the Midwest.

As we start the year 1978, I believe one thing stands out. The complex set of circumstances -- the Subcommittee knows them as well as do I -- which have undermined the economic vitality of much, if not in reality all, of the railroad industry are still on the march. They are headed West. They have reached the Pacific Coast.

While the Milwaukee Road has filed a voluntary petition for reorganization, a survey of its present situation is in order. After all, a railroad of considerable national importance remains, one which is operating every day. It is far too important a railroad for the nation to ignore.

Even at its presently depressed state of business, the Milwaukee moves more than 50 million ton-miles of freight a day. The Milwaukee's trains reach virtually every major center of population in the northern tier of states between the Great Lakes and the Pacific Ocean. In Chicago we take 15,000 commuters to work each day and bring them home again. We work, successfully, for Amtrak. We provide more than 11,000 jobs.

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Yet to this day the Commission has steadfastly refused even to hear our argument that the Commission must use the very mechanism that it created for precisely these circumstances. Small wonder that, in the interests of those we serve and employ, we have been compelled to take the Commission to court.

We have found it difficult to flail the Burlington Northern into competitive equality, as we are required by the Commission to do, using only the limited resources available to us.

We do not expect to shut down. Our physical plant and our rolling equipment are not the best, not only because they have suffered the ravages of the early winter but also because, over time, they have received less maintenance than we would have preferred to give them. Nonetheless, we are operating.

For a period of many months, we have had under way the most comprehensive analysis of our company's economic potential in its history. The entire Milwaukee Road has been, and continues to be, under an economic microscope. We know that, essentially, within the Milwaukee Road lies a viable carrier -- and that the Milwaukee Road which exists today, physically speaking, is not that viable carrier.

We find that upwards of 1,600 miles of the Milwaukee have no economic validity worth our continuing to operate them. We are well under way in seeking to abandon them through the procedures of the Commission and the 4R Act. We have an additional 2,000 miles of line under close study.

We have determined that, pursuant to the philosophies of the 4R Act and subsequent DOT studies concerned with redundant railroad, we can and should rehabilitate our main line from Chicago to Minneapolis into a first-class railroad.

Subject, of course, to the views of the Trustee or Trustees, we expect these rather major programs to continue. Management has been dedicated to the rehabilitation of the Milwaukee -- but not, I hasten to add, to its preservation in kind. To do so would be to deny the validity of the DOT's thesis that too much railroad plant exists particularly in the Midwest. Not only do we champion this thesis and believe it to be correct, as I recall we championed it before the DOT did.

I have made repeated references to the role of the federal government or its agencies in the present and future of the Milwaukee Road. I do so because I am convinced that, in this regulated industry, it is because of past governmental activity, both legislative and regulatory, that much of our problem has arisen. And however as much I might wish it otherwise, it must be of a future association with government that a solution to our problem will take form.

We knew long ago, and so said, that the future of a railroad like the Milwaukee is being shaped at least as much by how the Congress and the DOT and the ICC view the role of the railroads as by what the railroad can do for itself.

And so, I turn to the future and offer some comments. I can do little else because I am neither economic soothsayer nor reader of the minds of Trustees yet to be appointed.

It is time -- long past time -- that the inequality in taxpayer treatment of differing modes of transport be ended. There is no logic, political or otherwise, for it to continue.

On one side of the equation are intercity trucks and river barges; on the other the railroads.

Government might require trucks and barges to pay real, hard-dollar user fees which reflect the full cost of maintaining the facilities that government provides for them; which reflect the fact that these modes avoid any investment in

the right of way upon which they operate; which reflect the fact that these modes enjoy virtual immunity from property taxation in the regions where they operate. That would be one way to strike the balance.

Or, government might elect to relieve the railroads of those costs which the railroads' competitors of other modes never incur -- maintenance of and taxes on their right of way.

It is time too -- long past time -- that we understand what we are trying to do with, and pursuant to, the 4R Act, the most comprehensive piece of rail legislation most of us shall ever see. We must reread and understand the mandate of Congress as expressed in the 4R Act -- to rationalize, restructure and rehabilitate the essential services of the nation's railroads, be those railroads presently marginal or forever sound.

Plainly, the Congress desires that, where appropriate, railroads get together and coordinate their activities, eliminating parallel, underutilized, duplicative facilities which represent nothing more than an economic drag on the national, and on the corporate, purpose. We know from our experience that while the goal of coordination is certainly laudable, the incentive for railroads to coordinate seems lacking.

The government must encourage rail mergers -- but mergers which preserve the essential lines and services of the marginal carriers.

I have frequently reminded the railroads which are more fortunate than we that the problem of the marginal Midwestern railroads will hardly go away if it is ignored. It will in fact get worse. We have been required, to our astonishment, to remind the RSPO of the same thing in recent weeks.

Yet it appears that two of the major Western lines have turned their attention Southward. Rather than take an

active part in the ultimate restructuring of Midwestern lines, they apparently seek additional corporate strength elsewhere while continuing to ignore the problem on their doorstep.

Burlington Northern is one of those two major Western lines. Burlington Northern, of course, seeks a merger with the Frisco. I cannot and do not argue with the logic of such a merger. But I have no doubt that such a merger would so increase the strength of Burlington Northern as to effectively complete the job of eliminating the Milwaukee Road as Burlington Northern's competition between the Great Lakes and the Pacific Coast -- despite the desires and directives of the ICC and the DOT.

Is there an alternative? For government, yes there is. You will recall that I have mentioned it before, as long ago as the Spring of 1975.

Quite logically, government could encourage the creation of four "core-system" railroads in the private sector in the West. These "core-system" railroads would be fashioned around the existing Southern Pacific, Santa Fe, Union Pacific and Burlington Northern. To these carriers, in a manner prompted by certain incentives, would be added the appropriate marginal and other lines, or at least the essential parts of them.

I suggest that really only two roadblocks stand in the way of something like this happening in the very near future -- and these are the roadblocks that proper government incentive can push aside.

No company can logically take on a massive rehabilitation of even the best lines of the marginal carriers, given today's cost of capital, no matter how strong the company is. Government must provide low-cost financial assistance to get the job done. I find the framework for such a program embodied in the 4R Act.

No "core-system" railroads, no matter how strong financially, can easily afford the cost of labor protection which this comprehensive plan of rationalization would ultimately create, and which should of course be paid. Here too government should lighten the load on the "core-system" railroads and on the "acquired" railroads as well.

Repeatedly we've talked here this morning about the need for competition among railroads. Wouldn't what I've just proposed eliminate a great deal of competition among railroads?

It might; it probably would in some areas. But for what reason do we seek competition among railroads at every hamlet, and is it logical that we do so? After all, the railroad industry nationwide is competing within itself for only a little more than a third of only that portion of the intercity freight business upon which the regulatory process has a handle and thus can provide a statistical measure! As an industry the railroads are not able to return their cost of capital. I suggest that there are larger considerations for our national transportation policy than that there be two railroads in any given location.

But the Milwaukee Road is in an interesting dilemma. It cannot make sufficient money at its business to meet its obligations, yet under the law it cannot go out of business.

If that dilemma is to be the manifestation of national transportation policy as that policy is applied to our company, our future may lie in one of three directions:

1. The government will ultimately own the Milwaukee's fixed properties -- its lines of railroad -- and will lease them back to some operator.

2. Conrail will come West to acquire and operate the Milwaukee, or a new western counterpart to Conrail will come into existence.

3. Government will find it necessary to infuse into the Milwaukee a substantial amount of cash so that the Milwaukee may rehabilitate its roadway and equipment and get itself back on its feet while it trims the size of its plant, seeks coordinations and works out merger possibilities.

Subject as always to the thinking of our soon-to-be-appointed Trustees, I would think that the infusion of cash would be the least disruptive to national transportation policy, the least expensive, and the most consistent with our desire to maintain our railroads as much as possible in the private sector.

Mr. Chairman and members of the Subcommittee, on the day that we went to Court we told our employees that the legal step we were taking was the result of conditions we couldn't control. We asked them to regard it not as a defeat but as a new beginning.

I ask the same of you.

Thank you.

Mr. ROONEY. Thank you, Mr. Quinn.

Are you getting the cooperation you think you so rightfully deserve from the DOT?

Mr. QUINN. Well, my attitude, Mr. Chairman, I think, is explained further in detail in my full statement.

Mr. ROONEY. You indicate in your full statement the difficulties you have in obtaining approval of projects under the redeemable preference-share program under the 4R Act. Could you indicate the extent of these projects and whether or not any of them were refused by FRA?

Mr. QUINN. Well, in the fall of 1976 we began talking to the people at the Department and we finally filed an application, basically for 505 or preference-share financing, totaling about $109 million in December, I believe it was, of 1976.

Mr. ROONEY. I thought you asked for $91 million?

Mr. QUINN. $91 million was the reference made by one of the members of the Federal Railroad Administration dealing with the preference-share financing part of it. There were some parts of it that included a section 511 guaranteed Government loan. They

were lumped together in the one application which covered $109 million.

The regulations under the Department's responsibility or the Federal Railroad Administration's responsibility were not out until the summer of 1977, as I recall it. At that time, in an effort to get something done that could be accomplished in the work season on the Milwaukee Road on the track, which is limited because of our weather to the summer, spring, and early fall months, a so-called interim project was carved out of the larger application that we had filed in December of 1976. That was the $9.3 million which was a preference-share financing and that work has been done, starting sometime in about July and completed in the early part of November.

In September of 1977 we filed additional applications, again part of the earlier larger application I refer to as the $109 million part. This was related to section 511 guaranteed Government loans and it had to do with the rehabilitation of locomotives and freight cars.

We have been in the process of updating what we consider to be necessary in the way of further 505 or preference-share financing with respect to the track, basically in the area from Chicago through Milwaukee to the Twin Cities.

Mr. ROONEY. In your opinion, how much of an infusion of 4R financing program would have saved your railroad from bankruptcy?

Mr. QUINN. Well, I think it would be difficult to answer in that fashion, Mr. Chairman. I do believe that if we had been able to spend money in rehabilitating locomotives and freight cars and some more money in the track, though that probably couldn't have been added to very much until next year because the regulations weren't out in time to get the business going until the summer of 1977, I think we would have had more time within which to seek ultimate solutions.

I don't believe that we would be in the bankruptcy court at this time, though I hasten to say that there is no one button that you can press, in my judgment, to take care of the railroad problem, including the problems of the marginal railroads.

The competitive situation, the subsidy or quasi-subsidy of competing forms of transportation, other regulatory, frequently obsolete in nature, requirements and of course the inflationary spiral—all of these bear a part; however, Government infusion of funds, in my judgment, plays an essential part in keeping the lifeline open until more ultimate solutions can come about.

In the case of the Milwaukee, I think there has to be a slimming down of the property. I think there has to be some alliance with strength, a merger or massive coordination. Those things have to be done ultimately, but the important thing was to be kept alive until it could be accomplished.

Mr. ROONEY. Do you agree with the FRA statement, that the inability to borrow funds from either capital markets or the FRA was not a principal cause for your bankruptcy?

Mr. QUINN. Well, I think, I can only repeat, the trends—and I don't want to try to delineate the railroad problem today; it is too well understood by certainly this subcommittee—but the trends that have been adversely affecting the industry, and certainly the

marginal carriers, have been in existence for a long time and they still continue.

The hope of marginal carriers is to stay alive, perform the essential services that they offer in their territories, keep the jobs for their employees, take care of the shippers, until more permanent solutions can be arrived at, and permanent solutions, in my judgment, are going to have to be arrived at or the alternative is—and I am not saying something unique to myself—the alternative is nationalization.

So I look upon the efforts of the 4R Act as implemented by the financing parts of it as vital means of keeping these systems going until the more permanent solutions are arrived at; and if the help had come earlier we would have been in a better position.

Mr. ROONEY. Do you foresee a midwest ConRail?

Mr. QUINN. I see the possibility of it and I deplore it.

Mr. ROONEY. I take it you don't like the ConRail setup within the 17-State region in the East.

Mr. QUINN. I don't like the situation that brought about the necessity of a ConRail, and I have been saying publicly that unless there is a recognition of the fact that the same trends and adverse influences that brought about the necessity of ConRail in the Northeast, if they are not recognized—they are not localized to that part of the country; they are applicable to the rest of the country; they are being implemented or effected in the Middle West and they are growing——

Mr. ROONEY. But in your opinion the implementation of the 4R Act could more or less keep the railroads from going national?

Mr. QUINN. Yes, I believe so.

Mr. ROONEY. Mr. Russo?

Mr. RUSSO. Mr. Quinn, do you feel that the FRA is not vigorously implementing the 4R Act?

Mr. QUINN. Well, I prefer to fall back on the language that I used in my written statement, and that is, I said we at the Milwaukee have been disappointed in the length of time it took to work out programs and get them implemented.

Mr. RUSSO. Do you think now that they have worked out the various details that the implementation will be better?

Mr. QUINN. Well, I have to say I believe so, and I add I certainly hope so.

Mr. RUSSO. From what I understand, when the FRA made the $9-million loan recently, it was with the intention that the money would be able to get you through the winter months and in fact you would have cash on hand, but you chose to go through bankruptcy anyway. Is that a fair statement of fact, that you do have enough cash on hand but you chose to go through bankruptcy procedure anyway?

Mr. QUINN. No, Mr. Russo, that is not the correct statement of fact.

Bankruptcy, in my judgment, and certainly I am convinced in the judgment of our board of directors, is an absolute, last, irretrievable step to be avoided at all costs if at all possible; and it was that attitude and the recognition that we had arrived at as far as ability to pay our bills was concerned at about that stage that prompted the board of directors to take this step. There was no

discretion. There might have been discretion in that we couldn't pinpoint that we would run out of cash tomorrow or the day after but certainly the figures available to us indicated that in January at the best we would not have sufficient funds to take care of our bills and we did not want to precipitate a situation that I think we all remember existed at the time the Rock Island unfortunately had to go into bankruptcy. There was talk for some time about their shutting down, that they were not going to be able to operate after a certain date.

Well, we did not want that kind of chaos to exist in our territory. We didn't want our people to come to work and not be able to be paid, and so recognizing the inevitable, we took a step at a time when we thought it was the best prudent step to take to avoid the chaotic condition that existed in an earlier experience.

Mr. RUSSO. Now that you have filed bankruptcy under 505, you no longer can get redeemable preference shares; you have to apply for trustee certificates. I believe you have outstanding about—what, $100 million worth of applications now, $82 million?

Mr. QUINN. Well, a large sum.

Mr. RUSSO. Do you intend to continue to press those applications with FRA?

Mr. QUINN. Well, Congressman Russo, you put me in a sensitive position. As a result of the filing of the petition for voluntary reorganization, the court issued what is known as General Order No. 1 which required the present management to manage the affairs of the company pretty much business as usual until the appointment of the trustee, and the date for that action has been set by the court as January 18. The trustee is the person thereafter who will make the kind of decisions and give the kind of answer that is called for by your question, I believe.

Mr. RUSSO. Well, let me just ask you this: You acknowledge your railroad is in bankruptcy. Do you anticipate having more difficulty in obtaining financing from the FRA? For example, in my discussion with the Rock Island they have had tremendous difficulty in getting funds. I think the FRA has given an explanation as to the reason for it, but do you anticipate your railroad having difficulty now that you are in bankruptcy?

Mr. QUINN. Obviously, I have nothing to go on except impressions. I am not happy by what I see has been the experience of the Rock Island, though, of course, I have not been privy to the circumstances that have been talked about here today. I would hope that there would be a continuation of the kind of relationship between the representatives of the Federal Railroad Administration and our railroad that has heretofore existed, and I would hope that we would be able to—and I speak here as an individual rather than speaking for the railroad—I would hope that after the 18th and the appointment of a trustee that there would be an orderly and speedy movement toward attempting to implement what I consider to be the policy and the mandate of the 4R Act as set up by the Congress.

Mr. RUSSO. Let me ask you this: When you negotiated your 505 agreement with the FRA there was a contingency clause that was inserted and that clause was activated when the company filed bankruptcy. That was the clause that reverted the redeemable

preference shares to the most senior debt, behind your creditors. Is that an accurate statement?

Mr. QUINN. Generally speaking, I understand so, yes.

Mr. RUSSO. I don't have any more questions.

Mr. ROONEY. Thank you very much, Mr. Quinn. I appreciate your appearance before the committee today.

Now our next witness will be Mr. John W. Ingram, president of the Chicago, Rock Island & Pacific Railroad Co. Mr. Ingram will be introduced by Mr. William M. Gibbons, who is their trustee.

STATEMENTS OF WILLIAM M. GIBBONS, TRUSTEE, CHICAGO, ROCK ISLAND & PACIFIC RAILROAD CO.; AND JOHN W. INGRAM, PRESIDENT, CHIEF EXECUTIVE OFFICER, ACCOMPANIED BY NICHOLAS G. MANOS, COUNSEL

Mr. GIBBONS. Mr. Chairman and members of the committee, I have with me today my counsel, Nicholas G. Manos, and, of course, my chief executive officer, president, Mr. John W. Ingram.

As you may know, I have been trustee of the Rock Island since March of 1975 when Judge Frank J. McGarr appointed me, and have devoted full time to this job since then.

I do want to say that on behalf of some 7,900 employees of the Rock Island, I thank you for inviting us here. Our people have had and do have the utmost faith in our elected officials. We have not been let down at all. To a great and significant extent, it has been the congressional interest that has helped us over the hardest parts of our reorganization period to date. We have received from the Congress the encouragement to continue and for this we sincerely thank you.

Today's hearing is timely and most important. The subcommittee is very correct in identifying the problem as affecting more than just the Milwaukee Road. Effective rail service throught the Nation's agricultural belt is threatened if the only remedial efforts to be offered are the creation of long-distance merged truck lines with little or no concern for very vital gathering services.

The Rock Island pledges its full cooperation in all ways with this committee. We feel that here in this forum there is an understanding and concern that transcends other approaches and attitudes elsewhere in this great city.

I might also note that we are working on an almost daily basis in attempting to cooperate with the Milwaukee. We have no intention to prejudge their future or in any way to influence their court, but we have offered, and we will offer, their trustee or trustees when appointed every cooperation, every benefit of our experience as a carrier which has been operating under the protection of section 77 of the Bankruptcy Act.

Mr. Chairman and members of the committee, at a crucial time when there is an expeditious need for innovative action, not just thinking, we have a proposal into which much serious thought has been given and at this time I would like my very capable president, Mr. Ingram, to advance this proposal.

Thank you.

Mr. ROONEY. You may proceed, Mr. Ingram.

STATEMENT OF JOHN W. INGRAM

Mr. INGRAM. Mr. Chairman, I would like to submit my prepared statement for the record and just highlight it [see p. 75].

Mr. ROONEY. Without objection, it is so ordered.

Mr. INGRAM. I am delighted for the opportunity that you have given us to be here. I think the fact that you returned to Washington 2 weeks early for a hearing on railroad problems exemplifies your high interest and determination to find answers.

Mr. ROONEY. I hope the press picked that remark up.

Mr. INGRAM. The Milwaukee Road's position is where the Rock Island was a little less than 3 years ago. There are differences, of course, but I would hope that the Milwaukee employees and shippers are encouraged by the fact that after only 3 years of the reorganization process the Rock Island has been able to put 900 miles of track back into first-class condition, has been able to acquire 5 new locomotives, rebuilt 136 more and has repaired and returned to service some 6,600 freight cars out of our 25,000-car fleet. We have stable employment. Employment has been stabilized. We are paying our bills. We are meeting most of the demands placed on us.

We have not been able to meet all of the transportation demands we face, frankly, because FRA has been slow in processing our application for car repair funding. We need more freight cars on the Rock Island but we are heartened to know that that sizable demand is an indication that our services are needed as well.

As the committee is aware, Secretary Adams has scheduled a 2-day meeting for the 18th and 19th of the month at the Conrad Hilton Hotel in Chicago. In calling the meeting, the Secretary has said that we will all together—and I quote—"look for ways to speed up efforts to find solutions for the problems of midwestern railroads."

Mr. Chairman, the Rock Island intends to offer a remedial program at that meeting. This will not be a bailout for the properties involved. We have said all along that we are not looking for a handout; rather, what we want is to help develop a coordinated program involving all of the so-called marginal railroads in the Midwest.

Utilizing the procedures available under section 401 of the 4R Act, we would like the Secretary to endorse and assist in bringing about a thorough experiment that would draw the subject lines into a close but rather loose consortium, operating in all of the railroads' joint best interests.

We have much work to do between now and the meeting on the 18th to refine a specific program, but I would like to give you a thumbnail sketch of what I have in mind.

Let me begin by using a word that should probably not survive the planning and implementation period—Farmrail. I don't like the word very much because it seems to imply a midwestern Con-Rail, which is not what we are looking for; but it does focus attention on the massive rail transportation market that exists in mid-America, the agricultural and agribusiness market. It is a market that exists nowhere else. It is a market that needs its own special services.

Farmrail would not be a corporation on its own, although eventually it could be. It would be, as I said, a loose consortium of operating properties looking for ways to do things better together. Farmrail, I think, should consist initially of the Rock Island, appropriate lines of the Milwaukee, the Iowa and South Dakota lines of the Illinois Central Gulf, possibly the Katy—that's the Missouri-Kansas-Texas Railroad—and perhaps the Kansas City Southern. This combination of routes can be a basis for a money-earning network of rails spanning the vast territory between the Mississippi and the Rockies.

Farmrail would identify opportunities for run-through trains, for eliminating the inefficiencies of time-consuming interchanges. Farmrail would suggest and help implement critically needed terminal consolidations. It would identify and help implement opportunities for equipment pools, service pools, traffic pools, joint offline sales forces, and things of that nature.

Farmrail need never be a company; it could be, but it would be a forum for the implemention of commonalties among the so-called marginal midwestern granger railroads. If it works and helps resuscitate the lines involved, it could—and I stress the word could—ultimately be a basis for a strong, independent railroad at some future date. It could meld nicely and equitably with other supersystems that seem to be on the drawing boards today. But that is not the instant appeal of Farmrail.

Today's need in that great grainbelt gap in the Midwest is for transportation stability and consistency. The producers of America's crops deserve better than the haphazard transportation development that has plagued them in the past. The creation of Farmrail would bring improvements almost immediately while the vested interests, the Government, the users, all have an opportunity to develop and fine tune a national rail transportation policy.

I think Farmrail could be an excellent, efficient, and equitable solution, but for it to work, however, we must enlist the commitment and cooperation of at least three somewhat disparate entities: First, the railroads have to work together. Second, there will have to be a decision on the part of FRA to make available title V rehabilitation funds for Farmrail coordination projects, especially during the 1978 construction season, and that season is about to commence, when you start to take into consideration the time necessary to gather material, labor, and machinery to do the job.

The Rock Island and the Milwaukee have had a 243-mile mainline consolidation in operation since midsummer and, frankly, the only thing we are proving so far with that consolidation is that consolidation without rehabilitation doesn't accomplish much more than doubling the rate at which the track wears out. In that particular instance we may have to tell the Milwaukee to go back to its own line unless Federal rehabilitation loans are approved soon; and I think that would be tragic, Mr. Chairman.

Congress provided considerable sums for rehabilitation in the 4R Act. Those funds are necessary to finance consolidations and I think the money should be let out at a much quicker rate. The DOT has it and I think it should be used.

Third, and perhaps the most important, and also the least predictable, factor for Farmrail success would be the great enhance-

ment of that success by active cooperation on the part of the railroad unions. Experimentation with new services is far preferable to massive shutdowns throughout the Midwest. We must work together to create salable service in light density situations.

I suggest that Farmrail will give labor more work and more opportunities to earn than alternative plans, most of which seem to be based on shrinking the plant. We must experiment to see if the service we provide on light density lines can be modified effectively to meet the users' demands and we have to do it on a profitable basis, both to the carriers, to the shippers involved, and to our labor organizations, and I don't think that can be done if labor is unwilling to join in the experiment.

I envision some radical change is necessary in work rules, but those changes must be changes that will not be disadvantageous to labor; they must be advantageous to shippers. This level of work-rule change is needed on lighter density railroads. It need not be a precedent for the more profitable heavy density lines.

Mr. Chairman, my full text lists examples of types of consolidations and coordinations that we would expect under Farmrail. They range from joint yard facilities in Council Bluffs and Kansas City to jumbo covered hopper car equipment pools to centralized computer payroll plants. I will skip the details here.

The bottom line of my argument is that there is a massive difference between the problem you faced in the Northeast a few years ago and the troubles that are rising in the Midwest today. Northeast railroads were built to serve less-than-carload and passenger markets. Both of those markets have disappeared in the face of competition from highways and other forms of transportation; therefore, the northeast railroads had to change drastically.

Midwestern rail lines were built to provide transportation of agricultural production. That market has not disappeared; it's grown phenomenally. The American farm community has suffered much over the years and are we now on the verge of taking away one of their great advantages—the benefit of low cost transportation for the fruits of their labors? I don't think we should.

I think Congress recognized this when it enacted the Railroad Revitalization and Regulatory Reform Act of 1976. I think Congress intended—and please correct me if I am wrong—that railroads that are needed are railroads that will have access to Government loans. I think agricultural railroads are needed. In fact, I know they are needed.

My shippers keep calling up and ordering more cars than I can furnish for their movement. What we must do now is meet in the sort of conclave the Secretary of Transportation has scheduled for Chicago in the next 2 weeks, to determine how best these formerly competitive, light-density railroads can now form a consortium that will earn dollars, provide good jobs, provide needed services and avoid redundancy. I think we can do this with Farmrail.

Mr. Chairman, Mr. Gibbons and I will be glad to respond to any questions you or the subcommittee may have.

[Testimony resumes on p. 88.]

[Mr. Ingram's prepared statement follows:]

TESTIMONY OF JOHN W. INGRAM, PRESIDENT, CHICAGO, ROCK ISLAND AND PACIFIC RAILROAD COMPANY, BEFORE THE TRANSPORTATION SUBCOMMITTEE OF THE HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE; 2322 RAYBURN BUILDING, THURSDAY, JANUARY 5, 1978

Mr. Chairman and members of the Subcommittee: Thank you for this opportunity to be here. The fact that you would return two weeks early to a Washington hearing on railroad problems exemplifies your high interest and determination to find some answers. I heartily echo Mr. Gibbons' appreciation of Congress' involvement.

Nearly three years ago, when the Rock Island was in a position somewhat comparable to the Milwaukee Road's present status, we were afforded a similar opportunity to bring Congress a report on our condition and prospects for survival. As I remember the testimony of several apparently well-qualified experts, it was something of a foregone conclusion that the Rock Island could not possibly survive, and that neighboring railroads should gear up for a takeover of our essential services. I am delighted to report that we have spent three years confounding the experts.

It is premature to say that we are healthy and well (after all, the previous management had spent a decade driving the railroad down into the mud), but we are alive and we are neither a social burden to the public nor an economic burden to the federal treasury.

900 miles of track have been rehabilitated, 56 new locomotives have been acquired, 136 more have been fully rehabilitated to like-new condition. 6,628 freight cars have been repaired and put back into service, employment has been stabilized, bills are being paid, and transportation demands are being met most of the time.

Indeed, Mr. Chairman, the biggest problem on the Rock Island

today is the fact that demand exceeds supply. Shippers throughout our 13-state territory are constantly offering us business we cannot handle, simply because we do not yet have a large enough fleet of freight cars. We have applied for federal funds to fix bad-order cars, and since early last summer we have been providing the FRA with bi-weekly reports that identify the shippers by name. We specify the type and number of cars they want, and itemize what we were able to supply. To our knowledge, the FRA has never bothered to check or otherwise follow through on these records. But the application is still alive and pending. We wait. Our shippers wait.

Nonetheless, we are doing a great many things on our own. We are proving, I am convinced, that even when left alone by the government, a railroad with its back to the wall can take remedial actions that start it off on the road to recovery. We anticipate being wholly out of the woods in either 4 or 9 years (or so), depending upon the availability and level of federal financial assistance. If we can borrow the money, we can continue to improve at a faster pace.

I hesitate to say anything here that will put an increased strain on the slender thread that currently links the Rock Island with the Federal Railroad Administration. We have fought a couple of fairly public battles regarding Title V financing, and they have made it quite clear that they would prefer us to be less public -- and specifically, to stay off Capitol Hill. I try to remind myself regularly of the Golden Rule of Business: -- "he who has the gold makes the rules" -- and there is no question that FRA indeed is the party with the gold. Our shippers only pay when service is provided, and with a critical shortage of freight cars and a lack of FRA loans for car rehabilitation, we can't expect our revenues to increase as much as we'd like.

As this Committee (and most of Congress, for that matter)

is well aware, the Rock Island has yet to receive one thin dime in loans from the 4-R Act. All of our competitors who have applied for funding have at least received loans for interim projects. For instance, the Chicago & North Western has received upwards of $20 million to rehabilitate its route between Chicago and Omaha. This is a route not only directly parallel and competitive with the Rock Island, but with the Milwaukee, and the Illinois Central Gulf as well. The North Western has named its premier service on this route "Falcon" service, noting that the falcon is a predator and that the traffic carried is traffic taken away from other carriers. I have no bone to pick with the CNW. I do occasionally wonder what led the FRA to get into this "favoritism" sort of financing. FRA has assured us that our 4-R Act applications are being given serious consideration, however, and I am reluctant to do anything that might cause them to revert to the stated policy of the previous administration. That policy, you will remember, was to rationalize the Midwest rail situation by starving the marginal roads out of existence. They used to claim that when the whole lifeboat was foundering, the only thing to do was take the weakest occupants of that lifeboat and give them the heave-ho over the side. We are delighted that Secretary Adams has renounced this "Deep Six" policy. I look forward to the meeting at the Conrad Hilton Hotel in Chicago on January 18th and 19th at which Secretary Adams has said we will all, together, (quote) "look for ways to speed up efforts to find solutions for the problems of Midwestern railroads."

Mr. Chairman, the Rock Island intends to offer a remedial program at that meeting. We want to give the DOT and the FRA an opportunity to solve problems, not exacerbate them.

The program we will propose will not be designed just to bail out the Rock Island. As I noted earlier, the Rock Island does not, under present circumstances, need a bailout. Our customers would prefer rebuilt service <u>now</u> rather than waiting

for our internally generated funds to do the job.

We will propose that under the authority and procedures of Section 401 of the 4-R Act (now incorporated as Title V of the Department of Transportation Act), the Secretary take a lead role in bringing about a thorough experiment in a new approach to providing good rail service. I use the word "thorough" because if the effort is half-hearted and concentrates on isolated token measures, it will fail.

I will work with my people -- and with my colleagues at other so-called marginal railroads -- for the next two weeks in order to be able to present the Secretary with a rather complete program of opportunity. I trust we will get the time to make the full presentation rather than simply summarize it while the FRA staffs it out to a gaggle of consultants. I will attempt to describe now to the subcommittee what I have in mind.

Let me begin by using a word that probably will not survive the planning and implementation period. "FarmRail."

"FarmRail" will not be a Midwestern Conrail. It will not necessarily be a corporation on its own -- although eventually it could be. It will not be an operating railroad, it will be a consortium of railroads, operated in their joint best interests.

FarmRail should consist -- at the first -- of the Rock Island, appropriate lines of the Milwaukee, the Iowa and South Dakota lines of the Illinois Central Gulf, possibly the Katy (Missouri-Kansas-Texas RR), and possibly the Kansas City Southern. There would be no investment required to establish "FarmRail." In this regard it will be unlike the old Railway Express, or today's Trailer Train Corporation, companies that were and are owned by a consortium of carriers. FarmRail would be an operating entity, but not a total operating entity in the sense that it would ever operate a whole railroad system. FarmRail would identify opportunities for run-through trains; FarmRail would suggest and help implement terminal consolidations. FarmRail

would identify and help implement opportunities for equipment pools, revenue pools, traffic pools, and joint off-line sales facilities.

FarmRail need never be a company. It would be a forum for the implementation of commonalities.

FarmRail will be pulled together to do just what its name says: design, create and encourage rail transportation service for the breadbasket of the nation -- the huge granary that stretches from the Mississippi Valley to the Rocky Mountains -- the heartland that even today provides the largest part of the export goods that are necessary for a favorable balance of trade. FarmRail would be designed to provide transportation services that meet specific agribusiness and agricultural needs. FarmRail would encourage the development of new services, new techniques, new methods, new departures.

Let me state frankly -- here, two weeks prior to giving a more fully-developed presentation to the Secretary -- that this experiment will not work without the commitment and cooperation of at least three somewhat disparate entities.

First, the railroads themselves will have to pledge to work together. For us, it's a matter of hanging together or hanging separately.

Second, there will have to be an accelerated determination on the part of the FRA to quickly make available Title V rehabilitation funds for coordination projects especially during the 1978 construction season. Short cuts must be found around the innate timidity of agency lawyers; consultants who are paid by the day must be encouraged not to spend 30 days defining the exterior dimensions of a railroad spike. The money must come with reasonable dispatch to those who need it most.

Third, and perhaps most important and also the least predictable, FarmRail's success will require active cooperation on the part of the railroad unions. Agreement is needed that new departures

and new ways of experimenting are far preferable to massive shutdowns throughout the Midwest. We must work together to create saleable service in light density situations. Labor will certainly be paid an honest day's wage for what they do. I suggest that FarmRail will give labor more to do, more opportunities to earn, than the alternate plans -- most of which seem to be based on shrinking -- that have surfaced regarding the Midwest roads. FarmRail should be an experiment to see if the product that is produced -- the service that is purchased by the shipper -- can be modified effectively to meet the users' demands on a profitable basis. This cannot be done if labor is unwilling to join the experiment. Very honestly, I envision some radical changes in work rules. These changes will not be disadvantageous to labor. They must be definitely advantageous to shippers. This level of work rule change is needed on the lighter density railroads. It need not be a precedent for the more profitable heavy density lines. Anyone who thinks there should be changes in the way light density railroads do business, but then is reluctant to be part of the change, is simply posturing and is deluding his constituents. Our experience on the Rock Island over the past three years is that when the gallows are in full view, the perceptions of the rank-and-file are responsible, fair and innovative. I think this can be done for a consortium of Midwest "problem" railroads. At least it should be attempted.

What are the sort of consolidations and coordinations I have in mind? Precisely the sort of consolidations and coordinations the FRA had in mind when they first came out with their criteria for the distribution of Title V rehabilitation funds early in 1977. The Rock Island and the Milwaukee -- to this day -- have brought about the <u>only</u> consolidation as suggested by the FRA. This past summer we moved swiftly to create the longest coordination of mainline track in recent railroad history.

The ICC moved with gratifying speed in approving the routing of Milwaukee trains over 243 miles of Rock Island track between the "Quad Cities" on the Mississippi River and Kansas City on the Missouri River. Together, the two railroads move some 28 million gross ton miles a year over that route, almost 30% more than the FRA's arbitrary benchmark of 20 million gross ton miles per mile per year. That traffic has been moving in these volumes since mid-summer, and frankly, the track is wearing out under the tonnage. The coordination had been dovetailed with an application last May to the FRA for loan funds to rehabilitate the track. But FRA has not moved with the speed Secretary Adams is apparently looking for. The track gets more worn out every day (which I think is an endorsement of its essentiality). If the line is not fixed with federal loans, a large step will have been taken toward starving two marginal Midwest railroads into service collapses that would seriously affect the future of many hundreds of communities and industries along that corridor and beyond. In all honesty, Mr. Chairman, we will have to ask the Milwaukee to stop using that track if FRA continues to drag its feet on the financing. We don't want to do that. We believe in the benefits that can accrue to our shippers from federally funded coordination projects.

There are a great many other fairly obvious consolidations that can be effected. In Council Bluffs -- the Missouri River/Omaha gateway -- the Rock Island and Milwaukee yards are side-by-side. That should be one large joint yard.

In Kansas City the Milwaukee and the Kansas City Southern share a classification yard on the north side of town; the Rock Island is sandwiched into a flood plain between the Union Pacific yards and a residential section. Logically, the joint Milwaukee-KCS yard should be modernized and expanded and the ROCK and possibly the MKT should be in there too. It would benefit all carriers serving Kansas City.

There are mainline consolidations that could be effective. For instance, the KCS -- serving the Texas and Louisiana "chemical coast" complexes, should be able to provide run-through service north of Kansas City to Iowa (where they use a heck of a lot of fertilizer) and to the Quad Cities, a major farm implement manufacturing center. The same holds true for the Katy, which now terminates all northbound service at Kansas City. There should be a way for South Texas traffic to be expedited to Des Moines, to the Twin Cities, to Chicago itself.

At the same time, Iowa corn and soybean producers whose elevators are captive to Milwaukee Road tracks should have access to Gulf of Mexico ports. The Milwaukee goes east to the Great Lakes and west to the Pacific -- but most export grain moves over the Gulf. Interchanges take time. Run-through trains -- coupled with a sensible revision of crew districts throughout the territory -- would provide farmers, railroads and labor with an expanded opportunity to earn a fair and honest dollar.

Those are just a few of the operating improvements that could be made. The prospects for institutional coordinations are almost endless. For instance, all the railroads I have mentioned have fairly substantial sales offices in Manhattan. These could be consolidated, and quite effectively so. It's not an unheard-of practice. After all, the Union Pacific and the Chicago North Western's salesmen have been making joint calls for traffic over the Omaha gateway for some time now.

Suppose all the railroads in FarmRail centralized their computerized payroll functions. Are there savings to be made? You bet. Is there a competitive edge to be lost? I can't see how.

Could we centralize billing procedures? We might not want to do that system-wide on all railroads -- after all, we carry automobiles to Denver while the KCS is carrying coal to New Orleans and those two items don't have much in common. But I

suspect a grain shipper in Iowa or Oklahoma would like to have a choice of markets for his grain -- the Milwaukee to the river, the ROCK to Houston/Galveston or KCS to Baton Rouge/New Orleans -- even if his cars start on the "wrong" railroad. Revenue pooling? The Omaha-Chicago traffic on the RI, Milwaukee and ICG that now competes with those "Falcons" could well be consolidated in that new combined Council Bluffs yard and could all go over one route to Chicago with the three roads sharing the profit on a pro-rated or "pooled" basis. There would be no deterioration of competition, because those fast federally financed "Falcons" are still there in the corridor, as well as the BN's mainline through the sparsely-populated strip of border counties across southern Iowa.

Equipment pools are probably one area where the greatest gains could be made. I have already mentioned the ROCK's chronic shortage of rolling stock. The bulk of this shortage is jumbo covered hoppers -- the things that carry 100 tons of grain all at once. We haul them in 75-car trains. When we are in the middle of the winter wheat harvest in Texas and then up into Oklahoma, the Dakota wheat fields in Milwaukee Road territory are still under a foot or so of snow. A FarmRail consolidated service could make sure that a full and adequate fleet is available in Texas in the spring, in Kansas in June, in Iowa, the Dakotas and Minnesota in July, August and September, and available for northbound fertilizer loadings in the winter. The same could be done with locomotives and cabooses. Equipment pools for export grains could be as effective in the territory as equipment pools for automobiles and auto parts have been throughout American railroading for some years now. It's not a new concept. It's been inhibited in agricultural railroading only because of institutional and parochial barriers. For far too long we've taken it as an article of faith that we should compete destructively with our neighbors. I think the time has come for us to work

together under the protection of Section 401 of the 4-R Act. I think that our activities -- especially when we have Uncle Sam as our initial financial angel -- would be as far away from monopolistic and predatory practices as possible. Despite the bedtime fantasies of some bureaucrats I have met, I suspect the days of the robber barons are over.

Again, Mr. Chairman, these ideas are in the formative stages. They might change considerably upon review during the next two weeks. I would hope that I will be allowed to provide you with my full testimony before Secretary Adams' meeting, and if you see fit, that it might be incorporated into the continuing record of this hearing.

My underlying thought is that a coordination of facilities can be a profoundly important cushion for the next several years as we approach the massive task of developing a Midwest transportation service that meets shippers needs.

It must always be remembered that Midwest railroading and Northeast railroading are of very different natures. The Northeast spiderweb of rails was built because in the 1850's railroads were the only form of mechanized land transportation available. Those railroads in the Northeast were built to provide LCL (less-than-carload) freight service and intercity passenger service. In those days, that was the only way to go. There was a dollar to be made. Now, both LCL and passenger markets have disappeared. Northeast branch lines went exactly the way they should have gone.

In the Midwest, the rail lines were built to provide for the transportation of agricultural production. That market hasn't disappeared, it has grown phenomenally. The need for rail service not only exists, it is expanding. It would be a sad and sorry mistake if FRA's consultants—schooled in the ways of the Northeast— made the arbitrary decision that the only way to solve the Midwest rail problem would be to apply a Northeast

industrial-type cure. That won't work. It will only result in overloaded trucks destroying our already-deteriorating network of farm-to-market highways.

I have lived and worked with American railroads for my entire professional career, Mr. Chairman. I have a feel for the Northeast, having cut my teeth at the Long Island and the old New York Central. I have a feel for profitability, having learned much at the Southern Railway. I know the Midwest and the transportation needs of agribusiness, having done my hitch at the Illinois Central and now at the Rock Island. And, as you know, I did my 30-odd months of public service as FRA Administrator.

It is my very strong feeling--a conviction, in fact--that the FRA and the DOT can tackle this Midwest railroad problem foursquare if they really want to.

I think they do want to. I learned to respect Brock Adams' keen appreciation of big problems when he was on this committee and I was a bureaucrat.

I have the conviction--and the faith--that we are finally going to see a willingness to seek change when the railroads and the government and the brotherhoods convene in Chicago two weeks from today.

Front-money is the key.

A society entranced with moon landings, super highways, jet aircraft, massive locks and dams, chrome-plated Kenworths and subways to Rockville has offered short-shrift to the ponderous and traditional movement of that which we produce best--things that grow out of the ground under the watchful eye of men and women who represent the basic strength of our society, men and women who work from dawn to dusk for the privilege of bringing in a harvest. But those products must be moved. And rails will continue to move them best.

The farm community of this nation has suffered much. Are we now on the verge of taking away their one great advantage--

the benefit of low-cost transportation for the fruits of their labors?

I don't think so. I think Congress recognized this when it enacted the Rail Revitalization and Regulatory Reform Act of 1976. I think Congress intended (and please correct me if I am wrong) that railroads that are needed are railroads that will have access to government loans.

I think agricultural railroads are needed. In fact, I know they are needed. My shippers tell me so. Regularly and emphatically.

What we must do now is meet--in the sort of conclave the Secretary has scheduled for Chicago in two weeks--and determine how best these formerly-competitive railroads can now forge a consortium that will earn dollars, provide jobs, provide services, and avoid redundancy. I think we can do this with FarmRail.

But the financing must be there.

The ROCK and the Milwaukee have proved to a fare-thee-well that consolidation without rehabilitation does little more than wear out railroad track. It leads only to long-term deterioration.

The Committee is well aware that the BN wants to merge with the Frisco. You have read--as we have--that the Southern Pacific is talking with the Seaboard Coastline. These mergers are not, of themselves, injurious to American commerce. In fact they are probably sensible and right. But they cannot be allowed to occur in a vacuum. They leave what we might call a "Grain Belt Gap" between the Mississippi and the Rockies. That gap can be filled with FarmRail. That gap can be filled with a solid, effective, coordinated rail system that serves America's agricultural needs.

We are willing to explore the possibilities. We are hopeful that the Secretary is equally willing.

FarmRail will be an effective way to avoid massive liquidations in the Midwest; it also offers a way to avoid temporary discontinuities of service which might well occur if the Milwaukee's

trustee were to be appointed later this month and promptly throw in the towel. It is most definitely a way to avoid a "Conrail west," which would be the wrong solution to the wrong problem.

Mr. Chairman, the unfortunate--but perhaps inevitable--events at the Milwaukee Road can be the catalyst for forging a new consortium of rehabilitated railroads in the Midwest.

There is a crying need for a quick infusion of capital from the FRA under the financial assistance programs provided for in the 4-R Act. The ground will be sufficiently thawed for track-work in Missouri in 6 to 8 weeks. We will be able to work in Iowa by mid-March. A month after that we will be able to insert ties and tamp ballast as far north as the Twin Cities.

The tracks there need the work. The people there need the railroads.

I think the Milwaukee wants to improve and serve. I know the ROCK wants to improve and serve. I am sure the opportunities are there as far as the ICG lines in Iowa are concerned; I suspect, on the basis of personal conversations, that the Katy and the KCS want to show what we can really do when given the chance.

I think it is well worth doing. I think it will be a substantial improvement. I think it's what Congress had in mind.

I look forward to the opportunity to develop a continuing dialog and relationship with this committee that will keep you informed as to what is going on. You play a major role in telling the FRA what needs to be done. I hope you will accept this role and play it to the hilt. I look forward to meeting with you again.

Mr. ROONEY. Thank you very much, Mr. Ingram.

You state that the ideas for Farmrail are in the formative stage; is that correct?

Mr. INGRAM. That is absolutely correct.

Mr. ROONEY. I wonder if these ideas have been discussed with the other railroads, whether or not they have been discussed with the ICC, the FRA, or the unions, and what preliminary reactions have you received thus far?

Mr. INGRAM. We have had no discussions with the other railroads involved because of antitrust problems. We do compete with those railroads. The 401 conference the Secretary has scheduled for Chicago on the 18th and 19th is cloaked with antitrust immunity so that will be the time when we will get that sort of reaction.

The labor unions have been working very well with us, I might say. As you may know, we are involved in negotiation now in the railroad industry in the usual, 3-year format of our contracts.

The Rock Island is doing its own negotiation rather than being part of the national negotiation, and those talks are progressing very nicely and we have reason to believe that the unions would like to cooperate in such a plan.

Basically, what we are trying to do is to keep people gainfully employed in useful work, and I think that the opportunities for doing that may be far better in the Farmrail situation than in an independent, completely typical railroad situation that presently exists.

Mr. ROONEY. The Rock Island went bankrupt in March of 1975, nearly 3 years ago. As Chairman of this committee, I have some concern that the trustees and management have not come forward with a plan of reorganization. I wonder whether or not you would discuss where you are in reorganization planning and when that plan will be presented?

Mr. INGRAM. One of the biggest difficulties we have in putting together such a plan is our inability to fathom the route the Federal Railroad Administration and the Department of Transportation will take in implementation of the 4R Act. As you know, we have approximately $160 million worth of applications before the FRA, none of which has been really acted upon.

Mr. ROONEY. Have they indicated to you that they are acting upon these applications?

Mr. INGRAM. We have had many discussions and many requests for more data. We have shipped enough numbers through to them to choke a small sized elephant, I suppose. Basically, the difficulty in reorganization planning is that it must in turn be based on the rehabilitation planning of the railroad. We feel we can put the railroad back in the shape it should be in in approximately 9 years from now, 10 years from last year, and with our own funds; but if we get the kind of assistance from the Federal Government that we are looking for, we could probably do that in 5 years.

Quite obviously, it makes a big difference in reorganization planning which actually is the case.

Mr. GIBBONS. May I address myself to that for just a moment, Mr. Chairman?

Mr. ROONEY. Yes.

Mr. GIBBONS. One of the problems we have had in dealing with the FRA is their insistence on a very high type of lien with respect to creditors and the priority with respect to the creditors and their insistence upon that will and would cause us to engage in litigation which will extend probably from 6 months to a year.

It is true that when they talked about the interim financing that they did advance a proposal. That is a $2 million interim financing for the Quad Cities to Kansas City consolidated operation. They did advance a proposal which said that they would come behind cost of administration and the bondholders; however, they said that if at any given time after September of 1977 we lost a certain number of dollars cumulative that that loan would become immediately due and payable; and we didn't think that that was feasible.

We had been encouraged to start that work in the fall and we did start it and completed $2 million worth of work, and the Milwaukee was unable to come up with its share of it and unfortunately because we couldn't get the interim financing we did have to lay off some people prior to the time when they would ordinarily have been laid off.

As Mr. Ingram says, we cannot really formulate a plan of reorganization which will be in the best interest of as many creditors as we can get in until we know what the FRA's policy will be with respect to funding these projects which we have. This railroad was about 12 years in the deterioration that we found it in 1975 and it is impossible in the short period of time available to us to build it back up, which it must be, before we can emerge successfully from reorganization.

Mr. ROONEY. I know the FRA Administrator and his staff are still here and I am not going to ask you for a rebuttal time, but we would appreciate it very much if the Chair could have your views on the statements that were just made.

[The following letter from DOT was subsequently received for the record:]

DEPARTMENT OF TRANSPORTATION
FEDERAL RAILROAD ADMINISTRATION
WASHINGTON, D.C. 20590

OFFICE OF
THE ADMINISTRATOR

Honorable Fred B. Rooney
Chairman, Subcommittee on
Transportation and Commerce
Interstate and Foreign Commerce Committee
United States House of Representatives
Washington, D.C.

Dear Mr. Chairman:

When I appeared before the Subcommittee on Transportation and Commerce on January 5, 1978, I was requested to furnish the Subcommittee with written responses to statements made by witnesses on behalf of the Chicago, Rock Island and Pacific Railroad Company. This letter constitutes my response to that request.

Delays in Funding

The Rock Island witnesses stated that the FRA has unduly delayed funding the Rock Island's Title V applications, and its equipment program in particular. This is not true. We have consistently sought the financial, marketing, and technical data necessary to justify an investment of public funds and gain confirmation by the bankruptcy court. Our inability to get credible, workable data from the Rock Island has been the single most important cause of delay.

As early as March 1, 1977, the FRA sent a letter to the Trustee indicating major deficiencies that existed in the applications we had received to that date. Among the issues raised at that time were the need to know the long-term operating objectives and financial requirements of the railroad, the need for additional information to support the traffic and revenue projections, and the need for information sufficient to enable us to find reasonable security and protection. No reply to this letter has been received.

On July 22, 1977, the Trustee was again advised of the major deficiencies, with emphasis on the omission of comprehensive marketing, financial, operations, and maintenance analyses of the Rock Island. At that time, I offered the full cooperation of my staff in developing those analyses. In August and September, 1977, the FRA and Rock Island worked to define a 1977 work season program but, after negotiating draft financing agreements, reached an impasse on the security issue (discussed below).

On October 25 and 26, 1977, the FRA staff met in Chicago with the Trustee's staff to discuss a host of issues that remained unaddressed or inadequately presented in the Trustee's applications. Since those meetings we have assisted the Rock Island in presenting their financial analysis and finally received the base case (pre-project) financial analysis on December 27, 1977. However, we still await the financial pro forma statements (reflecting the results of the proposed projects), which are necessary to complete our analysis.

The Rock Island's application for financing of equipment rehabilitation is being updated so that we can move forward on a decision to rehabilitate approximately 2835 freight cars. We recently received from the Rock Island new information, by car type, on the amount and type of work to be performed on that equipment. The Rock Island has also supplied a five-year analysis of car fleet requirements and will provide internal rate of return analyses and amortization schedules for the equipment. This information will enable us to move ahead on the Rock Island's section 511 application.

Treatment of Railroads in Reorganization

Mr. Manos, the Trustee's counsel, indicated that we treat railroads in reorganization differently from other railroads and that our policy with respect to railroads in reorganization is unclear.

Our policy with respect to bankrupt railroads reflects, as Congressman Russo pointed out, the statutory mandate that we address bankrupt applicants differently if the assistance is in the form of trustee certificates. Section 505 provides for assistance to railroads in reorganization either through the purchase of redeemable preference shares issued as part of a court-approved plan of reorganization, or through the purchase of trustee certificates. Where the assistance is in the form of trustee certificates, three written findings must be made that are not required with respect to applicants issuing redeemable preference shares. They are that --

(1) such certificates cannot otherwise be sold at a reasonable rate of interest;

(2) the project to be financed can reasonably be expected to be maintained as part of a financially self-sustaining railroad system; and

(3) the probable value of the assets of the railroad in the event of liquidation provides reasonable protection to the United States.

In addition, while the 4R Act specifies the characteristics of redeemable preference shares, section 505 provides that the issuance of trustee certificates shall be on "such terms and conditions as may be approved by the Secretary and the reorganization court".

The Federal Railroad Administrator and a trustee may agree to convert the certificates into redeemable preference shares as part of a plan of reorganization. At the time of such conversion, all of the statutory characteristics of preference shares would attach. In that event, the reorganized railroad would be in the same posture with respect to the priority of the securities as an applicant which was not in reorganization. For this reason, we do not believe the requirements applicable to trustee certificates discriminate against or represent a major obstacle to funding railroads in reorganization.

Priority of Payment

Before FRA can agree to purchase trustee certificates under section 505, we must determine a position among the railroad's creditors that will enable us to make the statutorily required finding that "the probable value of the assets of the railroad in the event of liquidation provides reasonable protection to the United States." The Trustee of the Boston and Maine Corporation has proposed that the trustee certificate be junior to all secured debt and all current and future expenses of administration, but senior to all general, unsecured debt. The Rock Island Trustee proposed the same level of priority in his original applications, but subsequently modified it to require a position junior, also, to general, unsecured creditors.

In order to make the required finding of reasonable protection in connection with the trustee certificate which the Rock Island Trustee would have issued to finance the $2 million 1977 work season project, we proposed to the Trustee the same priority level that he offered in his original applications. In the alternative, we indicated to the Rock Island Trustee our willingness to purchase trustee certificates on a fully subordinated basis if payment acceleration and alternative security step-up provisions were included to protect the Government in the event of continuing losses. I should point out that expenditure of the funds provided under the 4R Act would not be included in the computation of losses used to trigger acceleration or a step-up. The Trustee has not shown any willingness to accept this compromise proposal.

Receipt of Comments on Applications

Finally, I want to put to rest a controversy which the Trustee has raised with respect to our receipt of letters from certain creditors of the Railroad urging us to delay approval of the Rock Island's applications.

Upon receipt of all applications under Title V of the 4R Act, we publish a notice and brief summary of the application in the Federal Register and invite public comment. All comments received are kept in a docket file open to all interested members of the public. The letters to which the Trustee refers were submitted in response to our notice and are available for inspection by any interested party.

In one of the letters, Mr. William W. Darrow, of the law firm of Isham, Lincoln & Beale, indicated that his client, the First National Bank of Chicago, Corporate Trustee under the First Mortgage Indenture of the Rock Island, had retained the consulting firm of Temple, Barker and Sloane, Inc. to prepare a report on the prospective earning power of the Rock Island. Mr. Darrow also indicated that his client expected the report to be completed by October 30, 1977, and to be filed with the FRA soon thereafter. That report was eventually filed with the FRA in December 1977. At no time did the FRA delay any of its considerations of the Rock Island's applications in anticipation of receiving that report. As noted earlier, we did not receive base case financial and traffic data from the Rock Island until December 27, 1977.

I appreciate the opportunity to address these matters, and I hope I have resolved any lingering questions.

Sincerely,

John M. Sullivan

JOHN M. SULLIVAN
Administrator

Mr. ROONEY. Mr. Russo?

Mr. RUSSO. Thank you very much, Mr. Chairman.

Is there any particular reason why they are not acting on those applications quickly?

You say that you have been taking the time, but obviously there must be some reasons that they are putting forth as to why they can't act on those applications. They are sending carloads of information. When you can send a whole trainload of information, if it is not the right information, does it do anybody any good?

Mr. GIBBONS. We have also conservatively spent a couple of hundred thousand dollars, including application fees, without allocating overhead to the cost to which I just referred. This has been going on since some time very early in the summer, perhaps prior to that time. We were at a loss to understand, and we have had several meetings with the FRA in the interim. We have sent all of the material which Mr. Ingram referred to. Some time in early December our counsel, Mr. Manos, at a conference with attorneys for the bondholders' trustee and attorneys for intervenor, Crown and others, discovered that letters had been sent by two law firms, one for the bondholders and one for the intervenors in our reorganization. They are creditors, bondholders.

We discovered that letters had been sent in August 1977 to the FRA, copies of which had never been forwarded to us, nor had we ever learned of them. These letters implored the FRA not to approve any loans to the Rock Island until a report from an independent analysts had been forwarded to the FRA, and that report was stated in those letters to be on its way in October.

Mr. RUSSO. Are you saying none of those letters were made available to you as trustee of the bankrupt railroad?

Mr. GIBBONS. No, sir, they were not.

Mr. RUSSO. Do you think it is incumbent upon the FRA to submit that kind of information to you?

Mr. GIBBONS. We think as a matter of courtesy the attorneys who sent the letters should have forwarded us copies, and we think that as a matter of right, we should have had copies from the FRA, because they involved applications which were then pending.

Mr. RUSSO. Did the FRA ever indicate to you they had such letters during the time those pending applications were pending?

Mr. GIBBONS. Mr. Manos and I met with Mr. Sullivan, Mr. James and Mr. Gallamore in December 1977, and at that time we became aware from them that they had those letters.

Mr. RUSSO. You say those letters were dated in August 1977?

Mr. GIBBONS. Both in August 1977.

Mr. RUSSO. From the time period of August to December, were there any negotiations going on between the Rock Island and the FRA about financing?

Mr. GIBBONS. Yes, sir, there were.

Mr. RUSSO. And was an independent study ever raised during those discussions?

Mr. GIBBONS. No, sir, they were not.

Mr. RUSSO. They were first raised in December; is that correct?

Mr. GIBBONS. In December, because at that time when Mr. Manos learned of this correspondence, he learned of this independent report which still had not reached the FRA but was going to be

forwarded to the FRA in about mid-December, and as I understand it, when we reached Washington, the gentlemen from the FRA had in their possession the report which was referred to in that correspondence.

Mr. RUSSO. You mean there is now an independent study on the financial situation of the Rock Island?

Mr. GIBBONS. Yes, sir.

Mr. RUSSO. Already?

Mr. GIBBONS. This is an independent study made by the bondholders, trustee, and by—by the bondholders' trustee primarily.

Mr. RUSSO. And what is this analysis supposed to furnish?

Mr. GIBBONS. I beg your pardon?

Mr. RUSSO. What information is it supposed to furnish?

Mr. GIBBONS. I really don't know.

Mr. RUSSO. Have you seen it?

Mr. GIBBONS. I have glanced through the report.

Mr. RUSSO. Does it deal with the assets of the railroad?

Mr. GIBBONS. Yes, it does.

Mr. RUSSO. How much does it value the assets of the FRA?

Mr. GIBBONS. I don't recall.

Mr. RUSSO. Does anybody from the FRA know?

Mr. LOFTUS. It doesn't deal with the assets, with the financial assets.

Mr. GIBBONS. It deals with the earnings of the railroad, the earnings possibility of the railroad.

Mr. RUSSO. Of course the fact that you are in reorganization, Mr. Gibbons, means that everything that is done, whatever agreements that you reach between yourself and the FRA, have to be based on some real hard data. Otherwise, both you and the FRA are going to be torn apart in court when you go there to get approval, because you have certain individuals, as you are well aware of, who will do whatever they can to make sure that you don't exist. I mean in defense of the FRA, although I have my own reservations about some of the problems you have, they have got to be very careful to make sure that everything can be substantiated, so that they don't take a beating in court nor do you take a beating in court.

Mr. GIBBONS. I don't think we ever walked into the FRA and asked for a hands down loan, grant or otherwise. We have furnished them with considerable data. One of the problems is of course as to what kind of a lien do they insist on when they approve the loan or grant the loan.

Mr. RUSSO. What type of a lien are you looking for?

Mr. GIBBONS. We have asked that the lien be subordinated to all of the creditors.

Mr. RUSSO. In your original application, wasn't it different than that?

Mr. MANOS. There was a modification thereafter that was written to the FRA, Congressman. Initially the applications required or requested a subordination to close administration and to secured interest.

Mr. RUSSO. Which is what the FRA is willing to do right now.

Mr. MANOS. That is correct.

Mr. RUSSO. Which was your original position when you went and made your application; is that correct?

Mr. MANOS. That is correct, but thereafter we amended that and we required or requested a full subordination because we felt that we should be in the same position as any other railroad, whether we are in 77 or not. We felt that we were being discriminated against while there was any other priority that was granted to us.

Mr. RUSSO. Do you know of any other railroad that has received different treatment than you have?

Mr. MANOS. Absolutely. The $60 million that Mr. Sullivan and the FRA have testified to under redeemable preference shares or a portion of it, I don't know the exact amount, has certainly been given under full subordination. All we wanted was the same treatment, nothing more.

Mr. RUSSO. Of course, as I understand it, redeemable preference shares are only given to solvent railroads, if I am not mistaken, as opposed to the marginal railroads.

Mr. MANOS. That is the crux of the problem. You put your finger on it, Congressman Russo. You know the FRA has stated they have absolutely no problem in interpreting your amendment. Obviously they have no problem because they have interpreted the Act to mean that they must look to the reorganizability of the railroad before they can fund it. This is the way that they are proceeding. This is their policy, and I don't know what the solution is. I can only look to the record. We have had our applications there since January, February, and March 1977. We have received nothing. Now we have another railroad in reorganization now in the same district. The question is going to be how rapidly is the FRA now going to act to help that marginal road or railroad reorganization? All we can ask is the same treatment as any other railroad, but I believe that something must be done, either by this commmittee, by Congress, or by the FRA, to clarify their position.

Mr. RUSSO. Isn't one of the big problems that you face with the FRA the difference in the value of the Rock Island's assets, in the case of liquidation? Your estimates are somewhere in the area of $473 million. The FRA's estimates are somewhere in the area of $273 million, and it would seem to me the course the FRA has taken is until you resolve that difference, it is very difficult to loan money or guarantee loans to the Rock Island. This is my interpretation of the facts. It may not be the right interpretation, but from what I can gather from the information I have heard, that until they resolve that issue, it is very difficult to make those types of loans. So I would think the first priority would be to resolve that difference and then see if they drag their feet in giving you any help. But I get the impression that your complaint is that they are dragging their feet in resolving what the difference is in the first place.

Mr. MANOS. That is absolutely correct.

Mr. RUSSO. Is there any particular reason why they are dragging their feet, in your estimation?

Mr. MANOS. Well, Congressman Russo, I can only state to the subcommittee that there seems to be some difficulty with the FRA's trying to decide what to do with railroads and reorganization. You know in March 1975, there were only two railroads then in reorganization. I am not talking about the northeast sector, but I am talking about the Boston & Maine and the Chicago-Rock

Island. When the 4R Act was enacted and became effective, the FRA I believe suddenly was confronted with an interpretation of the Act as to the priorities to be granted to 77 railroads as against what do they do with other railroads not in 77. I believe that this is still their problem. They just don't know how to act, despite the fact that they say they have no problem. I believe that they do have a problem, and that is the reason for the delay.

I can only look to the record. We have been dealing with the FRA now since March 1977 or earlier.

Mr. RUSSO. Does Boston have any problem in dealing with the FRA?

Mr. MANOS. Absolutely.

Mr. INGRAM. They haven't gotten any money yet.

Mr. MANOS. We are in the position of a patient that has undergone some radical surgery in the prereorganization stages. We have come out of surgery nicely, but somebody has forgotten to bring us some food, and this is exactly what the FRA is doing. They are withholding exactly what we believe Congress intended to give us, which is the funds to proceed to an ultimate viable situation.

The FRA is looking only to whether we are reorganizable. Now ultimately we feel that we are. We are convinced that we are, but the emphasis has been misapplied, Congressman. The emphasis has been placed on reorganization rather than on the high benefits that can be gained by the public interests in a particular project, or in the financing of particular equipment.

Now as far as the financing of equipment, and this is something that Mr. Ingram and Mr. Gibbons I am sure will address, we have been able, in the private sector, to achieve the acquisition of car supply with subordination features, where they waive any claims against the estate. It would appear then that in the private sector there are people that have more confidence in us than the FRA, and yet they are still playing around trying to decide in massaging their rules whether we should have any equipment guarantees. This is the complaint that the Rock Island had, and has, with respect to what the FRA is doing in implementing the act.

Now we acknowledge that some time was required, Congressman Russo, to evaluate and to come up with these rules. There is no doubt about that, but when you are dealing with a railroad in reorganization, where interim financing is extremely important, we believe that there should have been some flexibility. We have not seen that flexibility.

Mr. RUSSO. Let me just state this: Do you feel, Mr. Gibbons, that when a railroad goes into bankruptcy or reorganization, that it is more difficult for it to obtain funds from the FRA?

Mr. GIBBONS. That it is more difficult?

Mr. RUSSO. Yes.

Mr. GIBBONS. I would say that the recent history would certainly indicate that.

Mr Russo. Do you think that the losses that a railroad incurs while it is going through a reorganization is something that the FRA ought to take into consideration in lending dollars out? For example, your financial position over the last 3 years, I would imagine they are looking very closely at it and want to make sure

they don't send good money after bad money. I am not saying that the Rock is in bad shape. Frankly, you know the condition better than I do.

Mr. GIBBONS. I think a good deal of our losses are caused by the fact that we put so much money into the rehabilitation of our roadbed and our equipment.

Mr. RUSSO. So you won't realize profit right away?

Mr. GIBBONS. That is correct.

Mr. RUSSO. But over a long period of time you would.

Mr. GIBBONS. That is correct. Those will all show up when we begin to get a return on those investments. That should show up. This year we spent about $26.5 million more on the rehabilitation and maintenance of equipment and the roadbed than we did in 1976.

Mr. RUSSO. What is the projected loss for 1977–78?

Mr. GIBBONS. For 1978?

Mr. RUSSO. Yes.

Mr. GIBBONS. The figures just filed with the FRA, and I do not recall what the bottom line was for 1978, but I believe that our base case indicates a positive cash flow in 1979.

Mr. RUSSO. I have some figures in my head. I think there was one year you lost $19 million?

Mr. GIBBONS. Are you talking about since 1975?

Mr. RUSSO. Right, since reorganization.

Mr. GIBBONS. Yes, we lost I believe it was $23 million in 1975, no, excuse me, it was $30 million in 1975, about $23 million last year.

Mr. RUSSO. Do you expect it to go down this year?

Mr. GIBBONS. No, the loss will be larger this year.

Mr. RUSSO. And you expect in 1979 to reverse that and to show a profit.

Mr. GIBBONS. My recollection——

Mr. RUSSO. I would imagine your figures would take into consideration you getting help from the Federal Government; is that correct?

Mr. GIBBONS. The figures that we just filed with the FRA are without funding by the FRA.

Mr. RUSSO. And do you expect a return in 1978 if they don't help you?

Mr. GIBBONS. I beg your pardon?

Mr. RUSSO. If they don't help you, you still expect to make a profit rather than a loss by 1979?

Mr. GIBBONS. No. We will not make a profit, but these figures will indicate that we will be coming close to a profit by 1979.

Mr. INGRAM. One of the difficulties, Congressman, is the way railroads keep their books. When you expend money fixing track, that is considered an expense, and so if the FRA loans this money to repair track, we will technically incur a loss because of that loan, since we will spend that money on fixing the track. The more work we do on the track in putting the railroad back into shape and rebuilding freight cars, the greater our losses become under the kind of accounting that railroads use.

Mr. RUSSO. Is that a problem that you deal with, with the FRA? They look at it differently than you look at it.

Mr. INGRAM. Oh, no. I am sure they understand railroad accounting. That is not a real difficulty, but it does make the figures look bad when they come out in the press. As Mr. Gibbons said, the $20 million plus that we spent last year for repairing cars and fixing track increased our losses, and that will continue until we get the railroad rebuilt, before we get on a normal accounting basis.

Mr. RUSSO. Mr. Chairman, I just want to direct a question to Mr. Sullivan of the FRA. He is still here. I notice in the Milwaukee Road situation, the $9 million, if in fact they went into bankruptcy, the provision in the agreement was that you would take a subordinate position.

Mr. SULLIVAN. Except that now that they are in bankruptcy that position has accelerated to debt junior to prior debt.

Mr. RUSSO. Is the Milwaukee Road debt now subordinate to all claims, or is it somewhere in the middle?

Mr. VERMUT. Subordinate to all claims.

Mr. SULLIVAN. Mr. Vermut is from our legal area.

Mr. RUSSO. In this particular case the Milwaukee has had different treatment than the Rock Island.

Mr. VERMUT. No; because the trustees would be convertible in trustees' share for the Rock Island too and would have the same status as a preference share.

Mr. RUSSO. As I understand the problem they face in trying to get this $2 million that they are looking for, the position that you want for the Federal Government in that case is right after the secured creditors and costs of administration.

Mr. VERMUT. Yes, but in our agreements we accorded the Rock Island equal treatment with Milwaukee by allowing for a conversion into preference shares upon reorganization, so they would stand in the same stead as the Milwaukee in that condition.

Mr. RUSSO. I just wanted to make sure that was on the record.

Mr. MANOS. That would be only in the event of the future, Congressman Russo, in the event a planned reorganization was confirmed by the court, in which event there would be a full subordination under the preference share theory, but that is down the pike. As far as the present day situation is concerned, we have been discriminated against. There is a difference between the type of financing that was offered to the Rock Island than the priority that ultimately has been achieved now by the Chicago-Milwaukee under their present reorganization.

Mr. RUSSO. There may be a flaw in the law, and that is I think part of the reason we are having this hearing. When the Milwaukee went to the FRA, they were not in reorganization nor were they in bankruptcy. Therefore, they were quoted a different position based on the fact that they were not in bankruptcy, whereas you are in bankruptcy. You have a certain amount of creditors that the FRA has to be concerned with. Therefore, they treat you differently.

Now they are bound by certain statutory procedures. If you are in bankruptcy they have certain other requirements they have to look at. Maybe that is where we have to make a change. If the only way that the marginal railroads can survive is to say, "We have to go in and give you funding and subordinate the claims, it is the only way you will be able to make it if you are supporting all the

claims." We obviously didn't anticipate that in the original 4R Act, unless I understand the 4R Act differently, Mr. Chairman.

Mr. ROONEY. That is correct.

Mr. RUSSO. So we actually made that distinction, we made that split. Maybe in our oversight hearings it will require us to make certain amendments to the ConRail Act. We already have the son of ConRail and there is no reason we can't have the daughter, but the problem is we would like to alleviate the problem yet at the same time you know the Federal agencies are bound by certain statutes that we enact.

Mr. GIBBONS. I think the Secretary has the flexibility to subordinate the claim of the Department of Transportation, and the whole problem is what is the philosophy of the administration going to be with respect to the 77 railroads.

Mr. RUSSO. I think the person that can answer that is an individual named Brock Adams, and maybe some time we will have to have Brock Adams before our committee, Mr. Chairman, to find out what the philosophy is of the administration on section 77 railroads.

Mr. MANOS. Obviously, there has to be a clear delineation of what the Government policy is with respect to 77 railroads. We now have another railroad in reorganization and obviously that decision has to be made very shortly, because the funding is obviously needed.

Now with the Chicago Rock Island, for example, Congresman Russo, and, Mr. Chairman, we have had a tremendous problem with respect to car supply. We have been screaming for car supply in order to serve our shippers. We are constantly experiencing shortages in cars, and yet despite the fact that the FRA knows of this critical car deficiency, nevertheless nothing has been done with respect to the 511 applications.

Now perhaps understandably so. Maybe they are in their interpretation now implementing what they believe to be the letter of the law, and perhaps there must be some definition by declaration of Congress or perhaps by an amendment to the present legislation.

Mr. RUSSO. I am going to be meeting with representatives from the FRA to straighten out 511 if there are any problems.

Mr. Sullivan, is there any particular stated policy that the Secretary of Transportation has set forth for section 77 railroads that you are aware of?

Mr. SULLIVAN. None that I am aware of. And in fact where the Boston and Maine is concerned, we don't perceive any problem in going forward with the applications that we are processing for them.

Mr. RUSSO. I have no further questions.

Mr. ROONEY. Thank you, gentlemen. We appreciate your appearance before the committee.

Mr. RUSSO. I have one question for Mr. Ingram dealing with this farm rail.

Is there going to be a problem with railroads getting involved in this farm rail that are in reorganization? Is that going to create a problem?

Mr. INGRAM. I don't really think so. Coordination projects are quite possible, whether a railroad is in bankruptcy or whether it is

solvent. As an example, the Milwaukee and the Rock Island got together on the coordination of 200-some odd miles long between Quad Cities, Illinois and Iowa and Kansas City. So far the only problem with that one has been getting the financing to do the rebuilding work that is necessary for that.

Mr. RUSSO. Wouldn't a railroad that is solvent have a fear that maybe they would be stuck with the fully built, because they are dealing with another railroad that is in reorganization?

Mr. INGRAM. That can be easily taken care of by each railroad shouldering its portion of the burden according to whatever kind of facility agreement is put in force.

Mr. RUSSO. So you don't feel that railroads under reorganization create a problem entering into joint facility agreements?

Mr. INGRAM. No. I sort of work on the basis that if two railroads both can save money by coordinating their services, that profit should be taken, and ways can be found to do it.

Mr. RUSSO. Thank you very much.

Mr. ROONEY. Thank you, gentlemen.

Our next witness will be Mr. James R. Wolfe, president and chief executive officer of Chicago & North Western Transportation Co., Chicago, Ill.

STATEMENT OF JAMES R. WOLFE, PRESIDENT AND CHIEF EXECUTIVE OFFICER, CHICAGO & NORTH WESTERN TRANSPORTATION CO., ACCOMPANIED BY RICHARD M. FREEMAN

Mr. WOLFE. Thank you, Mr. Chairman.

Mr. ROONEY. You may proceeed, Mr. Wolfe.

Mr. WOLFE. Thank you, Mr. Chairman.

My name is James R. Wolfe. I am president and chief executive officer of the Chicago & North Western Transportation Co., which position I have held since October 1976. Prior to that time, I was vice president-operations of the Chicago & North Western.

The Chicago and North Western welcomes this opportunity to appear before your committee, since it is a midwestern railroad which operates in the same territory as both the Rock Island and the Milwaukee, and in fact is larger in virtually every respect than either the Rock Island or the Milwaukee.

We serve the same gateways—Chicago, Twin Cities, Kansas City; in the case of the Milwaukee, Green Bay, the Fox River Valley in Wisconsin; and Duluth, the Head of the Lakes area in northern Minnesota. We also, of course, serve the very important Missouri River gateway in the vicinity of Omaha, Council Bluffs, and Fremont, Nebr.

One of the purposes of a hearing, I believe, is for the committee to look into the financial condition of other midwestern roads. In that respect, I first would like to address myself to that particular question. The Chicago and North Western is an employee-owned railroad, which was purchased by a group of its employees from North West Industries, on June 1, 1972. Since that time the North Western has had I think a very acceptable record of net income, which we think is the first criteria for life of a corporation in our present free enterprise system. In the first 7 months of employee ownership, we earned over $9 million. In 1972 we made over $18 million. In 1973 we earned $14.4 million. In 1975, during the reces-

sion, we hit an operating loss of $8 million. In 1976 we made a recovery from the recession and earned over $8 million, and for the first three-quarters of this year, we have a net income of $13.5 million.

Now a question was asked as to the difference between the figures that I think a member of the committee presented concerning the Illinois Central Gulf, and the figures that the Chairman of the Interstate Commerce Commission presented. You will see some of the same differences in ICC statistics and North Western statistics, and the reason is that the North Western, as well as Illinois Central Gulf, Milwaukee, I think Burlington Northern, a number of other railroads, use depreciation accounting, generally accepted principles of accounting, in reporting their income, rather than ICC betterment accounting.

Now the difference simply is how much money have the railroads spent in major track programs? Under depreciation accounting the money spent for major track programs is capitalized over a period of time, whereas under ICC betterment accounting, money spent on major track programs goes to expense at the time that the money is spent, and therefore has its effect on the income statement.

Insofar as the reason that Milwaukee is in bankruptcy, cash, North Western's cash position at the present time, at the end of the year 1977, is about $40 million in cash and securities in the bank, which is a very strong cash position for our company.

We will have a net income, as I say, or do have for the first three-quarters, under depreciation accounting, of $13.5 million. We have substantially less net income under ICC betterment accounting. We are in a profitable position. However, we have performed substantial track programs during the year 1977, as did Illinois Central Gulf.

I also wish to emphasize to the committee that in the 5 years that we have owned the railroad, we have made debt payments of over $200 million. We have spent, insofar as capital expenditures are concerned, to improve the property, over $430 million under the depreciation system of accounting, and over $500 million under the ICC betterment system of accounting.

The property account of the North Western has been improved and increased during that 5-year period, meaning that the railroad plant has been strengthened.

I conclude on the financial condition of the North Western at this time by telling the committee that the North Western is in good financial condition, and we expect the North Western's financial condition to improve, mainly because we expect to be able to continue in the future the same plant improvement programs that were carried out during the first 5 years of North Western's existence.

Now let me turn, if you will, to the midwestern rail situation. As we all know, we have bankrupt carriers presently operating under section 77. These railroads compete directly with the North Western. We have heard today a variety of solutions. Mr. Quinn of the Milwaukee has proposed as possible solutions Government ownership, extension of ConRail to the West, a possible reorganization of

the Milwaukee with substantial transfusions of Federal money. We have heard from Mr. Ingram about Farmrail.

Now while we have heard all of those proposed solutions, I don't believe, at least in our opinion, you have heard enough about the basic underlying cause of the bankruptcies themselves, and until we know what those causes are, it seems to me that we are flying in the dark to try to prescribe corrective measures, and the basic cause of these bankruptcies is not a mystery at all. I think the Federal Railroad Administration, as a result of extensive studies, mandated by this Congress, has concluded what the cause is. The Interstate Commerce Commission, through its Rail Services Planning Office, has concluded what the basic cause is. Mr. Sullivan, in his testimony, stated what it is, and in fact Mr. Quinn in his testimony stated what it is.

The basic cause is a surplus of plant in the Middle West. There is simply too much railroad, and the North Western believes that we have to face up to that fact, and until we do, there will be no solution of the midwestern problem, at least not a permanent one.

As examples, and these come right out of the Federal Railroad Administration study on excess capacity, in the corridor between Chicago and Omaha, we have parallel lines of railroad of the Burlington Northern, the Milwaukee, the Rock Island, the Illinois Central Gulf and the Chicago & North Western. Between Chicago and the Twin Cities, the same tale is repeated.

Now I could go on and on and repeat these corridors of excess capacity which the Federal Railroad Administration has delineated, but they are there for all of us to see, and I simply ask the committee and anyone else who seeks to address themselves to the basic question of what is a solution to the midwestern problem to be sure that they have well in mind what the cause of the problem is. For example, would Government ownership solve the problem of surplus capacity? I think all we have to do is look at the statement handed in by the State of Illinois, and we can come to the conclusion that it won't because the solution of the State of Illinois is to preserve everything we have by transfusing Federal money into it or State money.

ConRail West: In my humble opinion, gentlemen, we don't need ConRail West because the West is a different situation than the East. We have a number of viable railroads operating in the West who are prepared and ready to give vital transportation services that the public demands.

Reorganize: That is really a question for the trustee in bankruptcy and not for me. However, if there is a reorganization of the Milwaukee, as there has been of the Rock Island, it seems to me that whatever Federal money is transfused into those systems must be given with an idea of whether it is going to proliferate and continue to support surplus plant, because if it does, it is wasted money—your money, my money, all of us in this room.

Farmrail: I haven't had a chance to look at the plan completely, but it sounds to me like a new name and an old solution. The new name is Farmrail. The old solution is coordination and consolidation within existing corporate structures which the industry has been hassling around with for 40 years, and Federal money to sustain existing corporate entities.

There is another solution, and I think that in the meetings that the Department of Transportation intends to have in Chicago, the participants will have to address themselves to this solution, and that is liquidation of possibly one or more of the bankrupt railroads and a transfer of vital transportation lines on those railroads to viable carriers.

As I say, the basic question of whether the Milwaukee will be reorganized, an attempt will be made to reorganize, or whether, in fact, it will be liquidated will be up to the trustee appointed by the court. I am simply proposing to this committee another alternative given the basic cause of surplus plant, to the present problem of the midwestern railroads.

[Mr. Wolfe's prepared statement follows:]

STATEMENT OF

JAMES R. WOLFE
PRESIDENT AND CHIEF EXECUTIVE OFFICER
CHICAGO AND NORTH WESTERN TRANSPORTATION COMPANY

ON

CHICAGO, MILWAUKEE, ST. PAUL AND PACIFIC
RAILROAD'S PETITION FOR REORGANIZATION

BEFORE THE
SUBCOMMITTEE ON TRANSPORTATION AND COMMERCE
OF THE
HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE

January 5, 1978

My name is James R. Wolfe. I am President and Chief Executive Officer of the Chicago and North Western Transportation Company, a position I have held since October, 1976. Prior to that time, I was Vice President-Operations.

Chicago and North Western is an employee-owned company operating in eleven midwestern states. A group of employees of the Chicago and North Western purchased the assets and assumed the liabilities of the railroad on June 1, 1972. In its first partial year of operations, the employee-owned company had a net income of $9,261,000. In 1973 and 1974, our net income was $18,095,000 and $14,400,000, respectively. After a setback in the 1975 recession year, when we lost $8,301,000, we came back in 1976 with earnings of $8,248,000. In the first three quarters of this year, we earned $13,542,000. At the close of business on December 29th, last Thursday, the North Western had approximately $40 million in cash or temporary investments in the banks, a relatively strong year-ending cash position. The North Western is in good financial condition today and we feel that our company will grow stronger year by year in its ability to generate additional traffic. That belief is based on what we have actually accomplished during the first five years of employee control, for during that period, 1972-1977, both rolling stock and the track structure have been consistently upgraded allowing us to provide a better transportation product to our customers.

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As to the midwestern rail picture, the North Western operates in much the same territory as the Milwaukee Road. We both serve the principal midwestern gateways -- Chicago-Twin Cities, Chicago-Omaha and Chicago-Kansas City. In addition, many of our secondary main lines and branch lines serve the same areas in Wisconsin, Minnesota, South Dakota and Iowa.

This is the second bankruptcy of a major midwestern railroad within less than three years, the Rock Island having gone into bankruptcy in the spring of 1975. At the time of the Rock Island bankruptcy, the western railroads worked out a plan, under the guidance of the Interstate Commerce Commission, to provide effective service for substantially all shippers using the Rock Island in the event it was liquidated as an operating railroad. As this second midwestern bankruptcy within three years demonstrates, there is not enough rail traffic in the Midwest to support the number of routes being operated. It thus is useful, in determining what should be done with the Milwaukee Road properties, to recall the Rock Island experience. It seems clear that had the Rock Island been liquidated, the Milwaukee Road would have been strengthened by additional traffic in the past three-year period and might well not be in the fate that it is today.

Fortunately, today there is general agreement among knowledgeable transportation people that the heart of the midwest rail problem is a surplus of rail plant. Sad though the bankruptcy of the Milwaukee Road is, its demise offers another opportunity to rationalize the midwestern rail plant. Just as the Chicago and North Western cooperated in the efforts of the Interstate Commerce Commission to start that rationalization effort in 1975, we are prepared to cooperate fully in such an effort now. The western railroads demonstrated their capacity to reach reasonable agreements in the case of the Rock Island three years ago, and we believe that they will be willing to do so again.

The Chicago and North Western has long been an advocate of consolidations and coordinations through joint operating agreements rather than corporate consolidations to solve the problem of excess midwestern plant. It has been and still is our view that consolidations and coordinations are feasible only on a line-by-line, route-by-route basis, and then only if the lines and routes from which traffic is rerouted are abandoned. By such an approach, two basic objectives are met -- enough density on needed rail lines is created to assure the viability of the needed lines and substantially all shippers which rely on rail service are assured of better service over the long term. Privately made coordinations and consolidations are, however, more difficult to achieve when a bankrupt carrier is involved because of the uncertainty as to who will fall heir by assignability to its joint facility agreements. That difficulty is overcome when the coordinations and consolidations are part of overall, planned programs approved by the appropriate Federal agencies.

We do not believe that a midwestern rail rationalization can be accomplished by corporate mergers. The North Western is not interested in merging with the essentially parallel and bankrupt Milwaukee and/or Rock Island. The merger of these corporate entities would not solve the problem of plant obsolescence, which, as I have stated above, is the main reason for the demise of our two neighbors. The other merger alternative, end-to-end mergers, obviously does not do anything to reduce rail plant.

We are pleased that the D.O.T. has called for a meeting of those interested in the Midwest rail problem for later this month. I can assure this Committee that the Chicago and North Western will participate in those meetings and that we will be prepared to assume our share of responsibility for assisting in solving the midwestern rail problem to the end of making certain that there will be no cessation of vital transportation services in our area and of finding a long term solution which will strengthen the midwest rail network.

Mr. ROONEY. Mr. Wolfe, you state on page 2 of your testimony the North Western is in good financial condition today, and you further go on to say, "We feel that our company will grow stronger year by year in its ability to generate additional traffic."

Mr. WOLFE. Yes, sir.

Mr. ROONEY. As I asked Chairman O'Neal this morning, there seems to be a misunderstanding, because, on page 14 of his statement, like on page 15 of the statement he disagrees with the assessments of ICG. He states: "The North Western financial condition, although improving, remains weak. A severe recession or combination of major adversities could force the railroad into bankruptcy."

Mr. WOLFE. I disagree; as chief executive officer of the North Western, I think I have reasonably good insight into the present condition. I think the best proof of the fact we can survive a recession is the fact that the North Western survived the recession of 1975 with flying colors.

Mr. ROONEY. You lost $8 million.

Mr. WOLFE. That is right. We made a recovery of $8 million in 1976.

Mr. ROONEY. The accounting procedures of ICG and the North Western and the ICC are greatly different.

Mr. WOLFE. Well, that is true. Let me explain why we adopted the system we did, if I may, because the question has come up.

When we purchased the railroad in 1972, of course there was a writedown of assets as a result of the price paid for the company at that time. When we formed our own company, we asked our independent accountants, Arthur Andersen & Co., what accounting system we should use. A very simple question that we posed to them, and Arthur Andersen recommended very strongly to us that we use depreciation accounting as the best possible system to accurately describe the financial conditions of the North Western, and that is why we went to that system.

I think the key question here is what is the present cash position of the North Western, because you know it was the lack of cash that caused the Milwaukee to file bankruptcy, and it was that that caused the Rock Island to file for bankruptcy. The cash position of North Western now is approximately $40 million in cash and securities in the bank. I think that factor has to be taken into consideration, and it may well be that Chairman O'Neal wasn't aware of the fact.

Mr. RUSSO. After you deduct liabilities, you have that?

Mr. WOLFE. Yes, sir; that is cash.

Mr. RUSSO. That is another case where we have figures around us and they tell two different stories.

Mr. WOLFE. No, they don't.

Mr. RUSSO. Let's go to page 14,

A loss of $2.6 million was suffered by North Western during the third quarter of 1977 as a result of a 4.3 percent decline in carloading for the same quarter in 1976.

Mr. WOLFE. Under our depreciation accounting we had a third quarter profit of $5.8 million.

Mr. RUSSO. You tell me how it works. I am not an accountant.

Mr. WOLFE. Neither am I.

Mr. RUSSO. What is depreciation accounting as opposed to what they are doing?

Mr. WOLFE. I explained it while you were out. Let me explain it again. Under depreciation accounting major track program work is capitalized over a period of time because it is regarded as a major improvement to the system. That is why it is called depreciation accounting. Under ICC betterment accounting, major track programs are expensed at the time the work is done.

Mr. RUSSO. How do you fellows do it? What kind of accounting do you use?

Mr. SULLIVAN. We end up in the final analysis of doing both.

Mr. WOLFE. If you do track work, which is improvement, you have to pay for it, and that is the only way there is going to be a difference is if you do it, you have to pay for it out of cash.

Mr. RUSSO. Can't we all agree on an accounting system that tells the story? Everyone wants to accomplish a certain purpose by the accounting method, and I would imagine that you can devise an accounting system that makes you look terrific and the same person can take it and say I don't want him to look good, and I am going to make him look bad.

Mr. WOLFE. The purpose is to accurately report what you have done, and Arthur Andersen has told us that this is the best system to use; it accurately portrays what we do, and that is capitalize the major track programs. But, as I say, it still comes out of cash.

Mr. RUSSO. In your situation that is fine, but in the situation of a marginal railroad that is looking for financing, I would imagine they are going to put their best foot forward in their financial statement, and someone who is going to loan them money is going to say we are going to take the worst possible outlook, and that is why someone says $473 million, and someone else says $273 million; using the same facts and figures, we arrive at different conclusions.

Mr. WOLFE. The North Western has a line of credit with major midwestern banks; the North Western sold an equipment trust last year——

Mr. RUSSO. This is damaging. If I were looking at the Chicago North Western, I would say they are not doing so well.

Mr. WOLFE. We prefer they use the best system, depreciation accounting, but the ICC doesn't.

What I was going to say is when a lender loans us money, in response to what you said, believe me, he looks at your cash, your capital account, your property account, and doesn't just stop at the income account, so all those things get looked at very carefully. The fact we are on depreciation accounting is well known in the accounting communities.

Mr. ROONEY. Mr. Wolfe, what has been your experiences with the FRA regarding obtaining funds under title V?

Mr. WOLFE. We have obtained, as you probably know, Mr. Chairman, about $25 million of preferred share financing. We experienced some negotiating problems at the onset with FRA, which I think were honest differences brought about by differences that each of us had in interpreting the law. And I don't think that is uncommon with a new statute. As we proceeded, those differences, many of them, were ironed out. However, we have prepared a list

of technical amendments which we think should be made to the law. I believe that FRA has honestly and diligently attempted to interpret the law as they see it, and I do think that since Mr. Sullivan has become administrator, the atmosphere in getting money out has changed.

Mr. ROONEY. That is the only nice comment that Mr. Sullivan has heard today.

I might say with the dialog we had with Mr. Wolfe, Mr. Russo, under the 4R Act of 1976 in title III, to reform the Interstate Commerce Commission, we directed a uniform cost and revenue accounting system, so hopefully the problem of accounting will be worked out.

Mr. WOLFE. I might point out, Mr. Russo, that all other industries use depreciation accounting, the same that we use.

Mr. RUSSO. Is the Rock Island on depreciation accounting?

Mr. MANOS. We are on depreciation accounting, but we must report to the Interstate Commerce Commission under their system, also.

Mr. WOLFE. That is right; which we do, too.

Mr. ROONEY. Thank you very much, Mr. Wolfe.

Our final witness will be Mr. John C. Spychalski, professor of business administration, Department of Business Logistics, Penn State University.

Welcome to the committee, Mr. Spychalski.

STATEMENT OF JOHN C. SPYCHALSKI, PROFESSOR OF BUSINESS ADMINISTRATION, DEPARTMENT OF BUSINESS LOGISTICS, PENN STATE UNIVERSITY

Mr. SPYCHALSKI. Thank you, Mr. Chairman.

By way of introduction, I should note that my duties at Pennsylvania State University center on teaching and research in the areas of transport economics, regulation, and management, and it is from that vantage point that I look upon various aspects of the dolorous problem that faces us this morning and indeed in a larger sense has faced the country for a longer period of time than some people would care to admit.

In view of your efforts to ration time and minimize duplication of points covered, I would like to focus on a number of conditions both internal and external to the railway industry that have not been emphasized by previous witnesses but which relate to the problem's causes and potential solutions.

In the area of causes, I would like to first focus on the policies, de jure or de facto, which I think have emerged from the Interstate Commerce Commission's approach to the granting of motor carrier operating authorities from the midsixties through the present.

If you look at the record of the Commission's action in this area very carefully, Mr. Chairman, I believe that you will find that the Commission, contrary to popular impression, has been rather liberal in its dispensation of certain types of motor carrier operating authorities and the particular types of authorities that have been issued cover commodities which are significant in the traffic bases of railways such as the Milwaukee Road.

These new authorities, together with linehaul economies made available by the interstate system, have greatly increased the

movement of certain types of commodities in truckload lots over distances traditionally looked upon as captive to rail carriers. For example, at my place of residence in central Pennsylvania, I recently purchased lumber that made its entire journey from Oregon in a truck trailer. Lumber is also being brought into the Eastern States by a combination of coastal steamship and either contract or irregular route, motor common carriers.

I thus would like to suggest that the Commission's approach to the granting of motor carrier operating authority be reviewed as part of a broader focus on the general problem at issue here when this subcommittee and related segments of the Congress deal with it in coming months. It may well be that the damage has already been done, that there is too much capacity in an economic sense in motor carriage, and that there is no going back in terms of what is legally or politically attainable, but I do feel that growing truck competition is an important cause of the problem that has had an accelerating effect since about 1971 or 1972.

The next point I would like to focus on is the inequality which exists between the regulation of agricultural traffic by railway, on the one hand, and agricultural traffic by road and water transport, on the other. As we all know, the movement of grain as well as all other types of agricultural traffic, is subject fully to the Interstate Commerce Act. However, in road transport a different situation exists. Under section 203(b)(6) and some other related provisions of that same section of the Interstate Commerce Act, a hauler of agricultural commodities by road is free to do business whenever and wherever that hauler pleases at any price which that hauler happens to strike in a bargain with a shipper.

Mr. RUSSO. The broker sets the price.

Mr. SPYCHALSKI. That is another important related point. Thank you, Congressman Russo. The role of the broker deserves some highlighting in this overall problem as well, but with my 15 minutes I will leave that to another day.

Mr. RUSSO. I spent 18 months on truckers, so I know you can't do it in 15 minutes.

Mr. SPYCHALSKI. At any rate, the point is if you are trying to compete in a price sensitive situation, and you are locked into the common statutory notice, 30 days—sure, under an emergency some lower deadline might be achieved, but generally that is the time required in ratemaking—how can you compete if the movement is particularly price sensitive? The same is true in rail competition with exempt barge carriers. During peak shipping periods, you can find instances where bargeload rates on grain may be 100 or 200 percent of what they might be at so-called off-peak. Economists, of course, find no difficulty in living with this, and say that it reflects the law of supply and demand and is an efficient means for rationing the available supply of water transport capacity. However, if that is appropriate for inland water transport, why is it not appropriate for rail transport?

I pose that question to you, and this leads us into another related topic, the continued role of personal and price discrimination in the Interstate Commerce Act, as it applies to rail transport. Is it time for a review of this society's views toward the practices of what some people perceive to be price discrimination in grain

ratemaking? I would commend that for some further attention at an appropriate point in time.

I single out grain traffic because it is such a significant element in the traffic base on both the Milwaukee Road and its neighbors in the so-called granger region.

I don't want to overstate some of the contributing roles that these imbalances in regulation might have had in the problem at hand, but I do think they have contributed in some cases, and I think imaginative rail management, fully cognizant of the possibilities that it could seize and utilize under a somewhat different regulatory framework, might be a factor that would assist in restoring some of these properties to viability.

Going back to the subject of discrimination for a moment, it is interesting to note that we treat price and service discrimination so differently in the regulated sector of transport than we do in the other parts of the economy. The Robinson-Patman Act restricts discriminatory practices in the sale of goods but does not apply to the sale of services.

Mr. RUSSO. But the way the Justice Department enforces the Robinson-Patman, we might as well take it off the books.

Mr. SPYCHALSKI. That is another interesting question.

Mr. RUSSO. I spent 18 months on that, too.

Mr. SPYCHALSKI. A commendable exertion of effort.

Mr. RUSSO. I will send you a report that we did on the Robinson-Patman Act.

Mr. SPYCHALSKI. I would appreciate it, sir, but the point I am leading up to at the moment is that since Robinson-Patman does not apply to services, the pricing practices of the unregulated or so-called exempt barge and motor carriers in the agricultural sector are not subject to any social control insofar as price discrimination is concerned, and that is the point I wanted to bring out and put on the stage and compare to the present set of obligations attending to those who attempt to sell rail transport services under the provisions of the Interstate Commerce Act as it presently exists.

Mr. RUSSO. Are you saying there are restrictions that prevent them from being viable railroads? Is that what you are saying?

Mr. SPYCHALSKI. I am suggesting that constraints that are placed on the pricing of railway services by these provisions may handicap the railways in competing for traffic with exempt motor carriers and with exempt water carriers.

Mr. RUSSO. Do you think there should be no restrictions whatever; in other words, because in these particular areas the motor carriers and barges are deregulated, there should be deregulation in the railroad industry in that area?

Mr. SPYCHALSKI. I am not saying there should not be restrictions. I am suggesting that the question of whether or not there should be constraints on the other forms of carriage should be looked at by this subcommittee.

Mr. RUSSO. We should put restraints on the truckers and barge companies?

Mr. SPYCHALSKI. I think this should be considered in an overall review of the problem, and you have two alternatives, either place the railroads in the same position as the other two or place the other two in the same position as the railroads are in. Of course,

one could get into whether it is administratively feasible to regulate motor carriage and around the corner is the agricultural bloc, and we all know what the Department of Agriculture's views on this would be. They have already been stated in past efforts to curtail the agricultural exemption.

In the 1960's, there were efforts to extend the agricultural exemption or equivalent to rail transport, and they also raised storms of controversy.

I would like to bring out one other point with regard to our society's view toward the practice of price discrimination and common carrier obligations in rail transport. It is interesting to note that certain shippers who favor the continuance of those constraints against discriminatory practices in rail transport and favor the continuance of the other obligation of common carriage in rail transport are the very same firms who are using exempt water and/or motor carriage as their base transport service, for example, in the grain area, in some cases, and who are reverting to rail only during peak season or during periods when the so-called base service for one reason or another happens to be either less than fully adequate for their needs or unavailable.

I would like to suggest that this topic be pursued if you should have a parade of shipper witnesses.

Mr. RUSSO. By the time you finish the testimony, you will have us going for another 10 years in looking at the problems.

Mr. SPYCHALSKI. I didn't want to replicate what went before us this morning.

Mr. RUSSO. It is interesting, by the way.

Mr. SPYCHALSKI. Incidentally, Mr. Chairman, if you are watching my time, I admire the way you run a committee. You would do well in the transport business.

Mr. RUSSO. He does well in the political arena.

Mr. SPYCHALSKI. It is a demonstration of comparative advantage.

Mr. ROONEY. Unlike Amtrak, we started on time.

Mr. SPYCHALSKI. The branch line abandonment question has been discussed extensively. I think even with the reforms in the 4R Act one may argue that there perhaps is still an imbalance to some extent between what is imposed on the carriers, on the one hand, relative to shippers. A shipper is not obligated to give a carrier advance notice of abandonment of a plant. A shipper can pull up stakes at will. The railway can't. I understand the rationale favoring certain constraints on the railway side, but by the same token, in my judgment from an equity standpoint there has been an imbalance here in terms of who has to bear the risk of uncertainty and the risk that goes with keeping an unremunerative line in operation pending final approval for discontinuance through an administrative process.

This might merit some closer attention if the daughter of the 4R Act comes to be, or at least in draft form comes to be considered.

I would like to raise here the role of contract rates, which ties in with our remarks a few minutes ago about our country's view toward discrimination in transport pricing and services. I think that greater reliance on contract ratemaking might assist the railways in competing for, and earning profits on services offered under circumstances commonly considered as either marginal or

hopeless. It might give rail carriers a better basis on which to make investments in rolling stock, by creating a stronger bond with shippers. So, I would suggest that the role of contract ratemaking be considered in any additional reforms to railway pricing that might be looked at by the subcommittee.

We, of course, already have contract ratemaking on an intrastate basis. In the State of Wisconsin, the Soo Line has pursued it. That line, of course, is the long arm of the Canadian Pacific Railway in this country, and the CPR has long been accustomed to using that form of pricing for some of its Canadian traffic.

Mr. Chairman, I have probably consumed enough time. If you would like to discuss or raise questions about observations I have made, I would be pleased to attempt to pursue them.

Mr. ROONEY. Thank you very much, Professor. As you know, we provided for seasonal rates for rail in the 4R Act. Are you saying to this committee it isn't working or needs some kind of modification?

Mr. SPYCHALSKI. I would say, Mr. Chairman, that the seasonal rate pattern that can be accomplished under the 4R Act is too inflexible relative to what you can accomplish under the freedoms that the unregulated motor and water carriers enjoy. A railway can adjust rates seasonally, but a regulated motor carrier can change rates by the minute or the broker can change rates by the minute and for that matter, of course, so can an inland water carrier which is moving commodities exempt under section 303(b).

Mr. ROONEY. You made some fine observations in your presentation this afternoon. I was wondering what suggestions you might give to the railroads to accomplish some of the suggestions you made here. I think this committee by and large would agree to most of the things you have said today. At least, I am speaking for the chairman.

Mr. SPYCHALSKI. Some of the points I have raised are beyond the discretion of individual railway companies. The arena of legislative action obviously applies to changes in how society looks upon personal discrimination in transport pricing, and to the manner in which the ICC looks upon motor carrier entry control. It should be noted that the current wave of popular opinion on motor carrier certification is in the reverse direction. We have an ever-rising tide of sentiment for substantial deregulation in the motor carrier area, and I would submit that there may be some interesting implications for the railway industry if some of the ideas advocated by Mr. John H. Shenefield, of the Antitrust Division, are implemented, and they may not augur well for a self-financing railway network.

Mr. ROONEY. I recognize the gentleman from Illinois for 1 minute.

Mr. RUSSO. Thank you very much, Mr. Chairman.

First of all, I want to thank you for appearing. I think you have raised some very excellent issues that we have to look at.

I would just suggest to you, since in the 15 minutes you probably didn't cover all the things you would like to, if you would submit that to the committee we would appreciate it and make it part of the record, because we are going to be looking at a lot of these areas that not only does this committee have jurisdiction over some of the issues you raised but also other subcommittees I sit on that will be involved in it certainly would like to look at it.

How do you feel about the comment made by the chief executive officer of the Chicago and North Western, where he says the main problem is excess capacity?

Mr. SPYCHALSKI. I would say that that certainly is a problem.

Mr. RUSSO. Is not the major problem, would you say?

Mr. SPYCHALSKI. I do not consider it to be the only problem.

Mr. RUSSO. What would you consider the main problem, Professor, causing the problems in the Midwest as far as the railroads?

Mr. SPYCHALSKI. I can't really assign weights to them. I can only array them, with no intention of implying that one may be more or less significant than another based on its position in the array.

We can start with the one that Mr. Wolfe raised in his testimony. That certainly is a problem. I think there is a question though of whether or not some capacity that presently looks excess could be made viable, and that is why I find some items of attraction in the very creative proposals that were received this morning from Mr. Ingram and his colleagues at the Rock Island.

I think there are some germs of merit in that suggestion.

I will say that the labor problem can't be understated. I think that Mr. Ingram posed a very constructive set of phraseology here in trying to cope with it this morning, but, frankly, the present set of work rules under which the railway industry operates, the present means or basis on which railroad employees are compensated—and I am speaking now of train and engine crews—makes it impossible to realize the economic potential of rail transport in many potential applications.

You could visualize, for example, a movement for which you might consider the use of so-called mini-unit trains. A few of these breakthroughs have occurred. It should be noted that both the Milwaukee and the North Western have negotiated some changes in work rules with their operating brotherhoods, but the problem is the distance between what has been negotiated and what really should be done. That is the problem in this area. There is an awful lot more that could be done.

Mr. RUSSO. You think the labor groups are beginning to realize if they keep pressing the way they do they are going to bankrupt the railroads and are going to end up losing their membership anyway?

Mr. SPYCHALSKI. I think some members of the leadership perceive that. I think it is a multifaceted problem.

To put all our cards out on the table, I think we should also acknowledge that some of the problem historically stems from the way in which labor relations have been managed on the employer side. I think we have gotten an infusion of individuals in recent years who may help change this insofar as railway management is concerned.

I think some railway managements are taking a more creative approach to managing their labor relations and attempting to manage change in a constructive way, but there are an awful lot of slips between the top and the middle level and lower level as it goes on on a day-to-day basis in a railway and one really has to go down and spend some time at the operating level in a rail firm to appreciate this.

Mr. RUSSO. Could you just list quickly—because I know the Chairman has allowed me only 2 minutes and we passed that 10

minutes ago—we have excess capacity; we have the labor problem——

Mr. SPYCHALSKI. Yes.

Mr. RUSSO. [continuing]. We have restrictive regulations. What else would you put into the pie?

Mr. SPYCHALSKI. We have talked about public policy insofar as regulations are concerned. Let's, of course, talk about the imbalance in public policy insofar as the promotion and taxation of nonrail forms of transport are concerned. That point has been made by several witnesses this morning but I think it is something that certainly cannot be disregarded.

I have some grave reservations about the adequacy of highway user charges with regard to vehicles in certain weight classes, particularly on certain segments of roadway other than the Interstate System. This is a point that is not always appreciated by some who look at highway weight capacity in a broad-brush sense. There can in fact be some significant disparities between the weight of a vehicle and the road that is carrying that vehicle in the different areas of the country; and this gets into how we fund that road and how much the vehicle pays for the roadway and whether or not some of the traffic moving in some areas might be moving by truck in situations where the cost of the roadway in effect has been vastly understated; and we see this in our own home State, Mr. Chairman, with coal trucking. There is just one vivid case example after another of deteriorated highway.

Mr. ROONEY. I used to chair the Pennsylvania Senate Highways Committee. I know very well some of the problems, like you know the trucking problems.

Mr. RUSSO. Is there anything else you would put in that?

Mr. SPYCHALSKI. I am speaking of the general area of user charges, of course. That is one element here.

Mr. RUSSO. In which the barge companies have it made.

Mr. SPYCHALSKI. Or their shippers have it made. I don't think that the savings have been captured by the commercial barge lines; they haven't gotten rich. I think that the benefits have flowed through to their principal shippers in oligopolistic industries.

Mr. RUSSO. I have nothing else. I certainly would appreciate it if you would send some comments in.

Mr. SPYCHALSKI. I will try to do so as soon as possible.

[Testimony resumes on p. 125.]

[Mr. Spychalski's supplemental statement follows:]

SUPPLEMENTAL STATEMENT OF
JOHN C. SPYCHALSKI
PROFESSOR OF BUSINESS ADMINISTRATION
DEPARTMENT OF BUSINESS LOGISTICS
COLLEGE OF BUSINESS ADMINISTRATION
THE PENNSYLVANIA STATE UNIVERSITY
BEFORE THE SUBCOMMITTEE ON TRANSPORTATION AND COMMERCE
OF THE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE
U.S. HOUSE OF REPRESENTATIVES
JANUARY 5, 1978

Introduction

The immediate cause of both the Milwaukee Road's financial distress and the modest-to-mediocre economic condition of various other Midwestern railways is lack of operating revenue commensurate with available plant capacity. This phenomenon might cause some individuals to conclude that (1) excessive trackage represents the only cause of the problem and hence, (2) that rationalization of the existing railway network constitutes the only necessary remedy. Such a conclusion is incorrect. Excess plant capacity is but one of numerous conditions which have sapped the vitality of both bankrupt and still-solvent railways in the Midwest and elsewhere. Some of these conditions are largely or wholly internal to the railway industry and/or to individual railway firms insofar as their causes and prospective remedies are concerned. Others, however, involve various aspects of governmental policy and can be dealt with only by means of public sector initiatives. The purpose of this statement is to highlight conditions in the latter category (and questions posed by those conditions) which appear worthy of attention in any Congressional efforts that might be taken to assist the railway industry in achieving a more favorable level of economic performance.

The Agricultural and Bulk Exemptions: Competitive Handicaps for Railways

All rail traffic is subject to economic regulation under the Interstate Commerce Act. Thus (among other things), no rail rate can be initiated or adjusted without the observance of advance notice and tariff publication requirements. In contrast, both for-hire truck movements of agricultural products and for-hire inland water movements of bulk materials are exempted from regulation by the Act. Hence, motor and water carriers operating under terms

of the agricultural and bulk exemptions, respectively, are free to accept or reject traffic whenever, wherever, and with whomever they please, and may price their services on whatever terms they find it possible to command in transactions with shippers. No rate publication or notice requirements apply to exempt carriers' charges.

The handicap which this set of circumstances imposes upon rail firms competing for the movement of rate-sensitive commodities such as grain -- which represents the leading transportable product of much of the Milwaukee Road's territory -- is obvious. Exempt carriers, or brokers of the services thereof, can use published rail rates as pricing bench marks against which to "sharpshoot" -- i.e., to set whatever prices they deem acceptable for particular movements in rail-competitive situations. Railways cannot readily respond with rate changes of their own, because regulation prevents instantaneous or timely responses to exempt competitors' pricing actions.

The greater pricing flexibility enjoyed by exempt carriers also enables them to achieve a higher degree of efficiency in equipment utilization. For example, exempt barge rates on grain fluctuate freely in response to changes in the demand for, and supply of, barge lines' grain carrying capacity. During peak periods, they sometimes exceed regulated rail rates by more than 200 percent. At other times, they decline to levels well below the lowest published rail grain charges. Water carriers faced with such a pricing environment have a very pointed incentive to maintain their capacity at levels which, in terms of cost requirements, will not greatly exceed the aggregate value which their customers place upon water transport service during peak and off-peak periods taken together.

If such ratemaking flexibility were possessed by railways, it is likely that the chronic problem of severe seasonal shortages in grain-carrying rolling stock would not exist. Moreover, grain shippers would not be induced, as many presently are, to rely upon exempt water and motor carriers for the fulfillment of their basic tonnage movement requirements, and to use rail transport only as a residual medium during periods when exempt barge and truck rates exceed rail rates and/or when disruptions occur in the availability

of exempt water and motor carrier services. The fact that numerous grain shippers have relegated rail service to a secondary or supplemental role in the fulfillment of their overall transport needs strongly suggests that the Congress should thoroughly probe the question of whether statutorily-prescribed common carrier obligations are still appropriate for railways in transport markets where they face competition from exempt motor and water carriers.

The anomaly which the agricultural and bulk exemptions pose in the area of social control of price discrimination also merits attention during any future Congressional review of rail carriers' common carrier obligations. Under the provisions of the Interstate Commerce Act, railways presently face restraints against rate and service discrimination which greatly exceed those imposed upon firms engaged in the sale of goods by the Robinson-Patman Act. Furthermore, exempt water and motor carriers face no statutory anti-discriminatory controls whatsoever, because the Robinson-Patman Act does not apply to the sale of services. An investigation of this anomaly should center upon evidence pertaining to the primary determinants of a carrier's propensity to engage in price discrimination, i.e., (1) the extent of the carrier's monopoly power in the individual markets or submarkets which it serves, and (2) the nature of its cost structure and unit cost behavioral characteristics.

Liberal Regulation of Entry into Motor Carriage

The Interstate Commerce Commission's policy toward the issuance of new motor carrier operating authorities -- i.e., certificates of public convenience and necessity for common carrier services, and permits for contract carriage -- is popularly portrayed as being highly restrictive (and has become the object of a mounting tide of vociferous criticism for its alleged anticompetitive consequences). However, a review of the record of Commission action in this area reveals that approvals of new operating authority applications -- oriented toward truckload lot-sized movements of raw and semi-finished materials and finished goods -- have mushroomed since the mid-1960's, and are continuing at an accelerating pace. It is

common knowledge to all who transact business in freight transport markets that operations conducted under such authorities, aided by line haul economies derived from the Interstate Highway System and by the widespread use of so-called owner-operators (who lease their driving services and vehicles to irregular route common carriers which possess the operating authorities), have penetrated deeply into the movement of traffics over distances traditionally considered captive to rail transport. In territory served by the Milwaukee Road, such truckers have captured a growing share of westbound manufactured goods together with eastbound agricultural commodities solicited as backhaul traffic under the freedoms accorded by the agricultural exemption. The rail losses exacted by such inroads include both traffic actually shifted from rail to highway, and a dampening of rate levels and earnings on commodities still moving by rail.

Another facet of the Commission's liberal dispensation of new operating authority involves manufacturing and merchandising firms with private trucking fleets. Through the use of adroit strategies during the application process, a number of such firms have succeeded in converting their motor operations from private carriage (in terms of legal form) to either contract or irregular route common carrier status for the purpose of obtaining revenue-producing loads in backhaul situations where traffic related to their own primary business activity is unavailable. This can and often does direct a double blow at rail transport. The shipper's economic commitment to the self-movement of traffic related to his own primary business is reinforced, while the for-hire backhaul traffics can be drawn from forays into additional rail markets.

Still another rail-competitive thrust by motor carriage, of particular significance in the agribusiness-oriented Midwest and Pacific Northwest, is the Interstate Commerce Act-based exemption which permits agricultural cooperatives to engage in the interstate for-hire trucking of non-farm commodities for non-members. Legal use of this exemption requires that non-member for-hire traffic be limited to no more than fifteen percent of a cooperative's total annual interstate transportation services, measured in terms of tonnage, and involve vehicle movements or route patterns incidental to and supportive of the cooperative's primary or member-

ship-related trucking activities. However, there is reason to question (1) the effectiveness with which this limitation has been, and can be, enforced, and hence (2) the actual extent of its influence upon transport competition.

Motor Carrier Deregulation: Negative Impact for Railways?

In testimony given before the Senate Subcommittee on Antitrust and Monopoly on October 27, 1977, Assistant Attorney General John H. Shenefield declared that the Carter Administration "is committed to substantial deregulation" of trucking. An extended critique of arguments favoring such action exceeds the ambit of this statement. Of immediate relevance here is the possibility that termination of motor carrier entry control and rate regulation would compound the adversities which have already been imposed upon rail rate levels, traffic volume, and earnings by the Interstate Commerce Commission's prolific issuance of operating authorities and by the agricultural and bulk exemptions. It thus seems essential that any legislative move toward trucking deregulation be deferred until a full range of evidence concerning its probable intra- and intermodal competitive consequences can be gathered and evaluated. And, a related matter deserving of scrutiny in such an investigation is the question of whether existing regulatory restrictions on railway-owned and controlled motor carrier operations should be repealed concurrently with either legislated or commission-administered decreases in constraints on entry into for-hire motor carriage.

Do Truck and Barge Rates Adequately Reflect Costs?

Widely-acknowledged, long-criticized, and still-existent governmental policies have resulted in the sale of motor and water freight services at rates which do not properly reflect the public costs of providing highway and river navigation facilities. The need for corrective action in this area is most glaring in inland water transport, which has persistently remained virtually free from user charges. The enactment of legislation requiring the payment of user fees on specific segments of the waterway system at levels commensurate with the construction, maintenance, and operating outlays relating to each segment is the only appropriate course of action if the Congress wishes to minimize freight transport subsidy needs from the vantage point of the freight transport network taken as a multi-modal nationwide whole.

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The highway system taken en toto is heavily supported (approximately 80 percent) by user charges. But, are the totals provided by user charges appropriate vis-a-vis the amounts financed by other types of taxes? And, do user tax revenues generated by vehicles in particular size and weight classes properly reflect (1) tne benefits which their operators derive from road usage, and/or (2) the specific construction and maintenance costs occasioned by their operation? The quest for an answer to the latter question is complicated by the fact that many highway cost elements cannot be traced on a causal basis, or in a relatively unambiguous manner, to particular vehicle classes, let alone individual vehicles. Nevertheless, there is strong evidence of the existence of underpayment on specific segments. For example, the states of Ohio and Pennsylvania contain much physically depreciated road mileage in areas where large volumes of heavy machinery, steel, coal, limestone, and even iron ore (between a Lake Erie port and Youngstown) move by truck. Studies of portions of this mileage reveal that its upgrading to, and maintenance at, capacity levels commensurate with traffic requirements cannot be financed via existing user charge revenues.*

There is a need for the performance of more extensive research in this general subject area. Analyses based on the famous AASHO road tests conducted at Ottawa, Illinois in the late 1950's constitute the most recent effort to ascertain linkages between road costs and vehicles in all weight and size classes, and the student of transport economics and policy who searches for a reasonably definitive study of the benefits derived from road usage by distinct classes of vehicle operators will labor in vain.

Additional problems of equity and economic efficiency in competitive relationships between road and rail transport arise from differences in ownership risk, fixed cost burden, and property taxation. Private ownership of right-of-way causes rail firms to bear both larged fixed capital and maintenance costs and the risk of capital value losses in the event that traffic sources decline

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*Pennsylvania Coal Transportation Task Force, Coal Transportation in Pennsylvania, Working Paper No.1, November 22, 1977, pp.13-14.

or disappear. Rail right-of-way is, of course, also subject to real estate levies in most taxing jurisdictions. In contrast, the payment of motor fuel taxes, the principal source of road user-generated revenue, varies with vehicle operation. Thus, a motor carrier need not contribute toward line haul right-of-way costs when decreases in his traffic volume and gross revenues are matched by decreases in the vehicle mileage which he operates -- except to the extent of his payment of license fees and certain other user charges of lesser significance, which remain fixed within the span of a calendar year. Capital loss risk in the event of either geographic shifts or complete losses of traffic is confined largely to the motor carrier's own terminal facilities (and the latter are frequently highly saleable, unlike the heavily specialized investment that comprises rail track and roadbed). Finally, no property tax element enters into the construction of highway user taxes.

In addition to the problem of understatement of public costs in motor carrier rates, there is also some symptomatic evidence that rates charged for rail-competitive motor carrier services, particularly in the exempt agricultural sector and in long-distance truckload lot-sized movements of regulated commodities, do not fully cover the long-run marginal costs (including a suitable driver's wage allotment and a rate of return on vehicle investment) actually incurred by carriers and/or owner-operators. The likelihood of such a misallocative result in the form of persistent, widespread bona fide ruinous rate competition is denied by most economists, who look upon motor transport as an industry in which unrestrained price competition is -- or would be, in the absence of regulation -- highly if not perfectly workable. A minority of transport academicians dissent to varying degrees from this viewpoint, as do some seasoned participants in transport markets, who claim having witnessed situations in which motor carrier behavior and performance differed markedly from conditions and outcomes portrayed by economists. The fact that long-distance truckload rates on numerous commodities now closely approximate rail costs for comparable lengths of haul suggests a need for further exploration of, and possible action on, this matter -- conventional arguments of economists and advocates of motor carrier deregulation notwithstanding.

Some Potential Changes in Railway Rate Regulation

Earlier portions of this statement dealt with various conditions (e.g., control of price discrimination, anomalies occasioned by the agricultural and bulk exemptions) that, when fully evaluated, might indicate a need for significant changes in railway rate regulation. Among such potential changes are the following:

1. Exemptions from rate regulation paralleling those presently applicable to motor and water transport.

2. Contract rates, which could provide railways with a means for developing stronger bonds with shippers, and thus decrease the uncertainty attaching to investments in (a) rolling stock, and (b) line and terminal capacity, particularly in situations where such capacity is devoted largely or wholly to one or relatively few shippers.

Conclusion

To look upon contemporary Midwestern and Western railway problems as stemming solely from duplicative line and terminal capacity is to disregard numerous other contributing causes which must also be corrected if the railway industry as a whole is to attain a satisfactory level of performance and lead a self-sustaining existence insofar as the supply of freight services is concerned. Moreover, these corrections must come soon. The price of undue study, debate, and unwillingness to confront highly controversial issues in a decisive manner will most likely be continuous governmental subsidy.

Mr. ROONEY. Thank you very much, Professor.

I want to say this: Usually with the last witness the people in the chamber leave. You have held everybody spellbound this afternoon, which indicates to me that Pennsylvania State University is still No. 1.

Thank you.

Mr. SPYCHALSKI. Thank you very much.

Mr. ROONEY. For the record, I would like to enclose a letter I received from the Department of Transportation of the State of Wisconsin, from Mr. Dale Cattanach, secretary; and also a statement from Mr. W. N. Deramus III, chairman of the board, Kansas City Southern Railway Co.

Mr. ROONEY. That concludes our hearing.

[The following letters and statement were received for the record:]

State of Wisconsin \ DEPARTMENT OF TRANSPORTATION

OFFICE OF THE SECRETARY
Room 1208 Hill Farms State Office Bldg.
4802 Sheboygan Avenue
Madison, Wisconsin 53702
Telephone 266-1113

January 4, 1978

The Honorable Fred B. Rooney, Chairman
Transportation and Commerce Subcommittee
House Interstate and Foreign Commerce Committee
U.S. House of Representatives
Suite 2313, Rayburn House Office Bldg.
Washington, D.C. 20515

Dear Representative Rooney:

As Secretary of Transportation for the State of Wisconsin I wish to commend you for your prompt decision to hold a hearing on the bankruptcy action of the Chicago, Milwaukee, St. Paul and Pacific Railroad. It is certainly timely for Congress to focus its attentions on the problems facing not only that railroad but several others in the midwestern section of the nation.

The purpose of this letter is to inform you of the importance of the Milwaukee Road to Wisconsin, to urge federal attention to the midwest's railroad problems, and to advise you that Wisconsin stands ready to help in any way that it can.

The Milwaukee Road is very important to the State of Wisconsin. It is more than a coincidence that the railroad carries the name of our largest city. It provides 24 percent of our rail mileage and carries 25 percent of our rail traffic. It actually constitutes almost 50 percent of the rail mileage in the southern and eastern portions of Wisconsin - our most populous area.

The Milwaukee Road serves each of our eight largest cities and all but four of our twenty largest cities. It carries 94% of the AMTRAK mileage in the state. For 184 Wisconsin communities it provides their only rail freight service. It directly employs close to 3,000 Wisconsin citizens.

Such a railroad is far too important - both to the Wisconsin economy and to the national transportation system as a whole - to permit its further physical and financial deterioration. Because of that importance, we need assurances that currently viable and essential lines and services will be continued in operation in a way which will adequately meet the needs of Wisconsin's and the nation's commerce.

Wisconsin has recognized this importance long before the current bankruptcy crisis, and, though we do not yet possess all the tools we might desire to financially or otherwise aid the railroads in our state, we are not

standing by idly. Our Legislature has provided funding to meet the matching requirements of rail service continuation assistance programs under both the 3R and 4R Acts. We have upon several occasions supported the railroads, including the Milwaukee Road, in abandonment actions, recognizing their need to eliminate costly sections of lightly used line. Over a year ago our Governor supported the Milwaukee Road's application for federal assistance under Title 5 of the 4R Act and, with federal approval of a part of that application, our Legislature took specific action to ease the tax burden associated with sale of the preference shares then authorized to upgrade its mainline through Wisconsin. And when the Milwaukee's bankruptcy action was recently announced, Wisconsin's Governor Martin J. Schreiber immediately urged regular customers of the railroad to "take a 'business as usual' attitude until the air can be cleared." He pointed out that "the worst thing that could happen would be for customers to abandon the railroad because such action would severely impair the company's ability to successfully restructure financially and continue to serve."

Right now, we in the Wisconsin Department of Transportation are exploring a variety of possible ways in which the state can be more helpful to the Milwaukee Road, as well as to our other financially struggling railroads, in achieving increased business and gaining a strengthened condition. As we do this though it becomes increasingly clear to us that the federal government must take the lead in addressing the rapidly emerging problems of the railroads of the midwest, as those railroads and problems far transcend the borders of an individual state. However, in urging a federal lead we would also urge that Congress and the federal government not lose sight of the important role that the individual states can and should play in such matters.

We believe the states can have much to offer constructively in bankruptcy proceedings and in the eventual restructuring of any railroads operating within their jurisdiction. We have been involved in rail planning in conjunction with the 3R and 4R Acts, for over three years and as a result of our efforts have some ideas on how the system may be streamlined without significant impact on Wisconsin communities and shippers. We particularly hope that Congress will seek the advice of the states in developing any new legislation and that the Executive Branch will continue to work with the states in implementing the programs you authorize.

Again my appreciation to you for your responsiveness to this issue. We in Wisconsin stand ready to assist where appropriate.

Sincerely,

Dale Cattanach

Dale Cattanach
Secretary

DC:nlt

CONRAIL

JOHN L. SWEENEY
VICE PRESIDENT
GOVERNMENT AFFAIRS

January 6, 1978

Honorable Fred B. Rooney
Chairman, Subcommittee on Transportation
and Commerce
Committee on Interstate and Foreign Commerce
U.S. House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Conrail wishes to offer the following observations about the situation arising out of the Milwaukee Road bankruptcy position:

Insofar as lines of railroad operated by the Milwaukee Road are concerned, it would appear that Conrail would be involved only with Milwaukee's Line from Chicago, Illinois to Louisville, Kentucky, which intersects Conrail at Chicago Heights, Delmar, and Danville, Ill., and at Terre Haute, Beehunter, Elnora, and Seymour, Indiana. In the event that any or all of this north-south line is liquidated, Conrail will be agreeable to exploring the possibility of serving rail customers at common points.

Insofar as subsidiary lines of Milwaukee Road are concerned, Conrail is deeply involved with the Indiana Harbor Belt Railroad. This Class I switching and terminal carrier is owned 51% by Conrail, 49% by Milwaukee Road. IHB serves as Conrail's primary route for the interchange of westbound traffic, and Blue Island Yard functions as Conrail's classification yard for eastward traffic received from connecting lines at Chicago. For this reason, it is essential that Conrail be represented in any discussions that involve a transfer of the Milwaukee ownership to another entity.

Sincerely,

John L. Sweeney

JLS/cdt

Illinois Central Gulf

An IC Industries Company

William J. Taylor
President and
Chief Operating Officer

Illinois Central Gulf Railroad
Two Illinois Center
233 North Michigan Avenue
Chicago, IL 60601
(312) 565 1600

January 10, 1978

The Honorable Fred B. Rooney
U. S. House of Representatives
Washington, D. C. 20515

Dear Chairman Rooney:

We understand that, at your Subcommittee hearing on January 5 relative to the receivership of the Milwaukee Railroad, there was discussion and some confusion as to the 1977 earnings of the ICG Railroad.

Apparently the source of any uncertainty lies primarily in accounting methods, as shown by the enclosed single page statement. The Interstate Commerce Commission chart of accounts charges virtually all roadbed investments in a given year, however, long-term they may be, against the current earnings for that year; this is known as "betterment accounting." Our railroad is required to report to the ICC on this basis.

Our public reports to shareholders, creditors and the investment community, as audited by public accountants and filed with the SEC, are prepared under Generally Accepted Accounting Principles (GAAP). We use "depreciation accounting" for long-term investments in railroad roadbed, which are capitalized and depreciated, just as in the case of freight cars, buildings and other capital assets, and consistent with normal accounting practice in virtually all non-railroad businesses.

During recent years, and particularly in 1977, we have invested heavily in the roadbed on a long-term basis. Therefore, you can understand that the more we improved our property, the worse we looked financially, under the ICC "betterment accounting" method.

The immediate effect on earnings under GAAP "depreciation accounting" was much less, because long-term roadbed investments are written off against earnings over the life of the investment rather than all in the first year. Obviously, we expect the investments to be useful and profitable over their economic lives.

The difference in a year of big roadbed improvement can be very large. The ICG Railroad earned $22.320 million in net income after taxes in 1976 under the GAAP method and only $15.227 million under the ICC method, a difference of $7.093 million.

For the first ten months of 1977, the ICC method produced net income after taxes of $6.226 million for the ICG Railroad, compared to $31.430 million under the GAAP method.

Under the GAAP method, approved by our auditors and the SEC, the ten months net income in 1977 was $31.430 million, almost double the $15.954 million earned during the same period of 1976.

We hope these remarks help to eliminate any confusion that arose.

Very truly yours,

ORIGINAL SIGNED
W. J. TAYLOR

Enclosure

cc: Honorable A. Daniel O'Neal, Jr.
Chairman
Interstate Commerce Commission
Washington, D. C. 20423

ICG EARNINGS - 1977 Compared to 1976

(Millions) (Including Real Estate)

	ICC Basis		GAAP Basis	
	1977	1976	1977	1976
Third Quarter				
Pretax	$ (7.361)	$1.941	$ 2.915	$ 2.324
Net Income	(7.361)	1.898	2.545	1.701
9 Months				
Pretax	(.463)	11.658	21.877	14.530
Net Income	(.463)	11.340	20.913	12.505
Ten Months				
Pretax	6.226	15.670	32.522	20.012
Net Income	6.226	14.432	31.430	15.954

( ) loss

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NOTE: Pre-tax figures are computed and do not appear as such in ICC reports; net income figures do appear in quarterly ICC reports, but monthly reports are not filed. Thus, there is no ICC report for 10 months.

1/10/78

Kansas City Southern Industries, Inc.
114 West 11th Street, Kansas City, Missouri 64105

IRVINE O. HOCKADAY, JR.
President

January 13, 1978

Hon. Fred B. Rooney
Suite 2313
Rayburn Building
Washington, D. C. 20515

Dear Representative Rooney:

During recent weeks, largely in the wake of the Milwaukee Road bankruptcy, much publicity has focused on rail problems in the Midwest. Kansas City Southern Industries, Inc.'s rail subsidiary has been in the spotlight, lumped with so-called "marginal" carriers.

I am taking this opportunity to state emphatically that Kansas City Southern Railway Company is not a marginal carrier. The enclosed letter, which I hope you will read, provides factual support for this conclusion.

It is frustrating to continually fight for our market share in the face of Government policies which have favored our barge and truck competitors and then have Government officials state that our prospects for survival are not good. We will have more to say about these Government policies in the coming dialogue with DOT.

For now, I merely wish to bring this problem to your attention, in the hope that you can assist in encouraging officials in agencies which report to Congress to become aware of the facts pertaining to companies about which they chose to comment and to recognize the ramifications of casual statements made to the press. I particularly stress how needlessly damaging these inaccurate remarks can be to the investing public, stockholders and employees.

Sincerely,

Enc.

Kansas City Southern Industries, Inc.
114 West 11th Street, Kansas City, Missouri 64105

IRVINE O. HOCKADAY, JR.
President

January 12, 1978

The Hon. Brock Adams
Secretary of Transportation
400 Seventh Street, S. W.
Washington, D. C. 20590

Dear Mr. Adams:

The Wall Street Journal today quoted "Federal officials" as stating that several railroads, including the Kansas City Southern, "are not doing well" or "have dubious long-term prospects".

The Wall Street Journal reporter declined to name these perennially faceless Federal officials but stated that he talked with people at the Department of Transportation and Interstate Commerce Commission.

Insofar as Kansas City Southern Railway is concerned, the statements made by these two Governmental agencies are wrong. The statements indicate either an almost unbelievable ignorance of the facts or a shocking willingness to ignore facts which are publicly known and readily available. While I recognize that you cannot control everyone in your organization, public officials have a minimum obligation to act responsibly when making public statements. Such officials should go to the trouble of getting their facts straight.

The facts are that:

1. In 1977, Kansas City Southern Railway (KCSR) earned approximately $8.2M after tax, its highest earnings level in ten years.

2. Further, in 1977, KCSR had one of the highest maintenance of way ratios in the rail industry (approximately 18%). Considering the substantial dollars spent on maintenance and the earnings level achieved, 1977 is perhaps the most successful year in KCSR's entire history.

3. In 1977, KCSR's return on equity will be one of the highest in the rail industry.

4. A frequently used Interstate Commerce Commission measure of successful rail operations is the ratio of net railway operating income to revenues (computed in accordance with I.C.C. methods of accounting). KCSR's 1977 ratio in this regard will be among the highest, and possibly the highest, in the railroad industry.

As to future prospects, the Railroad's performance in 1978 should continue to improve. It is interesting to note that on January 9, 1978, Standard & Poor's Investment Advisory Survey chose to rank Kansas City Southern as one among nine companies with superior earnings prospects for 1978.

It is unfortunate that Government officials in positions of responsibility do not have a more comprehensive understanding of the available facts before making public pronouncements.

Kansas City Southern Railway has over 3,000 employees in six states who worked hard and succeeded in making 1977 a banner year. Kansas City Southern Industries, Inc., the parent company, has thousands of stockholders who had their dividend rate increased twice during 1977. It is unfortunate that individuals in your organization manage to disregard relevant facts and at the same time ignore the interests and efforts of thousands of employees and stockholders.

I would be indebted to you for any specific suggestions you have as to how this kind of unfairness can be avoided in the future.

Sincerely,

P.S. I enclose a copy of a letter I sent you last January 5, 1978, which you have not acknowledged but which I had hoped would have prevented what now has happened.

I.O.H.,Jr.

Enc.

a similar letter was sent to Dan O'Neal/ICC.

Kansas City Southern Industries, Inc.
114 West 11th Street, Kansas City, Missouri 64105

IRVINE O. HOCKADAY, JR.
President

January 5, 1977

The Honorable Brock Adams
Secretary of Transportation
400 Seventh Street, S.W.
Washington, D. C. 20590

Dear Mr. Adams:

You have been quoted in the New York Times and in the local Kansas City paper concerning your judgments about the middle western railroads. I recognize that reporters frequently are highly selective in what they quote. However, your emphasis seems to be that some railroads in the Middle West are bankrupt, and those that aren't, soon will be. Never has there been mention of the fact that there are some profitable railroads in this part of the country.

In fact, Kansas City Southern Railway is just completing perhaps its most profitable year ever. The publicity which is being generated concerning rail transportation in the Middle West is a disservice to our stockholders and is inaccurate insofar as our company is concerned. I thought you should be aware of our views and I will be glad to send you detailed financial information to support my comments, if you think that appropriate.

Sincerely,

STATEMENT OF W. N. DERAMUS III,
CHAIRMAN OF THE BOARD, KANSAS CITY SOUTHERN RAILWAY COMPANY

The proposal being made by John W. Ingram to form a consortium of Midwestern railroads was not discussed with anyone at the Kansas City Southern Railroad. We learned about this proposal through the Stephen Aug article of Wednesday, January 4.

We have not seen the proposal and certainly have not had any opportunity to study it. Such a proposal would require a great deal of study as to feasibility and assessment of potential benefits and detriments to a carrier such as KCS.

Mr. Ingram's proposal, as reported in The Washington Star, would form FarmRail among five railroads. It is interesting to note that, of those, only the KCS and ICG are profitable. There would appear to be no advantage to KCS stockholders to take on problems of bankrupt or nearly bankrupt carriers. The problems of railroads in the Midwest can be solved in other ways, including holding down subsidies to competing modes.

[Whereupon, at 1:23 p.m., the subcommittee adjourned.]

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