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95-162 FINANCIAL CONDITION OF THE DELAWARE AND
HUDSON RAILWAY

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95-162

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

DETERMINING HOW THE FINANCIAL CONDITION OF THE
DELAWARE AND HUDSON RAILWAY CAME ABOUT, AND
WHAT, IF ANY, CORRECTIVE ACTION CAN BE TAKEN BY THE
CONGRESS TO RELIEVE THE SITUATION

AUGUST 15, 1978

Serial No. 95-162

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Delaware and Hudson Railway Co.:

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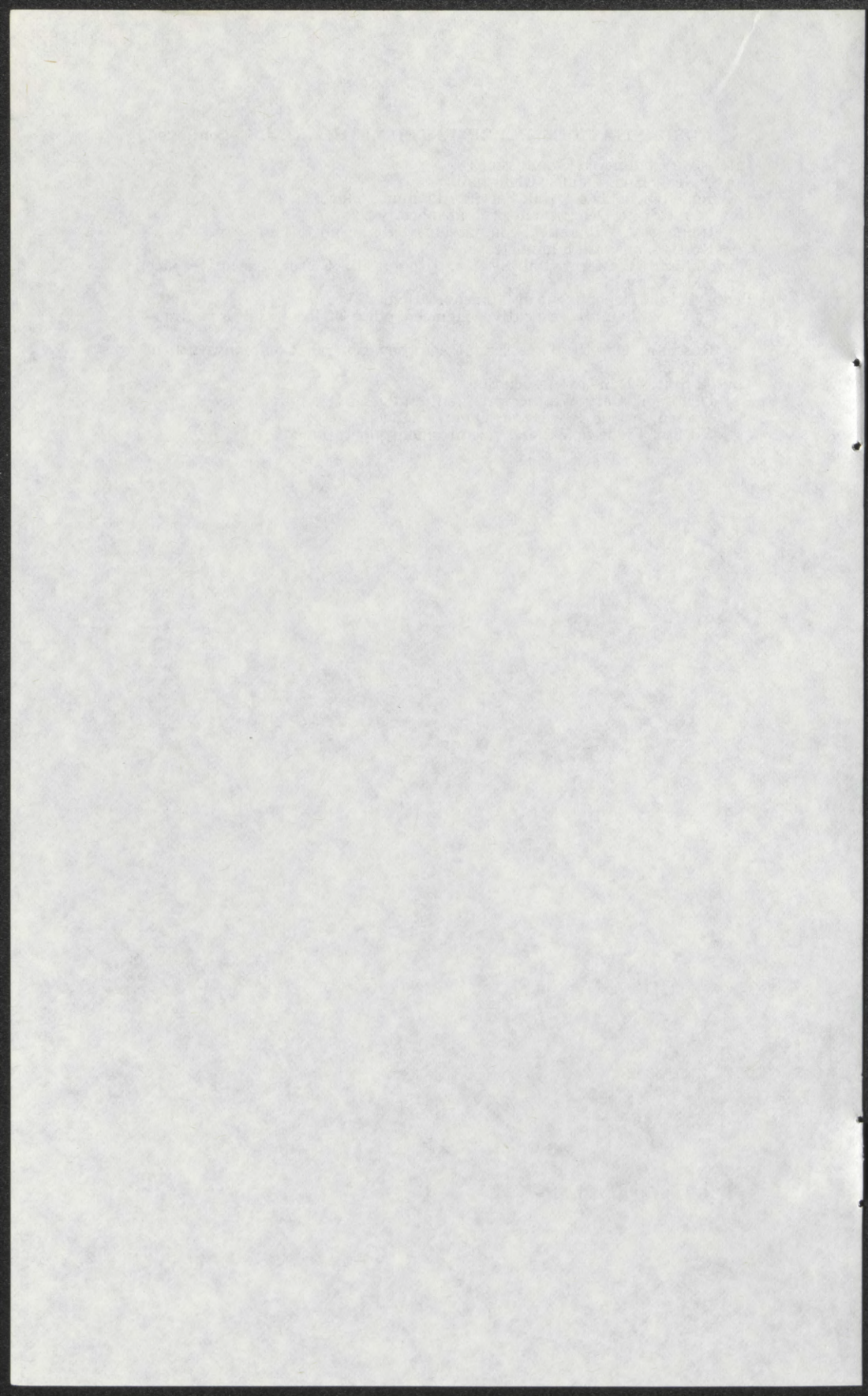
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FINANCIAL CONDITION OF THE DELAWARE & HUDSON RAILWAY

TUESDAY, AUGUST 15, 1978

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

The subcommittee met, pursuant to notice, at 10 a.m., in room 2203, Rayburn House Office Building, Hon. Fred B. Rooney, chairman, presiding.

Mr. ROONEY. The Delaware & Hudson Railway is presently in a very precarious financial condition. The purpose of our hearings today will be not only to determine how this condition came about but primarily to determine what, if any, corrective action can be taken by the Congress to relieve the situation.

The D. & H. Railway is one of the oldest in this country. It operated profitably until 1976, when as a result of the revised final system plan, its structure was more than doubled from 700 miles of track to about 1,650 miles of track. It has now become obvious that inadequate planning was given to this massive expansion of a small railroad. The railroad did not have adequate management, personnel or equipment to cope with this expansion. It is alleged that the D. & H. voluntarily accepted this expansion program. Technically, this is probably true, but I believe when the facts are analyzed today, we will find that the D. & H. really had little choice. In short, it had a choice between instant bankruptcy and a slim hope of survival.

We will want to examine a number of proposed solutions. One proposal is for the Congress to amend the conditions upon which the USRA may loan funds under authority granted in the 3-R Act. Another alternative would be to amend the conditions upon which the Federal Railroad Administration can loan funds under the Emergency Rail Services Act of 1970. A third alternative would be for the ICC to direct service for all or part of the D. & H. operations for a period of 240 days. A fourth alternative would be to increase the loan authorization in section 211 of the 3-R Act.

We must consider not only which alternative solution would be the most economical to the Federal Government, but also which would be best in assuring the viability of the D. & H. Railway. I am sure that we all have a commonality of interest in believing the essential services of the D. & H. must be retained. I fully understand that we can have differences as to what will constitute essential services and the manner in which this goal can be accomplished. In this regard, I want to

emphasize that this committee will not tolerate prolonged delays in reaching decisions. If it is determined that restructuring studies must be made, then we must be assured that these studies are carried out as swiftly as possible. As I have stated previously, little time was spent in planning for the expansion of the D. & H. operations, therefore we cannot tolerate delays in determining how the route system should be restructured. Similarly, protracted delays in determining the method of temporarily or permanently assisting the railroad's financial condition cannot be tolerated. It is essential that not only must essential rail services be continued, but just as important there must be assurances from all concerned that these essential services will not be disrupted.

It is very difficult for me to comprehend why we must have this hearing this morning because we have given the administration and the USRA authority in the 3-R Act and the 4-R Act to distribute funds to ailing railroads. I don't know why they don't give the D. & H. the money they need. It seems to me every time a railroad goes bankrupt, the Government is willing to assist it but is most reluctant to furnish assistance before it goes bankrupt or to prevent it from going bankrupt.

We are going to hear from four of our colleagues. The leadoff witness will be the distinguished gentleman from New York, Mr. Samuel Stratton.

STATEMENT OF HON. SAMUEL S. STRATTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. STRATTON. Thank you very much. I appreciate this opportunity to appear before you and your subcommittee this morning. As you begin this very important task of exploring ways to provide financial help to the Delaware & Hudson Railway to continue to operate in upstate New York, as well as Pennsylvania and elsewhere. I come here this morning as the representative of the city of Albany which, for many years, the headquarters of the Delaware & Hudson has been located in one of the most beautiful and distinguished historical—architecturally speaking—buildings in New York State, now turned over to the State university.

I have been interested in the D. & H. for many years, and during all of the problems it has been the one that survived without going into bankruptcy. I want to express my personal appreciation to you, Mr. Chairman, for the leadership you have been taking, as your statement has already indicated, in attempting to find some way to solve these problems that have now affected the D. & H. as well as the other railroads.

As you have pointed out very appropriately, it does seem ironic a railroad can operate on a profit for 150 years, and that 2 years after being assisted by the Federal Government be on the brink of bankruptcy. Year in and year out D. & H. has been able to show a profit while other rail lines in the northeast have been forced to go into bankruptcy. I know the officers and employees are deeply dedicated to getting the line back in the black and continuing the fine service for its customers that has earned the D. & H. a solid reputation over the years, providing a linkage between Canada on the north and the Southern

States on the south. This will be a key to finding a way for the D. & H. to continue to operate both in the short term and the long term.

I have no special expertise in the field of railroad financing and I think I would be inclined to leave it up to the members of this committee to determine which of the various options you have already referred to, Mr. Chairman, would be the best one. On the surface, I think, I am intrigued by the idea that under section 211, it would appear that funds could be loaned to the D. & H. for the purpose of continuing during this difficult period, and if the Congress were to inject a little additional money into that fund, that might take care of it. Perhaps there are other problems involved I am not fully aware of. I am under your leadership, Mr. Chairman, we will come up with the right solution. I do think it is extremely important we move swiftly in this situation. The time of the 95th Congress is running out and we need to have the opportunity to get this legislation both through the House and in the Senate.

I thank you for the opportunity to appear here, and I want to assure you my full support for whatever legislation you arrive at.

Mr. ROONEY. Thank you very much. You already promised me your support several weeks ago when this became eminent. I appreciate the support you have given not only myself, but this committee.

Mr. Hanley, there is a quorum on at the moment. Would you rather wait until after the quorum?

Mr. HANLEY. If it is OK—take it up immediately after the quorum.

Mr. ROONEY. The committee will recess for 10 minutes.

[Brief recess.]

Mr. ROONEY. I regret very much the delay. I went to congratulate the Speaker, who just became a grandfather Sunday, and he received a call from the President congratulating him, so I wound up as Speaker of the House of Representatives for about 15 minutes.

The next witness is our colleague from the great State of Pennsylvania, Congressman McDade. Nice to have you here.

STATEMENT OF HON. JOSEPH M. McDADE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. McDADE. Mr. Chairman, I am very grateful for the opportunity to testify on what I believe is one of the most critical issues to face this committee and the Congress for some time to come, a problem which I believe requires an urgent solution and one that, if unsolved, will cause economic hardship throughout the Northeast and Mid-Atlantic States in a way that perhaps has been unparalleled in our Nation. This problem is a failure by the U.S. Railway Association to approve further loan funding for the Delaware & Hudson Railroad. We have got to find positive actions to prevent further degradation of what still is the only solvent railroad in the Northeast.

When we consider this problem, we have to realize the reasons why the D. & H. is in this tough position before we can look for a solution. During the final months before the USRA final system plan was to be adopted, negotiations for an alternative rail system to be competitive with ConRail, fell through in the last half of the ninth inning. Although everybody, and I repeat, everybody, concerned wanted competition with ConRail and smaller rail systems, so they would be more

efficient, there wasn't time to start all over, and all of us accepted what we have today, a unified ConRail with the "bridge carrier D. & H." operating in between as the only competition. In the rush to complete a final system plan, we hoped that it would work, but I think we all knew that further adjustment was going to have to be made as we went through this process. Today, we are faced with making an "adjustment" and we have to make the right decision.

We allowed, in fact, the USRA urged and the Congress agreed that the D. & H. take on twice its miles of track yet it was given only one friendly connection to the West and to the East, and I am referring to the Norfolk & Western and the Boston & Maine respectively, and only one friendly connection to the South was provided. Previously, we had forced the Norfolk & Western to take the stock of the D. & H. We still ask whether that was wise. We cut the D. & H.'s friendly connection at Wilkes-Barre, Pa., and this is what we gave in return.

1. On the western flank, it bridges to Chicago and the entire Western part of the United States, the use of a yard already handling two railroads and operated by—and I am going to use in my testimony the word, hostile rail corporation. We can substitute "competitive" if we want to. Either way, from the standpoint of D. & H., it is a hostile situation to its West.

2. Trackage rights over 204 miles of rail, to its western connection, only trackage rights once again controlled by a hostile carrier.

3. No Southern outlet at all, except over tracks and in yards controlled by that same hostile carrier; and

4. Access to the New York docks over that same hostile carrier's tracks and then only for piggyback, but not including general freight or access to the "chemical coast."

Although the hostile connecting carrier has stopped pirating the D. & H. protected freight, it continues to solicit and they made an agreement that D. & H. would be protected. As of today, that hostile carrier goes around soliciting D. & H. traffic saying, we will take you from point to point, you don't have to transfer onto D. & H., and they do it every day.

With this operating position an accomplished fact, the USRA recently looked at the D. & H. financial condition and said, "no more money for you, you're too precarious." Well, some surprise. This is the decision that has brought all of us here today into this very trying time.

In order to understand, if I could, this USRA decision, I looked at the financial records, USRA's own financial records, comparing both ConRail and D. & H., and this is how I found the USRA comparing a railroad to which it is ready to loan \$2.3 billion, and everybody says that is the first step, it is going to be more, and one to which it will deny loan funds. The maximum request is \$20 million against \$2.3 billion, is the first step, D. & H., let's look at USRA's figures. The loss for June 1978, 16 percent better than had been expected, they are on an upward trend. ConRail, 45 percent worse than was expected. Car loading decrease so far this year, D. & H., according to USRA is 8 percent below what they had expected, and let's not forget since July there has been a strike on the Norfolk & Western, which has effectively closed the gate of the D. & H. to move West. When you look at ConRail, without any strike, they are 10.2 percent below what they were predicted on

loading decreases for this year, so they are doing worse on every measurement.

Obviously, I am concerned, but I think these figures speak for themselves.

I am substantially more concerned about the proposal of DOT and USRA and what they plan to do about this problem. I understand that their most favored option is to let the D. & H. go bankrupt and then roll it into ConRail, unified ConRail, which surrounds it, and my colleagues, I can't think of a worse solution to a problem.

In the first instance, ConRail can't serve this area, and if it tried, its record would be even more dismal than it is today. We all know that ConRail lost more money this year than last and more money this month than last. We know its service is worse than before and that these trends, by almost every single measure, are worse than last month and last year. Now the administration, which has the duty to oversee this giant railroad, wants to bankrupt the only solvent railroad, the only bridge to other railroads in the Northeast so that ConRail can run it. We are giving it to the worst managed railroad we find. I call that preposterous. As one example, let's take a look at what shippers think about D. & H.'s service. The only entry they have got to New York is Oak Island across the river where D. & H. is allowed, as I mentioned before, piggyback freight rights. Sea-Land is America's largest flag carrier. It is willing to offer the D. & H. a substantial surcharge per container plus the tariff to come back to Oak Island to serve their needs because they do it reliably. That is the action of a satisfied customer. It is what we see with respect to ConRail, and it hasn't been ConRail's record so far.

Now, the administration believes, as I understand it they ought to let D. & H. go bankrupt so it can apply for another kind of loan for its revenue needs. In the recent past, the administration has indicated alternatively that the D. & H. can and cannot qualify for these moneys. I understand that they now believe the D. & H. cannot qualify.

What does the D. & H. need? It needs some time. It is now in negotiation with its hostile connection, ConRail, to acquire trackage that ConRail has already listed as excess and wants to discard. These lines that are surplus and not wanted as far as ConRail is concerned are the same lines that would let the D. & H. make connections to friendly carriers and not have to operate through connections with its own competition or hostile carrier, to wit, ConRail.

What the D. & H. does not need is to be thrown into bankruptcy, spilt apart, destroyed as a bridge through the Middle Atlantic east, west and north and south from New England and handed over lock, stock, and barrel to ConRail.

The taxpayers certainly don't need another bankruptcy and a bigger ConRail. A bankruptcy with no avenue for new funds would necessarily mean the only option outside of economic chaos would be directed service. Now, modest estimates that we have gotten indicate the cost of "directed service" would be over \$15 million for that alone, and it would never be repaid. In addition, by statute, there must be a profit paid to whoever that designated carrier that would operate D. & H. is. Is that a prudent answer? I say no. The Treasury would not even get security for its money if this was done. Last, since "directed service" can only operate for a maximum of 240 days, our U.S. shippers are

going to turn to trucks or look for Canadian roads, and we are going to end up, after the end of "directed service" with nothing. The R. & M. certainly can't handle that much track outside its own State. Only ConRail can take on the task and it is little able to provide the capability necessary. Let me tell you what we found out about ConRail service.

Yard operations—At a large New Jersey yard, the ICC found that 50 percent of all cars were mishandled. In Baltimore, the ICC found that 80 cars were delayed up to 4 months for the oldest. That means sitting in a yard 4 months empty when they could have been out earning money. In Ohio, a boxcar on the siding 42 days after release by the shipper back to ConRail.

Transit time—The ICC by accident found a car that had traveled 1,680 miles throughout the entire ConRail system almost 2 months before an employee noticed that it was (A) empty; and (B) it needed to be repaired. Think of the loss of revenue from that one empty car that needed repairs.

Financial management—In January the ICC found ConRail had more than \$18 million in uncollected receivables over 60 days old, and this from a line that is losing \$1 million a day.

This is what has happened to ConRail. Let's not let this happen to another railroad.

We have to maintain D. & H. as the only competition that exists for ConRail in the Northeast, and through that section of the Northeast as a bridge to the East and West and North and South. This small railroad provides us with some very real and useful comparison on the meaning of competition and solvency.

In June 1978—D. & H. revenue was up 5.7 percent. ConRail was down 5 percent.

In June 1978—D. & H. expense was up 4.6 percent, ConRail was up 6 percent.

In June 1978—D. & H. net loss was 16 percent lower than had been predicted by USRA. ConRail was 123 percent higher than had been predicted.

Let this railroad find its own answers in the marketplace and not on FRA's drawing boards. The cost to the taxpayer is less than the benefits to shippers and the economy is much greater. I urge you, as members of the committee that have taken such great interest in the future of the railroads of this Nation, and I commend you, to find a vehicle to allow the D. & H. to draw down funds presently available to USRA in the till and funds that will be repaid from other railroads, plus a new authorization for just \$20 million, that is all, that could be discussed later in the year or early in 1979.

It is my honest conviction, gentlemen, to allow the D. & H. to collapse would be a mistake that we would never, ever be able to recover from.

I thank you for the opportunity to appear.

Mr. ROONEY. Thank you for that fine statement. Have you discussed this matter with this hostile carrier, ConRail?

Mr. McDADE. We have talked to ConRail many times.

Mr. ROONEY. What has their response been?

Mr. McDADE. They are negotiating, now, as I said, to try to allow D. & H. to acquire trackage they want to abandon. They haven't said yes, yet. They want to abandon it and here is the only competitive line

that forms a bridge, if you picture an X, east to west and north to south. They have a through route to let them connect away from ConRail. ConRail wants to abandon the route D. & H. wants and won't give it to them. That, to me, represents a squeeze play, and we have talked with D. & H. as well as ConRail about finding ways and means to make sure this competition exists. That is what the Congress wanted, that is what all of us want. We don't want to see the railroad go under. I am afraid unless we help D. & H. find time, unless we keep the feet to the fire of hostile competition, which is Government supported, we are not going to be able to see D. & H. survive. I am very grateful for the committee's attention to the matter. We know of your deep interest and hope you will find another way to make D. & H. move the way we want it to.

Mr. ROONEY. Mr. Florio, do you have questions?

Mr. FLORIO. No questions.

Mr. ROONEY. Our next witness is our very distinguished colleague, Chairman of the Postal Service Committee, Mr. Hanley. We welcome you to the committee.

STATEMENT OF HON. JAMES M. HANLEY, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. HANLEY. Thank you very much. Mr. Chairman, Mr. Florio, I want to commend you for your initiative, your understanding and your perspective on this very important subject matter. As has already been pointed out here several times this morning by you and others, that we are dealing with a problem related to the only solvent operation in the Northeast and God forbid if that should go bankrupt.

Mr. Chairman, and Mr. Florio, if you will bear with me, I want to offer a brief history of the developments which led to the present situation in hopes of providing a comprehensive picture of how we got to this present stage and where we might go from here.

The saga of the D. & H. starts with the Interstate Commerce Commission's ill-fated decision to approve the merger of the Pennsylvania Railroad and the New York Central into the Penn Central Railroad. Having created this soon-to-be-extinct dinosaur, the ICC compounded its error by concluding that the Erie Lackawanna Railroad, the Delaware & Hudson Railway and the Boston & Maine Railroad would fall victim to the behemoth Penn Central. Searching for a solution, the ICC resolved to merge these railroads with the financially healthy Norfolk & Western Railroad, and in one of the strangest chapters in regulatory history, the ICC ordered the mergers over the vehement protest of the N. & W. As we shall see later, despite its opposition, the N. & W. was to reap tremendous financial and tax advantages as a result of this action.

The ICC's merger order was upheld by the Supreme Court, stockholder opposition to the mergers was insufficient and with the creation of the N. & W. holding company, DERECO, the EL and D. & H. became the property of the N. & W. Not only had the ICC handed a consistently profitable railroad—the D. & H.—over to a corporate entity that had declared publicly time and time again that the D. & H. must sink or swim on its own, but by allowing the D. & H. holding company to retain \$20 million in liquid assets generated by the railroad, they placed the D. & H. in an untenable cash position from the

very start. It is interesting to note that this \$20 million of railroad-generated capital, taken out of the heart of the D. & H., was invested in International House of Pancakes stock at \$40, which soon plummeted to \$5, wiping out a solid cash asset which could have paid for needed improvements on the D. & H.

Despite this, the years between 1968 and 1973 were profitable to the D. & H., but again direct Government action was entered into the operations of the D. & H. and provoked the crisis we have today. When Congress created the framework with which to restructure the Northeast rail system into what is now known as ConRail, planners at the United States Railway Association soon realized that the D. & H. would lose several valuable connections. In addition, the 11th hour pullout of the Chessie from participation in the final system plan resulted in an offer to the D. & H. which would overnight double their track mileage. In the heady atmosphere of the moment, no one fully thought out the consequences of doubling a railroad overnight, particularly on the management and capital needs involved. There is no doubt that management of the D. & H. made a terrible mistake in agreeing to this plan, but there is also no doubt that the plan was a result of direct Government action, including the USRA's tying of short-term debt financing loans to acceptance of the expanded trackage rights. Initially, it was thought that the D. & H. could weather these problems, but events soon overtook the railroad and led to our current crisis.

Last fall, I was alerted to the fact that despite New York State's commitment of \$26 million for maintenance and trackage work, the expected volume of traffic was not realized and losses from the D. & H.'s new service to the Oak Island yard were draining off revenues at a rather heavy rate. Through the cooperation of my office, the NYS Department of Transportation, and others, we were able to eliminate that problem but not before substantial damage had been done. This led to a situation where the D. & H. was forced to seek section 211 loans from the USRA. Unfortunately, the loan authority was limited and the USRA had soon approved their total available funds. It was then suggested that the Federal Railroad Administration could assume the loan responsibility for \$7 million in loans used to purchase some 20 locomotives. At first the FRA balked and weeks of effort to get a ruling on the legal aspects out of the FRA's legal counsel were not successful until the combined pressure from the D. & H. and the rail experts of all of the Northeast States departments of transportation and this office finally got the message across during a special meeting on the D. & H. held in Albany last November. The ruling acknowledged that Congress had indeed provided for such a contingency, the loan transfer went forward, and \$7 million more became available for loan drawdowns by the USRA.

This was hardly the end of the D. & H.'s bureaucratic travails. Take, for example, what happened when the D. & H. proposed a section 401 unification and coordination study. This study option was built into the Railroad Revitalization and Regulatory Reform Act of 1976 by Congress for the express purpose of bringing to bear qualified expertise to help railroads reorganize, and make the necessary changes in their structure and operations to assure their continued

viability. The study can take from 1 year to 1½ years to complete. Given the difficult situation of the D. & H., one would expect the Federal Government to move swiftly to complete the study but a typical agency feud broke out over who would do the study and how it would be done. At one time, both the USRA and the FRA were saying they were going to do separate studies, spending large amounts of the taxpayers' money to duplicate each other's efforts. It was not until several of the Northeastern departments of transportation literally screamed bloody murder and I had written a strong protest to the Administrator of the FRA that these two agencies finally got together and started the study. This very critical study is now due next March, and, hopefully, will go a long way toward providing the D. & H. with the needed tools to turn its operations around.

While all of this was going on, the executive board of the USRA was becoming more and more reluctant to authorize additional loan drawdowns, and when several papermill strikes and a strike by employees of the Norfolk and Western cut into the D. & H.'s traffic volume, the board then turned down a request for \$600,000 for the month of August, thus precipitating the current crisis and creating the need for these hearings. This action was in spite of letters from several Senators and 11 New York State Congressmen, including you, Mr. Chairman, and our colleague, Jack Murphy, that they hold on until Congress considered the issue.

To sum up my previous comments, I would say that in general the D. & H. has been a victim of Government policy for the last 10 years and, despite their own mistakes and events beyond their control, the Federal Government has a direct responsibility to take whatever action is necessary to assure the railroad's continued viability.

I was, of course, very disappointed in the USRA action in turning down the last loan request and more particularly over what they are proposing as options to continued loan funding. In a letter dated August 7, USRA Administrator Donald C. Cole suggested that D. & H. could try for funding under the Emergency Rail Services Act. However, the USRA Executive Board Chairman admitted to reporters after the last board meeting that it was highly unlikely that such a request would be approved. Other experts I have checked with confirm this opinion. Why the USRA would float this as an option when they know it is not a option angers me no end. In addition, they have also proposed that the ICC can direct another carrier to run the railroad for a period of 240 days. With this so-called option, the Federal Government then picks up the tab for any losses. This is a direct expenditure of tax money and not a repayable loan agreement such as the USRA has been granting to the D. & H., and represents a nonrecoverable loss to the Federal Treasury of probably about \$15 million. The third option is reorganization, and I do not feel that this is an option at all because even the USRA admits the D. & H. can only operate under a bankruptcy reorganization for 2 to 4 months, which falls far short of the time needed to complete the long-delayed section 401 study, which hopefully would be completed in March.

I would like to outline two other options available to meet this crisis. The first is an amendment which I have drawn up that would provide an additional \$20 million in loan authority between now and December 31, 1979. The requirements would be changed so that the

USRA, which would oversee these funds, would be better able to approve the funds, thus giving the breathing space needed to revitalize the railroad. In addition, my amendment takes into consideration USRA concerns over the legitimate necessity of assuring these loans would be repayable. The loans would be treated like administrative expenses of a company operating under section 77 of the bankruptcy law, and the Government would in effect have first claim on any D. & H. assets to repay such loans thus assuring the Government will be fully protected from default. A detailed explanation of the amendment also accompanies my testimony. I intend to offer this amendment at the first available opportunity. [See p. 12.]

The second, longer-term option, is to force the ICC to reopen the original merger order and either amend it to require capital and operating assistance to the D. & H. by the Norfolk & Western, or force the ICC to find an entity more interested in the D. & H. and willing to commit the necessary support. Quite frankly, Mr. Chairman, the N. & W. has exemplified the worst aspects of railroading and corporate tactics and deserves to be roundly condemned for its actions. As I have attempted to point out to the ICC and USRA, the N. & W. has milked its relationship with the D. & H., drained off valuable capital needed to operate the railroad, and directly benefited from tax advantages resulting from the D. & H.'s losses. The New York State Department of Transportation and the USRA can provide you with the details of what has occurred, including declaring heavy dividends to the parent company in excess profits, and a series of other moves which have helped the parent at the expense of the D. & H. While the State of New York was committing some \$26 million and the USRA some \$27 million, the N. & W. went on with its sink or swim rhetoric and when that failed to suffice, they pointed with pride to the few thousands of dollars of switching and locomotive assistance they had provided, as if such meager resources were actually helping to turn around a railroad in deep financial trouble.

Obviously, we should not allow the N. & W. to reap the tax benefits for forcing the railroad into bankruptcy nor should it reap the profits from a railroad revitalized with taxpayers' money. As you can see by two letters from ICC Chairman O'Neal accompanying my prepared statement, the ICC has not gotten the message. Therefore, I have had the legal aspects of the issue studied by the General Accounting Office and the Library of Congress. A copy of these documents are with the subcommittee's counsel, and I hope they would remain confidential since they involve legal strategy which the State of New York is actively examining. I would also hope that when the representatives of the N. & W. testify later today the subcommittee would make clear their dissatisfaction with the N. & W.'s performance on this issue and also make it clear that Congress will not continue to tolerate this type of blatant corporate manipulation.

In conclusion, if the two options I have briefly outlined are effectively pursued, I strongly feel the D. & H. can be saved.

Mr. Chairman, gentlemen, again, my deep appreciation to you for providing this vehicle whereupon we can provide this observation.

[Testimony resumes on p. 24.]

[Attachments to Congressman Hanley's prepared statement follow:]

Explanation of Hanley Amendment

The amendment modifies the criteria for extending loans under the Regional Rail Reorganization Act of 1973 (45 U.S.C. §721) in those circumstances where a railroad has applied for or received a Section 211 loan prior to January 1, 1976, and has subsequently become the subject of a merger study by the Department of Transportation.

The amendment allows the government the option of giving a railroad a limited amount of money even if the money is not likely to be repaid, or the railroad is not likely to become self-sustaining, as an alternative to forcing the railroad into reorganization and directing another carrier to serve the customers of that railroad and be paid a reasonable profit by the U.S. if rail service of the railroad in reorganization ceases. At the same time, the amendment protects the financial interests of the U.S. by providing that any Section 211 funds advanced under the exception to the present statutory tests would be treated as expenses of administration in any subsequent reorganization thereby giving these loans a high priority position. This change would give the government the same protection as it would have if a railroad were in reorganization and were eligible for funds under the Emergency Rail Services Act.

Under existing law it is very difficult, if not impossible, to prevent a railroad that is in a difficult situation from petitioning for reorganization under Section 77 of the Bankruptcy Act. A railroad that is a prime candidate for merger and the subject of government merger studies cannot obtain government assistance without going into reorganization unless it can meet tests in existing law that the money will be repaid.

Once a railroad goes into reorganization, loan guarantees of trustee certificates under the Emergency Rail Services Act (45 U.S.C. §662) are not available unless there is a reasonable likelihood that the railroad will become self-sustaining. Even if that test can be met, which in many cases it cannot, there is no compulsion on the trustees or the reorganization court to apply for such certificates. Because of the priority given to these certificates in the reorganization proceedings, it may in fact be disadvantageous for the trustees to apply for those funds. Therefore, in many cases the only way that service can be maintained is for the ICC to direct another carrier to provide service for up to 240 days (49 U.S.C. §1, par.(16)).

The purpose of the amendment is to give the government more flexibility in responding to the problems of troubled railroads and in facilitating mergers by eliminating the involvement of a reorganization court. The amendment provides an additional and needed tool so that the government can provide assistance to railroads in a constructive way. It is an interim measure which protects both the financial interests of the U.S. and the transportation policy interests of the government by maintaining a climate where a long-term solution for railroads in the New England region can best be fashioned.

The amendment I am suggesting does not require the United States government to keep the railroad out of Section 77 of the Bankruptcy Act. It simply provides the government and the railroads with the option to avoid reorganization during the pendency of a merger study, if the government believes this would be in the public interest.

Amendment

The Regional Rail Reorganization Act of 1973 is amended --

(a) in section 210(b) thereof (45 U.S.C. 720(b)), by striking "\$395,000,000" and inserting in lieu thereof "\$415,000,000"; and in paragraph (1) thereof striking out "1976" and inserting in lieu thereof "1980".

(b) in section 211(f) thereof (45 U.S.C. 721(f)), by --

(A) inserting "(1) Except as provided in paragraph (2)," immediately after "Policy. " therein and a semi-colon in place of the period at the end thereof; and

(B) adding 2 new paragraphs at the end thereof as follows:

"(2) Until December 31, 1979, with respect to a railroad which had applied for or received a loan under subsection (a) of this section prior to January 1, 1976 and which has subsequently become the subject of a unification or coordination study under section 5 of the Department of Transportation Act (49 U.S.C. 1651), the Association is authorized to approve additional loans in amounts not to exceed an aggregate principal amount of \$20 million, upon finding by the Board of Directors of the Association that such action would achieve the goals of the Act and promote the goal of assuring adequate and competitive rail service in the region without the necessity of making the findings otherwise required by subsections (d) and (e)(3) of this section, and paragraph (1) of this subsection."

"(3) Any loan made pursuant to paragraph (2) of this subsection shall be treated as an expense of administration in any reorganization under section 77 of the Bankruptcy Act (11 U.S.C. 205) subsequent to such loan. Nothing in this paragraph shall affect rights referred to in the last sentence of section 205(j) of the Bankruptcy Act (11 U.S.C. 205(j)).

Dept. - Trans. - P.R.

November 15, 1977

Honorable A. Daniel O'Neal
Chairman
Interstate Commerce Commission
12th and Constitution Avenue
Washington, D. C. 20423

Dear Mr. Chairman:

I am sure you are aware that every day the financial situation of the Delaware and Hudson Railroad grows more and more desperate. While some rate-restructuring and service changes can have a slight beneficial effect upon the railroad, it is my feeling that insufficient support for the D&H from several sectors could precipitate bankruptcy. I refer specifically to the refusal of the D&H's owners to infuse capital into the railroad, the failure of the Interstate Commerce Commission to take effective and prompt action to mitigate operating problems on the railroad, and deliberate interference of the USRA in the management of the D&H.

To place this whole problem in perspective, we must go back a few years to the ill-fated decision of the Interstate Commerce Commission in approving the merger of the New York Central and the Pennsylvania Railroad into the Penn Central. Having created this dinosaur, the ICC compounded its error by concluding that the Erie Lackawanna Railroad, the Delaware and Hudson Railroad, and the Boston and Maine Railroad would fall victim to the behemoth Penn Central. Searching for a solution the ICC resolved to merge these railroads with the financially healthy Norfolk and Western Railroad and in one of the strangest chapters in regulatory history the ICC ordered the mergers over the vehement protests of the N&W. The merger order was upheld by the Supreme Court, stockholder opposition to the mergers was insufficient, and with the creation of Dereco the EL and D&H became the property of the N&W. Not only had the ICC handed a consistently profitable railroad (the D&H) over to a corporate entity that had declared publicly time and time again that the D&H must sink or swim on its own, but by allowing

Honorable A. Daniel O'Neal--2

the D&H holding company to retain \$20 million in liquid assets generated by the railroad, they placed the D&H in an untenable cash position from the very start.

This was in 1968 and since that time the N&W has done little to assist the D&H and, having benefitted substantially from the huge tax loss carry-forwards resulting from the bankruptcy of the EL, it must appear to the Board of the N&W that it would be more profitable for the N&W to let the D&H go down. Indeed, given the N&W's indifference to the current financial crisis of the D&H, it would be hard to not conclude that the N&W has no interest in assuring this railroad's survival.

Back in 1968 the ICC gave birth to this problem and I would now like to know what the ICC intends to do to rectify the situation. Specifically, I wish to know if the ICC has any authority under the merger agreement to order the N&W to commit financial resources to the D&H, and, if not, is the order amendable to require such an action? Does the ICC have the authority to order the N&W to sell the D&H to an entity more capable or more interested in assuring the survival of that railroad? Can the ICC shift current and past tax losses accruing to the N&W to the D&H's books where they can be of benefit to the D&H if the financial situation can be turned around? Has the ICC conducted an investigation to assure itself that the N&W is not draining off liquid assets of the D&H and actually assisting it into bankruptcy? If such an investigation has not been conducted, will the ICC undertake one? Finally, what other financial arrangements outside of USRA loan authority can be made available to the D&H to assure its survival?

I realize the ICC has conducted two reviews of the D&H situation and I am sure you are very concerned with the fate of this railroad. Unfortunately, I feel insufficient attention has been directed to the areas I have just outlined, and these areas should be fully explored. If we are to develop any concentrated effort to save the D&H. While the questions are extremely complicated, I want as complete a response as possible within ten working days of the receipt of this letter.

Thank you for your kind consideration and cooperation.

With best wishes, I remain

Sincerely yours,

James H. Hefley
Member of Congress

JCH:Tgm

March 1, 1978

The Honorable A. Daniel O'Neal
Chairman
Interstate Commerce Commission
12th and Constitution Avenue
Washington, D. C., 20423

Dear Mr. Chairman:

Thank you for your January 6th reply concerning the Delaware and Hudson Railway Company.

As you can see by the enclosed letters, I am seeking information on methods to require the Commission to amend its original order on the D&H. It is clear that the Commission made fatal errors in approving the merger of the Penn Central, and duplicated this error by forcing the N&W to acquire DERECO. Your vaguely defined objection that reopening this case will lead to regulatory uncertainty runs counter to a major principle of government. This principle is that a government has no choice when it makes a mistake but must make every effort possible to rectify it. Our responsibilities to the people of this country, and those directly affected by the financial condition of the D&H, leave us no room in this matter.

I certainly hope that the Commission will come to realize that the taxpayers cannot continue to support a private company through Federally backed loans, while that railroad's owner commits no financial resources to the railroad, but stands ever ready to reap the profits if the D&H can be turned around.

I hope to hear from you that the Commission will move in this area. Barring that I will actively pursue the ways and means to force the Commission to meet its responsibilities.

Thanking you for your kind attention and consideration, and with best wishes, I remain

Sincerely yours,

JME:tal
Enclosures

James M. Hanley
Member of Congress

Interstate Commerce Commission
Washington, D.C. 20423

OFFICE OF THE CHAIRMAN

JAN 6 1978

Honorable James M. Hanley
United States House of Representatives
239 Cannon House Office Building
Washington, D.C. 20515

Dear Congressman Hanley:

We share the concern you expressed in your November 15, 1977 letter about the financial condition of the Delaware and Hudson Railway Company. Of particular concern to us is the critical role which the D&H plays in providing competitive service to New York and New England.

The Commission has reviewed the D&H situation to assess the causes of the D&H's current position and to develop a solution. The plight of the D&H has resulted from many different factors. The inclusion of the D&H in the N&W system (through control of the Dereco stock) appeared to be a sound decision based on the information available at the time the decision was made. The D&H reported a profit in six of the first seven years after the D&H/Dereco/D&W relationship was established. The D&H achieved that record despite intense competition from the newly formed Penn Central and a poor economic climate in the early 1970's. The Final System Plan, which restructured the bankrupt railroads into Conrail, extended the D&H to Buffalo, Washington, Philadelphia, and Newark, and eliminated the D&H's traditional "friendly" connections with a devastating impact on the D&H. With the hindsight of nine years, which includes the Penn Central bankruptcy, poor economic conditions, and the Conrail restructuring, a different perspective might be taken of the D&H inclusion decision. However, none of these events could realistically have been considered when the D&H decision was made in 1968.

In 1973, the Commission analyzed the transfer of funds between the D&H and Dereco, Inc., to determine if funds were being siphoned from the D&H to the N&W. We found that between December 30, 1968 and February 6, 1970, the D&H provided a total of \$2.3 million in dividends to Dereco. The D&H also made two loans to Dereco in 1970; these were repaid, with interest, in 1971 and 1972. Although these funds could legally have been channeled to the N&W, Dereco used the funds to support the Erie Lackawanna prior to the EL's bankruptcy. The Commission's analysis found no siphoning of assets to the N&W.

Nevertheless, the tax benefits to the N&W resulting from the D&H's operating losses and investment tax credits have been substantial. Under existing tax laws, this is one purpose of establishing a holding company. In addition to providing a vehicle for realizing tax benefits, the N&W created Dereco to shield the profitable N&W from the assumption of the debt liability of the Dereco components. There does not appear to be any way to force a parent company to share with a subsidiary the tax savings it realizes because of the subsidiary's contribution to the consolidated tax returns. Because such a sharing of tax benefits must be voluntary on the part of the parent, a government agency can force the parent to share the tax savings only when the agency has some form of leverage over the parent. As an example, in 1975, the U. S. Railway Association, after consultation with the Commission's Bureau of Accounts, required Katy Industries, as a condition of a \$19 million rehabilitation loan, to pay its subsidiary, the Missouri-Kansas-Texas Railroad a minimum of \$2 million per year for the first three years of the loan. The Katy was also required to continue to compensate the railroad for any tax benefits which may be derived during the term of the loan.

More recently, the U. S. Railway Association required, as a condition of the D&H loan, that the N&W reimburse the D&H for future tax benefits, but only if the D&H attains a taxable income status. Absent some type of leverage over the parent, there appears to be no way to force a parent to share tax benefits with a subsidiary. It may be that additional legislation should be considered to correct this situation. Similarly, the Commission does not have the statutory authority to force a railroad to sell one of its subsidiaries. Under the Interstate Commerce Act, such transactions are voluntary actions initiated by the interested parties and approved or rejected by the Commission.

The Commission's orders in the N&W inclusion cases do not deal with the question of whether the N&W should commit financial resources to the D&H. At the time these orders were issued, the D&H was generally financially sound and continued to be until about 1975. Although the Commission has authority to modify its prior orders, we do not believe that consummated transactions should be reopened because doing so would subject all similar Commission orders to continuing future uncertainties. We do not believe that such uncertainty in regulatory decisions is good public policy.

The D&H's financial situation is serious. Its present operation is dependent on loans from the U. S. Railway Association, which is in a sense the D&H's "banker of last resort." The Commission is concerned about the potential for abuse in transactions between railroads and their parent organizations. In this regard, the Commission proposed remedial legislation to the 94th Congress, which will be reintroduced in the second session of the 95th Congress, to give the Commission additional authority over actions taken by conglomerate railroad holding companies.

A further complication in solving the current D&H problem is that the Commission is only one of the agencies involved. The Federal Railroad Administration, the U. S. Railway Association, and New York State also have active roles in the planning and implementation of a long-term solution for the D&H. We have been working with these other agencies in a coordinated effort to identify the causes and possible solutions to the D&H situation.

We recently met with officials of the Federal Railroad Administration to analyze the alternatives available to assure the continuation of essential services in the event that the D&H ceases operations because of a cash crisis. The Commission has the authority to order another railroad to perform these services on a temporary basis with Federal compensation of the losses. The Federal Railroad Administration also has certain authorities to assure continued service in specific situations. Subsequent to our meeting with the Federal Railroad Administration, we have been analyzing alternative approaches to ordering directed service over the D&H in case such an order becomes necessary. We are continuing to explore other avenues as well.

Sincerely yours,

(Signed) A. Daniel O'Neal
A. Daniel O'Neal
Chairman

Interstate Commerce Commission

Washington, D.C. 20423

OFFICE OF THE CHAIRMAN

APR 11 1978

Honorable James M. Hanley
House of Representatives
Washington, DC 20515

Dear Congressman Hanley:

I understand your concern about the financial condition of the Delaware and Hudson Railway Company and I appreciate receiving copies of your letters to the General Accounting Office and the Congressional Research Service of the Library of Congress.

I wholeheartedly agree with you that a government agency has a responsibility to make every effort possible to correct any mistakes it makes. The hindsight of ten years' experience tends to cast a different light on the decision made in 1968. If the Commission at that time could have foreseen the Penn Central bankruptcy and the Final System Plan restructuring, it might have imposed a condition on the N&W to assure the continued viability of the D&H. Of course, the Commission could have imposed such a condition as a precautionary measure without such foresight. But the fact remains that no such condition was imposed. One can understand, perhaps, why the Commission imposed no such condition by remembering that the D&H reported a profit in six of the first seven years after the Commission's decision.

As mentioned in my prior letter, many factors have contributed to the D&H's current financial condition, including the Final System Plan's restructuring of the bankrupt Northeast railroads into Conrail. It was clear to everyone involved at the time that the restructuring could leave the D&H without the connections necessary to maintain its traffic base and its financial self-sufficiency. In an effort to provide for some competition in the Region, the D&H was offered by USRA extensive trackage rights into areas it had not previously served. Unfortunately the extension sought and agreed to by the D&H management played a major role in the carrier's financial decline. Several had doubts about various aspects of the Final System Plan and about its impact upon competitors of Conrail. Indeed, in

its Evaluation Report and in Congressional testimony on the Final System Plan, the Commission publicly opposed aspects of the plan.

While the N&W has not gone out of its way to help the D&H during the current crisis, it has not yet been persuasively argued that the N&W is responsible for the problem.

Reopening the merger and imposing a condition on the N&W to somehow make the D&H viable raises fundamental questions, as mentioned in my last letter. The N&W entered into the transaction of which the D&H was a part under one set of conditions. To 10 years later impose a new condition and a new cost would be of questionable legal validity. And further it would place an aura of uncertainty around all such transactions which could cause additional financial difficulties for poor as well as wealthy railroads by raising additional obstacles and questions about the carriers' credit worthiness and stability. Of one thing we can be certain--any such attempt by the Commission would be fought in the Courts, probably delaying for a considerable time the benefits, if any, for the D&H.

Thus, unscrambling the egg now and requiring the N&W to support the D&H would be difficult at best, would raise questions about the finality of rail merger transactions, and would likely not finally solve the problems the D&H has experienced. I do want to make clear that, of course, the views I have expressed in this and previous letters do not represent a formal decision by the Commission on this matter. An appropriate petition could be filed to trigger such a response. I am not representing, however, that such a course would be worth the effort. In fact, I doubt that it would.

It seems to me that we need to direct our efforts at this time toward finding a long-term solution which will maximize both the profitability of D&H's operations and its service to the public. Realistically, it seems to me we have little alternative left other than to recognize the D&H in its present relationship to the N&W and to work from there. I will be most happy to talk with you or others about this matter.

Sincerely yours,

A. Daniel O'Neal
Chairman

NEW YORK STATE
DEPARTMENT OF TRANSPORTATION
William C. Hennessy, Commissioner



MAR 9 1978

The Honorable A. Daniel O'Neal
Chairman
Interstate Commerce Commission
12th and Constitution Avenue
Washington, DC 20423

Dear Mr. O'Neal:

This is in reference to Congressman James H. Hanley's March 1, 1978 letter to you regarding the Delaware & Hudson Railway Company.

I want to lend my full support to the Congressman in this letter. In our experience, the history of NSM control of the D&H has been completely devoid of the benefits we all foresaw for this arrangement in the late 1940s. The public interest has not been served by NSM control of D&H.

For example: D&H track and equipment deteriorated under NSM control. The people of New York have invested nearly \$20 million to correct this, but the problem is deeper, and only the Commission can correct it. I hope to hear from you soon regarding prompt action the Commission will take to correct the problems created by NSM control of D&H. Now that we are aware of them, we can be sure that delay will only worsen them.

Sincerely,

ORIGINAL SIGNED BY
WM. C. HENNESSY

W. C. Hennessy
Commissioner

cc: The Honorable James H. Hanley ←

U.S. HOUSE OF REPRESENTATIVES
1978-1979

ADMINISTRATIVE OFFICE
225 CATHON BUILDING
(702) 225-3701

ADMINISTRATIVE ASSISTANT
DAN COSTELLO

DISTRICT OFFICE
1255 FEDERAL BUILDING
RAGUKE, NEW YORK 13280
(315) 423-5657

DISTRICT REPRESENTATIVE
TOM DE VULJA

Congress of the United States
House of Representatives
Washington, D.C. 20515

August 1, 1978

The Board of Directors
United States Railway Association
955 L'Enfant Plaza North, S. W.
Washington, D. C. 20595

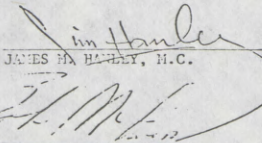
Gentlemen:

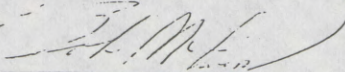
We urge you continue honoring the Federal commitment to the Delaware and Hudson Railway under the current \$30 million loan agreement. Continued drawdowns of the remaining \$2.5 million in loan authority are needed to prevent bankruptcy and consequently a rapid reduction in essential rail service to the Northeast.

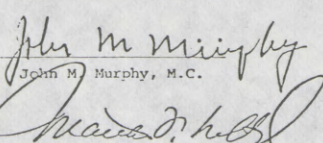
We need not remind you that a Section 401 study is now underway, and this is a procedure specifically designed and intended by the United States Congress to prevent these types of catastrophic reductions in essential rail service. In addition, the House is expected to review the situation of the Delaware and Hudson Railway on August 15th, and government support should continue until such a review can be completed. Finally, we completely reject the notion that the Norfolk and Western strike forecloses any chance for a successful continuance of the railroad. Rejection of a long-term loan on the basis of short-term factors, such as a strike, is bad policy and we, along with the Transportation Departments of New York, Pennsylvania and Massachusetts, and the Northeast Governors, object to this approach.

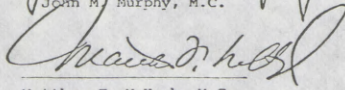
For these, and other reasons, we urge you to support the Delaware and Hudson until such a time as the Congress has had an opportunity to review the situation.

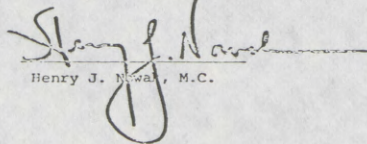
Sincerely yours,

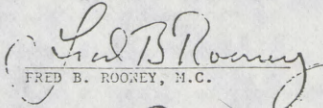

JAMES M. MURPHY, M.C.

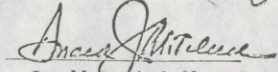

Robert C. McEwen, M.C.

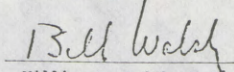

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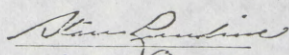

Matthew F. McHugh, M.C.

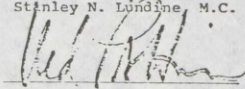

Henry J. Nowak, M.C.


FRED B. ROONEY, M.C.


Donald T. Mitchell, M.C.


William F. Walsh, M.C.


Stanley N. Lundine, M.C.


Edward W. Pattison, M.C.

Samuel S. Stratton, M.C.

LEGISLATIVE
POST OFFICE AND CIVIL SERVICE
CHAIRMAN SUBCOMMITTEE ON
POSTAL OPERATIONS AND SERVICES
BANKING, FINANCE AND
URBAN AFFAIRS
SUBCOMMITTEE:
HOUSING AND COMMUNITY
DEVELOPMENT
FINANCIAL INSTITUTIONS SUPERVISION,
REGULATION AND INSURANCE
THE CITY
SMALL BUSINESS
SUBCOMMITTEE:
SBA AND SBC AUTHORITY AND
GENERAL SMALL BUSINESS PROBLEMS
ANTITRUST AND RESTRAINT OF
TRADE ACTIVITIES AFFECTING
SMALL BUSINESS

United States Railway Association

955 L'Enfant Plaza North, S.W.
Washington, D.C. 20595
(202) 426-1991

Donald C. Cole
President

August 7, 1978

The Honorable James M. Hanley, M.C.
House of Representatives
239 Cannon House Office Building
Washington, D.C. 20515

Dear Mr. Hanley:

Thank you very much for advising the Association of your support for continued service on the Delaware and Hudson Railway (D&H). We share your concern and have tried to keep interested state and federal officials apprised of developments regarding our loan to the D&H.

To date, the D&H has borrowed \$27.3 million from the Association. On August 2, the Executive Committee of our Board of Directors considered a D&H request for the drawdown of an additional \$600,000 against the \$2.7 million remaining under our current loan agreement.

The Board was fully aware of both the D&H's need for funds and your strong support for additional assistance to the company. Nonetheless, in making a loan, the Association is required by Section 211(e) of the Regional Rail Reorganization Act of 1973 to find that "the applicant has offered such security as the Association deems necessary to protect reasonably the interests of the United States." The Association also must comply with the policy set forth in Section 211(f), that assistance be provided "...on terms and conditions which furnish reasonable assurance that... the railroads to which such loans are granted will be able to repay them within the time fixed..."

The Executive Committee ascertained that D&H's circumstances had deteriorated to the point where these statutory requirements could no longer be fulfilled and voted unanimously to deny the request.

Letter to James M. Hanley, M.C.
August 7, 1978
Page Two

This decision was not unexpected. As I advised a number of interested state and federal officials on July 20, our projections as of June, 1978, indicated that the D&H would not be able to continue operations in 1979 without additional external funding, beyond that remaining available under our current loan agreement. I further advised that the Company's financial situation had since grown more precarious than these projections. Traffic continues to fall behind the D&H's own forecasts. The current strike against the Norfolk & Western (N&W) is only partly responsible for this shortfall.

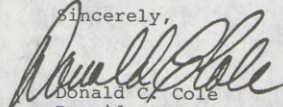
I want to emphasize that a D&H bankruptcy does not mean a cessation of its operations. If D&H were to file for bankruptcy at this time, its cash position would enable it to continue operations without external funding for two or four months.

Congress already has authorized the Federal Railroad Administration (FRA) to provide funds to a bankrupt D&H through the Emergency Rail Services Act (ERSA). As of July 1, \$50 million was repaid to that fund by the Penn Central Trustees. This money is available for loans to railroads which have filed for reorganization under Section 77 of the Bankruptcy Act. If the Department of Transportation were unable to make appropriate findings and, therefore, did not approve any loans, essential operations could be continued by the Interstate Commerce Commission pursuant to directed service orders. In bankruptcy, federal loans would have better security, the D&H would be under the control of a federal court rather than its present owner, the N&W, and federal loans would no longer benefit the N&W, which has refused to aid the D&H, as present loans do.

Currently, FRA is conducting a unification and coordination study requested by the D&H in December, 1977, pursuant to Section 401 of the Railroad Revitalization & Regulatory Reform Act of 1976. In addition, the Association in conjunction with the New England Regional Commission is studying the New England rail system. We are deeply concerned about the adequacy of rail service in the northeastern United States. Since the D&H serves as a bridge to the New England rail network and competes with Conrail for this business, the scope will include the D&H. Moreover, we are coordinating our study with the Section 401 study being conducted by the FRA.

* { Finally, I want to emphasize that the Association believes it is desirable that funds be made available to support normal operations of the D&H while the studies now underway, to seek solutions to its long-term problems, are completed and implemented. This has been the Association's main purpose over the past year in providing funds despite the D&H's declining prospects.

Sincerely,


Donald C. Cole
President

Mr. ROONEY. Thank you very much, Mr. Hanley, for that very comprehensive and detailed statement. I know your interest in this matter, and I am hopeful we can save the D. & H. from bankruptcy.

Our next witness will be my distinguished colleague from the Commonwealth of Massachusetts, Mr. Conte, who has been most helpful to this committee. I am most grateful to you for the fine cooperation you have given this committee, especially during the development of the ConRail. I greatly appreciate it.

STATEMENT OF HON. SILVIO O. CONTE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MASSACHUSETTS

Mr. CONTE. Thank you very much, Mr. Chairman. I appreciate the opportunity to appear before your subcommittee this morning and I compliment you on your opening remarks. You are a man of action, you want to get right to the jugular and get something done here. I agree with you wholeheartedly, and I certainly will cooperate with you through my position as ranking member of the Transportation Appropriations Subcommittee, whatever you decide to do. My remarks will be brief.

We in New England have painfully witnessed the gradual decline of the Delaware & Hudson for a number of years now, and have analyzed the impact its interconnection has on the operations and financial security of our regional railroads. We have found that not only is the D. & H. an important link to New England, it may be critical to the long-term survival of our railroads.

From New England's standpoint, the D. & H. is a vital "bridge carrier," serving as a primary connection from our area to the West, to the South, and to the Mid-Atlantic States. While the D. & H. system barely touches on New England soil, one of its main lines runs parallel to Vermont's entire western border, and there are several major interconnection points for our rail freight. For the benefit of your subcommittee, Mr. Chairman, I would like to submit for the record, along with my testimony, the D. & H. rail system map which shows the railroad's proximity to New England. [See p. 27.]

The Boston & Maine Railroad is the region's main line with the D. & H. The Delaware & Hudson interchanges about one half of its traffic with the B. & M., representing approximately one-third of the B. & M.'s volume. In order to gain perspective on the size of this freight volume, it can be pointed out that the Delaware & Hudson's revenues run around \$70-\$80 million per year while the Boston & Maine's revenues reach nearly \$100 million. Besides the D. & H., only ConRail operates directly to the west and south of New England, indicating the lack of carriers still operating in this area of the Northeast.

In addition to the B. & M., the Vermont Railroad and ConRail interchange directly with the Delaware & Hudson on New England shipments. On top of this, quite a number of our other railroads are dependent on the D. & H. through B. & M. as a middle carrier. This is particularly true of States such as Maine and New Hampshire, where the Main Central and the Bangor & Aroostook ship a good deal of freight through the B. & M. to the Delaware & Hudson lines.

In view of New England's substantial dealings with the D. & H., I am sure that this committee can understand our concern over the financial viability of the railroad. If the D. & H. were to declare bankruptcy and then cease operations at a later point in time, ConRail would be our only rail freight link to much of the rest of the country. While ConRail would undoubtedly do its best to pick up D. & H.'s former routes, the lack of competition inherent in this situation would harm both the railroads and consumers of my six-State region.

Because the Delaware & Hudson's problems have been known to us for some time, we in New England have already begun to deal with the restructuring of the railroad. The New England Regional Commission has been working with the U.S. Railway Association on a rail transportation study which focuses in large part on restructuring the D. & H. system. And the Federal Railroad Administration is also studying the D. & H. from the standpoint of working out a satisfactory solution to the railroad's problems.

Since these types of restructuring efforts are already ongoing, it seems a shame to allow the Delaware & Hudson to go under at this time. Let us first see if the D. & H. system can be cut down to workable proportions and made financially sound. Only if this proves to be unworkable should we turn our back on a railroad which is still an important link in the Northeast rail system.

Mr. Chairman, I think that we should carefully consider the ramifications of allowing additional rail bankruptcies in the Northeast at this time. Speaking as a New Englander, I could foresee a situation where the bankruptcy and final cessation of operations of the D. & H. forces the Boston & Maine Railroad, which is already in bankruptcy, into even more dire straits. At that point, other rail systems which may be healthy now might begin to feel the adverse effects. In short, what we could have here is the beginning of a rail "domino theory," whereby the failure of one railroad causes the financial difficulties of others.

It is clear that the Government cannot indefinitely bail out all of the railroads that incur financial problems. We have to see to it that cost cutting and efficiencies are realized wherever this can be accomplished. However, let us first try to help the railroads restructure themselves to see if they can make a go of it. Let us try to help the private operators make it before we are forced to involve the Government directly. It will be cheaper in the end and for the taxpayers, and we may yet be able to revitalize at least the major lines in a system like the Delaware & Hudson.

In closing, Mr. Chairman, I would urge your committee to take what actions are necessary to keep the Delaware & Hudson running at least until the restructuring studies can be completed and we have the benefit of these conclusions so that more long-term options can be put into effect for the D. & H. One promising interim response would be to amend section 211 of the 3-R Act to loosen the criteria for extending loans under this provision for carriers that have received a section 211 loan prior to 1976 and the increase funding under the section by \$20 million. This would certainly help the D. & H. avoid bankruptcy while a better solution can be determined.

I have just seen a proposal by a dear friend with whom I worked with very closely in the past. He is Alan Dustin, president of the Bos-

ton & Maine, who is going to testify here extensively on his proposal which would terminate the Emergency Rail Services Act of 1970 and replace it with a new provision to be created by the Emergency Rail Service Funding Act of 1978 (ERSFA) and would transfer the funding and loan guarantee authority under the present act to the new section.

I think that proposal has much to recommend it. Under this amendment to the Quad-R Act, any railroad may apply for financing from this new working capital fund where a cash emergency exists that may lead to a cessation of operations.

The criteria for financial assistance would be eased, and funding could be made available upon a finding that the application is essentially correct and honest, that there is no other practical financial solutions available on a ready basis, and that the financial assistance is in the public interest.

D. & H. would be able to meet this criteria.

Financing could be made available in several existing forms such as redeemable preference shares—working capital issue or trustee certificates—working capital issue. Working capital financing could also be made available in the form of an emergency rail services loan guarantee, made available to railroads in or out of section 77 reorganization.

In sum, I think this is a very good proposal and could work very effectively in resolving the D. & H. crisis.

[The map referred to by Congressman Conte follows:]

DELAWARE AND HUDSON RAILWAY COMPANY AND ITS FREIGHT CONNECTIONS

THE BRIDGE LINE LINKING NEW ENGLAND AND
EASTERN CANADA WITH THE SOUTH AND WEST



Mr. ROONEY. Thank you very much. We appreciate your testimony and I concur with your conclusions, and it is the hope of this committee we may be able to save the D. & H. some time in the near future.

Mr. Skubitz.

Mr. SKUBITZ. Thank you, Mr. Chairman.

I have been in the Congress for 16 years, and during the 16 years I have seen two of my colleagues in operation in the Congress of the United States. That is Mr. Conte of Massachusetts and Mr. Rooney of Pennsylvania, and I want to say, now, that I have concluded that if the people of the district that you two represent are not cognizant of the way you have taken care of your district on behalf of your constituency, if they ever vote you out, they ought to take away their voting rights.

Mr. CONTE. Thank you. I will tell you one thing—we are going to miss you around here—not for just what you said, but all of the help you have given us down through the years. You are right about Congressman Rooney, Fred is invaluable to meeting our transportation needs in the Northeast, which have really been hit hard over the last couple of decades. He has been very forceful and quick to deal with these problems. I try to do the same thing on the Transportation Appropriations Subcommittee where I am the ranking Republican. We are a great team.

Mr. SKUBITZ. I am sorry I missed Mr. Hanley's testimony. As I see this problem, the D. & H. was a sound railroad.

Mr. CONTE. You are exactly right.

Mr. SKUBITZ. Before the 4-R and then there was about 750 miles of Erie Lackawanna we were trying to pawn off on Chessie, and they wouldn't take it over because of labor problems so we pushed this over on D. & H. Now, I don't know what—it seems to me, certainly, we have got to keep the road going—there is no doubt in my mind about that. I am just wondering, in the reorganization program, rather than trying to keep feeding money into a program here that just can't succeed, as I see it, as it is now constituted, we can put in \$2½ million and let them go on another 5 or 6 months, and then they are going to be back, or we could turn it over to some other railroad to manage and spend \$14 or \$15 million in doing that, and when that was gone, we would be in the same position we are in today. I am sure what is running around in the chairman's mind and I know in my mind, perhaps we have got to do something about making the D. & H. a sound railroad, look at the 700 miles added on and see if that can't be worked out some way—branch line operation or something—I don't know what—in order to save the D. & H. from running back to Congress every so often until Congress gets tired of hearing about appropriations to D. & H. when it isn't D. & H.'s fault.

Mr. CONTE. You are right on target. You have a good hold of it.

Mr. ROONEY. There is an old Chinese saying. If a man saves a child from drowning—he is responsible for the rest of his life. That is what I feel about these bankrupt railroads.

Mr. CONTE. Thank you very much.

Mr. ROONEY. Our next witness is the Honorable Daniel O'Neal, Chairman of the Interstate Commerce Commission. Chairman O'Neal, we welcome you to the committee.

**STATEMENT OF HON. DANIEL O'NEAL, CHAIRMAN, INTERSTATE
COMMERCE COMMISSION, ACCOMPANIED BY DICK SCHIEFEL-
BEIN, RAIL SERVICES PLANNING OFFICE**

Mr. O'NEAL. Good morning, Mr. Chairman, Mr. Skubitz. With me today is Dick Schiefelbein from the Rail Services Planning Office.

I appreciate this opportunity to discuss the Delaware & Hudson Railroad's present situation and the outlook for the D. & H.'s future.

I have a longer statement, which I would like to submit for the record, and a summary statement, which is shortened, more in line with the testimony this morning. [See p. 31.]

Mr. ROONEY. Without objection, your statement will become part of the record and you may summarize it.

Mr. O'NEAL. A number of factors, as we have gone through or heard this morning, have contributed to the D. & H.'s financial condition.

Historically, this railroad has served as a connecting link, carrying overhead traffic between major trunk lines and the New England railroads' area. As a result of the Penn Central merger and the final system plan, two important D. & H. overhead traffic routings became unnecessary in less than a decade. This, obviously, had an impact on the carrier. The route extension into Oak Island Yard in New Jersey for piggyback traffic only has also proved to be very unprofitable to the D. & H. To make its problems worse, the D. & H.'s coal revenues dropped from over \$5.5 million to less than \$0.5 million per year, over this same period of time.

Unfortunately, the carrier's financial problems have not been resolved by the infusion of funds into the railroad. Further, better cost and operational controls at the D. & H. are likely to yield only minimal future returns. Even if the D. & H. were to declare bankruptcy, this would only cut the railroad's annual losses in half. Thus, bankruptcy alone will not solve the D. & H.'s problems. We believe that a restructuring of the D. & H. will be necessary to reverse its continuing losses.

The immediate problem we must deal with is how to keep the D. & H. in operation while a restructuring plan is being developed.

The USRA loan authority is the primary existing program which makes funding available to a railroad prior to bankruptcy. However, the necessary finding by USRA, that repayment by the D. & H. is likely, has become increasingly difficult, if not impossible, to make. But, even if USRA could make this finding and the funds be made available to the D. & H., we are talking about only \$2.5 million in loan authority. That is all that is remaining. That would not be sufficient to operate the D. & H. long enough for a restructuring plan to be developed.

On the other hand, it appears there would be sufficient funds available in the Emergency Rail Services Act program to maintain the D. & H.'s service during a planning period. The Penn Central trustees recently repaid \$50 million into the fund. Of course, the D. & H. would have to declare bankruptcy in order to become eligible for this money, and FRA would have to make the decision on the availability of the funds.

A third approach, which has also been discussed here today, is through section 1(16)(b) of the Interstate Commerce Act. This section authorizes the Commission to maintain services of a railroad for a 240-day period by directing another carrier to operate the lines of the railroad when it ceases or nears the point where it is about to cease operation. We have done preliminary contingency planning at the staff level, so that the Commission will be in a position to respond quickly with a directed service order if it becomes necessary.

However, while the Commission will be prepared to direct service quickly, we have serious reservations about this approach. Directed service, as has been said earlier today, is the most expensive means of continuing the operations of a railroad. This is because the railroad performing the directed service is entitled not only to be reimbursed for any losses incurred, but is also to receive a reasonable profit on the operation. In addition, unlike the USRA and ERSA loan programs, the money paid by the Government to the directed service railroad will not be repaid. It is a grant. Our most recent estimates indicate that directed service on the D. & H. would cost the Federal Government approximately \$15 to \$17 million. At this point, \$14.6 million of the \$15 million previously appropriated remains available for directed service. Finally, of course, we do not believe that a 240-day period is likely to be sufficient to permit a restructuring plan to be developed.

Another proposal advanced today by Mr. Hanley and Mr. Conte, in part, and which has been advanced in a somewhat different form on the Senate side, is a proposal which would authorize additional sums in loan money to USRA and permit USRA to grant a loan without making a finding that it can be repaid. This proposal could result in additional Federal assistance for the D. & H. However, such a solution would appear to be appropriate only if ERSA and USRA funding is unavailable or inadequate.

I would like to close by saying that the Commission recommends that the Congress and the Federal agencies focus on rail users and rail services rather than on rail corporations when making these funding decisions. Some prebankruptcy funding decisions could benefit the Norfolk & Western, which, through its subsidiary, Dereco, is the principal stockholder of D. & H. Of all the options, we see the Emergency Rail Services Act funding program as the least costly approach to achieving the goal of keeping the D. & H. in operation while a restructuring plan is being developed.

This concludes my prepared remarks. I will be glad to respond to any questions you may have on this matter.

[Testimony resumes on p. 35.]

[Mr. O'Neal's prepared statement follows:]

STATEMENT OF
A. DANIEL O'NEAL, CHAIRMAN

Mr. Chairman, Members of the Subcommittee:

The Interstate Commerce Commission is pleased to have this opportunity to discuss the Delaware and Hudson Railway's present situation and the outlook for the D&H's future. As you have indicated, Mr. Chairman, the D&H's financial condition is precarious. It incurs continuing losses on its operations, and over the last year has been forced to depend on loans from the United States Railway Association and grants from New York State to avert a series of cash flow crises. On August 2, 1978, USRA voted against extending additional assistance to the D&H.

A number of factors have contributed to the D&H's financial condition. We will discuss those events which we believe to be of particular significance. Historically, the D&H has served as a connecting link, carrying overhead traffic between major trunk lines and the New England railroads. Prior to the Penn Central merger in 1968, the D&H provided the Pennsylvania Railroad with a routing to New England that did not involve the Pennsylvania's principal competitor, the New York Central. However, the Penn Central merger diminished the need for this routing, because the merged railroad then had good routings of its own into New England.

A similar routing change took place with the implementation of the Final System Plan. Prior to Conrail, the D&H handled traffic from the Lehigh Valley and the Erie Lackawanna on a routing which was competitive with Penn Central's routings. The Final System Plan recognized this fact in its recommended "Conrail-Chessie" structure. Under the recommended structure, the Chessie was to acquire the Erie Lackawanna lines which connect with the D&H. This structure would have preserved the D&H's role as a competitive overhead route, particularly for mid-western traffic.

As we all know, the "Conrail-Chessie" recommendation was never implemented and the Final System Plan's second choice, "Unified Conrail", formed the basis of the Northeast restructuring. As part of the "Unified Conrail" structure, the D&H was offered several line extensions, including an extension, over trackage rights, to Buffalo. This extension protected the

traffic from the N&W which had formerly moved over the Lehigh Valley to the D&H. The Buffalo extension, however, did not preserve for the D&H the former Erie Lackawanna traffic which had moved over the D&H.

As a result of the Penn Central merger and the Final System Plan, two important D&H overhead traffic routings became unnecessary in less than a decade. To make its problems worse, the D&H's coal revenues dropped from over \$5.5 million to less than one-half million dollars per year, over this same period of time.

As part of the Final System Plan route extensions, the D&H also accepted trackage rights into Oak Island Yard in New Jersey for piggyback (TOFC/COFC) traffic only. This extension subsequently proved to be very unprofitable to the D&H.

The fact that the D&H has lost some of its important traffic flows and continues to incur substantial operating losses, has generated a question as to whether the D&H remains a necessary part of the rail system in the Northeast. We think it is.

The D&H's principal routes are competitive with Conrail routes. Without the D&H, the shippers in New England would be dependent on Conrail for service because all rail routings to the south and the west would involve Conrail. We might note that the Boston and Maine and D&H are currently handling approximately 100,000 cars annually on this competitive route. This traffic is important not only to the D&H, but also to the B&M, which is now in reorganization.

Unfortunately, the D&H's financial problems have not been resolved by the infusion of funds into the railroad. Further, better cost and operational controls at the D&H are likely to yield only minimal future returns. Even if the D&H were to declare bankruptcy, this would only cut the railroad's annual losses in half. Thus, bankruptcy alone will not solve the D&H's problems. We believe that a restructuring of the D&H will be necessary to reverse its continuing losses.

The immediate problem is how to keep the D&H in operation during the time a restructuring plan is being developed. There are three existing, and one proposed, Federal mechanisms

available to assist the D&H. These are the continuation of USRA loans to the D&H, loans under the Emergency Rail Services Act, directed service under the Interstate Commerce Act, and additional USRA loan authority which we understand may be considered.

The USRA loan authority is the primary existing program which makes funding available to a railroad prior to bankruptcy. However, the necessary finding by USRA, that repayment by the D&H is likely, has become increasingly difficult to make. Regardless, the USRA loan authority does not offer a solution to the immediate problem of maintaining the D&H while a restructuring plan is being developed. The \$2.5 million loan authority remaining, even if made available to the D&H, would not be sufficient to operate the D&H for very long.

The Emergency Rail Services Act provides funds to be loaned to the trustee of a bankrupt railroad in return for trustee certificates. It appears that there are sufficient funds available in this program to maintain the D&H's service during a planning period. The Penn Central trustees recently repaid \$50 million into the ERSA fund. Of course, the D&H would have to declare bankruptcy in order to become eligible for this money, and FRA would have to make the decision on the availability of the funds.

Section 1(16)(b) of the Interstate Commerce Act authorizes the Commission to maintain ~~the~~ services of a railroad for a limited period of time by directing another carrier to operate the lines of the railroad when it ceases operation. Although bankruptcy is not a statutory pre-condition to directed service, we believe that, as a practical matter, directed service should be available only when a railroad is bankrupt and has run out of cash.

We have done preliminary contingency planning at the staff level, so that the Commission will be in a position to respond quickly with a directed service order if necessary. While the Commission will be prepared to direct service quickly, we do have serious reservations about this approach. Directed service is the most expensive approach to continuing

the operations of a railroad. The railroad which is required to operate another's services is entitled not only to be reimbursed for the losses incurred, but it is also entitled to receive a reasonable profit on the operation. In addition, any money paid out by the government will not be repaid. In contrast, the USRA and ERSA programs cover only the losses incurred, and loans must be repaid.

There is a further restriction on the use of directed service. The authority to direct a railroad to operate over another railroad's tracks is limited to a 240-day period. It is not clear what actions could be taken if there were no solution after eight months. The original carrier might not be in a position to resume operations, and no other carrier could be required to perform the services. The operations on the railroad might simply cease.

With these considerations in mind we do not see directed service as a viable solution to the D&H situation. The 240-day period is not likely to be sufficient to permit a restructuring plan to be developed, and the cost of directed service to the Federal government would be high. Our most recent estimates indicate that directed service on the D&H would cost the Federal government approximately \$15 to \$17 million over the 240-day period. At this point, \$14.6 million of the \$15 million appropriation is available for directed service.

We understand there have been proposals which would authorize additional sums in loan money to USRA, and permit USRA to grant a loan without making a finding that it can be repaid. Loans would be available to both bankrupt and non-bankrupt railroads. These proposals could result in additional Federal assistance for the D&H. However, such a solution would appear to be appropriate only if ERSA and USRA funding is unavailable or inadequate.

In concluding this statement, we would recommend that the Congress and the Federal agencies focus on rail users and rail services rather than on rail corporations when making funding decisions. Some pre-bankruptcy funding decisions could benefit the Norfolk & Western, which through its subsidiary Dereco is the principal stockholder of the D&H. Of all the options, we see the Emergency Rail Services Act funding program as the least costly approach to achieving this goal of keeping the D&H in operation while a restructuring plan is being developed.

This concludes my prepared remarks. I will be glad to respond to any questions you may have on this matter.

Mr. ROONEY. Thank you very much.

On page 2 of your testimony, you state that the D. & H. accepted trackage rights into Oak Island Yard, which proved unprofitable. I understand this was the most unprofitable portion of the expansion program. Is that correct?

Mr. O'NEAL. Yes; that is true.

Mr. ROONEY. I question whether the D. & H. really had an option in accepting or rejecting these trackage rights in Oak Island. I would like to have you comment on that.

Mr. O'NEAL. I think they did have the option. They didn't have to take it, but they saw an opportunity there that just didn't develop. Do you want to say something about that? I would like Dick Schiefelbein to respond.

Mr. ROONEY. Yes.

Mr. SCHIEFELBEIN. After the FSP's recommended structure for the Northeast did not develop, there was a very short period of time available to come up with an alternate structure. This structure involved the extension of the D. & H. over trackage rights in several different directions. There was a very short period of time in which the D. & H. had to decide whether or not to accept the individual route extensions, and we are not really in a position to know whether they affectively had an option or not, but there was not very much time to do a thorough analysis and the Oak Island extension did turn out to be very unprofitable.

Mr. ROONEY. As I said in my opening remarks, I don't think they had an option. It was a choice of instant bankruptcy and a slim hope of survival.

Mr. SCHIEFELBEIN. Without the trackage, the D. & H. would not be in a good position. It would have been cut off from connections to the west and south.

Mr. ROONEY. On page 4 of your statement, Mr. Chairman, you state that the remaining funds and existing loan authority would not be sufficient to operate the D. & H. for very long.

I wonder if you could indicate to the committee how long you believe the D. & H. can operate on these funds?

Mr. O'NEAL. Are we talking about the USRA funds, the \$2.5 million available?

Mr. ROONEY. Right.

Mr. O'NEAL. At the current rate of loss, which is about \$600,000 per month, that works out to an extension of about 4 months, but there is also an indication that their traffic could continue to be reduced, in which case the company's losses would go up, and indeed, in our projections, which I will be happy to make available to the committee for the cost of using directed service for D. & H. we would project a somewhat higher cost, as we move along. In other words, by the time you get to say, December of 1978, the losses could be substantially higher, could be \$1.7 million or higher per month, so it is not a static situation; it is a dynamic thing and changes depending on the time of the year and how shippers view this carrier.

Mr. ROONEY. On page 6 of your testimony, you indicate that directed service would cost between \$15 to \$17 million over the 6-month period. Although an amount is not given, the Department, I understand, will

testify here today that this amount will be reduced because you would direct only essential services. Is that correct?

Mr. O'NEAL. Well, the Department's theory, which I am sure they can state much better than I can, as I understand it, their theory is that the Commission should only look to the continued provision of the essential services of the D. & H. We don't see a statutory requirement in the act that we focus only on the essential services. If the goal of the Government is to maintain the operation of this carrier so that there can be, at some point, a rational restructuring of the entity, then we think it makes more sense, or at least preliminarily I would say we think it makes more sense, to continue the entire carrier in operation. The reason for that is that if, in using the directed service approach, we start reducing the size of this carrier, then we are, in effect, restructuring the carrier "through the back door" without really looking at the entire picture and the total prospects for the carrier so I think we might view essential services of the carrier, that is, those services that are necessary only for providing local service, as maybe reducing the size of the operation by one-half. That does not necessarily cut the cost of directed service by one-half, because there are a lot of facilities that would still have to be maintained, yards and so forth, with cost that would not be eliminated. We don't have a number for that.

Mr. ROONEY. What was that figure you said D. & H. was losing per month?

Mr. O'NEAL. In this summer, let's say during July and August, the number is about \$600,000.

Mr. ROONEY. If they are only losing \$600,000, why would you give directed services for 8 months which is going to cost the Government \$15 to \$17 million?

Mr. O'NEAL. As I indicated earlier, we projected that costs will increase over this period of time. Our accountants in looking at this, have determined that by the time we reach December, the losses could be as much as \$1.7 to \$2.5 million during December. If you add 6 percent on top of that, representing profit for the carrier that would be operating the D. & H., that adds about \$200,000 to that number, and then all told that profit figure, by our estimates, would be about \$3½ million over the course of the directed service operation.

Mr. ROONEY. Don't you think this directed service is just merely postponing the inevitable?

Mr. O'NEAL. Well, I wish I knew what was inevitable for this railroad. Certainly, all we are talking about, whether it is directed service, emergency rail services funds, or continued use of USRA funds, we are not talking about a permanent solution through those funds. All we are talking about is continuation, kind of a marking time until the big picture can be seen and developed and this carrier can be restructured into a different kind of system. That is all we are talking about. There is no final answer in the use of these funds by themselves. There has to be a planning process.

Mr. ROONEY. In your statement, you indicated the D. & H.'s coal traffic has declined from over \$5.5 million to less than one-half million dollars.

What is the reason for that decrease?

Mr. O'NEAL. One reason is that the kind of coal they are hauling is eastern anthracite coal, which has some pollution problems and the demand for it has fallen off in recent years. There is also some indication some of the coal is more difficult to get to than it once was.

Mr. SKUBITZ. I think that is because of the high sulfur content and the environmentalists want pure air in the big cities. The State of New York for one was instrumental in passing the environmental laws which made it impossible to use that grade of coal up there. That created a problem for Lehigh and also one for D. & H. Is that not so?

Mr. O'NEAL. I am not prepared to say whose laws caused the problem.

Mr. SKUBITZ. You have to be a diplomat, but that is a fact.

Mr. O'NEAL. The efforts of governmental units at whatever level to preserve the environment have impacted on the use of this kind of coal, there is no question.

Mr. ROONEY. I will now recognize the gentleman from Kansas.

Mr. SKUBITZ. Thank you.

Mr. O'NEAL, do I conclude from your remarks then that you favor allowing the D. & H. to go into bankruptcy?

Mr. O'NEAL. I see no recourse at this stage. There are certain advantages to this carrier going into bankruptcy. One of them is that the N&W does not continue to draw or realize benefits from the tax losses of the D. & H. Now, if that kind of problem could be taken care of in legislation, that might change our views somewhat.

Mr. SKUBITZ. It scares the devil out of a lot of communities by doing that.

Mr. O'NEAL. Bankruptcy would certainly mean some local taxes wouldn't be paid.

Mr. SKUBITZ. People lose their jobs. That is a little worrisome to families. Then they see their industries start moving away. All of those things come in when you start talking about bankruptcy.

Mr. O'NEAL. The one thing to keep in mind about bankruptcy is that the railroad will continue to operate. It will not automatically stop as a result of bankruptcy.

Mr. SKUBITZ. Do people in cities understand that as well as you do, Mr. Chairman?

Mr. O'NEAL. I imagine the cities in the Northeast that have a lot of experience with bankrupt railroads would probably understand it better than I do.

Mr. SKUBITZ. Maybe you ought to run for Congress then. You would find out. Do you see any hope of D. & H. getting enough business or traffic to continue even under any reorganization program?

Mr. O'NEAL. I think there is a possibility, under a reorganized system. Now, I think we have to recognize—

Mr. SKUBITZ. Do you have any ideas how that reorganization should take place?

Mr. O'NEAL. Well, we have a few ideas.

Mr. SKUBITZ. Would you care to discuss them, at this point?

Mr. O'NEAL. I would like to have Mr. Schiefelbein discuss them and lay out a few of the ideas we have been talking about.

Mr. SCHIEFELBEIN. In the prepared statement, we discuss—

Mr. SKUBITZ. Are you an attorney for the ICC?

Mr. SCHIEFELBEIN. I am a transportation planning specialist with the ICC.

Mr. SKUBITZ. How long have you been with them?

Mr. SCHIEFELBEIN. Since the Rail Services Planning Office opened, about 4½ years ago.

In the prepared statement, we discuss various of the traffic flows that the D. & H. had been dependent upon, which through various restructurings are no longer available to the D. & H. These are principally, the Pennsylvania Railroad's former traffic flows to New England, which after the Penn Central merger, there was no reason for the Pennsylvania Railroad to need to avoid the New York Central Railroad any more, and thus the D. & H. routing was not necessary. The other was across the Erie Lackawanna which was competitive with Penn Central's routings, feeding midwestern traffic for the D. & H. to carry to New England. With the FSP restructuring, the Erie Lackawanna became part of ConRail and this traffic tended to flow in that direction. The trackage extension that the D. & H. got to Buffalo protected their traffic flow from the N&W. In the long term, it is very likely a restructuring would have to address a way of recapturing the traffic flow that had been on the Erie Lackawanna, that would have been preserved under the Chessie plan, but was not preserved under the unified ConRail plan.

Mr. SKUBITZ. Are you ready to tell us just where they would recapture and what the effect would be on the other line if they did recapture part of the business?

Mr. SCHIEFELBEIN. Certainly not in a quantitative manner. In a qualitative sense—I am not sure how one would go about implementing this—something akin to the original final system plan concept where the Chessie and the D. & H. would have a good direct connection so that the traffic that the Chessie handles or could handle out of the Midwest—

Mr. SKUBITZ. In order to save time, would you place in the record, your proposal and how you think they would operate with regard to traffic and the amount of traffic that would flow back?

Mr. O'NEAL. We would be happy to do that.

[The following information was received for the record:]

POSSIBLE DELAWARE AND HUDSON RESTRUCTURING

Because we believe that the loss of traffic from overhead routes which existed prior to the implementation of Conrail have contributed to the D&H's present situation, we have done some preliminary conceptual-level evaluations of the potential for recapturing the traffic flows.

It is important to point out that there is no guarantee that recovering these flows will assure the success of a restructured D&H, but we have concerns that a restructured D&H probably would not be successful without these traffic flows.

The traffic flow concept which we have been evaluating is similar to the traffic flows which would have existed in the Final System Plan's recommended "Conrail-Chessie" structure. The Commission supported the Conrail-Chessie solution, which would have given the Chessie most of the Erie Lackawanna line east of Akron, Ohio, and would have preserved the former EL traffic for the D&H through a connection at Binghamton. The critical "bridge carrier" function of the D&H would have remained intact. Because the recommended FSP structure was not implemented, the D&H lost this traffic flow. The extension of the D&H to Buffalo, while preserving the N&W traffic for the D&H, did not preserve the Erie Lackawanna traffic flows.

In concept, we believe that a D&H restructuring should include a connection between the Chessie System's main line in Ohio and the D&H line in New York.

Although we have not developed a scheme for such a restructuring, we see the recapture of traffic from the midwest which had moved EL-D&H as important to the viability of the D&H. The Chessie System has an extensive network of lines in the midwest and probably could draw that traffic to a Chessie-D&H routing.

We anticipate that traffic gains realized on such a restructured routing would principally be at the expense of Conrail. Because we have not attempted a quantitative analysis of D&H restructuring options, we do not know how much traffic could be drawn to such a restructured route.

Mr. SKUBITZ. Mr. O'Neal, I think that you testified that the \$21½ million that still remains in the USRA fund, they spent about \$27½ million to date—there is \$21½ million left—and your thought is it would take about \$600,000 a month to continue, and that has been the story that has been given to me. Mr. Rooney has placed his finger, I think, on a very important point, when he raised the question, Why would we go along for an 8-month period and put up \$15 to \$17 million under a bankruptcy reorganization, putting management in the hands of trustees, when we can keep it as it is for much less money, as we are operating today? Have you found any evidence, or is there anything to cause you to think that there has been mismanagement on the part of D. & H. up to this moment, or that anybody else could do a better job than the present management is doing, because any new management coming in is just going to hold the line to whatever reorganization program—

Mr. O'NEAL. Our feeling is the current management of D. & H. has made substantial improvement and is doing a much better job than the prior management.

Mr. SKUBITZ. If this is correct, it seems to me to make a lot more sense to continue the present program for 8 months and loan them money rather than go through a bankruptcy program. Get the reorganization program in line first rather than scare the wits out of people in cities all along the line. Maybe it is time to look for a new location or if they have, now is a good time to move.

Mr. O'NEAL. Well, I think those are all factors that have to be considered. Now, there is a possibility, of course, that if the carrier goes bankrupt, the management could change, or it could remain the same.

Mr. SKUBITZ. We give it to a new group to manage that is not familiar with it—if there was any evidence whatsoever that the present management was negligent or guilty of misfeasance in management, then I would be willing to go along with the change, but it seems to me that the present management has been doing about as good a job—not as good as you and I could do, of course—

Mr. O'NEAL. I hope they are doing a better job than I could do.

Mr. SKUBITZ. Go ahead and subsidize them until we get the reorganization in line, until the 8-month period is up. That is my own feeling.

Mr. O'NEAL. I think there is some merit to that approach.

Mr. SKUBITZ. I think there is a lot of merit—I don't think there is some—because you are—under your plan we don't only guarantee to the others—cost plus 6 percent—is that what you said?

Mr. O'NEAL. We are not proposing—I want to make this very clear—to use directed service except in an absolute emergency. That is the last thing that is available. That is the only time we are going to consider using it. I feel we have an obligation to the taxpayer not to use that very expensive approach to maintaining the operation of this carrier or any carrier.

Mr. SKUBITZ. Thank you.

Mr. ROONEY. When did the D. & H. merge with the N. & W.?

Mr. O'NEAL. 1968. It was included in the N. & W. Six of the first seven years were profitable years under that arrangement.

Mr. ROONEY. Considering the history of the relationship between the N. & W. and D. & H. I wonder if you can tell the committee whether the ICC developed any new policy with regard to the ongoing proposed mergers and including part of any of the bankrupt railroads in such mergers.

Mr. O'NEAL. Well, I am not sure if I know where we are headed on this. The Commission has recently adopted a policy for rail mergers in which we do indicate that we are going to be concerned not so much about corporate entities, but about the service to the public, and I guess to that extent there might be an adjustment in the way we look at this kind of merger.

Mr. ROONEY. Don't you think you should look at the corporate structure or the corporate entity? Isn't that just as important?

Mr. O'NEAL. I think that is part of it. Certainly, looking at corporate structure is part. I think we have to look at the overall needs of the public for the transportation mode.

Mr. ROONEY. Thank you very much, Mr. O'Neal. I appreciate your appearance before this committee, and certainly the cooperation your Commission has given the committee. It is nothing but the best.

Our next witness will be Mr. Robert E. Gallamore, Deputy Administrator of the Federal Railroad Administration.

STATEMENT OF ROBERT E. GALLAMORE, DEPUTY ADMINISTRATOR, FEDERAL RAILROAD ADMINISTRATION, ACCOMPANIED BY STEVEN R. DITMEYER, ASSOCIATE ADMINISTRATOR FOR POLICY AND PROGRAM DEVELOPMENT; CHARLES SWINBURN, ASSOCIATE ADMINISTRATOR FOR FEDERAL ASSISTANCE; AND MICHAEL T. HALEY, DEPUTY CHIEF COUNSEL

Mr. GALLAMORE. If I may introduce my colleagues, Mr. Steven R. Ditmeyer, Associate Administrator for Policy and Program Development, Mr. Charles Swinburn, our Associate Administrator for Federal Assistance, and Michael T. Haley, our Deputy Chief Counsel.

We welcome this opportunity to appear before you today to discuss the financial condition and prospects of the D. & H. Railway Co.

If I may, I would like to summarize my remarks, and have the full text included in the record. [See p. 45.]

Mr. Rooney. Without objection, the full statement will become part of the record.

Mr. GALLAMORE. The financial problems of the D. & H. did not begin a few months ago, or on April 1, 1976, the effective date of USRA's final system plan. The railroad's profitability and traffic base had been declining for several years before that. It is probable, however, that the assumption of additional trackage rights affected the financial performance of the D. & H. and much of the history of that period has been recounted this morning. As you know, the extension of the D. & H. through trackage right effected by the FSP and the 4-R Act occurred only after the preferred preliminary and FSP industry structure proposals fell through. There was little time for development of alternatives, but the D. & H. extension was sought to preserve competition in a region otherwise dominated by ConRail. D. & H.

undertook the increased operations voluntarily in an effort to protect its traffic base, and it is indeed unfortunate that events haven't turned out better.

As an indication of the problems the D. & H. faced before the FSP became effective, the D. & H.'s average annual net income for the first 5 years of the 1970's was 83 percent less than its average net income in the 1960's, and the tonnage of traffic carried by the railroad declined 15 percent in that 5-year period. The traffic trend reflected the general downturn in the economy of the region during those years. That downturn has continued since April 1976. This downturn is partially attributable to the effects of the Penn Central merger and the merger of the other carriers in the Northeast which connected with the D. & H.

At its last meeting on August 2, 1978, the Executive Committee of the USRA Board, with Secretary Adams in attendance, determined that the financial condition of the D. & H. had declined to the point that the statutory finding required prior to approval of D. & H. loan drawdowns could not be made; namely, that the D. & H. would be able to repay the drawdown within the time fixed for repayment.

The railroad's financial condition and traffic base have now eroded to the point where we no longer believe profitable operations are possible. The D. & H.'s traffic in the first 6 months of 1978 was 21 percent below last year, and last year the railroad lost \$12 million.

If the D. & H. goes into bankruptcy, as it may, the railroad would become eligible to apply to FRA for the guarantee of trustee certificates under the Emergency Rail Service Act of 1970. This has been mentioned earlier today. Based upon the information we have about the operations, financial condition and net asset value of the D. & H., we presently feel it would be difficult to make the public welfare, viability, and security findings required by ERSA. I wish to underscore that we have not attempted to make the findings yet, and that, indeed, we could not do so without a proper application before us, but we do believe it incumbent upon us to inform you of this circumstance.

With respect to the public welfare finding, we feel that D. & H.'s overhead traffic could be carried by other railroads and its other services could be provided under directed service orders or under the local rail services program.

With respect to the viability finding, there is little evidence, unlike the example of the Milwaukee Road which recently received an ERSA guarantee, that the D. & H. has a profitable core system, even if it sold or ceased operating certain lines. As to the security finding, the D. & H. has virtually no assets which are unencumbered. While the ERSA guarantee would be secured because under the statute it would be accorded the highest lien on the D. & H.'s property, it would displace security for the USRA loan and would further impair the security for the existing USRA loan, probably rendering a portion of that loan unprotected. Since the USRA loan represents an obligation to the United States, the displacement of USRA's lien would result in a lack of reasonable protection for the United States entire investment in the D. & H. That is, we simply wouldn't have a secured loan under the terms of ERSA. I hope you understand that would pose a difficulty for us in making the findings.

While we believe it is important to point out these difficulties, the D. & H. does have every right, if it files for bankruptcy, to apply for ERSA funds. If we receive such an application, we will give it fair and expeditious consideration.

If USRA section 211 loans and ERSA loan guarantees are not available to the D. & H. and the railroad cannot fund its own operations in reorganization, there would appear to be two choices facing the Congress, one being to continue service under a directed service order and the other being to fund the D. & H. operations under amended existing legislation.

Under section 1(16) (b) of the Interstate Commerce Act to direct one or more railroads to operate the essential portions of the D. & H. directed service of a magnitude necessary for the D. & H. has never before been ordered by the ICC—we recognize that. However, with careful planning, we believe the ICC can effectively use its directed service order authority to preserve essential D. & H. services. Because the entire system would not have to be operated, a directed service order operation need not be as expensive as Congress' second alternative, funding the D. & H. under amended law or new legislation for operation of its entire system.

During the period a directed service order was in effect, FRA could use its authority under section 401 of the 4-R Act to institute a proceeding among the D. & H. and other railroads to discuss sale or coordination of some or all of the D. & H. system. The section 401 mechanism and the Secretary's supplemental transactions authority under section 305 of the 3-R Act could be used to implement interim results of the section 401 proceeding. Such transfers or coordinations could avoid long-term Federal funding of these lines and possibly could result in more effective rail service in the region. As well, the period during which a directed service order was in effect could be used to consider FRSA—especially in light of any new circumstances that exist, and to give the D. & H. the time to either reorganize under existing bankruptcy procedures or file for abandonment of its properties.

As the chairman noted in his announcement of these hearings, FRA already has in progress a section 401 by the D. & H. to analyze restructuring in the region. The study is being closely coordinated with USRA and the New England Commission, and it is designed to evaluate alternatives for restructuring the New England rail system.

I believe it is now time to seek negotiations among the railroads. The study results will be useful to these negotiations, but we need more than the consultants report and the studies. We need to actually begin negotiations among the carriers.

Members of the committee, I recognize that our testimony may be disappointing to those who seek continuation of all local rail services to the D. & H. and of overhead service to New England in competition with ConRail connections. I hope you understand these conclusions are not reached lightly. Unfortunately, we have concluded that the railroad cannot become self-sustaining without fundamental, dramatic change, and maybe not even then. When we examine the services the railroad provides as a part of the Nation's rail system, we find

that its overhead traffic exists largely for the purpose of preserving intraindustry railroad rate competition, a goal that does not insure profitable rail service. Its local services could probably be provided more efficiently by another carrier, a substantially reorganized D. & H., or other modes.

So, if you ask us whether a Federal operating subsidy for local services should be approved, we must answer no. Other than the transitional assistance available in existing law, that is a local matter. If you ask whether operating assistance should be provided to insure competitive overhead service, we again say no. No other region of the country has received such assistance, and this type of service is not fundamental to the national economy. If you ask whether operating assistance should be provided as a matter of fairness to New York and New England in light of any FSP impact on the D. & H., we must respond that assistance already provided to ConRail, the D. & H., and prospectively the B. & M., is significant compared to similar aid to railroads in other parts of the country. If it is a question of fairness to D. & H., then we have crossed the line of what Federal Government commitment to private corporations are or should be; we have not and should not fund a corporation solely to keep it out of bankruptcy. Railroad employees, shippers and States all will be affected by the needed changes in railroad operations and economics. So will the taxpayer. We believe the changes can be accomplished in an orderly and equitable manner, but there is no escaping the necessity for change. The question is whether we have the collective will to guide events or whether factionalism will make that impossible.

In summary, it is the Department's position that existing Federal law should not be amended nor new legislation enacted which would maintain the existence of the D. & H. as a solvent company, or as a bankrupt company operating its entire properties. Rather, we perceive the desired solution, if existing Federal law precludes funding of the D. & H., to be a directed service order issued by the ICC to effect continued operation only of essential D. & H. services in bankruptcy.

A directed service order will provide the time within which the section 401 proceeding could make significant progress, the time within which the D. & H. could determine its own alternatives, and the time within which to consider ERSA. The Department is willing to assist the ICC in every practical way to implement such a directed service order.

That concludes my statement, Mr. Chairman.

[Testimony resumes on p. 52.]

[Mr. Gallamore's prepared statement follows:]

STATEMENT OF ROBERT E. GALLAMORE,
DEPUTY FEDERAL RAILROAD ADMINISTRATOR
BEFORE
THE SUBCOMMITTEE ON TRANSPORTATION AND COMMERCE
OF THE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE
HOUSE OF REPRESENTATIVES
AUGUST 15, 1978

Mr. Chairman and Members of the Committee:

I welcome this opportunity to appear before you today to discuss the financial condition and prospects of the Delaware and Hudson Railway Company (D&H).

Mr. Chairman, as you pointed out in your announcement of this hearing, the D&H has been on the brink of bankruptcy for several months. In fact, the railroad lost \$5.3 million in the first six months of this year and required \$6.4 million in Federal loans, as well as funds from the States of New York and Pennsylvania, to remain in operation. In addition, the D&H has been unable to make interest payments for a year on its loan from USRA and has yet to pay a \$1.7 million debt that came due April 1 of this year.

D&H Problems Did not Begin Overnight

I would like to point out, however, that the financial problems of the D&H did not begin a few months ago, or on April 1, 1976, the effective date of USRA's Final System Plan (FSP). The railroad's profitability and traffic base had been declining for several years before that. It is probable, however, that the assumption of increased operations by the D&H, under the FSP, and the changed competitive situation which has occurred since that time, has increased the railroad's difficulties. As you know, the extension of the D&H through trackage rights effected by the FSP and the 4R Act occurred only after the preferred Preliminary and FSP industry structure proposals fell through. There was little time for development of alternatives, but the D&H extension was sought to preserve competition in a region otherwise dominated by Conrail. D&H undertook the increased operations voluntarily in an effort to protect its traffic base, and it is indeed unfortunate that events haven't turned out better.

As an indication of the problems the D&H faced before the FSP became effective, the D&H's average annual net income for the first five years of the 1970's was 83 percent less than its average net income in the 1960's, and the tonnage of traffic carried by the railroad declined 15 percent in that five-year period. The traffic trend reflected the general downturn in the economy of the region during those years. That downturn has continued since April 1976.

USRA Board Action

At its last meeting, on August 2, 1978, the Executive Committee of the USRA Board, with Secretary Adams in attendance, determined that the financial condition of the D&H had declined to the point that the statutory finding required prior to approval of D&H loan drawdowns could not be made; namely, that the D&H would be able to repay the drawdown within the time fixed for repayment.

The D&H's serious financial problems have been under discussion by the USRA Board for over a year now. The USRA has continued to fund the railroad while three different presidents have attempted unsuccessfully to turn the company around. The railroad's financial condition and traffic base have now eroded to the point where we no longer believe profitable operations are possible. The D&H's traffic in the first six months of 1978 was 21 percent below last year, and last year the railroad lost \$12 million.

Emergency Rail Services Act of 1970

If the D&H goes into bankruptcy, as it may, the railroad would become eligible to apply to FRA for the guarantee of trustee certificates under the Emergency Rail Services Act of 1970 (ERSA). Based upon the information we have about the financial condition and net asset value of the D&H, we presently feel it would be difficult to make the findings required by ERSA. I wish to underscore that we have not attempted to make the findings yet, and that, indeed, we could

not do so without a proper application before us, but we do believe it incumbent upon us to inform you of this circumstance.

Three of the findings that are required in order to approve an ERSA guarantee would pose difficulties. These three findings are: a public welfare finding--that cessation of essential transportation services by the railroad would endanger the public welfare; a financial finding--that the railroad can reasonably be expected to become self-sustaining; and a security finding--that the probable value of the assets of the railroad in the event of liquidation provides reasonable protection to the United States.

With respect to the public welfare finding, D&H's overhead traffic could be carried by other railroads and its other services could be provided under Directed Service Orders or under the Local Rail Services Program. With respect to the financial finding, there is little evidence, unlike the example of the Milwaukee Road which recently received an ERSA guarantee, that the D&H has a profitable core system, even if it sold or ceased operating certain lines. As to the third finding, the D&H has virtually no assets which are unencumbered. While the ERSA guarantee would be secured because under the statute it would be accorded the highest lien on the D&H's property, it would displace security for the USRA loan and would further impair the security for the existing loan, probably rendering a portion of that loan unprotected. Since the USRA loan represents an obligation to the United States the displacement of USRA's lien would result in a lack of reasonable protection for the United States' entire investment in the D&H.

While we believe it is important to point out these difficulties, the D&H does have every right, if it files for bankruptcy, to apply for ERSA funds. If FRA receives such an application, we will give it fair and expeditious consideration.

Alternatives for Continued Operations

If USRA section 211 loans and ERSA loan guarantees are not available to the D&H and the railroad cannot fund its own operations in reorganization, there would appear to be two choices facing the Congress. The first is to permit the Interstate Commerce Commission (ICC), under section 1(16)(b) of the Interstate Commerce Act, to direct one or more railroads to operate the essential portions of the D&H.

Although Directed Service Orders have been used on a limited scale, directed service of a magnitude necessary for the D&H has never before been ordered by the ICC. However, with careful planning and input from all interested parties, including FRA, we believe that the ICC can effectively use its Directed Service Order authority to preserve essential D&H services. Because the entire system would not have to be operated, a Directed Service Order operation need not be as expensive as Congress' second alternative, funding the D&H under amended law or new legislation, for operation of its entire system.

A Directed Service Order would provide an opportunity for needed structural changes in the rail system serving the Delaware and Hudson markets. During the period a Directed Service Order was in effect, FRA could use its authority under section 401 of the 4R Act to institute a proceeding among the D&H and other railroads to discuss sale or coordination of some or all of the D&H system. The section 401 mechanism and the Secretary's supplemental transactions authority under section 305 of the 3R Act could be used to implement interim results of the section 401 proceeding. Such transfers or coordinations could avoid long-term Federal funding of these lines and possibly could result in more effective rail service in the region. As well, the period during which a Directed Service Order was in effect could be used to consider ERSA (especially in light of any relevant new circumstances) and give the D&H the time to either reorganize under traditional bankruptcy procedures or file for abandonment of its properties.

Future of the D&H and New England Rail Service

In our view, structural changes in the rail systems operating in the D&H markets are necessary to achieve self-sustaining rail service in the region. As previously noted, these changes could develop either through agreements negotiated directly among carriers or with the assistance of FRA as authorized by section 401 of the 4R Act and through the Secretary's authority to propose supplemental transactions affecting Conrail. The FRA has in progress a section 401 proceeding requested by the D&H to analyze restructuring alternatives to produce a stronger rail system in the region. The section 401 proceeding will include a study focusing on the most desirable system and, we are confident, negotiations among the railroads for implementing needed restructuring. Preliminary staff efforts will be supplemented by a team of contractors who are expected to begin work in a few weeks. The FRA section 401 proceeding is being closely coordinated with an effort directed by USRA and the New England Regional Commission (NERCOM) concerned with alternatives for restructuring the New England rail system.

Mr. Chairman, I realize our testimony may be disappointing to those who seek continuation of all local rail services of the D&H and of overhead service to New England in competition with Conrail connections. I hope you understand these conclusions are not reached lightly. We have pondered the circumstances of the D&H on many, many occasions, over a long period of time, and the answer comes out the same -- the railroad cannot become self-sustaining without fundamental, dramatic change, and maybe not even then. When we examine the services the railroad provides as a part of the nation's rail system, we find that its overhead traffic exists largely for the purpose of preserving intraindustry railroad rates competition, a goal that does not insure profitable rail service. Its local services, arguably not essential to the national transportation system but desirable to local communities, probably could be provided more efficiently by another carrier, a substantially reorganized D&H, or other modes.

If you ask us whether a Federal operating subsidy for local services should be approved, we must answer no. Other than the transitional assistance available in existing law, that is a local matter.

If you ask whether operating assistance should be provided to insure competitive overhead service, we again say no. No other region of the country has received such assistance and it is not fundamental to the national economy. If you ask whether operating assistance should be provided as a matter of fairness to New York and New England in light of any FSP impact on the D&H, we must respond that assistance already provided to Conrail, the D&H, and prospectively the B&M, is significant compared to similar aid to railroads in other parts of the country. If it is a question of fairness to D&H, then we have crossed the line of what Federal Government commitment to private corporations are or should be; we have not and should not fund a corporate structure solely to keep it out of bankruptcy, especially when more reasonable objectives would be achieved otherwise.

Our outlook and policy is by no means limited to the region served by the D&H and its connections. In the Midwest, we are undertaking far-reaching change in the structures of rail service through coordination, and we have said that fewer rail lines and fewer or significantly restructured companies will be the result. Railroads, employees, shippers, states, and local communities will be affected. So will the taxpayer. We believe the changes can be accomplished in an orderly and equitable manner, but there is no escaping the necessity for change. The question is whether we have the collective will to guide events or whether factionalism will make that impossible.

In summary, it is the Department's position that existing Federal law should not be amended nor new legislation enacted which would maintain the existence of the D&H as a solvent company, or as a bankrupt company operating its entire properties. Rather, we perceive the desired solution, if existing Federal law precludes funding of the D&H, to be a Directed Service Order issued by the ICC to effect continued operation only of essential D&H services.

A Directed Service Order will provide the time within which the section 401 proceeding could make significant progress; the time within which the D&H could determine its own alternatives; and the time within which to consider ERSA. The Department is willing to assist the ICC in every practical way to implement such a Directed Service Order.

That concludes my statement, Mr. Chairman.

Mr. FLORIO [presiding]. Thank you very much. We appreciate your very candid if not brutally frank analysis of the situation.

We are going to take a break. I understand there is a vote on now. There may be another vote after that, so we will just ask you to wait. I am sure the other members have some questions.

[Brief recess.]

Mr. DRUHAN. We have received a phone call from the chairman. He will be involved in other matters for some time, so he has suggested we recess until 2 p.m.

[Whereupon, at 12:30 p.m., the subcommittee recessed until 2 p.m. on the same day.]

AFTER RECESS

[The subcommittee reconvened at 2 p.m., Hon. Fred B. Rooney, presiding.]

Mr. ROONEY. I regret the delays very much. The ERA bill is up today and our proceedings will be interrupted by a series of votes. Before we begin the session this afternoon, I would like to introduce Mr. and Mrs. Gordon Long and their daughter, Sharon, and Richard and Ms. Theresa Moore from Center Valley, Pa. Mrs. Long was my secretary a long time ago. She was my secretary when she left Liberty High School, at age 17. She was one of my top aides when I went to the State senate and Commonwealth of Pennsylvania, and the 4 years I served in Congress. Nancy and Gordon and Ms. Moore, we are very pleased to see you here this afternoon. Will you stand up and say hello. It is nice to see old friends back. I have been asking Nancy and Gordon to come back to Washington to see the Congress in session. This is the first time they have been back, and we are pleased to have you here.

Mr. Gallamore, I understand that you have completed your statement.

Mr. GALLAMORE. Yes, sir, I have.

Mr. ROONEY. I want to thank you very much for presenting your statement to the committee. I have reviewed it and I have a couple of questions.

On page 2 of your testimony, you indicate that the traffic carried by the D. & H. has declined considerably for a number of years, including a period prior to the directed expansion in 1976. Is that correct?

Mr. GALLAMORE. Yes, sir.

Mr. ROONEY. Could you indicate to the committee how the D. & H. record compares to other railroads in the region, because I heard some staggering statistics that were quoted earlier by Congressman McDade this morning. Perhaps you might refer to your colleagues.

Mr. GALLAMORE. Steve may be able to provide us some additional information. There has been a decline of railroad traffic, generally, relative to the other forms of transportation. That has been very serious in the Northeast. That may be partly due to the increased pace of line abandonments in the wake of or part of the final system plan, so that would be a very difficult comparison to make, but we would try to provide additional information.

Mr. ROONEY. We would appreciate it very much.

Mr. GALLAMORE. There have been effects that have been mentioned by other witnesses attributable to mergers and—

Mr. ROONEY. Except that I think this railroad ought to get some credit for the fact it was profitable until 1976 and all of the neighborhood railroads were not. Is that correct?

Mr. GALLAMORE. That is correct—marginally profitable.

Mr. ROONEY. What is marginal profit?

Mr. GALLAMORE. I don't believe in any year that its net income was greater than \$3.4 million in the period 1970 to—

Mr. ROONEY. I am talking about percentage.

Mr. GALLAMORE. That would be on revenues of between \$60 and \$90 million, so we would have to calculate the percentage.

Mr. SWINBURN. The railroad did lose money in 1975, and made a very, very slight profit in 1974 and 1973, and was receiving money in those years from the State of New York to help it with rehabilitation programs of both track and equipment.

Mr. GALLAMORE. For the 1970 to 1975 period, the average net income of the D. & H. was less than \$1 million, \$600,000.

Mr. ROONEY. You strongly recommended essential services be continued by an ICC-directed service order. Is that correct?

Mr. GALLAMORE. Yes.

Mr. ROONEY. Could you indicate for the committee how much this would cost the Federal Government? I have heard \$15 million to \$17 million.

Mr. GALLAMORE. The ICC did testify to numbers in that neighborhood. Of course, that would be for provision of service for the whole system, and we recommended something less than the full system be operated.

Mr. ROONEY. Of course, you have heard testimony this morning by Chairman O'Neal, that D. & H. is operating at a loss of \$600,000 a month. Why should we get into directed services which would cost the American public \$15 million to \$17 million, when they operate at a deficit of only \$600,000?

Mr. GALLAMORE. I don't think they should be directing service over the entire system, at least for the 240 days.

Mr. ROONEY. What happens at the end of the 240 days?

Mr. GALLAMORE. First of all, there is a period of time before the railroad might have to go into bankruptcy. There would then be a period of time in which it could operate in bankruptcy before it would have to halt operations. Then there would be a period of time for which directed service would be applicable, and during that course of time, my testimony is, that I believe, through an acceleration and elevation of the 401 restructuring process, we can get this restructuring started.

Mr. ROONEY. Why can't you do it before they go into bankruptcy. I understand they may be going into bankruptcy next week. Did you hear my opening statement? Were you here?

Mr. GALLAMORE. I certainly did.

Mr. ROONEY. We have so many laws to save a small railroad like this. Why can't you people in the Department do something about it?

Mr. GALLAMORE. I think we need to get started with reorganization. In my opinion, we have wasted the time since last October.

Mr. ROONEY. You did waste your time.

Mr. GALLAMORE. It will be exactly the same next year if we don't get started.

Mr. ROONEY. Why were you wasting your time since last October?

Mr. GALLAMORE. Most of our time and energy has gone into ways of keeping the railroad out of bankruptcy. I think our attention ought to change from that to finding ways to restructure the railroad and see if there is a profitable core. I don't think there is any other answer that is responsible. I do think—I don't mean to say everybody has wasted their time—Mr. Shumaker is there in place now and I would concur with the testimony this morning that he is doing a fine job. But in terms of what the problem is, it hasn't changed—the basic problem has not changed. In terms of what our financing obligations are—they haven't changed. It is not good public policy to be using loan money that can't be repaid to cover operating deficits.

Mr. ROONEY. Can you tell me what alternative you think that the D. & H. should take? Do you think it should go into bankruptcy or not go into bankruptcy?

Mr. GALLAMORE. I think it would have to go into bankruptcy, eventually, if trends continue.

Mr. ROONEY. In all of the areas they serve, there would be no taxes for the local municipalities, no taxes for the States.

Mr. GALLAMORE. That is right.

Mr. ROONEY. Why did we create the sections of the 3-R Act and the 4-R Act which permit loaning money to ailing railroads? How can you justify ignoring these provisions?

Mr. GALLAMORE. Congress is faced with the situation of collapsing rail service in the Northeast.

Mr. ROONEY. How about the Midwest—don't you have the same problem?

Mr. GALLAMORE. We are finding the 4-R process gives us an excellent vehicle for restructuring, and that has come about since the bankruptcy of the Milwaukee Railroad. I think we can do the same thing in the Northeast. The circumstances aren't quite as favorable. I think we can make some progress to restructure. The Congress of the United States is faced with the collapse of rail service—seven railroads have gone into bankruptcy in that area, cutting off the traditional connections of the D. & H.; the Penn Central merger changing traffic patterns in that area, perhaps, as was testified to this morning; Congress then passing legislation that requires repayment, requires the Government to obtain security, tells the Government to put in money on a loan basis if you can obtain security, and we, as administrators of the program, let alone as policymakers, find it very difficult to flaunt the will of the Congress in this regard. The legislative history is quite clear on the subject. Loans are not a good way to continue operations of a failing railroad.

Mr. ROONEY. They are not?

Mr. GALLAMORE. They are not if there is no security. We have to find some other—

Mr. ROONEY. How do you feel about ConRail. We have \$2.1 billion in outstanding loans to ConRail. ConRail is now asking for another \$1.3 billion, and I have read financial pages of many of the leading financial papers in this country that they are going to need another \$1.3 billion.

Mr. GALLAMORE. We supported the additional financing.

Mr. ROONEY. Do you think ConRail will ever repay its debts?

Mr. GALLAMORE. Well, I certainly hope so. The whole idea of the plan was to create a financially self-sustaining railroad. As you know from our communications, there is an increasing amount of pessimism about their ability to do that without changing the system. With respect to the D. & H., it is just not on the same scale in terms of essentiality or in terms of jobs and impact on the overall National economy. Our testimony is that most of the D. & H.'s essential services can be provided by other carriers or to substantially restructured D. & H. That is not the case with ConRail right now.

Mr. ROONEY. On page 4 of your testimony, you indicate the transfers under section 401 proceeding could avoid long-term Federal funding. I do not believe long-term Federal funding was ever considered as an option. Nevertheless, I question why you would object to short-term Federal funding until such time, in my opinion, a determination can be made under the 401 proceedings, and USRA and New England Regional Commission studies completed?

Mr. GALLAMORE. The ESRA money does require these security findings, and if the security isn't there, that is difficult to do. The USRA 211 loan provided a substantial amount of funding. The State of New York has provided a substantial amount of funding. Pennsylvania has provided funding. I think we have to get on with the reorganization and not postpone it inevitably. I am afraid that is what would happen with the ESRA funding option.

Mr. ROONEY. But the reorganization wouldn't be for 1½ years.

Mr. GALLAMORE. That is not our testimony. The study is—

Mr. ROONEY. That is my understanding.

Mr. GALLAMORE. We can begin to make interim steps. The study will support the process of reorganization that I believe has to occur, but there is no need to postpone negotiations among the railroads for restructuring opportunities until that study is complete. I think that if we will elevate and accelerate that process, we can make a substantial improvement in less than 1½ years. We have had good success in the Midwest. Again, the circumstances are much different here, but I don't see any reason why we can't get involved in a big way, give it our full effort, work with those carriers up there and the States, and show you some pretty positive results.

Mr. ROONEY. Mr. Gallamore has just completed his statement. I have asked a few questions. Mr. Florio, you were here during his testimony. I was wondering whether or not you might have any questions?

Mr. FLORIO. I was just wondering if we might get some general responses from you as to what direction you think is most desirable. As I understand it, at this point—

Mr. ROONEY. Bankruptcy.

Mr. FLORIO. If that is an alternative, it seems to me that that seems to be a prerequisite for some of the governmental programs to come into play to be utilized.

Mr. GALLAMORE. That is true for both ESRA and directed service orders.

Mr. FLORIO. And it seems to me, talking this morning to some of the principals, particularly in the railroad, they are not very enthused

about that. Do you see any other alternative other than going into bankruptcy to attempt to qualify for some of the Federal programs?

Mr. GALLAMORE. I think bankruptcy has certain advantages that the committee ought to consider. Norfolk & Western stock control at present may pose some additional, I won't say impediments, but some additional issues that would have to be addressed in the restructuring process. In bankruptcy, the United States is the principal creditor of the D. & H. and would have every interest to restructure. The trustee, hopefully, would have every interest to restructure. Other railroads in that part of the country would have every interest to restructure, I believe. Directed service is an option. I realize it has never been tried on this scale and has some drawbacks, but it can be done without new legislation. It recognizes the prepayment problem. It is honest; it is grant money and does not continue losing operations with loans; it would be administered in such a way that change could begin to happen. Indeed, in *Ex parte 293*, which was the ICC's own investigation of how directed service might be structured and the cost principles that would pertain to directed service, it is concluded that the intent of Congress was for profitable main lines that might be an essential part of the system and have some hope of profitable operation by the directed service carriers to receive first priority for directed service. I don't think it is hopeless.

Mr. FLORIO. The suggestion has been made that a \$20 million loan guarantee would assist in avoiding bankruptcy. In your considered opinion, how long would that forestall what appears to be inevitable?

Mr. GALLAMORE. A \$20 million loan guarantee—possibly a year, 1½ years.

Mr. FLORIO. Do you see any—

Mr. GALLAMORE. I do think that that may lessen the incentive on everybody's part to get on with the restructuring. I think there is a substantial risk, we would be back here in approximately the same position we are in now.

Mr. FLORIO. As to the 401 study—what is your projection now for when we are going to have that available?

Mr. GALLAMORE. As I tried to say in my testimony and earlier, the crucial thing is not the study itself. The crucial thing is the negotiations that have to occur between and among the railroads with our participation and with the cooperation of the ICC. That needn't be delayed until the consultant's report is complete. Obviously, the studies will be helpful, adding information on traffic and potential routings and so on to these deliberations, to these negotiations. That is where the heart of the work has to be done.

Mr. FLORIO. My assumption was the study was designed to provide an impartial evaluation of what direction restructuring should take.

Mr. GALLAMORE. I think that was the original theory. I think time has moved us to a point we should accelerate that process and begin to push the negotiations aspect. In other words, let the proposals come out of our conferences with those affected carriers and—

Mr. FLORIO. It is your assumption this would be facilitated by the bankruptcy?

Mr. GALLAMORE. To a certain extent, it would be. I mentioned the N. & W. stock difficulty. I think if all interested parties don't recognize

the problem is immediate, I think that is another possible reason for the reorganizing not happening as swiftly as it might otherwise.

Mr. FLORIO. Thank you.

Mr. ROONEY. Thank you very much.

In fairness to Mr. Skubitz, he did want to ask some questions. Are you planning on leaving?

Mr. GALLAMORE. I will be here for a while. I intended to leave but I can stay. If you would like me to, I will be happy to stay.

Mr. ROONEY. Thank you.

Our next witness will be Cary W. Dickieson, vice president and general counsel of the United States Railway Association.

STATEMENT OF CARY W. DICKIESON, VICE PRESIDENT AND GENERAL COUNSEL, UNITED STATES RAILWAY ASSOCIATION, ACCOMPANIED BY FREDERIC W. YOCUM, JR., VICE PRESIDENT, OPERATIONS AND MARKETING; AND JOSEPH P. WELSCH, VICE PRESIDENT, FINANCE

Mr. DICKIESON. Mr. Chairman, with your permission, I will provide a brief summary of my testimony, and ask that the rest be included in the record.

Mr. ROONEY. Without objection, the full statement will be included in the record.

Mr. DICKIESON. I am Cary Dickieson. With me, on my right, is Fred Yocum, the association's vice president of operations and marketing. On my left is Joe Welsch, vice president, finance.

We are here today to talk about the Delaware & Hudson Railroad. This is a railroad that has been sick for a long period of time.

Mr. ROONEY. How long a period of time? I understand in 1976 they were still making a reasonable profit.

Mr. DICKIESON. No; it was losing money in 1976 and 1975. Indeed, over the past 4 years, it has continued to exist only because \$50 million has been pumped into the railroad by USRA and New York State. Now, the causes for the decline of the Delaware & Hudson are threefold.

First, you have a major change in the economy of the area served by the D. & H. and its connections. Utilities have converted from coal to oil. The Interstate Highway System has been completed. The manufacturing base has changed primarily to light manufacturing and service industries, and away from heavy manufacturing. This has caused a long-term, steady decline in the traffic available to D. & H., and all railroads in that region.

The second problem was brought about by the Penn Central merger and the other eastern mergers, B. & O. and C. & O., and N. & W.

Finally, the problem was further exacerbated in 1976 by the inability to consummate the preferred industry structure of the final system plan, when the major transaction involving the Chessie could not be consummated. I would like to pause on that because you did ask some questions about that earlier.

With the inclusion of the Erie and Lehigh Valley and other railroads directly in ConRail, D. & H. would have been completely sur-

rounded by ConRail and have no external connections. We felt it was essential to provide it with those connections. Therefore, we offered them, and they requested and accepted, under those circumstances, extensions to Buffalo, to Philadelphia, and to Washington. We felt those extensions were essential to its survival.

Mr. ROONEY. Did you hear the testimony by Mr. Hanley and Mr. McDade this morning? They say they are surrounded.

Mr. DICKIESON. They are not.

Mr. ROONEY. You disagree with that?

Mr. DICKIESON. They interchange at Buffalo with the Norfolk & Western, and with the Chessie, so they still retain their historic Western connections as best we can do it, and they can go down to Washington and interchange with the Southern carriers and interchange with the B. & O. at Philadelphia. The extension to Oak Island was not one we felt was essential. It was requested by D. & H. and the State of New Jersey. It also required that we increase the amount of the loan by \$2 million. Because of that, we offered them a \$28 million loan, including the Oak Island extension, instead of a \$26 million loan without Oak Island.

I think it is fair to say all of us feel that the line extensions have not been as successful as we had hoped they would be in protecting the D. & H. But without those extensions, the situation would be far worse.

At the present time, the Delaware & Hudson needs external funding: this year between \$10 and \$15 million. We think, based on its current performance, the decline in its traffic, its external funding needs next year will also be of that magnitude. The association, at the present time, only has \$2.7 million available under the present loan agreement. I think it is quite clear that even if we were to continue funding the D. & H. with our loan money, it is going to run out in the next few months.

Mr. FLORIO. Is that funding just to maintain their operating expenditures?

Mr. DICKIESON. That is right. We also have a difficulty under the statute. The statute, as you have heard earlier today, requires us to make findings concerning the ability of the railroad to repay the loan in a timely fashion. We can't make those findings at the present time. We cannot ignore those findings. Congress designed section 211(a) as a loan program, not a grant program. We are beyond the point where we can say with any assurance D. & H. can repay any additional loans, much less the ones they have received thus far.

The association believes that the solution here is to engage in a restructuring of the D. & H. in the context of overall restructuring of the New England railroads. That is the purpose of the study that we are engaged in with the New England Regional Commission. That is part of the purpose of the 401 study.

It is our belief that whether the D. & H. is inside or outside of bankruptcy, that someone should continue to fund the normal operations of the D. & H. until those studies are complete.

That, basically, summarizes my testimony. My colleagues and I will be glad to answer any questions.

[Testimony resumes on p. 77.]

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

STATEMENT OF CARY W. DICKIESON
VICE PRESIDENT AND GENERAL COUNSEL
UNITED STATES RAILWAY ASSOCIATION

Mr. Chairman and Members of the Committee:

I am Cary W. Dickieson, Vice President and General Counsel of the United States Railway Association. I have with me today from the Association Frederic W. Yocum, Vice President for Operations and Marketing, and Joseph P. Welsch, Vice President for Finance. My purpose is to inform you of the current condition and prospects of the Delaware and Hudson ("D&H") and of the background and status of the Association's loan to that railroad.

Statutory Requirements

Before discussing the history of this particular loan, I think it would be useful to describe the statutory context in which the loan was made and is now being administered by the Association.

Section 211(a) of the Regional Rail Reorganization Act of 1973 authorized the Association to make loans to Conrail, Amtrak and other railroads in the Northeast for the purpose of "achieving the goals of the Act".

Section 211(e) of the Act establishes three prerequisites for the granting of such loans. Under that section, the Association must find in writing that:

- (1) The loan is necessary to achieve the goals of the Act or to prevent insolvency;
- (2) The business affairs of the applicant will be conducted in a reasonable and prudent manner; and
- (3) There is such security as deemed necessary to protect reasonably the interests of the United States.

Furthermore, it is stated as a policy in Section 211(f) that it is the intent of Congress that all Section 211(a) loans be made under terms and conditions which furnish reasonable assurance of timely repayment and that the goals of the Act are reasonably likely to be achieved.

These statutory requirements make it clear that the Association has an obligation to ensure that the financial

assistance authorized by Section 211(a) may be employed only in circumstances that are consistent with a loan and not a grant program. The Association approaches that responsibility not merely as lawyers reviewing a proposed trust indenture--although we must have a proper concern for not acting beyond our lawful powers or contrary to our other responsibilities under the Act. Nor do we approach it merely as bankers--although we can't ignore the clear intent of Congress under the Act to distinguish between grant programs and loan programs and we can't undertake to abolish that distinction by making grants disguised as loans.

In defining our obligation in respect to Section 211(a) loans we draw our basic guidelines from the Act's provisions and its legislative history.

As for the Act itself, we cannot wholly disregard the fact that in the matter of repayment and security, only one important distinction is made on the basis of the identity of a borrower. "Where applicable", the Act states, loans are to be treated as an "expense of administration". What this apparently says is that for loans to bankrupt railroads, Congress had special concern for assurances of repayment and adequate security--even though this absolute statutory requirement might well induce a reorganization court faced with creditor objections to refuse to approve a loan which is important to the goals of the Act. In the case of loans to marginal railroads threatened with insolvency, this suggests to us that we cannot ignore reasonable considerations of repayment and security.

Given the important public purposes of these loans, it might be suggested that certain critical situations would warrant the assumption of some added repayment and security risks not warranted in other Section 211(a) loans. But as I have noted, we could not be justified in making outright grants in the guise of loans. To be specific, the Association cannot repeal the statutory prerequisite of Section 211(e), covering any Section 211 loans, of "security . . . to protect reasonably the interests of the United States". Nor can it nullify the stated Congressional policy of Section 211(d) and (f) which contemplates the timely repayment of Section 211(a) loans. Moreover, we believe it necessary to look at the timely repayment and

reasonable security requirements as having a kind of inverse relationship. That is, as the possibilities of timely repayment seem less assured, the question of adequate security becomes more important.

OPERATING HISTORY OF THE D&H

The D&H's problems did not begin with the Final System Plan. The company's fortunes had been declining for many years. The wave of railroad mergers in the east during the 1960's threatened its existence. In 1968, the D&H's rail assets were assumed with little enthusiasm by a subsidiary of the N&W, while important parts of its liquid assets were retained by the D&H's former parent, the Delaware and Hudson Company. The groundwork for future problems was thereby laid.

Historically, the D&H had been a profitable railroad. Freight revenues remained relatively constant during the sixties at between \$40 and \$44 million per year. During this period the D&H also enjoyed a net profit each year, rising gradually to a high of \$5 million in the mid-sixties, tapering off to \$0.8 million in 1968, and back up to \$3.5 million in 1969. However, the tonnage carried by the D&H actually had been declining for some 20 years as the economy of D&H's territory and New England shifted away from industrial production toward light manufacturing and service industries (Exhibit 1).

Beginning in 1970, there was a severe change in the D&H's traffic and net income position. In 1971 and 1972 revenues fell sharply. This loss in business can be attributed to several significant factors that coalesced at this time.

The winter of 1969-1970 was one of the worst ever experienced in the northeastern United States. Car movements were crippled by heavy snowfalls and sub-zero temperatures, which resulted in substantial revenue losses. Utilities on the D&H converted from coal to oil, one major industry closed its plant and a second sharply reduced its production. Completion of the Penn Central Merger and the inclusion in that carrier of the New Haven Railroad resulted in the diversion of traffic from the D&H. This series of business setbacks was followed shortly thereafter

by Tropical Storm Agnes in June, 1972, which caused considerable damage to rail properties throughout the Northeast, disrupting service by the D&H and some of its connections for many months thereafter. Labor costs increased dramatically as new national contracts for railroad employees providing wage increases of approximately 44 percent for the period January 1, 1970, through June 30, 1973, were implemented.

Due to the foregoing combined circumstances, net income fell sharply. Internally generated cash flow was barely adequate to service D&H's debt obligations. In short, the D&H was approaching a precarious financial position.

Exhibit 2 demonstrates the financial results of D&H operations for 1970-74. In three of those years the D&H reported negative net income. Extraordinary gains from sales of property wiped out the losses in two of the three loss years. Also, beginning in 1974, the D&H began to receive substantial aid from New York state.

It was in this context that, in the fall of 1975, the D&H sought loan assistance from the United States Railway Association under Section 211(a) of the Act.

USRA's Loan to the D&H

On October 17, 1975, the D&H applied to the United States Railway Association for a loan of \$37.6 million pursuant to Section 211(a) of the Act, to be used for the following purposes:

- (1) Financing the purchase of lines of railroad offered to the D&H under the Final System Plan (\$0.6 million);
- (2) Financing the acquisition of 20 new diesel-electric locomotives (\$7.4 million); and
- (3) Refinancing the D&H's long-term debt and for working capital (\$29.6 million).

Of the findings required by Section 211, the USRA staff felt the most important was that regarding the D&H's ability to repay. The D&H's recent history prior to the loan request indicated a mixture of positive and negative earnings, and a consistently declining traffic and revenue base. The D&H

predicted a change from historic performance based on three assumptions:

- Substantial Revenue Increases. The traditional decline in traffic would be reversed due to economic recovery and rate increases.
- Cost Control. The D&H felt it had a demonstrated ability to control or reduce costs under inflationary pressure.
- Debt Service Levels Not Excessive. The D&H could meet debt requirements and still improve cash position and working capital.

While the staff advised the Board that "great caution must be taken in making a positive finding of ability to repay," it recommended, and the Board approved on January 8, 1976, a \$26 million loan.

Subsequent to this action, the lines offered to the Chessie under the Final System Plan were not acquired, due to unsuccessful negotiations with labor. The Association therefore was forced to revise the proposed system of the D&H, and altered its forecast of the D&H's performance accordingly. On February 9, 1976, the Association's Board of Directors found that additional line extensions (to Buffalo, Washington and Philadelphia) requested by the D&H would "considerably enhance" its ability to repay the loan.

Finally, on March 3, 1976, the USRA staff presented to the Board an analysis similar to the February forecast but including additional trackage rights to Oak Island requested by the D&H and New Jersey. The staff concluded that in these circumstances the increased revenues would support a loan of \$28 million. The Board approved the larger loan.

To summarize, the Board's expectation that the D&H could repay the \$28 million loan rested on three key factors:

1. D&H would reverse its recent trend and experience real growth in its traffic base.
2. D&H would achieve substantial new operating efficiencies producing significant cost savings.
3. The line extensions would provide D&H with the ability to hold on to its overhead traffic thereby minimizing the adverse effect of the absorption of its friendly connections into

Conrail. If D&H were to fall short significantly in achieving any one of these key expectations its ability to repay the loan would be seriously jeopardized.

During 1976, D&H's operating and financial results were consistent with its projections. However, beginning with the winter of 1976-77, the D&H's operations deteriorated sharply. The inability of the D&H to reverse the decline in the spring and summer led the Association to intensify its monitoring efforts. By August, the D&H's finances had become so critical that additional money from USRA was required if the D&H were to continue operating. Since August 1977, the Association has modified the Loan Agreement on several occasions to permit continued operations by the D&H while solutions for its short and long-term problems were sought.

1. On August 8, 1977, the Agreement was amended to increase drawdowns for 1977 from \$2,500,000 to \$4,500,000, to reduce drawdowns for 1978 from \$3,000,000 to \$2,000,000, and to eliminate the scheduled drawdown for 1979;

2. On November 22, 1977, the Board approved the request of the D&H to defer the interest payment in the amount of \$1,074,444.05 due on December 20, 1977;

3. On December 13, 1977, the Board approved the request of the D&H to accelerate the drawdown of the loan's remaining \$2,000,000 and to increase the aggregate amount of the loan from \$28,000,000 to \$30,000,000;

4. In January 1978, the Board approved the release of the Association's security interest in the 20 locomotives and consented to D&H refinancing those locomotives with an FRA guaranteed loan, a transaction which had the effect of making an additional \$7.4 million in federal assistance available to the D&H.

5. On May 24, 1978, the Board approved a proposal to permit the refinancing of \$1.75 million in notes owed to insurance companies which were overdue, the request of the D&H to defer the interest payment in the amount of \$1,063,231.22 due on June 20, 1978, and the advance of loan funds not to exceed \$350,000;

6. On June 29, 1978, the Board approved the request of

the D&H to amend the Loan Agreement to no longer require the D&H to pledge \$1,750,000 in bonds as required since the D&H was unable to refund the bonds held by certain insurance companies as part security for loans. The Board also approved a \$500,000 drawdown requested by the D&H, and an additional \$500,000 to pay retroactive wages in July, 1978, if national labor negotiations were completed by then.

These modifications were made under Section 211(d) of the Act in response to the D&H's increasingly critical cash position. Each was made after the Association found that the action requested was necessary and appropriate to achieve the Congressional policies declared in Section 211(f) of the Act--namely, that the terms and conditions of the loan furnish reasonable assurances that the borrower will be able to repay within the time fixed and that the goals of the Act are reasonably likely to be achieved. These two policies are somewhat in conflict since a rigid insistence on the provision regarding repayment could defeat the policy concerning the goals of the Act. Thus, an appropriate balance between them is required.

The Association's purpose in approving these modifications was to permit D&H's management to get control of its operations and costs, thereby achieving short-term stability, while studies were commenced to find the solution to D&H's long-range problems. As the year progressed, it became increasingly clear that despite substantial operating improvements, the continued decline in D&H's traffic meant that it could not achieve even a breakeven cash flow position. By Spring, the D&H's prospects were sufficiently uncertain that the Association's Board was experiencing considerable difficulty in making the required statutory findings and was acting on loan modification requests by increasingly divided votes.

Our June, 1978 projections indicated that the remaining funds the Association could advance to the D&H probably would be sufficient only to sustain operations through the rest of the year. These projections also showed that the D&H would not be able to continue to operate in 1979 without external funding in the order of \$10 to \$15 million. Without such funding, the D&H

probably would have to file for Section 77 bankruptcy reorganization early in 1979.

Current Status of the D&H

When the Association's Board of Directors met on August 2, 1978, the D&H's financial situation had become even more precarious than it had been on June 29th. Despite improved operations and better cost control, D&H has continued to fall behind the traffic levels forecast in its projections. Moreover, since July 10th, a strike against the Norfolk & Western Railroad (N&W) has resulted in the rerouting of rail traffic through Canada as well as the diversion of traffic originating on the N&W to other modes of transportation. Due to the strike, the D&H was losing approximately an additional \$37,000 per day above its normal monthly loss of several hundred thousand dollars. Prior to the August 2 Board meeting, the D&H financial forecasts indicated that the company could continue operating in August and September without the scheduled loan drawdowns of \$600,000 and \$250,000 for the two months. The D&H was, in fact, expecting to receive a \$387,000 grant from the State of Pennsylvania. The railroad also expected to sell surplus assets in August and September with expected cash flow benefits of \$2.5 million. However, late on August 1, the D&H notified the Association that it was requesting the August drawdown.

With the D&H financial position as precarious as it was, the Association's Board of Directors, acting through the Executive Committee, was unable to make the findings requisite to modifying a Section 211(a) loan to approve the drawdown. In particular, it appeared that there was little likelihood that the able to make timely repayment of the funds advanced. Although with the remaining loan funds the D&H might be able to continue operating in 1978, it would need \$10 to \$15 million more cash to operate in 1979. Furthermore, in the balance that USRA must make under the provisions of Section 211(f) between the policy concerning timely repayment and that of furthering the goals of the Act, it seemed clear that additional funding of the D&H under Section 211(a) would not constitute so much a loan, as it would a grant. Since Congress had made a strong distinction between the loan characteristics of Section 211(a) funds and the grant

provisions of other Rail Act programs which were also designed to further the goals of the Act, the staff recommended that the Board not approve the D&H's August request for a \$600,000 drawdown. Consequently, the possibility exists that the D&H could be forced to file for protection under the Bankruptcy Act before the end of the year.

Conclusion

The Association is charged by Congress with the responsibility to manage the Section 211(a) loan provisions of the Act in a manner that protects the financial interests of the United States in such loans and furthers the goals of the Act. These conflicting requirements, given the severe financial problems of the D&H, have not been easy to resolve.

For the past year, the Association has sustained D&H's operations while endeavoring to get all concerned parties to focus on the need for promptly finding a lasting solution to its problems. The continued inability of the D&H to achieve a positive cash flow, however, has brought the Association to the point where it cannot continue funding D&H consistently with statutory requirements.

I want to emphasize that a possible D&H bankruptcy does not mean a cessation of its operations. If D&H were to file for bankruptcy at this time, its cash position would enable it to continue operations without external funding for two to four months. Moreover, other programs specifically addressed to the funding needs of bankrupt railroads now are available.

Congress already has authorized the Federal Railroad Administration (FRA) to provide funds to a bankrupt D&H through the Emergency Rail Services Act (ERSA). As of July 1, \$50 million was repaid to that fund by the Penn Central Trustees. This money is available for loans to railroads which have filed for reorganization under Section 77 of the Bankruptcy Act. If the Department of Transportation were unable to make appropriate findings and, therefore, did not approve any loans, essential operations could be continued by the ICC pursuant to directed service orders. In bankruptcy, federal loans would have better security, the D&H would be under the control of a federal court rather than its present owner, the N&W, and federal loans would

no longer benefit the N&W, which has refused to aid the D&H.

Currently, FRA is conducting a unification and coordination study that was requested by the D&H pursuant to Section 401 of the Railroad Revitalization and Regulatory Reform Act of 1976. In addition, the Association, in conjunction with the New England Regional Commission, is studying the entire New England rail system. The Association is deeply concerned about the adequacy of rail service in the northeastern United States. Since the D&H serves as a bridge to the New England rail network and competes with Conrail for this business, the scope of the study will include the D&H. Moreover, we are coordinating our study with the Section 401 study being conducted by the FRA.

Finally, I want to emphasize that the Association believes it is desirable that funds be made available to support normal operations of the D&H while these studies now seeking solutions to its long-term problems are completed and implemented. This has been the Association's main purpose over the past year in providing funds despite the D&H's declining prospects. The D&H's condition now has deteriorated to the point where the Association may not be able to provide further aid. In weighing possible alternatives, Congress may wish to consider bankruptcy as the course which best suits D&H's present circumstances and the interests of the Federal Government. While Congress may determine that bankruptcy should be a precondition to further federal assistance, the Association believes that such assistance should be provided until the studies are completed.

Mr. Chairman, I appreciate this opportunity to explain the Association's actions concerning the D&H to this committee. My colleagues and I will be pleased to answer questions you or the other members may wish to ask.

EXHIBIT 1

DELAWARE AND HUDSON RAILWAY COMPANY

TONNAGE

(1955-75)

TONS

(000's)

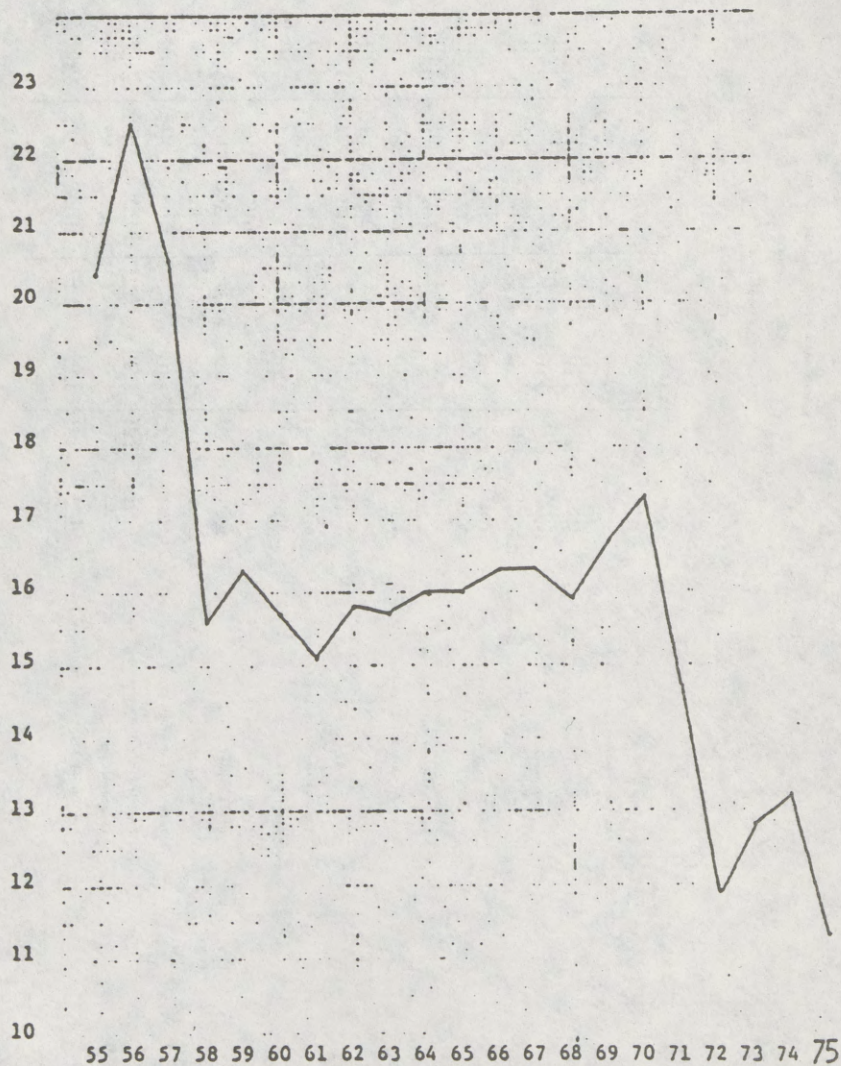


EXHIBIT 2

DELAWARE & HUDSON RAILWAY COMPANY

OPERATING RESULTS

($\pi, 0005$)

ICC ACCOUNTING

	1974	1973	1972	1971	1970
Railway Operating Income	\$52,592	100.0	\$44,415	100.0	\$46,062
Railway Operating Expenses					
Maintenance of Way	6,131	11.8	5,415	12.2	6,335
Maintenance of Equipment	10,696	20.3	9,034	20.3	10,701
Traffic	1,495	2.8	1,321	3.0	1,455
Transportation	19,949	37.9	16,737	37.8	18,455
Misc. & General	3,218	6.1	2,952	6.6	3,032
Total Operating Expenses	41,495	78.9	35,528	80.0	37,756
Net Income from Operations	11,107	21.1	8,889	20.0	8,308
Railway Tax Accruals	6,161	11.7	5,464	12.3	5,588
Provision for Deferred Taxes	581	1.1	948	2.1	---
Railway Operating Income	4,365	8.3	2,477	5.6	2,720
Rent Income	364	.7	616	1.4	46
Rents Payable	2,826	5.4	2,137	4.8	203
Rent Rents	1,421	2.7	1,422	3.2	1,892
Net Railway Operating Income	1,903	3.6	956	2.2	1,659
Other Income	1,199	2.3	1,104	2.5	1,031
Total Income	3,102	5.9	2,060	4.6	2,681
Misc. Deductions	124	.2	142	.3	177
Income Available for Fixed Charges	2,978	5.7	1,918	4.3	2,504
Interest and Other Charges	1,988	3.8	2,115	4.7	2,139
Reported Net Income (Loss)	990	1.9	(197)	(.4)	365
Extraordinary Items	---	---	2,607	5.8	373
Net Income After Extraordinary Items	\$990	1.9	\$2,410	5.4	\$738

Mr. FLORIO. Somebody like whom? What are the alternatives?

Mr. DICKIESON. We cannot continue funding, under any circumstances, beyond the \$2.7 billion under the existing law. As you have heard earlier, if the D. & H. were to become bankrupt, it could apply for money under the Emergency Rail Services Act. If it were to run out of cash, it could apply for a directed service order. Those are the two other programs presently available.

Mr. ROONEY. In other words, you are saying they should go into bankruptcy?

Mr. DICKIESON. We don't really have a view on that. We can't keep them from bankruptcy because our money is going to run out in just a few months. After that, the rest of their money is going to run out a few months later.

Mr. ROONEY. You loaned them \$30 million. Is that correct?

Mr. DICKIESON. Yes.

Mr. FLORIO. Did you make a finding at that point that those loans were capable of being repaid?

Mr. DICKIESON. My testimony recites the problem we have had in making the finding. We made it initially in 1976 when we approved the loan. In the past year, D. & H. has gone through this period of difficulty, and has been kept alive because we have consistently modified the loan agreement, amounting to \$10 to \$15 million in assistance.

Basically, the problem is, in terms of the funds, that while the operations have improved, the continuing decline in the traffic means that the railroad has not overcome its cash flow deficit. We had hoped that could be arrested. We have not had that hope realized. The state of the progress of the restructuring study has not been as rapid as we had hoped. Despite the fact we have tried to alert everybody to the problems of the D. & H., there has not been, until today, all that much movement or awareness or involvement trying to solve its problems.

Mr. FLORIO. If the railroad would go into bankruptcy, what is the status of the Government's claim on the previous loans?

Mr. DICKIESON. We become a prebankruptcy claimant with our security, and our security is not that good at the present time. The best security we had, the 20 locomotives, we allowed D. & H. to re-finance with—

Mr. ROONEY. What difference does it make—FRA, USRA, it is all one Government, isn't it?

Mr. DICKIESON. That is right, and if the question you are basically asking is, are we very well protected on our present loan, the answer is we are not.

Mr. FLORIO. Weren't you required to make a determination that the loans would be secure?

Mr. DICKIESON. When we originally entered into the loan, yes; that is a requirement, and at that time, we made the findings; but to modify the loan, we don't have to repeat the security finding.

Mr. FLORIO. How much do you anticipate the Government is going to lose if the railroad goes into bankruptcy?

Mr. DICKIESON. Frankly, the range is anyplace from zero to \$30,000. I need to know what happens to the railroad. Is it going to be bought by somebody else? Are large sections—

Mr. FLORIO. The maximum liability is \$30 million.

Mr. DICKIESON. At the present time, yes.

Mr. ROONEY. Wasn't this \$30 million that was originally loaned to the D. & H. before the expansion?

Mr. DICKIESON. No, sir.

Mr. ROONEY. As I understand it, it was. It was applied for.

Mr. DICKIESON. D. & H. applied for a loan back after the final system plan was published.

Mr. ROONEY. Exactly.

Mr. DICKIESON. One of its primary purposes was to provide a very small amount to enable them to buy a line that is not part of the line extensions we are talking about.

Mr. ROONEY. Do a little track work.

Mr. DICKIESON. And to refinance its existing debt and provide working capital. We approved that, conditioned upon the completion of the Chessie acquisition because the analysis we had done, the projections D. & H. had provided, assumed that transaction; without that, the numbers were totally different, so the initial loan in January of 1976 was conditioned upon the Chessie transaction going forward. That was also a \$26 million loan. When the Chessie transaction came apart, there had been some fallback recommendation in the final system plan that required some implementing legislation adopted in the 4-R, concerning the line extensions. D. & H. felt they were essential we felt they were essential. We looked at how the system would work in that context, without the Chessie transaction, but with the line extensions, and we still felt a \$26 million loan was good.

Mr. ROONEY. Didn't the D. & H. use the moneys for expansion purposes rather than the original intent?

Mr. DICKIESON. No. The primary use of the money was for working capital. That is where most of it went. They bought the 20 locomotives.

Mr. ROONEY. But they expanded the system and it wasn't sufficient, so consequently they needed that additional money to take care of their present system, and then when it was expanded twice the size of the present system, they used it for expansion purposes.

Mr. DICKIESON. The expansion was primarily an operational expansion. They did not acquire many additional assets except for freight cars which we also conveyed to them as a result of the expansion.

Mr. FLORIO. Could you tell us again what happened to the locomotives?

Mr. DICKIESON. D. & H. bought 20 new locomotives with money they borrowed from us.

Mr. FLORIO. Those locomotives were used as security to justify the loan?

Mr. DICKIESON. Yes. We held a conditional sales agreement on the locomotives.

Mr. FLORIO. Then, what happened?

Mr. DICKIESON. In the fall of last year, when it became clear D. & H. was in serious financial difficulty and would not survive without us being able to get more money into it, D. & H. refinanced those same locomotives with a loan guarantee from the Federal Railroad Administration.

Mr. FLORIO. Refinanced the locomotives?

Mr. DICKIESON. Yes. FRA, in effect, bought our conditional sales agreement. We, in turn, used that to pay down the loan so the additional \$7 million could be——

Mr. FLORIO. How did you justify it?

Mr. DICKIESON. Because at that time we felt we could still make the finding—it was the only way to keep the company out of bankruptcy at that time. We felt, with new management coming in, there was a possibility that with that money, by the end of this year, they would reach an even cash flow position.

Mr. FLORIO. What was the security for the second loan?

Mr. DICKIESON. It was the remaining security we had under the first loan.

Mr. FLORIO. That is double talk. What you are saying is you had the locomotives.

Mr. DICKIESON. We had a pledge of \$12 million of bonds. We have a second mortgage on the entire system, and we also have the locomotives, so when we permitted them to refinance the locomotives, we kept the first mortgage bonds, and we kept the second mortgage in an increased amount.

Mr. FLORIO. Thank you.

Mr. DICKIESON. If we had not engaged in that transaction, the D. & H. would have been bankrupt earlier this year.

Mr. FLORIO. You can make the same argument again now. Why not roll over the original collateral and refinance with the same 20 locomotives.

Mr. DICKIESON. I don't think you can use the locomotives any further.

Mr. FLORIO. I think there is a question whether it should have been done the second time. To refinance those locomotives again, utilizing them again as security for the second loan, it seems to me is questionable at best.

Mr. DICKIESON. I agree. It was a difficult decision, but the Board made it in the hope that it would buy enough time to get the D. & H. to a position——

Mr. FLORIO. How long ago was that?

Mr. DICKIESON. That was January of this year.

Mr. FLORIO. What has changed so dramatically in the last 8 months so to change the projection of the market and traffic—it seems to me we are not talking about a couple of years ago.

Mr. DICKIESON. Despite considerably improved management and better operations, better service by the D. & H., the traffic decline has continued, and D. & H. is substantially below its projection for the future. With the traffic at the present levels, it simply cannot break even. Our hope had been, with the better operations, the better service, that they would regain enough traffic to break even.

Mr. FLORIO. What studies have you conducted from January of this year to lead you from such different projections than the ones you had in January to justify the loan the last time?

Mr. DICKIESON. We have 9 months fewer of projections and 9 months more of operating history.

Mr. YOCUM. Basically, what has happened is our worst suspicions have been confirmed. We had hoped there could be a turnaround with better service and better cost control. The volume has not come back. Most recently, of course, the serious problems associated with the N. & W. strike have accelerated—the crisis is much more real this month. We probably wouldn't be here right now if it weren't for that particular situation that made the findings impossible. They had been very difficult even before that.

Mr. FLORIO. Thank you.

Mr. ROONEY. As I understand, the expansion of the D. & H. was just to promote competition?

Mr. DICKIESON. That was the basic reason, although not only competition—we didn't feel the D. & H. could survive at all without the line extensions then and even today.

Mr. ROONEY. If the expansion was justified to promote competition, has the policy now been changed?

Mr. DICKIESON. No, not as far as we are concerned. Our problem is, for the reasons Mr. Florio pointed out, we can't make those findings any more. He was suggesting we shouldn't have made them as long as we did.

Mr. ROONEY. Now, we are back to the big ConRail concept. Is that correct? As I understand it, the Chessie was supposed to take over part of it. They backed out and ConRail—

Mr. DICKIESON. If Chessie had taken on the Erie Lackawanna, they would have been operating the historic route from Buffalo to where there would have been an interchange with the D. & H. at Binghamton.

Mr. ROONEY. Thank you very much. I appreciate your testimony.

Our next witness will be Mr. William H. Polk, executive engineer of the Pennsylvania Department of Transportation. Mr. Polk, we welcome you.

STATEMENT OF WILLIAM H. POLK, EXECUTIVE ENGINEER, OFFICE OF LOCAL AND AREA TRANSPORTATION, PENNSYLVANIA DEPARTMENT OF TRANSPORTATION, ACCOMPANIED BY GARETH W. ROSENAU, ASSISTANT ATTORNEY GENERAL, COMMONWEALTH OF PENNSYLVANIA

Mr. POLK. Good afternoon.

The Commonwealth of Pennsylvania truly appreciates this opportunity to appear before this committee and be heard on the very urgent matter of the Delaware and Hudson Railway, and its importance to our State and Nation.

My name is William H. Polk. I am executive engineer for the Office of Local and Area Transportation in the Pennsylvania Department of Transportation, which department has been designated by the Governor to coordinate with the Federal Railroad Administration on the State rail plan, and on the operation of light density lines excluded from the Federal final system plan. I am a civil engineer with many years of experience with freight and passenger railroads, as well as Government service dealing with transportation. I have been author-

ized to appear here today and testify on behalf of Penn-DOT by the deputy secretary for local and area transportation, Mr. E. L. Tennyson, who is charged by act 1200 of 1970 with this responsibility.

The U.S. Secretary of Transportation, in his comprehensive study of the Northeast and Midwest rail crisis 4 years ago, found that the preservation of rail competition in major markets, such as Boston to the west, and New York to the west, was essential to consumer interests and to the national interest. As a result, Congress established the U.E. Railway Association to plan the restructuring of the Northeast railroads so as to enhance viability and competition. Congress allowed the plan to take effect, but it never actually was consummated as planned and as legislated. The objectives of the legislation and of the plan have not been accomplished. Instead of competition, we have a tight constricting monopoly, and instead of viability, we have escalating losses and deteriorating service.

The Delaware and Hudson Railway is the key to this issue. Until 1976, the D. & H. was a profitable connecting line from northeast Pennsylvania to New York State, New England and Canada. It carried coal, newsprint, paper products, and general merchandise between the Pennsylvania Railroad, the Erie Lackawanna Railway and the Lehigh Valley Railroad in the northeastern Pennsylvania area of Wilkes-Barre and Scranton to and from the Boston and Maine R.R. the Vermont R.R. and the Canadian railroads in competition with the New York Central Railroad. As indicated in prior testimony this morning, when New York Central was merged into the Pennsylvania Railroad, D. & H. lost its competitive position with respect to the Pennsylvania Railroad because that carrier, first Penn Central, and now ConRail, took the traffic away from D. & H. to keep it on its own New York Central acquisition.

The D. & H. still had the Erie Lackawanna Railway with which to do business at Binghamton, N.Y., and Scranton, Pa., and the Lehigh Valley Railroad at Dupont, near Wilkes-Barre. It was hurt, but still viable, until USRA allowed ConRail to become a monopoly.

When USRA submitted its plan to Congress, it provided for the continued future viability of the D. & H. by providing that the Chessie system, in the form of the Baltimore and Ohio Railroad, would take over the Erie Lackawanna Railway and trackage rights on the Reading (Railway) Co. so as to offer competitive railroad transportation to all points served by the D. & H.

As students of this problem know well by this time, the Chessie acquisition of the Erie Lackawanna fell through. The plan approved by Congress never really took effect. It is true that USRA slipped a contingency alternative into the plan for this case, but it was never approved in the extensive public hearing process and it was never intended as a proper solution.

Because the law mandated competition, USRA bullwhipped the D. & H., a small 700-mile carrier, to take over some of what was to be an obligation of the Chessie, a 12,000-mile carrier, with economic strength in proportion to that. The D. & H. was forced to take a circuitous, overloaded route to Buffalo, for which they had and have to pay ConRail tribute on every car they move. They were also forced to

take on a flood damaged Penn Central line from Wilkes-Barre to Sunbury, Pa., with trackage rights to Enola, near Harrisburg to get main line connections to the Southwest. They were forced to take a circuitous route to Philadelphia for a B. & O. connection, but on none of these trackage rights were they permitted to accept or set off local business, except at Bethlehem, Pa. The D. & H. was allowed to serve Bethlehem Steel. Continuing east to Oak Island (Port of New York) they were denied the right to carry anything but unprofitable piggyback. The D. & H. was caught between the rock and the hard place. If they did not agree, they would have no connections to or from the South or West with a friendly railroad. They could not survive. If they did agree, only the future would show if they could double their operation overnight on unfriendly rails, pay tribute to their competitor on every car handled, and still pay their own bills. Rather than face certain demise, the D. & H. chose to take the risk. They could have won, they should have won, but because of USRA and ConRail, they lost. That is why we are here today.

In spite of these enervating and debilitating handicaps the D. & H. is still one of the most efficient rail carriers in the Northeast. It still has traffic, it still serves essential markets, it has shippers and communities totally dependent upon it, and it stimulates improved ConRail service by offering a choice to a few and a yardstick on performance for many.

Statistics show that the D. & H. has one of the most efficient operations of any Northeast railroad. How is it that we are on the verge of losing one of our most efficient railroads, while subsidizing the least efficient? Why did USRA refuse additional Federal aid to the D. & H. while they agreed to \$1¼ billion additional for ConRail?

Incidentally, there is another northeast carrier as efficient as the D. & H.: the Boston & Maine, up in New England. This, however, just adds to the irony of this situation. The B. & M. depends upon the D. & H. to do business with the outside world, via the Mechanicville, N.Y., gateway.

To quantify the values here involved, the Congress has given ConRail \$2½ billion to get back on its feet, but it has sunk deeper into the red, so Congress is preparing to give ConRail another \$1¼ billion because the Nation has no alternative. We need the rail service. In supporting ConRail, however, Congress has made it impossible for competitors to continue to exist. I know it was not Congress' intention to do this, but by allowing subversion of the original USRA plan, the present result became unavoidable.

What was done is done. What do we do about it? ConRail has used its size and location to strangle competitors, while losing its own shippers with poor service. USRA has documented this for Congress. Had the D. & H. and B. & M. been given equal encouragement, which in fairness, they needed, these two little railroads would have received \$125 million initially and another \$62½ million on tap. Instead, D. & H. got only \$27 million and has been refused a little more.

The irony of the USRA attitude is all the more frustrating and infuriating when it is seen that the D. & H. has been moving freight for an actual cost of 2¼ cents per ton per mile, when the same work

on ConRail cost 3 cents. Congress should take notice that the difference looks like only 0.75 cent per ton-mile, but it is 33 percent more via ConRail. If we apply that 33 percent higher ConRail cost to the \$170 million of work done by the D. & H. and the B. & M., it amounts to a public saving of \$57 million per year, yet USRA will not loan \$1 million more to save it. It appears that it does not help anybody for ConRail to divert traffic from its competitors. The more freight ConRail hauls, the more money ConRail loses, and at the same time efficient carriers are being destroyed. Congress must act on this problem. Congress must take steps for saving the D. & H. until the recommendations which will result from the section 401 FRA analysis can be implemented. Congress should and can save the D. & H., and in so doing will save the B. & M. and New England as well as shippers almost everywhere.

This is a complex problem. It is difficult to solve in one session. However, we can't wait. Payrolls must be met. Services must continue. Economies must be made. The Commonwealth of Pennsylvania has provided some State funds to help out. Additional Federal funding is desperately needed, immediately. In our judgment, such action would be a small price to pay. Actually think of it as an investment for rail viability. It will be recovered many times over.

Thank you for this opportunity to testify.

[Testimony resumes on p. 93.]

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

Before the Subcommittee on
TRANSPORTATION and COMMERCE OF
COMMITTEE ON INTERSTATE and FOREIGN COMMERCE
United States House of Representatives
August 15, 1978

The Commonwealth of Pennsylvania truly appreciates this opportunity to appear before this Committee and be heard on the very urgent matter of the Delaware & Hudson Railway, and its importance to our society. The Committee is to be commended for offering this opportunity for public expression.

My name is William H. Polk. I am Executive Engineer for the Office of Local and Area Transportation in the Pennsylvania Department of Transportation, which Department has been designated by the Governor to coordinate with the Federal Railroad Administration on the state rail plan, and on the operation of light density lines excluded from the federal Final System Plan. I am a Civil Engineer with many years of experience with freight and passenger railroads, as well as government service dealing with transportation. I have been authorized to appear here today and testify on behalf of PennDOT by the Deputy Secretary for Local and Area Transportation, Mr. E. L. Tennyson, who is charged by Act 120 of 1970 with this responsibility.

The United States Secretary of Transportation, in his comprehensive study of the Northeast and Midwest rail crisis four years ago, found that the preservation of rail competition in major markets, such as Boston to the west, and New York to the west, was essential to consumer interests and to the national interest. As a result, Congress established the United States Railway Association to plan the restructuring of the Northeast railroads so as to enhance viability and competition. Congress allowed the plan to take effect, but it never actually was consummated as planned and as legislated.

The objectives of the legislation and of the plan have not been accomplished. Instead of competition, we have a tight constricting monopoly, and instead of viability, we have escalating losses and deteriorating service.

I am not suggesting that Congress was at fault. Congress provided for competition and efficiency. Unfortunately, the United States Railway Association has not acted in the public interest, nor in strict accordance with the law, to the end that the intent of the legislation has been nullified and the taxpayer did not get what he paid for.

The Delaware & Hudson Railway is the key to this issue. Until 1976, The D&H was a profitable connecting line from northeast Pennsylvania to New York, New England and Canada. It carried coal, newsprint, paper products and general merchandise between The Pennsylvania Railroad, the Erie Lackawanna Railway and the Lehigh Valley Railroad in the Northeastern Pennsylvania area of Wilkes-Barre and Scranton to and from the Boston & Maine RR, the Vermont RR and the Canadian Railroads in competition with the New York Central Railroad. When New York Central was merged into The Pennsylvania Railroad, D&H lost its competitive position with respect to The Pennsylvania Railroad because that carrier, now Penn Central, took the traffic away from D&H to keep it on its own New York Central acquisition. This is why our Governor objected to the Penn Central merger. It was not only illegally monopolistic, in our view, because it was obviously in restraint of trade and unfairly damaging to competitors, but it also was economically undesirable and unsuccessful. It makes no sense to take direct movement traffic from a profitable railroad and reroute it not only to injure the profitable railroad, but to add cost to the consumer as well. The Governor appealed this merger to the United States Supreme Court, but his appeal was denied, since the Court did not yet realize that Penn Central was not viable.

The D&H still had the Erie-Lackawanna Railway with which to do business at Binghamton, New York and Scranton, Pennsylvania, and the Lehigh Valley Railroad at Dupont, near Wilkes-Barre. It was hurt, but still viable, until USRA allowed ConRail to become a total monopoly. Since April 1, 1976, USRA has made it impossible for the D&H to continue with traditional viability. The D&H ability to exist has been confiscated by USRA. The public interest has been totally subverted.

When USRA submitted its plan to Congress, it provided for the continued future viability of the D&H by providing that the Chessie System, in the form of the Baltimore & Ohio Railroad, would take over the Erie-Lackawanna Railway and trackage rights on the Reading (Railway) Company so as to offer competitive railroad transportation to all points served by the D&H and the B&O. The Chessie lines are well managed and profitable. They have a large freight car fleet. The D&H was to have access in all directions. PennDOT and our Governor still objected to the USRA plan for Consolidated Rail Corporation, because it was too large to manage and because it was too monopolistic, but we did agree that if we were to have ConRail over our objections, the Chessie acquisition of the E-L lines was strategic and essential, both economically and in the public interest.

As students of this problem now know, the Chessie acquisition of the E-L fell through. The plan approved by Congress never took effect. It is true that USRA slipped a contingency alternative into the plan for this case, but it was never approved in the extensive public hearing process and it was never intended as a proper solution.

Because the law mandated competition, USRA bullwhipped the D&H, a small 700-mile carrier, to take over the Chessie obligation, where Chessie was and is a 12,000-mile carrier, with economic strength in proportion. The D&H was

forced to take a circuitous, overloaded route to Buffalo, for which they had and have to pay Conrail tribute on every car they move. They were also forced to take on a flood damaged Penn Central line to Sunbury, Pennsylvania, with trackage rights to Enola, near Harrisburg to get main line connections to the southwest. They were forced to take a circuitous route to Philadelphia for a B&O connection, but on none of these trackage rights were they permitted to accept or set off local business. At Bethlehem, Pennsylvania The D&H was allowed to handle local business, but continuing on to Oak Island (Port of New York) they were denied the right to carry anything but unprofitable piggy-back. The D&H was caught between the rock and the hard place. If they did not agree, they would have no connections to or from the south or west with a friendly railroad. They could not survive. If they did agree, only the future would show if they could double their operation overnight on unfriendly rails, pay tribute to their competitor on every car handled, and still pay their own bills. Rather than face certain demise, The D&H chose to take the risk. They could have won, they should have won, but because of USRA and Conrail, they lost. That is why we are here. The USRA and Conrail have put to the wall the only profitable railroad in the Northeast, excepting a few short lines.

The D&H is still not a lost cause to the nation, or to the railroad system. It is a lost cause to its owners, however. The Congress need shed no tears for the owners of D&H. The owners are the Norfolk & Western Railway, which has already taken its tax loss advantages from D&H ownership and has refused to help D&H in any constructive way. There will be no confiscation, in our opinion, if N&W loses its \$1 equity in D&H. N&W's negative attitude toward piggy-back was one main reason for D&H's problem, since D&H must interline much of its piggy-back with N&W. The N&W is still very im-

portant to D&H, however, because it forms vital connecting links to the mid-west via Cleveland, Detroit, Chicago, St. Louis, Kansas City and Omaha. It also has a potentially vital link to the southwest via Roanoke, Knoxville, Atlanta, New Orleans and Memphis, but today Conrail has a link of this route under its own anti-competitive control.

The D&H also has vital Chessie connections at Philadelphia and Buffalo but only after paying Conrail tribute on the traffic exchanged. It is a sad commentary on USRA's view of competition when a small carrier must pay tribute to its large, government subsidized competitor, in order to do any business at all.

In spite of these enervating and debilitating handicaps, the D&H is still one of the most efficient rail carriers in the Northeast. It still has traffic, it still serves essential markets, it has shippers and communities totally dependent upon it, and it stimulates improved Conrail service by offering a choice to a few and a yardstick on performance for many.

In the first quarter of this calendar year, the first quarter under the new ICC accounting system, The D&H had the best results, meaning the least bad results, of any Class I railroad east of the Allegheny Mountains and north of the Mason-Dixon Line. True, the D&H lost money, but at a lesser rate than the efficient B&O, or the Western Maryland, or the Pittsburgh & Lake Erie, or the Bessemer & Lake Erie. It did far better than Conrail or the C&O. How is it that we are losing the most efficient railroad, while subsidizing the least efficient? Why did USRA refuse federal aid to The D&H while they agree to \$1¼ billion additional for Conrail? Perhaps we should put both Conrail and USRA under the anti-trust laws.

Let me inject here a slight correction of what I have just said. The D&H was not actually the most efficient of these carriers. The Boston & Maine was, up in New England, by a thin hair of one percentage point. This,

however, just adds to the irony of the situation. The B&M depends upon the D&H to do business with the outside world, via the Mechanicville, New York Gateway. It might be wise and appropriate to look at the B&M and the D&H as one strategic northeast system.

To quantify the values here involved, the Congress has given Conrail \$2½ billion to get back on its feet, but it has sunk deeper into the red, so Congress is giving Conrail another \$1½ billion because the nation has no alternative. We need the rail service. In supporting Conrail, however, Congress has made it impossible for competitors to continue to exist. I know it was not Congress' intention to do this, but by allowing subversion of the original USRA plan, the present result became unavoidable.

What was done is done. What do we do about it? We, the government, have "loaned" Conrail \$2½ billion with another \$1½ billion coming. Conrail has used its size and location to strangle competitors, while losing its own shippers with poor service. USRA has documented this for Congress. Had the D&H and B&M been given equal encouragement, which in fairness, they needed, these two little railroads would have received \$125 million initially and another \$62½ million on tap. Instead, D&H got only \$37 million, and has been refused a little more. The irony of the USRA attitude is all the more frustrating and infuriating when it is seen that The D&H has been moving freight for an actual cost of 2¼¢ per ton per mile, when the same work on Conrail cost 3¢. Congress should take notice that the difference looks like only 3/4 of a cent per ton-mile, but it is 33% more via Conrail. If we apply that 33% higher Conrail cost to the \$170 million of work done by The D&H and the B&M, it amounts to a public saving of \$57 million per year, yet USRA will not loan \$1 million more to save it. It does not help Conrail to destroy their competitors. The more freight they haul, the more money they lose.

It is most unfortunate that USRA did not make a viable plan for the solution of the Northeast and Midwest rail crisis. We still have the problem in worse form. We must recognize the huge subsidies to the interstate highway system and the St. Lawrence Seaway which diverted rail traffic and helped cause this problem. We must recognize the Penn Central merger resulted from incorrect analysis. We must now solve these problems. We cannot continue without a solution. Rail freight on the D&H moves for 2½¢ per ton mile and would move for 2¢ if we got it working right. The best that highway trucking can do with bulk commodities within the structural limits of highway loading is 4¢ to 5¢. We cannot afford to lose these railroads and spend twice as much on alternate transportation, for which we lack facilities, even if we had the billions to pay for it.

I might inject here that my statement concerning highway subsidies may not be understood. Congress levied a 4¢ per gallon tax to build the interstate system in 1955 thereabouts. The purchasing power of that tax now has declined to only 2¢. On the other hand, only 25% of the 4¢-a-gallon taxpayers use the interstates, so 75% of the facility has been paid for by non-users. This is called cross subsidy. It has been legislated illegal for rail application. Previously, railroads were expected to use cross subsidy to do business, but now it is no longer feasible or possible. That is why railroads cannot survive in their present economic posture against highway and seaway competition underwritten by the taxpayers. However, the economics of railroading are so favorable that the taxpayer cannot afford the alternatives, which would double the cost of transportation.

Congress must act on the problem. First, Congress might pass a resolution directing USRA to advance D&H and B&M up to half as much proportionately as USRA advances Conrail. To explain that, Conrail has received the equivalent of ten months total revenue in USRA loans. The D&H and

B&M should be allowed up to five months, i.e., half as much. That would be \$120 million to date, of which D&H got only \$37 million. For the immediate future, D&H needs another 2½ months worth, or \$30 million plus \$30 million for B&M. This is nowhere near proportional to Conrail, but only half as much in proportion. I justify only half as much because the B&M and the D&H are more efficient.

Should Congress do this, and we believe they must, there is the problem of paying it back. The ultimate payback is more efficient transportation than if it isn't done, but to satisfy the hard terms of loans, USRA should be directed to re-structure D&H a little bit. D&H needs and should be given a modest 75-mile trackage rights extension from Enola near Harrisburg to Hagerstown, where B&O, WM and N&W connections can be made for Cumberland (gateway to the west), Roanoke, the midwest, and the southwest. Trackage rights should also be granted to D&H over Conrail from Enola to York, and from New Freedom to Baltimore where friendly connections can be made to Potomac Yard, gateway to the south, over the shortest route. Conrail should be required to reduce their trackage rights charges to 4¢ per car mile so long as D&H has a lower operating ratio than Conrail. D&H should not be charged to pay their competitor's higher costs, which costs are federally subsidized. USRA should also designate that the Hagerstown route will not enter the main streets of Shippensburg or cross the main streets of Chambersburg, but will utilize alternate parallel trackage which avoids them. PennDOT offers trackage it owns to complete the link between York and New Freedom.

USRA should also designate D&H trackage rights via Conrail to Croxton and Jersey City from Binghamton via Scranton and Dover, N. J. This is a much shorter route than the tortuous 278-mile present route forced on D&H

by USRA. The new route would be open to all traffic, including local traffic. It will save 85 miles per car each way. It will give the New York metropolitan area the competition the original Secretary's report mandated. This short route will not solve the whole problem, however. The D&H now has unviable piggyback rights only between Bethlehem and Oak Island, N. J. in the New York Harbor via ConRail's former Lehigh Valley line. The D&H should be given unlimited trackage rights over the little used ConRail alternate line between these points via Raritan, N. J. This is not nearly so direct a route as the route via Dover but it reaches traffic sources not available to the short route. These D&H extensions will take nothing valuable away from ConRail, which does not use or need these routes for long haul purposes, and cannot afford to serve them for short haul only.

The D&H should also be given trackage rights by USRA to avoid the congested, circuitous Buffalo line when propitious, over ConRail track from Hornell via Jamestown, N. Y. and Meadville, Pennsylvania to Sharon, Pennsylvania where connections can be made with several profitable midwestern railroads. This route from Binghamton, N.Y. to Youngstown, Ohio would be 38 miles shorter for D&H users than the present route via Buffalo, which lacks one-carrier connections and suffers long yard delays.

A sketch map is attached to my testimony to outline the strategic nature of these minor adjustments to the rail linkage that will have such great leverage on viability. Congress should and can save the D&H and in so doing will save the B&M and New England, as well as shippers almost everywhere. The stimulation of effective, if modest, competition will improve service, increase revenue, and cut costs, cutting losses.

The D&H does not exist in a vacuum. The ConRail problems remain. Con-

rail must cut its costs and improve its revenue. This is obvious. Costs are not cut by eliminating service, and revenue is not increased with higher charges. The history of past railroading reveals the defeat that follows such unbusinesslike railroad practices.

Conrail costs will be cut by moving cars. Including its own cars, Conrail spends \$1 million per day on car rentals. This is preposterous. Conrail handles 5 million cars per year, and should not pay more than \$40 per car, or \$200 million per year. The savings from prompt car movement and good utilization are enormous. Such car movement will also increase revenue by attracting traffic that now pays more to go by highway to insure arrival at destination within reason. Conrail can also save millions on fleet maintenance. Conrail now spends above average on equipment maintenance for less than average results. Correction here will help. Track repairs will eliminate slow orders, if done properly, which will cut car time and crew time, saving money, and reducing taxi bills.

The problem remains, however, that Conrail is believed too large for effective management. It should not be abandoned down to size, but divided into three efficient size railroads with separate authority and responsibility, and separate accounting. Past studies have shown that 30,000 employees are a practical limit on railroad efficiency. (Healy, Tennyson).

A three system Conrail configuration might be:

- 1 - Northeast - Potomac Yard, Philadelphia, Harrisburg, Pittsburgh, New York, Connecticut, Rhode Island, Massachusetts, including Poughkeepsie bridge. Pittsburgh would be electrified for many reasons.
- 2 - Great Lakes - Boston, Albany, New York east shore, Buffalo, Detroit, Cleveland, Indianapolis, Chicago, Toledo, Columbus, West Virginia, Youngstown, Pittsburgh.

3 - Buckeye - Pittsburgh, Columbus, Indianapolis, St. Louis, Akron, Cleveland, Detroit, Canton, Lima, Cincinnati, Louisville.

The viability of the Great Lakes and Buckeye systems seems assured. The Northeast system will be a problem, but that problem can be solved by Amtrak subsidies for the Northeast Corridor and token rentals charged to the Northeast freight system. There should be no loss on electrified operation of the most dense main line in America between Pittsburgh and Harrisburg, and much of the balance is owned by Amtrak, already supported by government, as is the urban transit network in every American and Canadian city, whether bus, rail, or water.

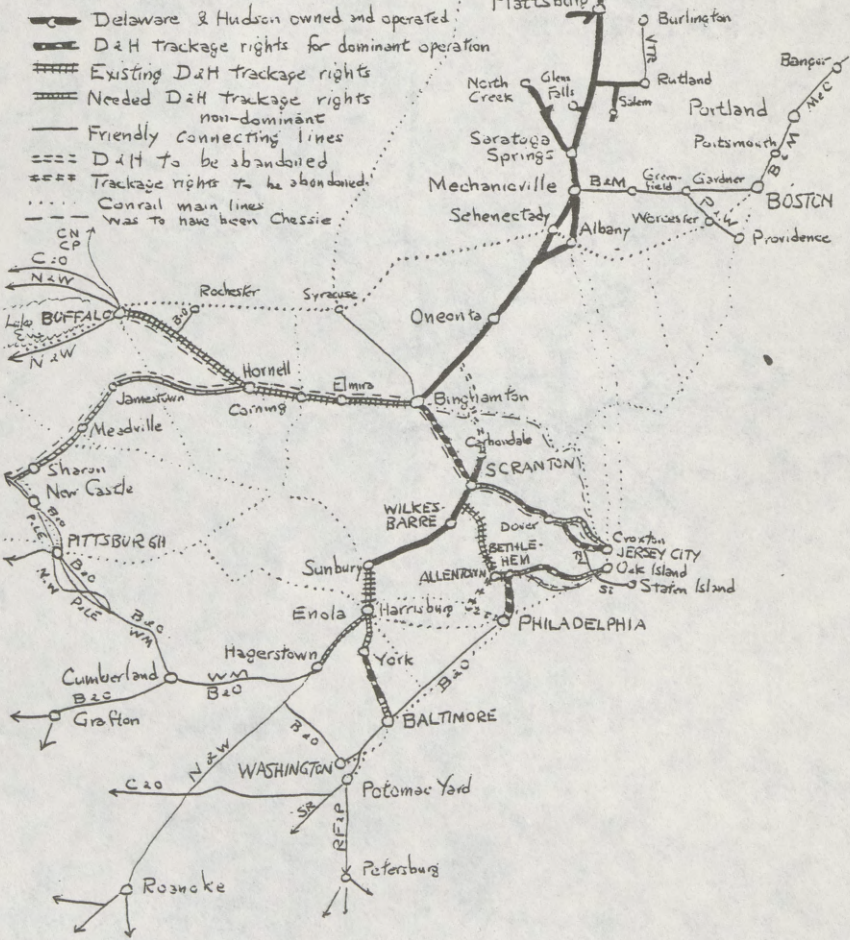
This is a complex problem. It is difficult to solve in one session. However, we can't wait. Payrolls must be met. Services must continue. Economies must be made. Pennsylvania believes that the D&H and B&M problems can be solved quickly and effectively by a simple resolution directing USRA to take the necessary action. Modest funding authorization, not to exceed \$60 million may also be necessary. This is a small price to pay for rail viability and will be recovered many times over.

Conrail's board, under USRA enlightened guidance, can begin the decentralization process immediately, with accounting changes to account for the three systems separately. Some arbitrary form of revenue credit can be developed internally to report on operational effectiveness until complete separation is achieved. The Chairman of Conrail can function as the Chairman of AT&T or General Motors, presiding over operating subsidiaries which are carefully monitored for individual efficiency, and which are promptly responsive to needed changes and corrections.

We certainly do thank you for this opportunity, and we appreciate it greatly. If you have any questions, I will try to answer them or seek the correct answers.

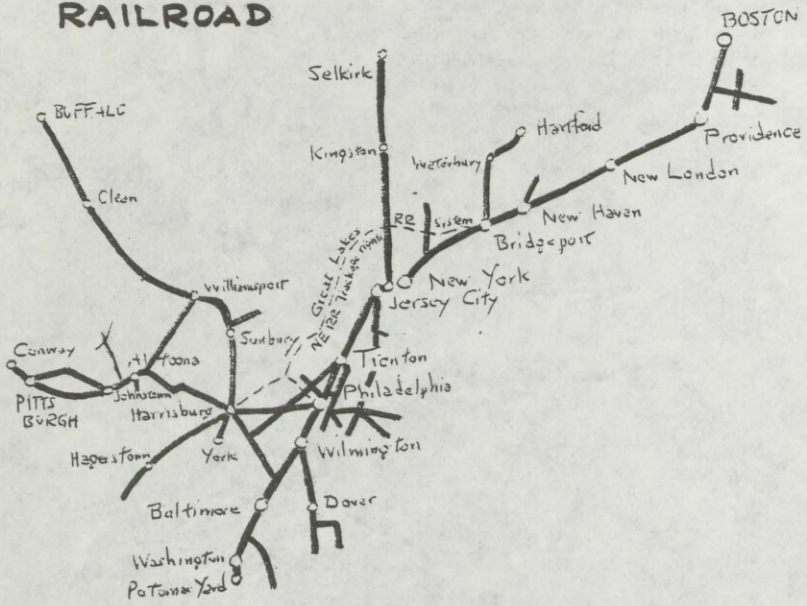
THE DELAWARE & HUDSON RAILWAY RESTRUCTURED

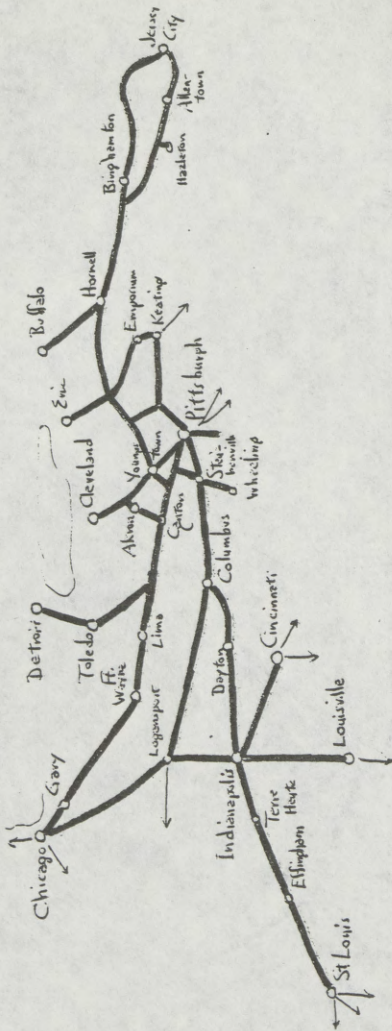
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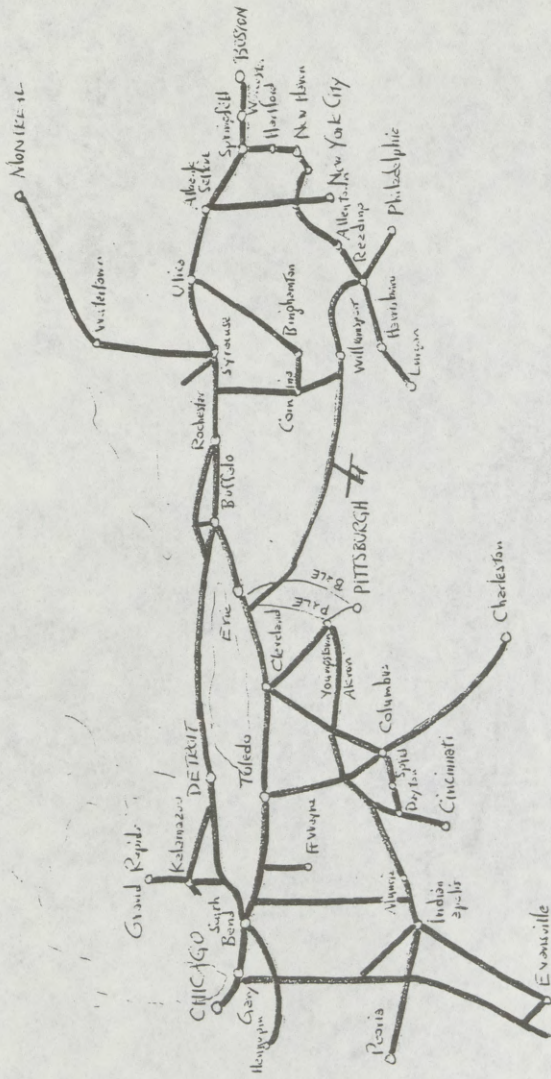
CONRAIL DECENTRALIZED

THE NORTHEAST RAILROAD





CON RAIL
DECENTRALIZED
BUCKEYE RR SYSTEM



CON RAIL DECENTRALIZED GREAT LAKES RR SYSTEM

Mr. ROONEY. Thank you. You have been a great help to the Commonwealth of Pennsylvania in trying to resolve some of the problems the railroads have, especially in the Northeast. I appreciate the great help you have given me. Both you and Mr. Tennyson have been very helpful to this committee, and I am deeply appreciative of your support.

I know my colleague from New Jersey has another appointment, so I will yield to the gentleman from New Jersey.

Mr. FLORIO. You have heard the other witnesses that there appears no way short of bankruptcy, FRA and USRA feel, any governmental assistance can be provided.

In your conclusion, you said that the Congress should assist. Are you suggesting a direct appropriation of assistance?

Mr. POLK. I am not prepared, Mr. Congressman, to identify precisely what form that assistance should take. I would only say I think it would be very regrettable if the recourse to bankruptcy was the one we ended up with.

Mr. FLORIO. Why? Assuming we are talking about an interest in preserving the service, there are apparently, some mechanisms from the ICC such as directed services that bankruptcy does not mean that the service is going to be automatically terminated other than the stigma of bankruptcy, what is it that you are concerned about?

Mr. POLK. I am sure there is something of the stigma of bankruptcy. I worked with the Milwaukee Road, and I was with it when it was bankrupt. I think there is something about a bankrupt corporation that creates an adverse attitude among both the customers of that railroad and among the workers, and I am sure there are more substantial reasons than what I am touching on there. I really hope that ways can be found to avoid a bankruptcy. I know I don't know all there is on both sides of this question, and the reasons that were cited or the arguments that were cited here earlier today that there may be some advantages of bankruptcy are something I would like to hear more about. At this moment, I would hope, from what I know, and what experience I have had, that bankruptcy could be avoided, at this time.

Mr. FLORIO. Thank you.

Mr. ROONEY. On page 6 of your statement, you say:

If we apply that 33 percent higher ConRail cost to the \$170 million of work done by the D. & H. and the B. & M., it amounts to a public savings of \$57 million per year, yet USRA will not loan \$1 million more to save it.

You refute something that a previous witness has said. I think that hereafter, this staff is going to be directed to arrange for panel discussions rather than just hear individual testimony. With singular presentations everyone gives their testimony and leaves. There is little opportunity for counter questioning, other than the fact they said this and they said that. From here on in, I think I am going to order my staff director, when we have something as serious as this, to arrange for panel discussions so that one witness can refute the other witness.

On page 8 of your testimony, you state ConRail should be required to reduce their trackage rights charges to 4 cents per car mile. What does ConRail charge at the present time?

Mr. POLK. I am sorry, I don't know precisely what they charge.

Mr. ROONEY. Perhaps you can get that information and give it to us.
Mr. POLK. Yes, I would be glad to get that information for you.
[The following information was received for the record:]

ConRail presently charges D&H 10 cents per car mile.

Mr. ROONEY. Would you indicate how much the Commonwealth of Pennsylvania gave the D. & H. railroad in the past year?

Mr. POLK. We recently entered into an agreement with the D. & H. which provides something in the order of \$390,000.

Mr. ROONEY. Was it a loan or a grant?

Mr. POLK. That was a grant, similar to other programs that the Commonwealth has for purchasing service from transportation carriers. They are providing service benefits to the Commonwealth of Pennsylvania by their continued operation.

Mr. ROONEY. Why does the Commonwealth believe that these funds can be given to the railroad without conditions being imposed such as by the Federal Government, with the assurance it is going to be repaid. Perhaps your colleague might want to comment, or yourself.

Mr. POLK. Perhaps both of us. I would say we saw a desperate situation. The Governor is very concerned about the railroad system generally in the Commonwealth, its importance to the Commonwealth. He was especially concerned about the situation of the Delaware and Hudson. He shares, I think, a view that is shared by Governor Carey and others in States served by the D. & H., and he asked us to come up with some ideas of what could be done to help bridge this gap or this problem, help carry the railroad through long enough until action could be taken at the Federal level. I think that is our role, one of providing, admittedly, a small amount of money in the total picture, not a small amount to us in the Department of Transportation.

Mr. ROSENAU. I might add, the statutory framework under which the Commonwealth is operating in giving this money to the D. & H. contemplates grants rather than loans, so we have the statutory authority to give grants to carriers.

Mr. ROONEY. How can a bankrupt State like Pennsylvania give a bankrupt railroad additional moneys?

Mr. ROSENAU. Maybe it is the blind leading the blind.

Mr. POLK. I am sure you are referring to the highway problems.

Mr. ROONEY. That is what I am talking about—transportation.

Mr. POLK. It happens our public transportation assistance programs, out of which these funds came, are out of the general fund. The general fund is furnished or it is based upon the income tax, the sales tax and other sources, not the motor vehicle fund.

Mr. ROONEY. What is the problem with the transportation fund in the Commonwealth of Pennsylvania—the failure of the legislature to appropriate additional gasoline taxes—is that it?

Mr. POLK. Yes; and it goes back perhaps a little further than that. It goes back to the time—Pennsylvania has probably more miles of State-owned and State-maintained highways than many others, if not all of the States. We have 44,000 miles of State-owned and maintained highways, more than New York and all of the New England States and New Jersey combined. We built a lot of highways during the 1960's, and in doing so, when we finished the State part of that con-

struction, in some cases it was 100 percent, in others it was a shared Federal-State combination, but the State funding portion was bond financed, and we found ourselves, a few years ago, heavily involved with debt service for what we had done in the past, and it is that debt service that is making it extremely difficult plus the rising costs of maintaining our existing system. As you said, the legislature has not seen it in their wisdom at this time to provide any additional gasoline tax funding.

Mr. ROONEY. As you may recall, back in the late 1950's and early 1960's, I was the chairman of that State highway committee. Perhaps I should have stayed there. After today's hearing I may wish I had.

Thank you very much, Mr. Polk. I appreciate very much your testimony and great cooperation.

Now, we will hear from the Honorable William C. Hennessey, the commissioner of the New York Department of Transportation.

STATEMENT OF WILLIAM C. HENNESSEY, COMMISSIONER OF TRANSPORTATION, NEW YORK STATE DEPARTMENT OF TRANSPORTATION, ACCOMPANIED BY LOUIS ROSSI, RAIL ADMINISTRATOR

Mr. HENNESSEY. Mr. Chairman, with me today is the rail administrator for the Department of Transportation in New York State, Louis Rossi.

I am here today to offer my views on the financial condition of the Delaware and Hudson Railway, and what can be done about it. I am here today representing New York State as part owner of the D. & H. In 4 years, we have invested almost \$25 million in the railroad for track and equipment improvements to which we have title. It is not a loan, it was a grant, and we today enjoy the partnership role that we have with D. & H., and we would like to keep it that way, and it offends me very much to see the leading Federal agencies here today espousing bankruptcy, the same leading agencies that put the railroad in the near-bankrupt position they are in today. You will find that perhaps I will be deviating from my testimony, as I go along, but you will find that same hard theme throughout the whole thing.

Mr. ROONEY. You are recognized for 10 minutes. Your statement will become part of the record, and you may summarize.

Mr. HENNESSEY. I will summarize it and you may gong me. I too, think it is ironic.

Mr. ROONEY. With Hennessey, Carey and Rooney, this thing has got to move and Murphy—where is Murphy?

Mr. HENNESSEY. I like your style, Mr. Chairman. Your press release, too, is very well written, and I agree with it in every regard. It was a good piece of work, and I think that it should be circulated throughout the whole railroad world.

Congressman Hanley spoke of the chronology of the D. & H. history, and I am not going to delve on that. My paper goes into that in great detail. It does answer some of the questions that you have raised here, and in answer to your last question, I believe that rate is 10 cents a car, if you are interested in that little bit of trivia.

In 1967, one of the things we have to remember is that ICC testified today in their style of bankruptcy, and I wonder about the mood of ICC in testifying in that fashion. If something comes up in front of them, perhaps, in a year or so, they may well have pointed the D. & H. toward bankruptcy today, and that bothers me more than just somewhat. It is the same ICC that spun off \$20 million of the D. & H. hard cash at a time when they should have been stashing it away for their own operations in the years to come. That \$20 million still isn't accounted for to this day. As Congressman Hanley said, we at DOT may have something more to say about that as time goes on, and during the N. & W. ownership, they compelled dividends year after year. I don't know whether it was wise or not. They purchased new cars, perhaps for tax reasons, and then mortgaged the cars a year later, and there are a lot of things involved in those years that perhaps, with a little better management, with a little better parenthood, we wouldn't be where we are today. Insofar as USRA is concerned, it is more than just this \$26 million that we are talking about. D. & H. asks USRA for \$37 million to start with, they get \$26 million, and besides that, they get an additional part of money that they have to pay back with, in total, amounts to \$57 million when one starts to add on the original equipment that they had to take on with the expansions. They took on a debt with that equipment, so at one time, they faced a debt of \$57 million instead of this \$26 million we are talking about today.

USRA has not been quite fair, I don't think, in the way they have handled the D. & H. in comparison to ConRail. You know perfectly well, I don't go around kicking ConRail. I think ConRail is doing a pretty good job.

Mr. ROONEY. It is the only ballgame in town.

Mr. HENNESSEY. That is right, and I am going to play in that game. They, in New York are trying to provide the services we need. We look over them. We are a watchdog. We get into the bowels of their organization and they let us and I think it pays off in the long run, but insofar as our relationship with ConRail is concerned, and our relationship with D. & H. is concerned, I don't see any difference. I would like to see the D. & H. treated in the same fashion as we treat ConRail. Just because it is a little railroad, I don't think it should be used as a toy for the bureaucrats in Washington to deal with. Leave them alone. If they were given \$26 million, give them the \$26 million and let them manage in a railroad-like fashion. I think perhaps they can make some wise management decisions if we leave them alone and don't saddle them with a lot of extraneous things they have to accomplish when they take on these loans.

I would like to just quickly go through some actions that we would recommend, and I start on page 4, and I am not going to read all of the details of each of these actions, but the first thing, we know perfectly well—that further D. & H. funding has to be authorized. When Congressman Florio asked about the type of funding, I think appropriation would be perfectly all right. I think any signal to USRA they better point up that \$2.3 million at this time is the proper way to go. I know, if you took the lead in that regard, Mr. Chairman, there would be a lot of us praying for you at night. If that has any weight, if we are allowed to talk like that. Also, that D. & H. outstanding Federal loan

obligations be converted to grants. I don't think that should be too hard to do. When we were talking about buying this railroad ourselves, we were talking about a writeoff of all of those obligations, and that would have to be done in any event, and surely if it is a bankrupt railroad—I notice that the people from USRA and FRA fidgeted something awful when you asked them about that money in the future—I don't have any shyness at all about saying you can kiss that money goodbye if D. & H. goes into bankruptcy—you and I both know that. I think we ought to try to keep D. & H. alive. Lets keep this thing going, at least give it a little breath of life.

An immediate Federal operating and marketing plan should be developed—these people were fidgeting all over the place again. They didn't tell you they hadn't started that 401 study yet. I think it is time that 401 study got underway, and got done and somebody better start taking the lead on it and as far as the D. & H.'s future is concerned, I think they better start having an interim plan between the \$2.3 million and the final or we are not going to be out of the woods in 6 months when we have to do this again.

Finally, an immediate review of the operating rights arrangements between D. & H. and ConRail from USRA. I think ConRail ought to be thinking about giving up some of their good runs. I think ConRail ought to be able to at least consider some of the things we are talking about with ConRail. ConRail day after day is trying to deal with these kinds of situations, and they know what is good for D. & H., and when ICC testified today that Oak Island was a bad investment, it wasn't—that is wrong. Oak Island is a valuable investment. We may see D. & H. turning that into a valuable piece of real estate one of these days. They have things going on right now that may prove Oak Island is workable and doable. We have to give them a chance to get their management house in order. I think all of this would lead to a fair establishment of rates. This is one of the things we are talking about in trying to deal with the ConRail and D. & H. relationships. D. & H. needs a better rate overall of these things. I am over to page 6, now.

Over 2 years have elapsed without D. & H. and ConRail having resolved these matters or sent them to arbitration. These are the kinds of rates I was just talking about and the kinds of privileges D. & H. could exercise. USRA must be called upon to settle these questions fairly, in the interests of both parties. D. & H. is paying to ConRail annual fees exceeding \$6 million. If I were president of D. & H. today, I might say, get lost, that \$6 million will just keep me out of bankruptcy the next 2 years, and sue me if you want to but there is a pot of money. In this business of bankruptcy, is that marginal? I think that perhaps there are ways we can deal with this thing besides just saying, let's designate an operator and get it into the courts. In all, if only the ownership component of these fees were capitalized, in only a few years they would exceed the total purchase price of these segments to Chessie; leaving D. & H., in effect, the money to pay the maintenance costs. ConRail doesn't pay even the maintenance costs as these funds came from Federal loans on which ConRail owes no interest or principal for several years. As it is unclear who owes money to who, D. & H. should be authorized to temporarily suspend its payments to ConRail until USRA resolves these nuclear elements of the final system plan.

And, I would just like to close—I have made some notes on the previous testimony, just a little bit, but just to take a few liberties, and I would like to say, never before, to my knowledge, has our Government meddled in the affairs of a private corporation to the extent USRA, FRA, and the Treasury have in the case of the D. & H. They have control of the board of directors, have compelled management changes so not one single person making more than \$30,000 is there today that was there when this deal was cut. In my mind, Mr. Chairman, this whole scenario has been played to the tune of the Fishwick trot and New York still wants to save the D. & H. We are still willing to pay our fair share, and we are still willing to pay even more.

In summary, Federal involvement in railroading created D. & H.'s current plight, but the answer is not for the Government to turn its back and walk away now. D. & H. must be afforded more time to plot its future, must be relieved of the strangling financial obligations it was forced to undertake as a result of Federal planning. If the four steps I have identified are followed, I am confident a self-sustaining D. & H. is achievable. I ask you to back us in this support, Mr. Chairman.

[Testimony resumes on p. 101.]

[Mr. Hennessey's prepared statement and attachment follow:]

STATEMENT OF WILLIAM C. HENNESSY, COMMISSIONER OF TRANSPORTATION,
STATE OF NEW YORK

Congressman Rooney and members of the Subcommittee on Transportation and Commerce, I am very pleased to be here today to offer my views on the financial condition of the Delaware and Hudson Railway and what can be done about it. At the outset, I'd like to make it perfectly clear that I'm here representing New York State as part owner of the D&H. Since 1974 we have invested almost \$25 million in the railroad for track and equipment improvements to which we have title. The collateral to the federal loans, in fact, specifically exclude New York's properties.

I too think it's ironic, as expressed in your July 31, 1978 press release, that a transportation company can operate at a profit for 150 years, and within two years after being assisted by the Federal government, it is on the brink of bankruptcy. A simple chronology is instructive.

THE D. & H. PROBLEM: A CHRONOLOGY OF FEDERAL BUNGLING

First, the ICC

1967:

ICC approves D&H inclusion in N&W system specifying N&W's preferred plan of stock control rather than merger.

ICC sets inclusion conditions that were never monitored or enforced (such as unified management and greater equipment availability).

ICC permits spin-off of \$20 million in D&H working capital; this was the working capital which could have kept D&H solvent right up to today without the subsequent USRA loans.

1968-1970:

N&W compels D&H to declare dividends it could ill afford to prop up the EL (another flaw in the ICC merger decision).

D&H purchases 200 new box cars for \$3.2 million in cash in 1969, possibly at the behest of N&W to take advantage of a bonanza provided by the Tax Reform Act of 1969. D&H could not spare the cash.

Post 1970:

In 1971, one year after declaring a \$2 million dividend, D&H mortgages 200 box cars (remember the ones purchased new in 1969?) to raise cash.

N&W uses D&H losses for tax savings (in part created by placing D&H on accelerated depreciation). Tax credits alone give N&W in excess of 4% return on its investment in D&H.

D&H leases N&W locomotives—one of the original ICC merger stipulations.

Next USRA

October 1975:

D&H asks USRA for \$37.5 million loan to refinance debt and gain debt service relief.

January 1976:

USRA Board authorizes only \$26 million.

February 1976:

Chessie declines Final System Plan designations. USRA then conditions loan upon acceptance by D&H of trackage rights to Buffalo, Philadelphia and Potomac Yard. Rather than increasing the amount of the loan to D&H to cover a doubling of operational size, USRA accelerates drawdown of loan and changes the use of a significant portion of the loan from debt refinancing to working capital.

March 1976:

USRA denies D&H request for additional designations and traffic solicitation rights. Worse yet, USRA, after little or no analysis, approves conveyance of encumbered equipment to D&H under Conditional Sales Agreements involving lease payments totaling \$28.9 million over and above the loan itself.

In all, instead of a \$37.5 million loan and no service extensions, USRA concocted and saddled D&H with an ill-fated scheme in which the railroad assumed total liabilities of \$57.0 million.

April-May 1978:

USRA undertakes an eight week intensive effort to develop a refinancing scheme for \$1.7 million in D&H corporate debt due April 1, 1978. In the end, USRA gave away part of its collateral. Only a month earlier, USRA had approved payment of another debt, due after this one.

August 1978:

USRA disapproves further drawdown on D&H loan using the short-term cash crises created by the N&W strike as an excuse to halt long-term loans. This was done despite positive progress—a \$300,000 grant to D&H from Pennsylvania, a new service situation worked out by NYSDOT with D&H, Chessie, GN&W and Conrail involving salt traffic and a rearranged grant program from New York State.

In the case of D&H, all we have seen is one hasty federal action followed by another hasty federal action.

Keeping true to form, USDOT, Treasury and USRA now advocate bankruptcy as a "solution" for D&H; few outsiders can see any advantage to bankruptcy in terms of readily available assistance or cash benefits to the Company. I think this Subcommittee should insist that each of these agencies explain in detail just what benefits each sees to bankruptcy and specifically just what each would do to help D&H in bankruptcy. Everything we see in New York indicates that bankruptcy will precipitate a crisis situation leading to cessation of service.

Congress found that federal intervention in the Northeast/Midwest railroad-ing situation earlier this decade was necessary, and the best planning money could buy, said that the Final System Plan was the appropriate way to proceed. Even more so today after nearly two and a half years of Conrail and an extended D&H there are no alternatives. The federal government must complete the task it undertook when it implemented the Final System Plan and make D&H succeed.

Specifically, with regard to the D&H, completing this task now requires four actions:

1. That further D&H funding be authorized. At this crucial juncture with the FRA conducting its mandated Section 401 study of the D&H and the USRA reviewing New England railroading, the D&H may soon require added financial assistance beyond current authorizations to carry it through the coming winter. New York State is also actively considering its appropriate role should the railroad fail. These efforts will reveal the future options for the D&H and how they can be achieved, but the coming year or so necessary to complete the studies must be secured through further authorization of federal funding.

2. That D&H's outstanding federal loan obligations be converted to grants. I think we would all have to agree that the federal government bears the responsibility for the failure of D&H to be able to repay its federal loans. These loans, predicated on hasty analysis should be wiped off the books. Not only would immediate elimination of this debt provide immediate relief to the railroad, it would give D&H a chance to attract private financing, and should the long-term

answer be a merger with a viable carrier, loan forgiveness would most likely be one necessary ingredient. Finally, it should wipe-out the chance of a potential Tucker Act claim by N&W, particularly when acceptance of the Board's plan for extended service was a condition precedent to the loans (see attachment).

3. An immediate federal operating and marketing plan should be developed. Conrail obtained this benefit as a result of the \$40 million studies leading to the Final System Plan; D&H never got the benefit of such an effort. We estimate that a minimum of \$1 million in annual operating savings and \$4.5 million annually in new revenues can be generated.

4. An immediate review of the operating rights arrangements between D&H and Conrail from USRA. This should lead to:

a. Establishment of a fair charge;

b. Resolution of D&H's rights to utilize vacant yards and terminals, jointly manage dispatching, and all other operating disputes; and

c. Establishment of D&H's rights to traffic at Buffalo and Niagara Falls, Allentown-Bethlehem, Oak Island and the Port of New York, which are the three big market centers D&H serves jointly with Conrail.

Over two years have elapsed without D&H and Conrail having resolved these matters or sent them to arbitration. USRA must be called upon to settle these questions fairly, in the interests of both parties. D&H is paying to Conrail annual usage fees exceeding \$6 million. In all, if only the ownership component of these fees were capitalized, in only a few years they would exceed the total purchase price of these segments to Chessie; leaving D&H, in effect, the money to pay the maintenance costs. Conrail doesn't pay even the maintenance costs as these funds came from federal loans on which Conrail owes no interest or principal for several years. As it is unclear who owes money to who, D&H should be authorized to temporarily suspend its payments to Conrail until USRA resolves these unclear elements of the Final System Plan.

As you know, New York has supported this Subcommittee's view that Conrail is succeeding and that to fulfill its role additional assistance and time should be extended to Conrail. But to keep the funding of D&H in proper perspective, it must be remembered that Conrail, which operates a plant about twenty times larger than D&H's, will receive assistance over one hundred times greater than D&H. Conrail does not even have to begin to pay its loans back for decades; D&H has already paid back interest equal to one-twentieth of its loan obligations. In fact, the cost of the federal plan for Conrail, all by itself, exceeds the amount of assistance given to D&H.

In summary, federal involvement in railroading created D&H's current plight but the answer is not for the government to turn its back and walk away: the D&H must be afforded more time to plot its future and must be relieved of the strangling financial obligations it was forced to undertake as a result of federal planning. If the four steps I identified are followed-through, I am confident that a self-sustaining D&H is achievable in 1979.

I, Donald C. Cole, do hereby certify that the following resolution is a true and correct copy of a resolution adopted at a meeting of the Board of Directors of the United States Railway Association on March 3, 1976.

In Witness Whereof, I have affixed my name as Secretary and have caused the corporate seal of said Corporation to be fixed hereto.

DONALD C. COLE,
Secretary.

RESOLUTION

Whereas the Board of Directors, on February 19, 1976, upon further consideration, approved a loan from the Association to the Delaware and Hudson Railway (D&H) in the principal amount of \$26,000,000 subject to certain terms and conditions; and

Whereas such loan was premised on financial projections which did not centerplate trackage rights from Allentown, Pa., to Oak Island Yard (Newark), New Jersey; and

Whereas the Board has subsequently offered such additional trackage rights to the D&H; and

Whereas, the Board has considered further the loan application of the D&H and has determined that the loan authorized by these resolutions will be made on terms and conditions which furnish reasonable assurance that D&H

will be able to repay the loan within the time fixed and that the goals of the Regional Rail Reorganization Act of 1973, as amended, are reasonably likely to be achieved: Now, therefore, be it

Resolved, That (1) A loan from the Association to D&H in the principal amount of \$28,000,000 be, and it hereby is, approved subject to the terms and conditions set forth in paragraphs 2, 3 and 4 of this resolution; (2) The acceptance by D&H of the additional offers of trackage rights to Buffalo, N.Y. (via the present Erie Lackawanna Railway); Philadelphia, Pa., and Potomac Yard, Washington, D.C. (via the present Penn Central), and to Oak Island, (Newark), New Jersey, shall all be conditions precedent to the Association's consummation of the loan approved in this resolution; and (3) That the loan Agreement shall provide for a term of 15 years and shall require the maximum security for the loan which D&H can reasonably provide which security will specifically include the pledge of the D&H stock and other offers set forth in the letter of November 28, 1975 from the President of the Norfolk and Western Railway Company to the Association.

Mr. ROONEY. Thank you. You sound like Mayor Koch.

Mr. HENNESSEY. Thank you.

Mr. ROONEY. You said that New York State has an investment in D. & H. How much of an investment do you have in D. & H.?

Mr. HENNESSEY. \$24 million.

Mr. ROONEY. Do you think it will ever be repaid?

Mr. HENNESSEY. We are not going to ask for it. It is worth that much to us to know D. & H. is in existence. That the industries that the D. & H. support and one of the things that bothers me more than anything else about today's hearings is the nonchalant attitude the Federal agencies have about bankruptcies. We have had 6 bankrupt railroads in New York State, and we have some experience. We saved the New York industry in New York State with our rail transportation bond, \$1 billion.

Mr. ROONEY. You saved millions and millions of jobs in the State.

Mr. HENNESSEY. Exactly.

Mr. ROONEY. This committee, I think, 2 years ago, gave the State of New York \$49,040,000. They asked for \$50 million for the Olympics, and I knocked out \$960,000 for ABC. I didn't think Howard Cosell should have a Taj Mahal for himself. It is an investment. People are going to be at work, going to be enjoying the Olympics in 1980 in New York State. I agree with you wholeheartedly in your statement today. I commend you and Governor Carey and your transportation committee in the State for trying to save a railroad such as the D. & H., serving that Northeast part of this country.

Mr. HENNESSEY. Thank you, Mr. Chairman.

Mr. ROONEY. I extend my solicitations to my former colleague Governor Carey.

Mr. HENNESSEY. Thank you very much. He would like that.

Mr. ROONEY. Our next witness will be Mr. Robert B. Claytor, the executive vice president of the Norfolk & Western Railway Co., but before that, I think the committee is going to take a 10-minute recess so I can find out what is going on on the floor.

[Brief recess.]

Mr. ROONEY. We are under the 5-minute rule. I understand there has been no time set for a vote, so we will hear from Mr. Claytor as scheduled. Mr. Claytor, you are recognized for 10 minutes.

Mr. CLAYTOR. I will try to keep it to that, Mr. Chairman.

STATEMENT OF ROBERT B. CLAYTOR, EXECUTIVE VICE PRESIDENT, NORFOLK & WESTERN RAILWAY CO.

Mr. CLAYTOR. Mr. Chairman, thank you very much for this opportunity to appear before this committee. I am Robert B. Claytor, executive vice president and a director of Norfolk & Western Railway Co. Since 1968, I have served as a director of Delaware & Hudson Railway Co. I guess that makes me the longest serving D. & H. director. My prepared statement has been distributed, and with your permission, I would like to file it with the committee. [See p. 105.]

Mr. ROONEY. Without objection, your statement will become part of the record and you may summarize it.

Mr. CLAYTOR. I suppose the N. & W. has been painted as the villain. I will do my best to try to dissuade you.

Mr. ROONEY. That is one of the reasons I said hereafter, we are going to have negotiation sessions. We will have a panel discussion because everybody makes a statement and leaves the room, and there is no time for rebuttal.

Mr. CLAYTOR. I certainly agree with you. I think we could make more progress because we are here to try to develop the facts rather than have argument seriatim to try to reach a conclusion that way. I will try to be helpful to you and tell you what the role of the N. & W. has been in this. Our role basically, is the stockholder of the D. & H., which, of course, is a very sick railroad. If I could go back in history just a little bit. D. & H. had petitioned the Interstate Commerce Commission in 1965 for inclusion in the then existing N. & W. system. Such a petition was filed, and the Commission compelled the N. & W. to acquire control of the D. & H. Now, in the inclusion case, the N. & W. opposed the inclusion of the D. & H. in its system—it did not fit properly. D. & H. was not concerned it would be harmed by the N. & W. merger, but rather feared that the proposed Pennsylvania-New York Central system would take away its business and it would be harmed if it did not find a home with the N. & W. We agreed the Penn Central would harm the D. & H. and it did. In fact, the Commission found in its case back in 1964 that the N. & W. merger would have no harmful effects on the D. & H. N. & W. paid full value for the D. & H. assets. In fact, it has to be by anyone's measure, an inflated value.

The fair market value of N. & W. shares of stock and the note which we issued to acquire control of the D. & H. at the time was approximately \$42 million. While the D. & H. has been operated as a separate company, certainly in its own interest, N. & W. has provided the requested management assistance and equipment. We put the full force of our soliciting people all throughout the United States for the D. & H. We have not asked D. & H. to do that in return for us. They can solicit freight anyway they want.

While D. & H. is independently managed in the past, we have provided key personnel for technical assistance to resolve particular problems. We have leased equipment to the D. & H., including locomotives, hoppers, gondolas. We have cooperated with the D. & H. in the solicitation of traffic and the establishment of joint rates and routes.

As you have heard earlier, as a bridge carrier, the D. & H. has always been dependent on its connecting lines. Historically, it looked to

the Erie Lackawanna and Lehigh to the west: to Erie Lackawanna, Lehigh Valley, Penn Central, Central of New Jersey and Reading for reaching the New York City, New Jersey and southeastern Pennsylvania markets; and to Penn Central to the south. Formation of ConRail incorporating these lines placed D. & H. in an extremely difficult, if not impossible position from a competitive point of view and it has suffered the consequences ever since.

During the reorganization process, a decision was made by the planners to provide continued intermodal competition in the Northeast. However, once all plans for Chessie's acquisition of the major properties of Erie Lackawanna and Reading had fallen through, the burden of implementing that decision fell on D. & H. As you also know, USRA agreed to loan D. & H. an original \$28 million and D. & H. extended its routes to the point that has been described today. The effect has been that, despite loan assistance from USRA, D. & H.'s operations have become increasingly unprofitable.

There remains the question of the future course of D. & H. With the present configuration of ConRail, it is for Government and not the private sector to determine, in the public interest, the value of intra-modal competition in the region, and that is one of the questions you have before you. N. & W. cannot carry the burden of D. & H.'s survival. In addition to the initial investment of \$42 million N. & W. has paid \$22 million in dividends on the stock it was required to issue in order to acquire D. & H. While the inclusion of D. & H. in our consolidated tax returns as required by law has permitted tax benefits to the N. & W., such benefits total only about one-half of N. & W.'s initial investment; and there is absolutely no possibility of ever recouping totally our investment in D. & H., a property we did not seek, but were forced to acquire.

While N. & W. cannot commit future investment in D. & H., we look to D. & H. for interchange of traffic in competition with ConRail and we continue to have a sizeable investment in the property. But the future of D. & H. rests with Government policy. We will continue to exert our efforts for whatever role is cast for D. & H.

I have one or two other minor matters I would like to clear up for the record. One of them is the question of N. & W. requiring that D. & H. pay dividends. I think the answer to this is found very succinctly in a letter from Chairman O'Neal of the ICC to the Hon. James M. Hanley, which is included in the record. I would like, with your permission, to read two sentences from this.

Mr. ROONEY. I thought Mr. Hanley said he would like to have that remain anonymous, at the present time. If it is your wish to include it in the record, fine.

Mr. CLAYTOR. I would be glad to explain it.

Mr. ROONEY. I thought Mr. Hanley said this morning, and perhaps my staff director could correct me, he wanted that to remain confidential. Did he say that?

Mr. CLAYTOR. It was included in the papers which I received with Congressman Hanley's testimony.

Mr. ROONEY. Mr. Hanley spoke about this this morning with respect to the letter he received from the ICC.

Which one did he want to remain confidential—GAO? All right, you may include it.

Mr. CLAYTOR. Thank you, Mr. Chairman. I am quoting from the letter of January 6, 1978:

In 1973, the Commission analyzed the transfer of funds between the D&H and Dereco, Inc., to determine if funds were being siphoned from the D&H to N&W. We found that between December 30, 1968 and February 6, 1970, the D&H provided a total of \$2.3 million in dividends to Dereco. The D&H also made two loans to Dereco in 1970; these were repaid with interest in 1971 and 1972. Although these funds could legally have been channelled to the N&W, Dereco used the funds to support the Erie Lackawanna prior to the EL's bankruptcy. The Commission's analysis found no siphoning of assets to the N&W.

I have one other thing to clear up. In the event of bankruptcy of the D. & H., D. & H. would be removed from N. & W.'s corporate financial statements, but would not automatically come out of N. & W.'s tax returns. It is part of N. & W. consolidated tax returns; and whether or not D. & H. is in bankruptcy, we are required by law, to include it in our consolidated tax returns so long as we retain stock control.

Thank you. I will be glad to answer any questions.

[Mr. Claytor's prepared statement follows:]

STATEMENT OF ROBERT B. CLAYTOR

I am Robert B. Claytor, Executive Vice President and a Director of Norfolk and Western Railway Company.

Since 1968, I have served as a Director of Delaware and Hudson Railway Company. I am familiar with the NW-Nickel Plate-Wabash unification and the subsequent proceedings involving inclusion of the Delaware and Hudson in the NW system. With this background, I am aware of the origin of NW's stock ownership of D&H and the relationship between these companies since that time.

NW was required on July 1, 1968, to acquire control of D&H under an order of the Interstate Commerce Commission. Norfolk and W. Ry. Co. and New York, C. & St. L. R. Co. Merger, 330 I.C.C. 780 (1967). D&H had petitioned the Interstate Commerce Commission in 1965 for inclusion in the then existing NW system pursuant to a condition imposed by the Commission in the NW-Nickel Plate-Wabash unification proceedings permitting such petitions within five years from the date of its order approving the unification. Norfolk and W. Ry. Co. and New York, C. and St. L. R. Co. Merger, 324 I. C. C. 1 (1964). Although NW vigorously opposed the petition on the grounds that the inclusion in the then existing NW system would not be consistent with the public interest and that the proposed terms would not be equitable to NW, the Commission's order of inclusion was upheld by the United States Supreme Court. Penn-Central Merger Cases, 389 U.S. 486 (1968).

D&H was not concerned that it would be harmed by the unified NW system, but rather feared that the proposed Pennsylvania-New York Central system would seriously impair D&H. Norfolk and W. Ry. Merger, supra, 324 I.C.C. at 30. In fact, the Commission found that the NW unification should have no harmful effects on D&H. Ultimately, the Commission

responded to D&H's concerns and decided that the preservation of rail competition in the New York - New Jersey metropolitan area and in New England was necessary from a public service standpoint. It decreed that this could better be accomplished by inclusion of D&H in the NW system than in the Penn-Central system. Norfolk and W. Ry. Merger, supra, 330 I.C.C. at 796.

As directed by the Commission, NW formed a subsidiary holding company, Dereco, Inc. (Dereco), which would own the outstanding stock of the new D&H corporation. On July 1, 1968, in exchange for 1,000 shares of D&H common stock, Dereco transferred to D&H 412,627 shares of NW common stock and a \$1 million NW promissory note. D&H then exchanged the NW shares and the note in a taxable transaction for the assets, liabilities and obligations of old D&H. In addition, the Commission authorized the old D&H to retain so-called "excess working capital" in the amount of \$20.7 million. The fair market value at the time of issuance of the NW shares and the note used to acquire the old D&H assets was approximately \$42 million.

In accordance with IRS requirements, through Dereco D&H has been included in NW's consolidated tax returns. This has permitted NW to use D&H losses to offset income from other sources. However, at year end, 1977, the consolidated group tax benefits to NW reflected only about one half of NW's initial investment of approximately \$42 million. Moreover, since July 1, 1968, NW has paid out approximately \$22 million in dividends on the shares of NW stock issued for acquisition. NW remains far short of recapturing the cost of its sizable investment and there is no possibility of ever recovering totally such investment in D&H - a property it did not seek but was forced to acquire in the public interest.

From its inception D&H has been operated as a separate company and in its own interest, within the NW system. NW's stockholders have been assured that NW has not assumed or

guaranteed any liabilities of D&H and has no financial commitments toward its operation. At the same time, NW has provided requested management assistance and equipment and has worked closely with D&H in freight solicitation.

Presently, D&H's chief operating officer and chief engineer are on leave from NW. In addition, special teams have assisted D&H to help resolve particular problems. We have also provided equipment to D&H. Multilevel rack cars have been leased and furnished to handle automobile traffic. Hopper and gondola cars have also been supplied. Grain trains have moved to Albany, New York, since 1969. Until the last several years, NW supplied all of the covered hopper cars for the movement. We still supply more than our share. On several occasions, NW has leased locomotives to D&H to ease power shortages; and equipment has been leased from D&H to reduce excess capacity. Our sales personnel solicit D&H routing over Buffalo. Our pricing policy is to work with D&H in every possible way to attract profitable traffic over our joint routes with D&H. We have a continuing interest in helping D&H, but this must stop short of additional investment.

As a bridge carrier, D&H has always been very dependent on connecting lines. Historically, D&H looked to EL and Lehigh Valley for outlet to the West; to EL, LV, Penn Central, Central of New Jersey and Reading for reaching the New York City, New Jersey and southeastern Pennsylvania markets; and to Penn Central to the South. Following the bankruptcy of Penn Central and these other railroads, the agonizing process of reorganizing and structuring rail service in the Northeast began under the auspices of USRA.

During the reorganization process, the planners made the decision to provide continued intramodal competition in the Northeast. However, once all plans for Chessie's acquisition of the major properties of EL and Reading had fallen through, the burden of implementing that decision fell

on D&H. USRA agreed to loan D&H an original \$28 million to acquire new locomotives, repay debt, replenish working capital and acquire certain rail properties from insolvent railroads. NW consented, as a condition of the loan, to Dereco's pledge of its D&H stock to USRA. D&H, in turn, extended its routes, largely via trackage rights on ConRail, to Buffalo, the vicinity of Newark, Bethlehem, Philadelphia, Harrisburg and Washington, D. C.

The effect on D&H of competition from ConRail is now obvious. Despite substantial loan assistance from USRA, totaling some \$31 million as of January 1978, and more than \$18 million in assistance from the State of New York, D&H's operations have been increasingly unprofitable.

There remains the question of the future course of D&H. With the present configuration of ConRail, it is for government and not the private sector to determine, in the public interest, the value of intramodal competition in the region.

While NW cannot carry the burden of D&H's survival, we have an interest in its future. We look to D&H for interchange of traffic in competition with ConRail and we continue to have a sizable investment in the property. But the future of D&H rests with government policy. We will continue to exert our efforts for whatever role is cast for D&H. I understand that the Federal Railroad Administration is undertaking a comprehensive financial, economic and restructuring review of the Northeast rail carriers serving the markets in which D&H participates. NW's participation has been requested and we have offered our assistance.

Thank you for your time and for the opportunity to appear here today. I will attempt to answer any questions you might have.

Mr. ROONEY. Mr. Claytor, I believe you heard the previous testimony whereby one party recommended D. & H. go into bankruptcy and use Emergency Rail Services Act funds, whereas another suggested the operation be continued through directed service. I wonder, in your opinion, which do you think would be the better approach to guaranty service to the States that D. & H. is now involved in?

Mr. CLAYTOR. I don't want to weasel the answer but I may have to. As far as the Norfolk and Western is concerned, and that is whom I am testifying for—not in the role of a D. & H. director—I have to wear two hats—we don't take a position as to whether or not the D. & H. should go into bankruptcy. We feel continued Government support of the D. & H. is going to be required for perhaps an indefinite time until it can be restructured or studied. Whichever method is applied should result in continued service to the public.

If you ask me, personally, how I feel about it, I would have to say that the infusion of funds at this point, prior to bankruptcy would probably save money in the long run because it is going to be more expensive to keep the D. & H. going, I think, on a directed service order than any other way, as has been testified here today. That is my personal view. I have to give it to you as such. I have to say, as a D. & H. director for 10 years, I have seen this railroad go downhill as a result of Penn Central and ConRail competition. Its service is important to the Northeast, but I see no way that, in its present configuration, it can survive without continued infusion of funds from some source.

Mr. ROONEY. According to the USRA, the N. & W. caused D. & H. to pay \$2.1 or \$2.3 million, I believe, in dividends, including \$2 million in dividends in 1970, a year in which it had, a net income of only \$619,000, and a deficit in 1971 of \$2.5 million. I would like to have your comments on this matter.

Mr. CLAYTOR. Certainly, Mr. Chairman. The \$2 million dividend, which is the principal amount, was paid in 1970. To that point, the amount paid out in dividends represented, I believe, a little less than half of the net income of the D. & H. since its inclusion in 1968 through 1970. At the time, and in the context of things, this was a reasonable and proper thing to do. At that time, as you know, everyone was very concerned with Erie Lackawanna service being continued; and the N. & W., through its subsidiary Dereco did cause this to happen with the clear intention of trying to keep essential service going to the public. At that time, Erie Lackawanna was the one in trouble, not the D. & H., which was in a net income position. We felt we were doing the right thing from the point of view of the public interest. N. & W. did not get one cent from D. & H.

Mr. ROONEY. Along those lines, you indicate on page 3 of your statement that you received approximately \$21 million in tax benefits due to D. & H. losses. Is it not true you also received benefits from D. & H. dividends prior to its becoming an unprofitable railroad?

Mr. CLAYTOR. No, sir. The only dividends that have been paid by the D. & H. since N. & W. acquired it, was that \$2.3 million mentioned, which went to Dereco.

Mr. ROONEY. Do you think there are any circumstances under which you might believe that the D. & H. can become a profitable railroad if they got some help from the Federal Government as they have

received from the State of New York and the Commonwealth of Pennsylvania.

Mr. CLAYTOR. This may depend on a restructuring of all of the New England railroads. I am not sure the N. & W. has a position, but I will be glad to give you mine. If there were a restructuring of the New England railroads, and much of the traffic which presently moves through Canadian routes out of this country, through Canadian Pacific, could be channeled through the Boston and Maine—that is, all of this traffic kept within the Continental United States so that D. & H. and B. & M. could enjoy the revenues—I think there is a possibility the D. & H. could be viable. I think that is a prerequisite to D. & H. becoming viable. The problem with the D. & H. is very simple. It doesn't have enough business to live on. It must have more business. It must get more business from New England and from its Canadian connections.

Mr. ROONEY. But at the same time, despite the fact that it might be losing money and the Government might be putting money into it, it is still keeping jobs in the Northeast?

Mr. CLAYTOR. It certainly is. If you are a shipper on the D. & H. and there is talk about shutting it down, it may not be a matter of national import, but to you, it may be the most important thing in the world. The D. & H. has an obligation to continue service to the public and as D. & H. director, that has been my primary concern.

Mr. ROONEY. In your testimony, you refer to the assistance D. & H. has had from the N. & W., with respect to equipment and sales personnel. Is this practice still existing?

Mr. CLAYTOR. Yes, sir. We supply grain cars, more than our share, for grain trains. We have equipment which is presently leased to the D. & H. at per diem, really the very rock bottom rentals that we could justify. That equipment remains leased, and we have not recalled it.

Mr. ROONEY. In your testimony, you note that the Government must determine the value of intramodal competition in the Northeast. I wonder what your evaluation of intramodal competition is in this area?

Mr. CLAYTOR. I think it is intramodal between railroads, is what I really intended to refer to.

Mr. ROONEY. Well, you have got trucks.

Mr. CLAYTOR. Very much. That is a whole other world. There is going to be intermodal competition regardless of whether D. & H. disappears today, because the intermodal carriers are here to stay. They are the ones primarily responsible for D. & H.'s problems. I think the question we have before us is whether there should also be intramodal competition, in other words, a second railroad, one competing with ConRail to be kept alive, and I certainly hope it can be done.

Mr. ROONEY. The Chairman of your Board, I believe, has ascribed to the firewall approach to the Northeast rail program?

Mr. CLAYTOR. Yes.

Mr. ROONEY. I believe I read that in Business Week last week.

Mr. CLAYTOR. Yes, sir.

Mr. ROONEY. And he commented about the firewall approach to the Northeastern rail problem. I wonder whether or not this approach influences N. & W.'s attitude toward D. & H.?

Mr. CLAYTOR. Well, I am not sure I am able to or could analyze Mr. Fishwick's motive, but I suppose I am a part of making that decision. It really didn't have any effect on my attitude.

Mr. ROONEY. Do you believe we can have a firewall approach with respect to the outright ownership of the rails by the Federal Government versus private enterprise?

Mr. CLAYTOR. I think so and I hope so. Nothing is certain in this life, and this has to be, of course, a defensive position. It may be that it won't work. You have to recognize that fact, in which case total nationalization is the only answer. That is the one thing we are trying to stave off by giving a part of a cake, you avoid giving away the whole thing. Maybe it will work, maybe it won't. I think it will.

Mr. ROONEY. Do you think that we can, with the help of the Congress, with the help of the States, especially in the Northeast because this is where the cancer has begun, with respect to the railroad problem in this country, do you really believe that we can eventually stave off nationalization of the railroads in this country?

Mr. CLAYTOR. Well, forever is a long time, but certainly as far as I can see, that would be my hope and expectation.

Mr. ROONEY. I share your sentiments, and I hope, as chairman of this committee we can salvage our Nation's railroads.

Mr. CLAYTOR. I don't think they are hopeless.

Mr. ROONEY. I don't either, and I don't think railroad management would like to see our railroads nationalized. Also, I don't think any one of the railroad brotherhoods would ever want to work for the Federal Government. I share your concern.

Mr. CLAYTOR. Thank you.

Mr. ROONEY. Our next witness will be Mr. Kent Shoemaker, president and chief executive officer of the Delaware & Hudson Railway Co.

Mr. Shoemaker, you may proceed.

STATEMENT OF KENT P. SHOEMAKER, PRESIDENT, CHIEF EXECUTIVE OFFICER, DELAWARE & HUDSON RAILWAY CO., ACCOMPANIED BY WILLIAM P. QUINN, COUNSEL

Mr. SHOEMAKER. Thank you, Mr. Chairman. I have with me today, Mr. William P. Quinn, counsel for D. & H. from Philadelphia.

I am Kent P. Shoemaker, and I am president and chief executive officer of Delaware & Hudson. For the purpose of helping to explain things in my remarks, we have prepared a map which I hope will be useful.

Mr. ROONEY. Mr. Shoemaker, you are, in my opinion, our star witness today. The time is yours. You are not limited and you can proceed in any way which you deem necessary.

Mr. SHOEMAKER. I appreciate that. We have prepared comprehensive remarks which I am submitting for the record. [See p. 117.]

Mr. ROONEY. Without objection, your remarks will appear in the record and you may continue to summarize.

Mr. SHOEMAKER. I will try to be brief. There is certain ground that has been covered by other witnesses which it isn't necessary that I do verbally.

Mr. ROONEY. What I would like to have you do is after you deliver your summary is to comment on some of the comments that were made by some of the previous witnesses.

Mr. SHOEMAKER. I would be more than happy to.

Mr. ROONEY. Because I am sure they offended you as much as they confused the committee.

Mr. SHOEMAKER. I would concur in that.

Basically, my remarks really attempt to answer three questions. That is, what is the present financial condition of the D. & H.? How did we arrive at this point? And what should be done?

Addressing the first question on just where are we in terms of our current financial condition, I want to be very candid and say the situation is what I would describe as perilous. While our cash position is such that we have, in theory, cash available to last into November or December, depending upon external events, particularly the duration of the N. & W. strike, nevertheless our board has a clear fiduciary responsibility, in the absence of concrete longer range funding or even intermediate funding, to assess whether bankruptcy is a sensible course, and in that connection a board meeting will be held immediately following such time as the summer session is terminated to assess the prospects of legislation. I didn't want any misunderstanding about that. That is not a scheduled meeting to apply any pressure whatsoever, but the board, in its last deliberations, after USRA denied our loan drawdown, at my request, wished to wait until we see what legislative action could be accomplished or initiated before deliberating on the matter further.

With respect to, "how did we arrive at this point in time?" You have heard a lot of testimony. I think, for me to try to go through a whole history again is not necessary as it is covered in my written remarks, but I would like to make two points about it and that is simply, as you look at our map, the blue line essentially represents what was originally D. & H. before the initiation of a final system plan. Those blue lines are less than half of the total lines now operated by D. & H. through the line extensions you have heard so much about. Suffice it to say there were only \$2 million in additional financing provided from the original \$26 million that was provided for the D. & H., to operate under its original lines with the expanded operations. In hindsight, and in my judgment only, coming to the property very recently, that was clearly insufficient.

The second point is that there is sort of a general perception and understanding that the D. & H. in its present expanded form is an outright disaster, that one has to start from scratch, let it go into bankruptcy, is not recoverable, et cetera, and this, I think, is absolutely incorrect, in my personal judgment, because, while both the extensions and implementation of those extensions is certainly flawed, it indeed is correctable in our judgment, and in fact, we have an extensive strategic planning effort initiated to identify the best means of doing so. Incidentally, I should say to you, this is completely consistent with the intent of both the final system plan and whatever should develop out of the two federally funded efforts on studies in the Northeast in connection with New England.

With that, let's get to the crux of the problem at the moment and that is—where do we go from here?

Essentially, as we have heard from other witnesses today, there are two basic options. That is, simply, let the D. & H. slide into bankruptcy, or continue with USRA funding which, in our judgment, does take legislative action.

Mr. ROONEY. How much would you need?

Mr. SHOEMAKER. Our basic estimate of need is based on our current projections, the same \$15 million that might be expended in directed service for 240 days continuing through funding, would last us from 18 to 24 months.

Mr. ROONEY. And after that?

Mr. SHOEMAKER. And I should say that I don't concede that it is good money after bad, and there is no chance the Government can recover it. It certainly has a better chance of recovering it, in my judgment, than a directed service route, where we know there is no chance of recovery. I think, when we are really talking directed service, we have to ask five essential questions, and I am actually referring directly to my written testimony, and these questions are—

Item 1. How much will directed service cost the taxpayer? And as we have already heard, the ICC has estimated it would cost \$15 million or over.

Mr. ROONEY. As I understand it, \$15 to \$17 million.

Mr. SHOEMAKER. Item 2. What will directed service cost the shipping public? Directed service has never been attempted on any large scale, and indeed some transportation experts believe it will be unworkable and lead to severe service disruptions and significant localized unemployment.

As you have heard from the testimony today, it is unclear whether the ICC would even order a single carrier to operate these services of D. & H., and in fact, it would appear to be the recommendation of the Department of Transportation that it be segmented in some fashion. Thus, while we are in the process of finding some solution, the Northeast, and in particular, New England, would be denied competitive service as mandated under the 3-R Act by Congress.

Question No. 3. How much will the trustee and reorganization court complicate any attempted supplemental transfers or other postdirected service proposed solutions? Might not a restructuring plan following directed service—particularly one hastily conceived—be frustrated by a reorganization court?

Question No. 4. Who will bear the costs of rail and other labor dislocations? Under title V of the 3-R Act, a protected employee is an employee of an acquiring railroad adversely affected by a transaction which is any action taken pursuant to the provisions of the 3-R Act. Cannot D. & H. employees argue they have been adversely affected by a transaction and are entitled to the protections under title V? How will such arguments impact the viability of supplemental transfers or impact taxpayers?

Question No. 5. Could the Government's use of directed service result in D. & H. being operated by several carriers? Could this, in turn, deny the shipping public the competitive service mandated under the 3-R Act? This is the point I added to the first comment. I believe it is clear that the recommendations for directed service by the Department of Transportation are not in the interest of the taxpayers or the

shippers or the railroad system in the Northeast. However, if means can be found to provide the funding to continue the cheaper option under USRA tutelage, the following advantages would be obtained.

1. The management of D. & H. could concentrate on running an efficient railroad during the pendency of the studies and reconfiguration planning. An efficient operation would reduce the need for external funding and provide consistency of competitive rail service. Significant opportunities exist to enhance D. & H. operations and service, thereby reducing the need for public funding. These opportunities are significant. I might mention to you, at this point, in my judgment, the D. & H. since the initiation of the final system plan, has never operated as the plan intended, or Congress had intended it to be, in terms of a significantly competitive element to ConRail.

Mr. ROONEY. I thought that was the whole purpose of it?

Mr. SHOEMAKER. It was the purpose of it and it does provide partial competition, but even in the limited markets where D. & H. presently competes with ConRail, the structuring is flawed to the extent that I am not as proud as I would like to be of the relative abilities D. & H. has to provide competitive service. The point is, these are correctable, and we will be proceeding with those efforts and recommendations to identify those means and we will come up with specific recommendations, shortly.

Mr. ROONEY. The blue line there was your original 700 miles. Is that correct?

Mr. SHOEMAKER. That is correct.

Mr. ROONEY. And the yellow line is the additional 950 miles?

Mr. SHOEMAKER. That is correct.

Mr. ROONEY. It seems to me that blue line—you are operating an area—Scranton, Wilkes-Barre, Binghamton, where you lost \$5½ million from anthracite coal down to \$1½ million—the opening of that line to the west, to Buffalo, and the south, to Washington, Philadelphia, the beautiful area of Bethlehem, Pa., I would think that would be a very profitable market for you?

Mr. SHOEMAKER. It potentially is but I want you to keep in mind that the D. & H., as structured, other than Bethlehem, Pa., the D. & H. has no routes to serve any of the communities on those expanded lines except extremities and even those rights are in some cases still under dispute because they have never been clarified relative to the intent of the final system plan.

Mr. ROONEY. Tell me something about the Allentown/Bethlehem/Easton area. You serve that point, don't you?

Mr. SHOEMAKER. Yes; we serve it but via a contractual arrangement that has never been put technically in place where ConRail handles D. & H. traffic from Allentown Yard to and from Bethlehem plant operations in Bethlehem. Much of the execution of the final system plan at key points involve not only D. & H. running over ConRail but ConRail providing terminal services, either switching interchange, industry switching, in effect, handling their competitor's business. Now, I am not picking at ConRail about that. All I am simply describing is that I think in reality that is a flawed planning operation. If, in fact, the only significant competitor of ConRail got a signifi-

cant opportunity to control its own operations and service, and that is exactly what happens at a place like Allentown, Bethlehem, and it also happens in Buffalo——

Mr. ROONEY. I don't understand. What do you ship from Buffalo to Bethlehem?

Mr. SHOEMAKER. Well, various miscellaneous materials needed by a steel company. Most of our business with Bethlehem Steel at Bethlehem is structural steel, outbound business. And, in fact, the Bethlehem Steel Plant is the only single plant D. & H. has rights to serve in the entire Bethlehem area, but the execution of those rights are via contractual arrangement where ConRail acts as D. & H.'s agent and handles cars from Allentown to and from Bethlehem. We have been working with ConRail on a number of these projects and they are not being currently uncooperative in trying to work out arrangements where we can segregate our operations to be, for a practical matter, legitimately competitive with each other. Over-the-road operations, where you share a line of road, are not nearly as potentially debilitating in terms of competitive situations where one carrier or the other, when they are in competition with one another, try to share terminal operations.

Mr. ROONEY. Would you rather go back to your own little 700-mile segment?

Mr. SHOEMAKER. Absolutely not. I say that for this reason. I completely support USRA's testimony in that regard. Sometimes there is no going back and the fact there are no friendly connections left through which D. & H. could provide a combination of through routes—thereby providing competitive service to ConRail—means, in effect, D. & H. would be isolated in its original configuration. It isn't the expansion that is bad, it is the execution of the expansion, and in some cases, in a relatively minor form that is correctable.

Mr. ROONEY. Is ConRail as hostile as it was previously testified it has been to D. & H.?

Mr. SHOEMAKER. Well, we have certainly had a past history of hostility. Currently, I think we are working out our problems well, and I have met with Mr. Jordan a number of times recently, and it is, frankly, in both of our interests to get our problems resolved.

To go on to that third primary reason why an alternative course to directed service, in other words, continued USRA funding is desirable—pardon me—the fourth primary reason. I would basically say—it starts on page 10 of my testimony, item 3, that is, basically, costs to the Government would be less than costs of pursuing the other option, which we have talked so much about already, and I must reiterate again, we feel confident that \$15 million would provide 18 to 24 months of continued operation.

Item 4. There would be greater flexibility in developing a long-term solution. Interference of a trustee and reorganization court would be eliminated. Planning options would not be foreclosed as they might be under directed service, and I think that is extremely important. We have two federally sponsored efforts to find fundamental means to improve service and solve some of the severe railroad problems in New England. A course that results in directed service, particularly a

course that breaks up the operation of D. & H. as a unit, which is a distinct possibility, may well foreclose options that will be developed in those federally sponsored eastern efforts.

Last, and perhaps most important of all, in my personal judgment, is that competition would not be destroyed under that course. I happen to be a personal proponent of competition whether it be in the railroad business or any other business, and frankly, I am astounded at the reasoning that suggests that somehow competition in the airline business, competition in the motor carrier business and water carrier business is important, but somehow it really isn't needed in the Northeast, and I truly believe that the maintenance of the D. & H. as a competitive system, which is the only game in town in terms of the competitive structure to ConRail, is fundamental to the philosophy of a competitive system nationally, and I also believe that following that up, to go into a single ConRail, has severe national implications.

Let me just conclude my summary remarks by saying that I think the States of New York and Pennsylvania have done their share and New York particularly has gone a second mile in terms of funding and even Vermont has been helpful through NERCOM funds, on behalf of the New England commission. I believe it is time for us to get on with the job of resurrecting and finding a way for D. & H. to operate effectively. I truly believe that if any other course is followed but continual funding through USRA out of bankruptcy, that we have a potential disaster in terms of retaining any competitive structure in the Northeast.

Thank you.

[Testimony resumes on p. 132.]

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

TESTIMONY OF KENT P. SHOEMAKER
PRESIDENT AND CHIEF EXECUTIVE OFFICER OF THE
DELAWARE AND HUDSON RAILWAY COMPANY

INTRODUCTION

My name is Kent P. Shoemaker, and I am President and Chief Executive Officer of Delaware and Hudson Railway Company ("D&H"). D&H's principal place of business is 40 Beaver Street, Albany, New York 122207. Our Company employs approximately 2000 people.

D&H today is an operating system of approximately 1650 miles (See attached map). It owns about 700 miles of its own trackage, as it has for more than 150 years, in New York, Pennsylvania and Vermont. Since April 1, 1976, D&H has operated an additional 950 miles of trackage and has extended its operations to Maryland, New Jersey and Virginia. All but about 50 miles of this new trackage consists of operating rights on trackage originally conveyed to Consolidated Rail Corporation ("Conrail"). Both Conrail and D&H acquired their interest in the latter trackage under the Final System Plan issued by United States Railway Association under the Regional Rail Reorganization Act of 1973.

In my testimony today I will address the following questions:

1. What is the present financial condition of the D&H?
2. How did we get into our present financial difficulties?
3. What are the options available?
4. Where should we go from here?

THE PRESENT FINANCIAL CONDITION

The D&H is in a perilous financial condition. On August 2, 1978 the United States Railway Association (USRA) refused to extend a requested \$600,000 to the D&H. The \$600,000 was part of a drawdown on the remaining \$2.7 million dollars of a \$30 million loan from USRA to the D&H. It is clear from our current financial projections that D&H will require external financing in order to remain financially solvent during the period necessary to conclude government studies directed towards a long-term solution to the problems of the the railroad.

The immediate effect of USRA's refusal to advance further funds to D&H is that the D&H is without credit. Our current projections of our cash position are such that we could operate to November or December without external financing. However, the D&H Board of Directors is likely to petition for reorganization under section 77 of the Bankruptcy Act long before the cash runs out if there is little or no prospect for external financing. The D&H Board could take such action as early as August 18, 1978 -- the proposed date of its next meeting.

HOW THE D&H ARRIVED AT ITS PRESENT FINANCIAL CONDITION

The causes of Northeast and Midwest railroad ills have been thoroughly studied. I need not rehash with this Subcommittee the historical, governmental, industrial, labor and managerial reasons for the financial collapse of numerous railroads in the Midwest and Northeast. Suffice it to say that the D&H, while not enjoying the greatest financial health, survived as a profitable railroad during a period of time which saw seven other railroads in the region petition for reorganization.

Congress recognized the uniqueness of the D&H and of the financial problems that would confront the Company as it began competing with the legislatively created Conrail. Therefore, Congress made the D&H eligible for financial loans under section 211 of the Regional Rail Reorganization Act (3 R Act).

D&H took advantage of this eligibility by applying for a \$26 million loan to be used for debt restructuring, locomotive acquisition and the purchase of minor line extensions. With this loan the D&H hoped to be in a position to serve its historic role as a bridge carrier between the South and West and New England and Canada and compete against the giant legislatively-created Conrail.

A series of events then occurred which brought the D&H to its present precarious financial situation:

1) Two weeks before the Final System Plan was to be approved it had to be aborted in part. Under the proposed plan Chessie, assisted by the D&H, was to extend lines into the East and become the primary competitor to Conrail. But at the last minute Chessie backed out, leaving the government without a Final System Plan.

2) As a result the U.S. turned to the D&H, which was at its mercy. The U.S. proposed to the D&H that it become the competitor to Conrail and assume the role envisioned for the large and financially healthy Chessie. To "encourage" the D&H to agree to go along with this hastily conceived new Final System Plan, the government rejected the D&H's initial request for a loan which would have allowed the railway to restructure its debt and be in a position to compete with Conrail as a bridge carrier. Instead, USRA said it would give D&H a loan if D&H agreed to undertake a large part of the service originally proposed for the Chessie. In effect, the government gave the D&H no choice. If D&H refused to accept the role prescribed for it by the government under the new Final System Plan, it could die a slow death under the heels of the giant, government-created Conrail. If it went along with the hastily conceived plan, it might have a chance of surviving and could expect to be aided in its efforts by the very government which had given it this Hobbesian choice.

Therefore, D&H agreed to assume its hastily developed role under the Final System Plan and was transformed from a 900 mile railroad to a 1650 mile railroad overnight. To cope with this increased expansion to 1650 miles the government agreed to loan the D&H only two million dollars more than D&H had requested to operate a 700 mile system on a financially sound basis.

I have attached as Exhibit A to my statement a detailed history of the USRA loan agreement, its purposes, and its deficiencies. For present purposes, I will simply make the

following points:

- USRA was unwilling or unable to grant D&H the funds which D&H had stated were necessary to refinance safely its original 700 miles.
- The \$2.0 million added to the loan to cope with the Chessie-related extensions of an additional 950 miles was woefully inadequate. Although the additional route miles operated by D&H as the result of Chessie's declination more than doubled those that would otherwise have been operated, the loan was increased by a little more than seven percent.
- Compounding the inadequacy of funding, D&H's debt structure was doubled. Prior to the line extensions, D&H's debt was a modest \$24 million, primarily for equipment. Under USRA's plan, D&H assumed total liabilities of \$57 million, including the \$28 million provided by the USRA loan. The result is a heavy cash drain for debt service of well over \$5.0 million annually in the 1976-80 period and well over \$7.0 million beginning in 1981. Under D&H's loan proposal, debt service would have been only \$1.3 million in the early years and \$4.0 million annually in the 1980s.

D&H emerged from the Final System Plan with weaknesses apart from a tenuous financial structure, among which the following are prominent:

1. Inadequate route structure. The route structure contemplated by the plan has been burdensome to D&H in the following respects:

- While planning for D&H was premised on the principle that D&H needed access to major markets to compete effectively, the reality of the route extensions did not, in fact, provide new market access to any significant degree. D&H expansion was accomplished primarily through overhead operating rights to reach friendly rail connections. D&H was not given the right to serve sources of possible new traffic on these extensions except for limited service to a yard point [Oak Island] in the New York metropolitan area and one Bethlehem Steel Plant.
- Traditionally, a significant portion of D&H's traffic originated or terminated on friendly connecting railroads which were absorbed by Conrail. D&H traffic extensions did not

provide new traffic sources to offset the traffic losses to Conrail.

- D&H's resulting routes are more circuitous and have less favorable grades in comparison with Conrail's. This is true for all major markets where D&H and Conrail are competitive.

2. Lack of operating control.

- Under the Final System Plan, almost 50 percent of D&H main line train operations use Conrail lines and facilities. Conrail, a major competitor of D&H, maintains and provides supervision on these lines and operates the major yards that provide terminal handling of D&H traffic.
- In effect, Conrail is controlling the service quality of much of its main competitor's traffic.

Notwithstanding the above infirmities, D&H sought aggressively to operate its new rail structure successfully. However, despite our efforts and some initial successes the infirmities could not be overcome. These infirmities were accentuated by other events.

The bitterly severe weather of January and February, 1977, had its impact on D&H when the freight service through Buffalo came to a stop. The D&H incurred losses in the first two months of that year of \$3.3 million, or 97 percent of the total loss incurred for the first six months of 1977. (Conrail is reported to have lost in excess of \$100 million as a result of the harsh winter.) This staggering and unpredictable major loss was the first, and in many respects, a precipitating factor of, a series of events which have brought D&H to its present precarious financial position.

The events of February 1977 stimulated an austerity program. After a careful study, D&H concluded that it was incurring an annual loss of about \$3 million in conjunction with its metropolitan New York [Oak Island] operations. USRA concurred with D&H's conclusion that it should immediately withdraw from this service and let Conrail handle the traffic. In fact, USRA did more than concur in D&H's conclusion that it should immediately withdraw from this service and let Conrail handle the traffic. USRA made it plain that it would not accelerate an additional \$2 million draw-down unless D&H withdrew from Oak Island and made other internal changes.

For the balance of 1977, there were additional stringent cost-cutting measures at a sacrifice of service quality which, not unexpectedly, had the effect of decreasing traffic volumes. As is well known, the winter of 1977-78 was again severe, with predictable consequences on revenues.

These events occurred against a background of continual re-evaluation by USRA when D&H did not produce revenues which had been forecast. Consequently, since at least as early as the spring of 1977 until the present time, D&H has operated in a constant atmosphere of crises as USRA deliberated whether to advance the further funds provided in the loan agreement and to readvance \$7.5 million made available through a refinancing of the locomotive indebtedness as part of a guarantee by the Secretary of Transportation under Section 511 of the Rail Reorganization and Regulatory Reform Act of 1976.

In March and April of this year, D&H operated near or better than its business plan. Traffic has subsequently fallen below projections, and we are convinced that this is, in part, due to the unfavorable publicity caused by the continuing USRA deliberations as to whether to continue to advance

funds to D&H as well as the effect of unanticipated strikes affecting the N&W and important traffic-generating shippers.

As mentioned above, the refusal of USRA on August 2, 1978, to advance the remaining portion of the \$30 million loan has precipitated the latest crisis.

OPTIONS AVAILABLE

All parties agree that the only long-term option for the D&H is to return to the drawing boards and seek an overall solution to the Northeast railroad situation. DOT and USRA are in favor of pursuing this course of action. USRA is studying the reconfiguration in cooperation with the New England Regional Commission. In addition, the Department of Transportation is undertaking a merger, consolidation, and unification study under authority of section 401 of the 4-R Act.

There are basically two short-term options. The first option is to continue extending loan funds to the D&H until the studies are complete and a long-term solution is worked out. This approach would call for amending section 211 of the 3-R Act so as to permit the USRA Board to continue to advance D&H the loan funds. D&H could operate the railroad free from the crisis environment of the past and free of the complications of a bankruptcy trustee and court.

The second option is to have the government wash its hands of the D&H situation that it has been largely responsible for creating. Under this option, D&H would be forced to petition for reorganization and operate the railroad for a month or two. The Federal Railroad Administration has indicated that Emergency Rail Service Act guarantees would not be available. Thus, after a month or two, D&H operations would cease and the ICC would direct other

carriers to operate D&H lines for the next 240 days. After 240 days, directed rail operations would cease and the government would be forced to come up with another emergency plan for transferring the lines of the D&H in much the same way the government came up with a new Final System Plan when the Chessie System backed away from the original Final System Plan.

FUTURE DIRECTIONS

Apparently, the Department of Transportation has chosen to pursue option number two, the bankruptcy option. FRA will testify here today in favor of bankruptcy and directed service and argue for picking up the pieces in a crisis environment following the 240 days of directed service by hastily exercising its supplemental transfer authority. Lines not transferred could be supported by the States and the Federal government under the branch line subsidy program. Pursuit of this option seems particularly anomalous in the light of the government's long-term studies involving the D&H's lines. It is quite possible that the use of D&H facilities to suit the exigencies of directed service will foreclose options otherwise available to long-range planners. In other words, the short-term option will prevent a long-term solution.

These are the questions that should be asked:

1. How much will directed service cost the taxpayer? The ICC has estimated that such service would cost upwards of \$15 million dollars for a 240 day period.

2. What will directed service cost the shipping public? Directed service has never been attempted on any large scale. Some transportation experts believe it will be unworkable and lead to severe service disruptions and significant localized unemployment.

3. How much will the trustee and reorganization court complicate any attempted supplemental transfers or other post-directed service proposed solutions? Might not a restructuring plan following directed service--particularly one hastily conceived--be frustrated by a reorganization court?

4. Who will bear the costs of rail and other labor dislocations? Under title V of the 3-R Act a protected employee is an employee of an acquiring railroad adversely affected by a transaction which is any action taken pursuant to the provisions of the 3-R Act. Cannot D&H employees argue they have been adversely affected by a transaction and are entitled to the protections under title V? How will such arguments impact the viability of supplemental transfers or impact taxpayers?

5. Could the government's use of directed service result in D&H being operated by several carriers? Could this, in turn, deny the shipping public the competitive service mandated under the 3-R Act?

I believe the directed service course that the Department of Transportation recommends is improvident both from the standpoint of protecting the taxpayers' pocketbooks and from the standpoint of developing a sound rail transportation system in the Northeast.

If option one (continued USRA funding discussed above) were pursued, the following advantages would obtain:

1. The management of D&H could concentrate on running an efficient railroad during the pendency of the studies and planned reconfiguration. An efficient operation would reduce the need for external funding and provide consistency of competitive rail service. Significant opportunities exist to enhance D&H operations and service, thereby reducing the need for public funding.

2. Economic disruption resulting from cessation of operations of the D&H would be avoided.

3. Costs to the government would be less than costs of pursuing the other option. Loans (as opposed to outright grants for 240 days of directed service) in the neighborhood of \$15 million should carry the D&H through the period of study and reconfiguration (18-24 months). The estimate of \$15 million for directed service would provide only 240 days of service. Other directed service costs associated with rail and other labor dislocations would be eliminated.

4. There would be greater flexibility in developing a long-term solution. Interference of a trustee and reorganization court would be eliminated. Planning options would not be foreclosed as they might be under directed service. There would be time to complete all studies and plan carefully for restructuring.

5. Competition would not be destroyed.

The states of New York and Pennsylvania have done their share. New York particularly, has gone a second mile. At this stage, however, the only branch of government that can now protect the American taxpayer and shipping public is the United States Congress. Legislation to enable USRA to continue to provide external funding to the D&H must be immediately forthcoming if we are to avoid pursuing a short-term option which would prevent a long-term solution. On behalf of the management and employees of D&H, our shippers, and American taxpayers, we urge Congress to take immediate action to secure the legislative solution being proposed by Congressmen McDade and Hanley.

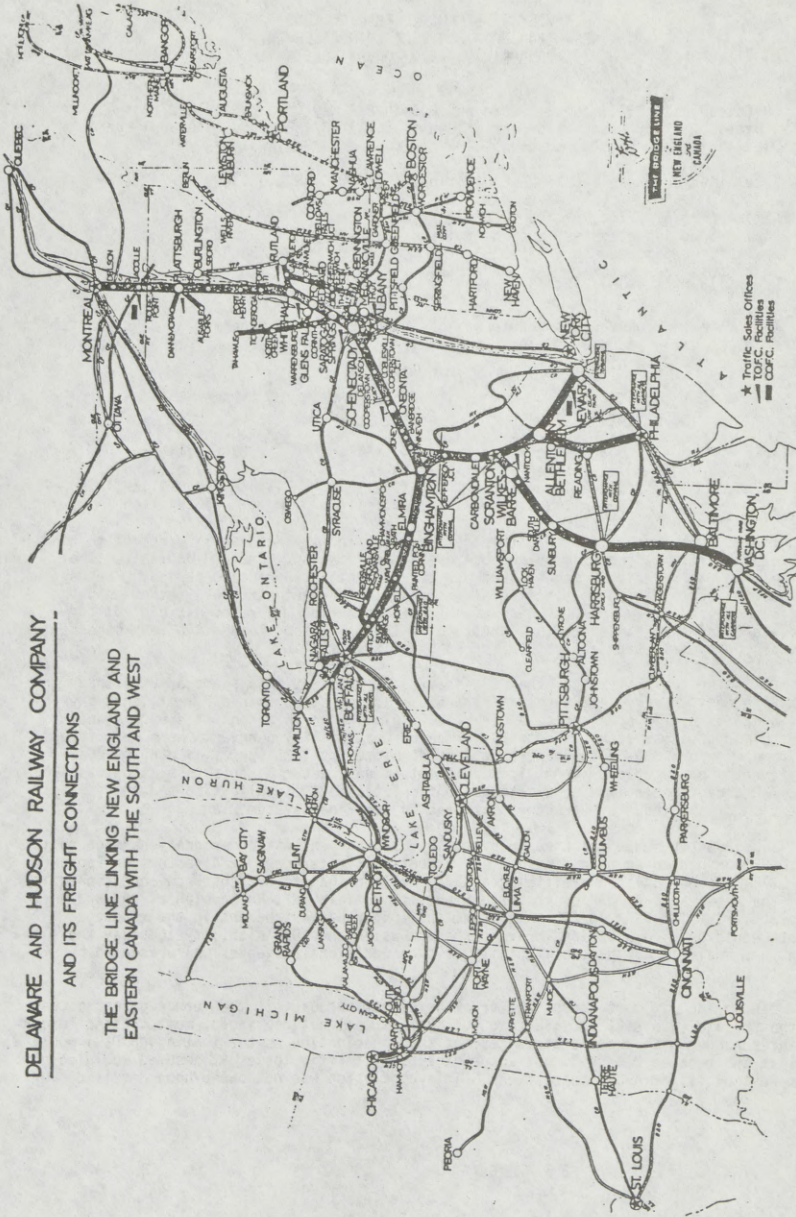
I think enough damage has been done, and that the time has come to keep the railroad in place and to encourage shippers to move traffic on it. I believe recent experience confirms this judgment. Penn Central's cash-starved properties deteriorated during reorganization despite emergency grants of public funds. Conrail and the American taxpayer are now paying the price as Conrail faces a monumental effort to rehabilitate line and equipment. D&H's problems are on a much smaller scale, but the fundamental problem is the same.

I appreciate the opportunity of appearing before you, and I would be pleased to answer questions.

DELAWARE AND HUDSON RAILWAY COMPANY

AND ITS FREIGHT CONNECTIONS

THE BRIDGE LINE LINKING NEW ENGLAND AND
EASTERN CANADA WITH THE SOUTH AND WEST



REVIEW OF FINANCIAL TRANSACTIONS
RESULTING FROM D&H/USRA LOAN AGREEMENT
AND APRIL 1, 1976 CONVEYANCES

On October 11, 1975, the Delaware and Hudson Railway Company applied to the United States Railway Association for a loan to total \$37,584,006. The application specified that the requested proceeds were to be used as follows:

Locomotive purchase and line acquisitions	\$ 7,954,000
Refinancing of principal and interest payments on indebtedness (excluding lease payments) coming due for 1976-1983 (A proposed new maturity for the refinancing was set at December 31, 1995)	29,630,006

The proposed repayments schedule was designed to provide significant debt service relief in the early years as shown below for 1976-1979 (in subsequent years the new debt service would be higher):

	<u>Existing Debt Service</u>	<u>Proposed Debt Service</u>	<u>Amount of Relief</u>
1976	\$5.065 million	\$1.405 million	\$3.660 million
1977	5.154 million	1.973 million	3.181 million
1978	5.362 million	2.575 million	2.787 million
1979	3.379 million	2.964 million	.415 million

It should be emphasized that this refinancing, and the debt service relief to be generated by it, was the primary purpose of the application. The D&H debt structure at the time was relatively modest, but was bunched into a short time period. The D&H application contemplated no significant increase in the debt structure (other than for the locomotives), only a lengthening of the payment period. Further, it did not contemplate changes in the operating structure of the D&H, other than a few very minor line acquisitions designated to D&H in the Final System Plan.

Following the analysis by the USRA staff, the Association's Board of Directors authorized on January 8, 1976 a loan of \$26.0 million rather than \$37.6 million, payable over four years on a schedule essentially similar to that requested by D&H and for the purposes requested. Contrary to the request of D&H, however, there were to be no drawdowns for 1980-83 as the projections developed by USRA suggested D&H would be sufficiently profitable by that time to make them unnecessary. This resolution required that D&H accept minor line acquisitions contemplated in the application and the implementation of the industry structure outlined in the Final System Plan.

Subsequently, when the Chessie System refused the extensive designations made to it, the D&H loan had to be reconsidered. At a meeting of its Board of Directors on February 19, 1976, the Association reaffirmed a \$26.0 million loan to D&H, but now conditioned it upon the acceptance by D&H of trackage rights to Buffalo, NY, Philadelphia, PA, and Potomac Yard. The USRA staff stated that the longer hauls inherent in the trackage rights would provide additional revenues and thus enhance D&H's ability to repay the loan. No analysis of the profitability of such additional revenues was presented by USRA to D&H.

D&H decided it must accept the trackage rights because, if the former direct access to the Chessie (via RDG) and N&W (via EL) systems were not continued, most traffic formerly interchanged with those systems (except that originating or terminating on D&H) would be lost and because D&H could not absorb the heavy traffic losses it assumed would result from loss of its friendly connections. This conclusion was not based upon detailed

E X H I B I T A

traffic diversion studies, and time was not sufficient to permit other than simple revenue-cost calculations of the effect of operating the new lines. D&H concluded that it had little alternative other than acceptance of the major traffic extensions (Wilkes-Barre (Dupont) - Allentown, Binghamton - Buffalo). While it was not clear that additional trackage rights, such as those to Oak Island and Potomac Yard, were necessary, D&H accepted these additional designations as a condition to the loan.

Reflecting the impact of the new configuration on working capital requirements, the nature of the loan was now changed from that originally contemplated in the loan application. Rather than increasing the total loan to reflect additional working capital needs and expected first year losses, the USRA increased the amount of drawdown in the first year from \$14.0 million (authorized January 8) to \$20.0 million, thus reducing drawdowns in later years and changing the use of proceeds of the \$6.0 million differential from debt refinancing to working capital.

Following this Board action there ensued a frantic two-week period during which the D&H sought to convince USRA of the need to increase the loan size, both in light of the original requested purposes and of the uncertainty of the financial demands likely to result from operating the larger system. Additionally, negotiations were conducted to arrange for conveyance of additional equipment required by the increased operating size. Finally, the D&H requested additional designations and traffic solicitation rights to help ensure profitable operations on the new lines. As designated on February 19, D&H was only given the opportunity for longer haul of any existing traffic it could preserve for itself. It was not given the right to solicit traffic along these new lines. Recognizing that under the new Conrail structure D&H would lose many friendly connections, D&H requested the following from USRA:

- . Overhead trackage rights between Allentown, PA and Oak Island Yard, NJ
- . Access to Bethlehem Steel traffic
- . Access to CNJ traffic previously designated to Chessie
- . Trackage rights from Oak Island to Greenville and the car floats
- . Interchange rights at Bound Brook and Oak Island Junction
- . Trackage rights to Port Newark, and
- . Erie Lackawanna stock in Trailer Train Corporation

At its Board meeting on March 3, 1977, the Association dealt with these issues. The Board denied all additional requests for trackage and other rights (outlined above) except for access to Bethlehem Steel and trackage rights from Allentown to Oak Island Yard for TOFC/COFC traffic only.

Additionally, the Board approved an increase in the total loan to \$28.0 million (still conditioned upon acceptance of the previously offered trackage rights), and changed the drawdown schedule to provide for \$23.0 million to be drawn down in the first year and only \$5.0 million in subsequent years. Although the Board granted only a \$2.0 million increase in the loan size, D&H had submitted on February 22 financial projections based on the new system which indicated an additional cash need of \$9.0 million over the \$26.0 million loan previously authorized. This increase was refused. The use of the proceeds of the approved amount was to be:

1976

- Locomotives and acquisition of rail properties pursuant to the Rail Act	\$ 7,959,248
- Repayment of amounts due on indebtedness	4,360,000
- Working Capital	10,680,752

Subsequent Years

- Repayment of amounts due on indebtedness	5,000,000
	\$28,000,000

Finally, the Board approved conveyance of encumbered equipment to D&H under conditional sales agreements or leases. This caused a dramatic increase in D&H's debt

loan, and thus cash requirements, represented by this equipment. In accepting this equipment D&H accepted principal and lease payments totaling \$28.9 million over and above the loan itself. Again, there was little or no analysis by USRA or D&H to substantiate whether the new trackage rights would be sufficiently profitable to justify this huge new amount of equipment debt. The sum involved was about double the equipment debt and lease obligations D&H held prior to entering into the USRA loan transaction.

To gain perspective on the impact of the USRA loan and trackage right designations on D&H at conveyance date, it is worthwhile to summarize the evolved form of the USRA transactions at that date in comparison with that originally contemplated in the Loan application:

- . Instead of a \$37.6 million loan, D&H assumed total liabilities of about \$57.0 million, representing a very large increase in its debt structure. This debt resulted in a heavy annual cash drain for debt service totaling well over \$5.0 million annually in 1976-80 and well over \$7.0 million beginning in 1981. These amounts should be compared (see page one) to the loan application proposal which expected debt service of \$1.0 - 3.0 million in the early years and over \$4.0 million subsequently. (Although difficult to calculate, it is appropriate to add to the debt total above a capitalized value for that portion of trackage rights payments to Conrail which represents a return on investment to Conrail.)
- . Instead of primarily refinancing existing long-term debt, about 35% of the \$28.0 million loan represented assumption of new long-term debt to finance short-term losses and working capital needs - a rather questionable banking practice.
- . The assumption of new liabilities at April 1, 1976, totaling about \$39.0 million (representing the new equipment debt of about \$29.0 million plus the working capital designations of \$10.0 million of the \$28.0 million loan - total working capital designations were subsequently further increased) was predicated on an assumption of significant new profitability stemming from trackage rights, which actually provided D&H non-competitive routes and access to little new profitable traffic (Bethlehem plant of Bethlehem Steel). The assumption was made with virtually no analysis or documentary support, there being insufficient time to do such analysis between withdrawal of the Chessie, from the planned industry structure, and conveyance date, April 1, 1976.

Viewed retrospectively in this light, it seems unlikely that either USRA or D&H should have proceeded with the transaction as then structured. Indeed, the original loan was probably improperly premised. Having always been unofficially acknowledged as necessary in order to preserve some semblance of competition to Conrail, it would have been better to have officially justified the loan on this basis (rather than questionable financial projections), and then sought to reconfigure the D&H so as to make it truly competitive to Conrail, and on a financially self-sustaining basis.

Unfortunately, the desire to maximize Conrail traffic overruled considerations of a truly competitive route structure. The result has been a continuing need for government funds to sustain D&H. In essence the government has bought/is buying a figment of competition. And even if new D&H management is now able to significantly reduce losses, it is highly questionable whether D&H can ever develop a sustainable traffic base as now configured. Some amount of restructuring is necessary.

Financial Events Subsequent to April 1, 1976

Under the terms of the USRA loan, D&H drew down \$21.5 million in 1976, rather than the originally scheduled \$23 million. An additional \$2.5 million was to be advanced in 1977, \$3 million in 1978 and a final \$1 million in 1979 for a total loan of \$28 million. Following the heavy costs associated with the severe winter of early 1977 and continuing losses from traffic declines and Oak Island problems, by the summer of 1977 it became clear that D&H would require additional external funds over the \$2.5 million already received. Accordingly, the D&H requested, in July, an additional \$2 million to be taken from the loan amounts still available for 1978 and 1979. This request was approved by the USRA and the \$2 million was taken down in August through October. Continuing heavy losses from poor traffic, however, caused the D&H cash position to worsen critically such that it was necessary to approach again USRA and the Federal Railroad Administration to discuss further federal assistance.

D&H decided to pursue the following objectives to mitigate the short-term financial crisis and to reestablish a traffic base:

- 1) Request deferral of the \$1 million in interest due on the USRA loan in December.
- 2) Request the remaining \$2 million available under the loan, to be advanced also in December 1977.
- 3) Request an increase of \$2 million in the USRA loan (this particular sum of \$2 million had recently become available for the USRA to reloan).
- 4) Apply to the Federal Railroad Administration for refinancing of 20 locomotives under the Loan Guarantee program of Section 511 of the Railroad Revitalization & Regulatory Reform Act (4R Act). The new obligation for these locomotives would be placed with the Federal Financing Bank.
- 5) With the funds available from the refinancing above, approach USRA and repay a \$7.5 million Note due them for these same 20 locomotives and then request a new loan of these funds for working capital purposes.
- 6) Request a study of merger possibilities by the U. S. Department of Transportation under Section 401 of the 4R Act, in addition to co-operating with the State of New York and the New England Regional Commission in the search for solutions to the difficult rail situation in the Northeast.

D&H has concluded agreements with USRA and FRA implementing the above financing objectives and on December 1, 1977 requested FRA to begin a Section 401 study to plan unification or coordination of D&H with other railroads. USRA agreed to the additional financing for 1977 and 1978 (of the \$7.5 million in new funds which became available via FRA refinancing, D&H has drawn down \$4.8 million leaving \$2.7 which the USRA has now refused to advance), notwithstanding its finding that D&H had only short-term viability. The Section 401 merger study request was, therefore, a key to USRA's commitment of additional funds, since long-term viability was thought to be dependent on consolidation or merger with other lines. In response to its requests, FRA now finally has before it consultant proposals for various aspects of the study. At the same time, USRA has invited proposals on a "New England Rail System Restructuring Analysis" which would embrace a study of D&H's structure.

Mr. ROONEY. Thank you very much, Mr. Shoemaker. Is your present precarious financial condition, partially responsible for loss of traffic due to the shippers looking for alternate modes of transportation?

Mr. SHOEMAKER. You mean, why did it now jump into a particularly severe situation? While our traffic volumes this year were somewhat disappointing, I think they are understandable and I don't think, in my own judgment, it represents a continual and unending erosion of D. & H. traffic as has been testified here today. Basically, we have had a continued series of industrial strikes, particularly paper companies in New England which have adversely affected traffic volumes. We have had somewhat of a slow summer. The precipitating element that caused the current crises certainly is Norfolk and Western's strike, and there is no denying that the harm to D. & H. is significant.

Nevertheless, I believe, on the whole, the comparison of this year's traffic and last year's, has dangerous results if you don't analyze it, simply due to the fact that the comparison of last year and this year includes 6 months of traffic to and from Oak Island for the type of operation that D. & H. subsequently discontinued, with the just encouragement of USRA, but nevertheless, that was almost 3,000 cars a month for 6 months, and that is half of the decline of this year against last year.

Mr. ROONEY. Didn't Mr. McDade say that it could be profitable?

Mr. SHOEMAKER. Yes, he did, and in fact—

Mr. ROONEY. Can it be profitable?

Mr. SHOEMAKER. We expect to immediately return, in a big way, into New York, and the arrangements with Sea-Land for a new operation, intermodal operation, have been accomplished, which will result in significant new profitable freight volumes for our company, and, in fact, I think, if that puzzles a lot of people, that wonder how can you handle the same kind of business and now make money when the carrier was losing its shirt in the past—

Mr. ROONEY. You have an increased rate?

Mr. SHOEMAKER. A substantially increased rate and disciplined operation with less terminal services for the shipper. I think there is an awfully good lesson in this and that shows you how badly the shipping service really desires rail competition in a disciplined form.

Mr. ROONEY. Discipline in your operation. You are presently, as I understand it, losing \$600,000 a month. Do you see any way a loss of this magnitude can be reduced in the near future and if so, how? Also, I think Chairman O'Neal testified \$600,000 was lost this month but that losses will increase in the future. Is that true?

Mr. SHOEMAKER. I don't think it is. That is basically a philosophy that says our erosion problem is unending. My written testimony describes the fact that D. & H. is not as competitive with ConRail, as the highway system in certain areas. The strategic problem I mentioned to you is directed toward improving the structural deficiencies that again are consistent with the FSP. We think this will have a very, very helpful impact on those results. I wish I could give you the concrete numbers as to what that will do. We are midway through an intensive strategic planning effort to try to identify exactly what that will do.

Mr. ROONEY. Do you think that restructuring is your only hope for survival?

Mr. SHOEMAKER. I think it is probable that restructuring is going to be required, but I won't even give you a complete yes to that. I don't know. I see so many opportunities for self-help, particularly if we can get these minor structural changes that I just don't know whether I could be that negative.

Mr. ROONEY. You talked about your improved relationship with ConRail. How about Boston & Maine—how are your relationships with them?

Mr. SHOEMAKER. I think excellent. In fact, we have initiated new services with the Boston & Maine in the last month, and currently are involved in assessment of more such changes. After all, their interest and D. & H.'s are closely allied, and I guess no railroad system for the most part stands alone. Your destiny is really tied to each other, and B. & M. and D. & H.'s is certainly a common concern.

Mr. ROONEY. How long do you think it will take to complete this study?

Mr. SHOEMAKER. Our own framework will—I hope to have it done this year. Frankly, if we continue—

Mr. ROONEY. We have heard 18 to 24 months.

Mr. SHOEMAKER. I see little chance of fruitful results for at least a year. I listened with interest to the Department's comment that maybe some input from those ongoing studies would be helpful. That would be delightful if that is the case. I can't see less than 1 year, 1½ years, before we get overall meaningful results from those efforts. What I was referring to was our own efforts, where we are primarily looking at the extensions on the map to try to make them work consistent with the FSP.

Mr. ROONEY. This committee is going to make every effort to save the D. & H. I don't believe that the ICC should involve itself. I think that you have got to get some help from the USRA and from the Department of Transportation. Let me ask you one final question. In your opinion, is it absolutely essential that Congress take some action this week and not wait until September to be able to—perhaps you might want to refer to counsel on this—to stay out of bankruptcy?

Mr. SHOEMAKER. Well, I have already referred to counsel on this, as you might imagine. Frankly, I think that is exactly the case. I think that clearly the board, and I think properly so, has a fiduciary responsibility to not let the cash erode to the point where a court might not have funds to continue essential public services while the court assesses its alternatives, and that is very, very blunt, but that is how I see it.

Mr. ROONEY. As chairman of this committee, I can assure you we will make every effort to keep you out of bankruptcy. We will make every effort to keep the ICC out of designated carriers, and hopefully, before Thursday evening, you might have a solution.

Mr. SHOEMAKER. Thank you, sir.

Mr. ROONEY. Thank you, Mr. Shoemaker. You made a very capable witness.

Our last witness will be Mr. Alan G. Dustin, president of the Boston & Maine Corp.

STATEMENT OF ALAN G. DUSTIN, PRESIDENT, BOSTON & MAINE CORP., ACCOMPANIED BY WILLIAM J. RENNICKE, ASSISTANT TO PRESIDENT; AND RAY CHAMBERS, WASHINGTON, D.C. REPRESENTATIVE

Mr. DUSTIN. Thank you, Mr. Chairman. I have with me today Mr. William J. Rennieke, my assistant, and Mr. Ray Chambers, our Washington representative. I have a prepared statement to submit, and as you review it you will note that a good deal of the information in my prepared statement has been pretty well covered today. However, I would like to zero in on certain points that I think are most important and add other items that I think might be pertinent to the discussions we have had today.

I have had the privilege of spending some 21 years of my career in various capacities on the D. & H. Railroad between 1947 and 1968, and the last 4 years I have been president and chief executive officer of the Boston & Maine Corp., which is an important connection to the D. & H. and conversely the D. & H. is an extremely important interchange connection with us. The D. & H. has been one of the largest volumewise interchange points for the B. & M. over the years.

I do appreciate the opportunity to present testimony to the House Commerce Subcommittee today. I would like to take the opportunity to give you a little basic background of the B. & M. so you might better put us in perspective and how our financial condition might relate to the other carriers in the Northeast.

We were talking a little earlier about the stigma of bankruptcy. We have suffered from that over 8 years, having gone into bankruptcy in 1970. We have consistently lost money since 1957, 21 years. Unlike D. & H. and ConRail, however, we have not borrowed or received grants of any amount from the U.S. Government. We have been fortunate to receive over \$3½ million in labor grants from the New England Regional Commission during the past 3 years and a \$2 million grant from the State of New York last year for the rehab of one of our major yards and part of our main line in New York State. However, our cash is tenuous and from time to time becomes critical.

Mr. ROONEY. And you pay no taxes?

Mr. DUSTIN. No, sir. Section 77 relieves us from making fixed charges on our bonded indebtedness.

Mr. ROONEY. How much does that amount to a year?

Mr. DUSTIN. \$4 million on our bonded indebtedness and we are relieved of about \$3 million a year in property taxes, but we have to accrue it and all of our income statements and reports to the ICC and others include this on a fully accrued basis.

I might say we are almost up to date on settling with all of the communities for back taxes and in some instances current taxes on a two-thirds basis for those communities that would accept two-thirds settlement. We have reduced our tax liabilities through this method over the past 3 years from \$19 million to about \$7 million, by using funds from property sales primarily to the Massachusetts Bay Transit Authority.

The only access we have to the outside world, domestically, is via ConRail and the D. & H. Both railroads that are obviously troubled.

We need a healthy interchange partner at Mechanicsville served by the D. & H. Without the D. & H., we would be completely captive to ConRail. Although we get along well with ConRail, we recognize the problems they have and we don't feel comfortable in the role that they play. If we were captive to ConRail, their philosophies with regard to an interchange partner might change.

We walk a perilous line. We have no funding available to use in the event we run out of cash. In a bankruptcy situation, if we do run out of cash and can't meet our payrolls, we shut our doors and throw ourselves upon the mercy of the ICC. Bankruptcy, in my judgment, is not the solution that the D. & H. should be looking for even on a temporary basis, and in my judgment, it would be temporary, because bankruptcy provides relief from paying certain obligations on a monthly basis, taxes and fixed charges. Relief to the D. & H. from having to pay taxes and fixed charges, in my judgment, wouldn't provide enough cash to permit them to continue on. I think, within a few short months, they would probably run out of cash in a bankrupt situation and then face the prospects of liquidation. Section 77 of the Bankruptcy Act, which places you under the jurisdiction of the trustees and the court perhaps has been beneficial and was designed to be beneficial for railroad reorganizations, but in my judgment, it is another layer of redtape. It creates more delay in having to go before the court for even minor decisions, to say nothing about important or major decisions. It is a time consuming, expensive, delaying situation.

Perhaps when the Bankruptcy Act was passed years ago it served a proper purpose, but what has happened to ConRail or what has happened to Penn Central and the other components of ConRail indicates very clearly section 77 of the Bankruptcy Act doesn't meet the modern situations of the railroads in the Northeast, because it places you under the jurisdiction of the courts, and the fact that the court has an obligation and often considers the highest priority, to protect the interest of the creditors, as compared with a railroad manager like myself who is more interested in serving the public by carrying out an efficient railroad operation. It is an easy step to go from bankruptcy into liquidation, if the court feels that this has to be done to protect the creditors' interest, bondholders or other secured creditors.

I would think, if the D. & H. were placed under the jurisdiction of a court, and they did run out of cash, it might be the election of the court not to take the directed service option, but rather to go for liquidation, which I think would be the worst course. Any control by USRA or the FRA, through a bankruptcy and placement under the jurisdiction of the court, I think, would be relatively small because the jurisdiction would be totally under the court and the trustees.

To get to another area, the final system plan, one of the requirements of the final system plan was there should be two competing railroad systems in the Northeast, and I would like to quote what I consider to be a pertinent part, including the foreword of the final system plan, which relates to the B. & M. and the D. & H., and I quote:

The preservation of competition requires specific steps either to bring other carriers into the area, or create two carriers out of the bankrupt railroads to provide a level of competition; alternative through service between New England and the west and the south could be provided effectively by extensions of the D. & H. to the junction point served by one of these two carriers—either the Norfolk and Western or the Chessie System.

That ends the quote. The final system plan provided for extending roads to meet the D. & H., and partly extension of the D. & H. on a modest basis to reach friendly connections. It provided for two competitive systems in the Northeast. Even before ConRail came into being, there was major changes because Chessie failed to carry out their part of the final system plan implementation. I think we are all familiar with the reasons, but the final system plan, as it was presented, was adopted by the Congress of the United States in November 1975, and in my judgment, that was a mandate to have two competitive rail systems in the Northeast. Whether I am right or wrong, it seems to me if there is going to be the elimination of the D. & H. through one cause or another, which would eliminate two competitive systems in the Northeast, this should be a decision for Congress.

I might say that the anthracite handling of coal by the D. & H. was not essential to their profitability. Anthracite movements on the D. & H. pretty well dried up between 1955 and 1960. The D. & H. continued making very good profits through 1968, strictly on traffic, without any heavy volume of anthracite, without any heavy volume of coal, period.

In 1969, which was really the last good financial year, their net income was \$31½ million on revenues of \$45 million, which is pretty good. Their collective losses since 1969 have reached a total of \$17½ million through the end of 1977. It is no mere coincidence that their future changed abruptly at the time the Penn Central merger of 1968 was being carried out. The loss of interchange traffic from the Pennsylvania Railroad at Wilkes-Barre or Buttonwood, Pa., over the jointly owned track, at that point, which was a direct result of the Penn Central merger, was devastating to begin with on the D. & H. They lost around 300 carloads a day, and then add to that the loss of the rest of their friendly connections when ConRail came into being; namely, the Lehigh Valley at Binghamton and Wilkes-Barre, the CNJ at Wilkes-Barre, which was fed also through the Reading Railroad, and another important one, the Erie Lackawanna, which provided a direct route between Binghamton and Chicago. That route was substituted by Binghamton to Buffalo, a more circuitous and time consuming route, and over tracks owned by ConRail. These have all been pretty well covered today by a number of witnesses.

It is important to recognize that the D. & H. is pretty much a victim of circumstances, almost totally beyond their control. The competitive railroad system as envisioned by the final system plan obviously has not materialized either through the D. & H. or ConRail. Today, the D. & H. finds itself with twice as much railroad and a 20 percent drop in traffic. Loss of shipper confidence has recreated a loss of traffic between ConRail and the D. & H., and this has created a loss to us, too, because we share traffic with these carriers. I don't say this in a derogatory manner. As I mentioned before, this is completely beyond the control of the D. & H. If you lose an essential part of your traffic and you are in the transportation business, obviously, you are going to have financial troubles, and this is what has happened to the D. & H., the B. & M. and ConRail as well. We all suffer the same ills. To put this decline in perspective and illustrate the adverse effect it has had on the B. & M.: During the first 6 months of 1974, the B. & M. received 53,000 carloads from the D. & H. at Mechanicville, N.Y., our only interchange point with them. We

received about 28,000 carloads or a 57 percent decline—this should be noted as a correction in my prepared statement—during the first 6 months of 1978, and that is another correction on my prepared statement. It should be 1978 instead of 1974. During the first 6 months of 1978, the B. & M. delivered to the D. & H. at Mechanicville 13,000 carloads, compared with a total of 25,000 carloads for the same 6 months period in 1974, or a 49 percent drop. Obviously, no industry can suffer that kind of loss without having a major impact on its financial and physical viability.

Where has all of the business gone? It certainly has not gone to ConRail. Our business with ConRail is off about 20 percent. It is my belief that the rail traffic that has not been diverted onto the highways, which is really our primary competitor, has been diverted through Canada. The Canadian superior routings, and a higher degree of service reliability, have syphoned off a great deal of the overhead business that used to be enjoyed by the U.S. carriers.

Mr. ROONEY. Tell me something about this. You say that the Canadian companies are syphoning off your traffic?

Mr. DUSTIN. It is traffic that is competitive.

Mr. ROONEY. Where does your traffic go to?

Mr. DUSTIN. There is a good deal of traffic that originates in Maine. Maine is a heavy originating State from the standpoint of high valued material, paper, paper products, lumber, lumber products.

Mr. ROONEY. So it goes to Brownville?

Mr. DUSTIN. Brownville, or it could go up the mountain division of the Maine Central.

Mr. ROONEY. Where does it come back into the United States?

Mr. DUSTIN. Usually around Detroit. See the State of Maine, obviously, sticks up into the confines of Canada, so the Maine railroads don't have this competitive factor. D. & H. and ConRail primarily do have this competition. The Maine railroads can handle traffic to and from the Canadian railroads just by going due west through Canada back into domestic United States. Our only service route, distance wise and revenue wise, division wise is through Mechanicville to the D. & H. and Rotterdam to ConRail. We don't have the good option of going there through Canada. It hurts us. Canadian railroads are good managers. They have excellent properties and have a lot more freedom to do what they think should be done than the domestic carriers in the United States, but it does take a lot of money away from the domestic carriers, ConRail, D. & H. and B. & M. on traffic that goes through Canada.

Conversely, the eastbound is in the same situation. Mr. Claytor was mentioning this a little earlier and I am glad to see what his attitude is toward this because right now the N. & W., who controls certain traffic interchanges, handles a considerable amount of traffic through the Detroit gateway to and from the Canadian railroads, and we would like to see them exert whatever influence they might have to handle this domestically through the D. & H. and the B. & M. to and from Maine, but the fact that there is a problem in the northeastern carriers, and there is a certain lack of confidence and disillusionment in the shipping public, there is more traffic, I am certain, going through Canada. The Maine railroads actually do a little better divisionalwise if they are able to handle this traffic through Canada, so it is a very real threat to us and our attempt to survive.

I completely support continued financial assistance to the D. & H., at least until the present management has an appropriate opportunity to identify and work to solve some of its major problems. I have attached in an addenda a proposal which I think makes sense as a means of providing the necessary assistance. I believe it is a sound and reasonable approach to maintain the D. & H. as an existing entity until certain conclusions can be made.

I would like to make one point on the present configuration of the lines. Right now I think we are probably at a historical low in the traffic flow via ConRail, D. & H., and B. & M. I know our traffic volume on the B. & M. for the first 6 months is the lowest since prior to 1900 and I assume the same situation exists on ConRail and D. & H., and if so, and if we do have faith in reassurances of our railroads and do feel we need railroads in the future for any number of reasons, because we are more efficient movers of traffic, because we have an energy problem, because we are less demanding on land and have less pollutants we throw into the air, I think we shouldn't make any rash decisions now that might eliminate lines in the future we might be sorry about.

Another point—with regard to the N. & W. Before ConRail came into being, we had the Erie Lackawanna which provided, at one time, second morning service between Boston and Chicago. ConRail, our competition, has fairly consistent second morning service between Boston and Chicago. We have been trying for several years now to get with the D. & H., the N. & W., to provide third morning consistent piggyback service between Chicago and Boston, and it has been a dismal failure for several reasons. There is between 30,000 and 35,000 trailer loads a year available to this joint route if we can provide not second morning but third morning because we have a lot of shippers that want another competitive route between Chicago and Boston. Right now, quite frankly, ConRail has more piggyback traffic than they can handle, and I have to admit they have got it all.

I think the directed service possibility has been discussed pretty freely today. I am certainly opposed to it. I think it would be chaotic, much more expensive to the Government. It might be cheaper for one association, more expensive for another, but in total, it would be much more expensive for the taxpayers. It is only an interim solution. It solves no problems. It imposes the very same operating practices that are in existence today. It is only a caretaker situation to buy time. I am afraid, in an actual realistic application of this, it would be a disaster. I think time is of the essence. We have lost 10 months in getting around to a study that actually hasn't started yet.

Mr. ROONEY. And we have 48 hours to pick it up.

Mr. DUSTIN. And even when the study is completed, unless some real good solutions are in the study and they are going to be implemented, it is not going to make much difference in the outcome. I think we have got to move fast, within 48 hours, or within a year to come up with some definitive conclusions and decide where we go from there because the sand is running pretty fast and one of these days it might catch up with us, too, and if something happens to us, what we are worrying about with the D. & H. might be completely academic.

I appreciate the time.

[Testimony resumes on p. 148.]

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

Testimony of Alan G. Dustin, President
 Boston and Maine Corporation
 August 16, 1978
 Before the Subcommittee on Transportation and Commerce
 House Interstate and Foreign Commerce Committee

My name is Alan G. Dustin. I am President and Chief Executive Officer of the Boston and Maine Corporation. I have spent the past 31 years in the railroad industry, including 21 years on the Delaware & Hudson Railway in various capacities and 4 years on the Boston and Maine as President and Chief Executive Officer.

I would like to thank the members of the House Commerce Subcommittee for inviting me to participate in the hearings on the Delaware and Hudson Railway (D&H).

As you are probably aware, one of the requirements of the Final System Plan was that there should be two competing railroad systems in the northeast. I would like to quote from the Final System Plan a brief paragraph which outlines the place of the D&H and the Boston and Maine as they were envisioned as important parts of an integrated transportation system in the northeast:

"The preservation of competition required specific steps either to bring other carriers into the area or create two carriers out of the bankrupt railroads to provide a level of competition....Alternative through-service between New England and the west and the south could be provided effectively by extensions of the D&H to a junction point served by one of these two carriers (Norfolk & Western or Chessie System)".

The phrase that I have read to you was part of the concluding criteria of one of the largest planning efforts ever undertaken either in this country or any other. Total expenditures which went into the planning of ConRail and the development of the Final System Plan were close to \$50 million. The Final System Plan took almost two years and the time of countless individuals to complete. More importantly, the Final System Plan, as it was presented, was adopted by the Congress of the United States as it sought, in late 1975, to recommend the structure and predict the result of a revitalized rail transportation system in the northeast as mandated by the Regional Rail Reorganization Act of 1973. Unfortunately, history has shown that the rail network envisioned by the architects of the Final System Plan has not materialized as intended either in the form of ConRail or in an extended Delaware & Hudson system representing an essential component of the so-called second competitive rail network in the northeast.

In 1969, which was the last good financial year for the D&H, their net income was \$3.5 million on revenues of \$45 million. Collective losses since 1969 reached a total of \$17.5 million through the end of 1977. It is no mere coincidence that the D&H's future changed abruptly at the time the Penn Central merger of 1968 was being carried out.

For years prior to the Penn Central merger, the D&H maintained substantial interchanges with the Pennsylvania Railroad at Wilkes Barre, Pennsylvania and acted as a bridge line for much of the traffic between the Pennsylvania Railroad and the New England region.

There were conditions included in the ICC order approving the Penn Central merger intended to prevent a diversion of traffic from the D&H but these conditions were never properly enforced by the ICC. Consequently, the heavy movement of cars between the former Pennsylvania Railway and the D&H were progressively diverted around the D&H which started the devastating erosion of their traffic.

The Penn Central merger threat also resulted in the Norfolk & Western's acquisition of both the D&H and the Erie Lackawanna; they were forced to by Order of the ICC and upheld by the United States Supreme Court. The presumed strengthening of the D&H and the Erie Lackawanna through a Norfolk & Western acquisition never materialized.

The fortunes of the D&H continued to slide through the early 1970's and the situation climaxed with the commencement of ConRail on April 1, 1976. With the beginnings of ConRail, the few remaining independent friendly connections, which the D&H enjoyed substantial interchanges with, disappeared into the ConRail system. Traffic flows to and from the Erie Lackawanna, Lehigh Valley, Central Railroad of New Jersey, Reading and other ConRail predecessor roads suddenly began to disappear as those roads were absorbed into ConRail.

A failure on the part of the Chessie to acquire lines connecting to the D&H in accordance with the Final System Plan forced the D&H, in an eleventh hour move, to accept the USRA's offer to extend its lines from Binghamton to Buffalo and from Wilkes Barre to Washington and down into the Oak Island section of northern New Jersey, all via ConRail lines. Although it was a defensive arrangement to reach distant "friendly" connections, the economics of this extension are questionable.

The competitive railroad system as envisioned by the Final System Plan has not materialized. Today, the D&H finds itself with twice as much railroad and a 20% drop in traffic. Loss of shipper confidence, extensive delays in handling traffic, equipment problems, deferred track maintenance and the severe weather conditions during the past two winters are only a few of the factors which have substantially thwarted the fulfillment of the Final System Plan. In fact, not only has the D&H proved to be an ineffective competitive system for ConRail, but neither ConRail nor the D&H have proved to be the kind of strong effective carriers that were needed to compete with the substantial amount of traffic which moves in and out of the State of Maine through Canada and into the midwestern regions of the United States as well as the traffic which has been diverted to truck.

To put this decline in perspective and to illustrate its adverse affect on the Boston and Maine; during the first six months of 1974, the Boston and Maine received 52,809 carloads from the D&H via Mechanicville, New York. During the same period of 1978, the Boston and Maine received 28,676 carloads from the D&H or a 57% decline. During the first six months of 1974, the Boston and Maine delivered to the D&H at Mechanicville 12,782 carloads compared with a total of 24,782 carloads for the same six month period in 1974 or a 49% drop.

Where has all the business gone? It certainly has not gone to ConRail. Between 1974 and 1977, our western interchange with ConRail has dropped 19,249 cars or 20%. It is my belief that the rail traffic that has not been diverted onto the highways is now moving through Canada. The Canadian railroads and their U.S. subsidiaries, through car supply, superior routings, and a higher degree of service reliability, have syphoned off a great deal of the overhead business which was once enjoyed by the U.S. carriers.

Both ConRail and the D&H, envisioned as competitors in the Final System Plan, have proved to be no competitors at all when compared to the alternatives available to the New England and midwestern shippers. Despite the \$40 million in loans which have been made to the D&H by the USRA during the past two years, the railroad has not improved and has not become supportable in its present condition or configuration.

I completely support continued financial assistance to the D&H, at least until the present management has an appropriate opportunity to identify and work to solve some of its major problems. I have attached in an addenda a proposal which I think makes sense as a means of providing the necessary assistance. I believe it is a sound and reasonable approach to maintain the D&H as an existing entity until certain conclusions can be made.

I realize that it is a very tempting idea to look at the substantially depressed traffic levels which exist in the region today and say that the railroad system as it presently exists is unnecessary to support the traffic base which it moves. I strongly caution against making such a hasty short-sighted decision. I believe we are looking at what I hope to be the historical low point in rail traffic in the New England area and northeast region. A hastily conceived discarding of any of the major railroad properties in the region may one day deny the railroad system the opportunity to capitalize on what should be its increasing market share resulting from the inherent advantages of the railroad as the most efficient mover of commodities.

A responsive carrier west of Buffalo could allow the Boston and Maine and the D&H to regain much of the 30,000 to 35,000 trailer loads of piggyback business which it has lost since the Erie Lackawanna passed into ConRail. Prior to the commencement of ConRail, the Boston and Maine, the D&H, and the Erie Lackawanna maintained an attractive east/west piggyback operation between the Metropolitan Boston area and the Chicago region. Despite numerous attempts to reinstate the piggyback operations which we enjoyed prior to the start-up of ConRail, the Boston and Maine and the D&H have never been able to get the N&W interested in offering attractive and consistent third morning deliveries between Boston and the Chicago region. I suspect that the loss of piggyback alone has cost the D&H close to \$4 million in gross revenues per year.

In addition to helping draw attention to the plight of the D&H, I feel that it would be appropriate to continue some form of financial aid to the D&H. As I indicated earlier, I have attached a proposal for such aid. However, I think it would be appropriate to discuss the directed service alternative that I understand has been considered as attractive by many of the planning groups here in Washington. I believe directed service would only prove to be an expensive and chaotic alternative to the present financial schemes which are supporting the D&H.

The apparent shortcomings of directed services are numerous. First of all, it is only eight months in duration, which is too short of a planning horizon to make a substantial change in a railroad. Secondly, because of the very severe restrictions it places on the directed railroad in the areas of maintaining existing labor contracts and agreements, very little could be done to improve the cost structure of the railroad while directed services are in operation. More importantly, it does nothing more than mark time.

An additional problem with the directed services option is that it does nothing more than provide a caretaker. The D&H needs the funding and resources to make the necessary improvements it requires to become the strong competitor it was envisioned to be in the Final System Plan.

In closing, I must emphasize that the time frame in which we must deal with this problem is compressing more and more each day. Unfortunately, we have been marking time in the case of the D&H for far too long. As most of you know, the 401 Study request was made last November. Here we are now in August of 1978, ten months after the request was made, and to date, the contract has not been let to hire the consultant to conduct the study. Ten months is far too long to wait to deal with the problem as important as the one we are faced with on the D&H.

Shipper confidence continues to erode. The longer we wait to come to grips with these problems, the less chance we will ever have of recovering the business we have lost to the highways or the business which is currently being diverted through Canada. We must commence to take action now while we still have the opportunity and the traffic base to leverage our actions.

I want to thank you for your interest and I will be willing to answer whatever questions you might have.

ATTACHMENT I - Boston and Maine Position on Interim Funding for the Delaware and Hudson Railway Company

The Boston and Maine fully supports the availability of interim funding for the Delaware and Hudson Railway Corporation (D&H). If existing programs to not allow adequate financial assistance, and new legislation is required, we ask that Congress consider a new emergency rail services financing program that would give the Secretary or USRA flexibility to meet cash crises on railroads in a region undergoing Section 401 (PL-94-210) planning.

It appears that legislation will be required to meet the D&H cash flow problem in a rational way. The Board of the U. S. Railway Association has already rejected a D&H request for an additional drawdown on its \$30 million loan due to a perceived inability to repay. Officials of the Federal Railroad Administration are doubtful that they could make the required security finding under the Emergency Rail Services Act of 1970-- even if the D&H were to go into Bankruptcy (a requirement of ERSA). Most knowledgeable observers feel that Section 77 Bankruptcy would provide only short-term financial relief. Further Bankruptcy could have some very real deficits in terms of traffic. Private sector funding does not appear to be available for working capital. An ICC directed service order might prove costly in the extreme and totally ineffective in resolving D&H problems.

The only legislative proposal to date is the one proposed by Senator Daniel Moynihan to alter the USRA loan programs of the 3-R Act (PL 93-236). The Moynihan proposal would authorize an additional \$20 million for the D&H and waive the "adequacy

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of security" and "probability of repayment" requirements. The Boston and Maine supported the Moynihan amendment when it appeared that it might be the only viable alternative to the financial collapse of the D&H. However, it appears that the D&H cash position is improved to the point that cessation of service is not eminent.

As a matter of legislative principal, the Boston and Maine feels it is not good policy to pass "single railroad" financing legislation. Rather, we propose that Congress take this opportunity to create a new Emergency Rail Services Financing Act of 1978. The program should be broad and give its administrator maximum flexibility. We suggest the following basic principals:

- 1) The funds may be made available to any railroad in danger of cessation of vital service in a region where 401 planning is underway.
- 2) This working capital funding may be made available to railroads in or out of Section 77 re-organization.
- 3) The Secretary may set terms and conditions for repayment of the loan. If the Secretary determines that there is not reasonable likelihood of repayment, he will be encouraged to utilize the 401 process to expedite restructuring of viable rail service. If he determines that restructuring of the carrier is hopeless he may discontinue drawdowns on the loan, and recommend a "directed service option" to the Commission.

The Boston and Maine recommends that the emergency working capital be in the form of a loan, or guarantee, but that the terms of repayment be flexible--perhaps a range from redeemable preference share terms to ERSA loan guarantee terms. Along these lines it may be appropriate to end the Emergency Rail Services Act of 1970, transfer the available funds in ERSA to the new program, and combine it within Title V of the 4-R Act. Attachment II provides an outline of such a proposal.

ATTACHMENT II - Outline Proposal for Emergency Rail Services
Financing Act of 1978

A. PURPOSE--To amend the Railroad Revitalization and Regulatory Reform Act of 1976 to provide emergency working capital financing for railroads experiencing a cash crisis in a region undergoing 401 planning. Also, to terminate the Emergency Rail Services Act of 1970, and to transfer the funding and loan guarantee authority to the new Section created by the Emergency Rail Services Financing Act of 1978 (ERSFA).

B. PROGRAM AND FINDINGS--A new Section 506 of the 4-R Act will be created and entitled "Emergency Working Capital Financing."

1) Application. Any railroad may apply so long as there is a cash emergency and the railroad is within a 401 planning region. Each applicant for working capital shall set forth--

°A description of the problem

°A statement that failure of the Secretary to make working capital available will result in cessation of service.

2) Findings. The Secretary will find--

°That the application is an essentially correct and honest statement of the problem.

°That other funds of the railroad or other reasonable cost effective solutions are not available on a ready basis.

°The financial assistance is in the public interest.

NOTE--If the Secretary finds the funding is in the public interest, but there is little prospect of repayment by the company, he is encouraged to use his 401 process to speed rationalization. If the carrier, or the Commission,

ATTACHMENT II - Page two

or other public body refuses to implement 401 recommendations the Secretary considers essential viability of the rail system over which the carrier operates, the Secretary may terminate Working Capital funding, and turn the matter over to the ICC for a directed service order or other solution.

3) Program. Railroad working capital financing may be in the form of purchase by the Secretary of redeemable preference shares-working capital issue or Trustee Certificates-working capital issue. Terms and conditions of redemption or repayment shall be the same as redeemable preference shares under current law.

Railroad working capital financing may also be in the form of an Emergency Rail Services Loan Guarantee. Loan Guarantees may be made available to railroads in or out of Section 77 Reorganization. A loan guarantee will bear interest at a per annum rate deemed reasonable by the Secretary and its maturity date may be no later than 30 years from the date of original issuance.

4) Authorization-Financing for this program shall be the result of a transfer of the ERSA-1970 obligation level and fund availability. This would mean that the aggregate outstanding amount of redeemable preference shares-working capital and trustee certificates-working capital and loan guarantees for working capital could not exceed \$125,000,000 at any one time. At the time of enactment, \$50,000,000 would be available as a result of the \$50,000,000 repaid to the ERSA fund by Penn Central Trustees on July 1.

Mr. ROONEY. I have no questions, Mr. Dustin, not because you are the last witness—I think you have summed it up very well. Usually the last witness is anticlimatic, but I commend you for your presentation here. I agree with everything that has been said by you, by Mr. Shoemaker and by the N. & W. I think we have got to move quickly and make sure that the D. & H. doesn't go into bankruptcy. I think within the next 48 hours, Congress has got to act to save the D. & H. We will make every effort possible.

There will be included in the record, at this point, a statement by Mr. James R. Snyder.

[Mr. Snyder's prepared statement follows:]

STATEMENT OF
J.R. SNYDER, CHAIRMAN, LEGISLATIVE COMMITTEE
RAILWAY LABOR EXECUTIVES' ASSOCIATION

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

ON BEHALF OF THE RAILWAY LABOR EXECUTIVES' ASSOCIATION, ITS MEMBERS AND THE EMPLOYEES OF THE NATION'S RAILROADS WHOM THEY REPRESENT, I WOULD LIKE TO EXPRESS OUR APPRECIATION FOR THE OPPORTUNITY TO PRESENT TO YOU THEIR VIEWS ON A SUBJECT WHICH WE BELIEVE TO BE MOST VITAL TO THOUSANDS OF THE RAILROAD EMPLOYEES WE REPRESENT AS WELL AS TO A SIGNIFICANT AND ECONOMIC SEGMENT OF THIS COUNTRY.

MY NAME IS J.R. SNYDER, I AM CHAIRMAN OF THE LEGISLATIVE COMMITTEE OF THE RAILWAY LABOR EXECUTIVES' ASSOCIATION AND THE NATIONAL LEGISLATIVE DIRECTOR OF THE UNITED TRANSPORTATION UNION. MY OFFICE IS LOCATED IN THE RAILWAY LABOR BUILDING AT 400 FIRST STREET, N.W. WASHINGTON, D.C. ACCOMPANYING ME IS MR. WILLIAM G. MAHONEY, COUNSEL TO THE RAILWAY LABOR EXECUTIVES' ASSOCIATION.

THE RAILWAY LABOR EXECUTIVES' ASSOCIATION IS AN UNINCORPORATED ASSOCIATION WITH WHICH ARE AFFILIATED THE CHIEF EXECUTIVE OFFICERS OF ALL OF THE STANDARD NATIONAL AND INTERNATIONAL RAILWAY LABOR UNIONS IN THE UNITED STATES. THE ORGANIZATIONS WHOSE CHIEF EXECUTIVE OFFICERS ARE MEMBERS OF THE RLEA ARE LISTED BELOW:

AMERICAN RAILWAY SUPERVISORS ASSOCIATION
AMERICAN TRAIN DISPATCHERS ASSOCIATION
BROTHERHOOD OF LOCOMOTIVE ENGINEERS
BROTHERHOOD OF MAINTENANCE OF WAY EMPLOYEES
BROTHERHOOD OF RAILROAD SIGNALMEN
BROTHERHOOD RAILWAY CARMEN OF THE UNITED STATES
AND CANADA
BROTHERHOOD OF RAILWAY, AIRLINE AND STEAMSHIP CLERKS
HOTEL & RESTAURANT EMPLOYEES & BARTENDERS INT'L. UNION
INTERNATIONAL ASSOCIATION OF MACHINISTS & AEROSPACE
WORKERS
INTERNATIONAL BROTHERHOOD OF BOILERMAKERS & BLACKSMITHS
INTERNATIONAL BROTHERHOOD OF ELECTRICAL WORKERS
INTERNATIONAL BROTHERHOOD OF FIREMEN & OILERS
INTERNATIONAL ORGANIZATION OF MASTERS, MATES & PILOTS
OF AMERICA
NATIONAL MARINE ENGINEERS' BENEFICIAL ASSOCIATION
RAILROAD YARDMASTERS OF AMERICA
RAILWAY EMPLOYEES' DEPARTMENT, AFL-CIO
SHEET METAL WORKERS' INTERNATIONAL ASSOCIATION
SEAFARERS INTERNATIONAL UNION OF NORTH AMERICA
TRANSPORT WORKERS UNION OF AMERICA
UNITED TRANSPORTATION UNION

CHAIRMAN ROONEY, IN ANNOUNCING THESE HEARINGS, QUITE

ACCURATELY POINTED OUT THE BASIC SOURCE OF THE D & H'S FINANCIAL DIFFICULTIES. CHAIRMAN ROONEY SAID:

"THE D & H'S FINANCIAL DIFFICULTIES ARE THE DIRECT RESULT OF BUREAUCRATIC BUNGLING. IT SEEMS IRONIC TO ME THAT A RAILROAD CAN OPERATE FOR 150 YEARS, AND WITHIN TWO YEARS AFTER BEING ASSISTED BY THE FEDERAL GOVERNMENT, IT IS ON THE BRINK OF BANKRUPTCY."

THE DELAWARE AND HUDSON EMPLOYS 785 OPERATING PERSONNEL AND 1,015 NON-OPERATING PERSONNEL. THERE ARE APPROXIMATELY 200 EMPLOYEES NOW ON FURLOUGH WHO WOULD NOT BE ON FURLOUGH BUT FOR THE DETERIORATING SITUATION FACING THE D&H. IN TOTAL THEN, THE D&H EMPLOYS SOME 2,000 RAILROAD WORKERS.

ANY SUBSTANTIAL DISRUPTION OF THE OPERATIONS OR SERVICES OF THE D&H WILL HAVE SERIOUS ADVERSE ECONOMIC EFFECTS THROUGHOUT NEW ENGLAND. FOR EXAMPLE, THE BOSTON AND MAINE RAILROAD HAS BEEN SUCCESSFUL IN STAVING OFF LIQUIDATION OVER THE PAST DECADE BUT IT HAS BEEN, AND CONTINUES TO BE, A DIFFICULT STRUGGLE. SOME THIRTY PERCENT OF ITS TOTAL TRAFFIC IS INTERCHANGED WITH THE DELAWARE AND HUDSON. THERE CAN BE LITTLE DOUBT THAT A SUBSTANTIAL CURTAILMENT OF SERVICE BY THE DELAWARE AND HUDSON WOULD BE DISASTEROUS TO THE BOSTON AND MAINE. AT THE PRESENT TIME, THE BOSTON AND MAINE EMPLOYS SOME 2,535 NON-OPERATING EMPLOYEES AND 865 OPERATING EMPLOYEES; A TOTAL OF 3,400 EMPLOYEES. THESE MEN AND WOMEN AND THEIR FAMILIES -- NOT TO MENTION THE BUSINESSES IN THEIR NEIGHBORHOODS -- ARE DEPENDENT FOR THEIR LIVELIHOODS UPON THE CONTINUED OPERATION OF THE BOSTON AND MAINE. THE CONTINUED OPERATION OF THE BOSTON AND MAINE IS VERY MUCH DEPENDENT UPON THE CONTINUED OPERATION OF THE DELAWARE AND HUDSON.

THE RECENT HISTORY OF THE D&H SHOWS THAT THE SMARTEST FOLKS IN THE WORLD CAN'T CREATE SUCCESSFUL RAILROADS BY SITTING AROUND A TABLE AND DRAWING LINES ON A MAP. THE D&H SHOULD HAVE BEEN LEFT ALONE UNDER THE 3R ACT. IT WAS DOING ALL RIGHT. AS CHAIRMAN ROONEY NOTED IT HAD BEEN DOING ALL RIGHT FOR ABOUT 150 YEARS. THE FEDERAL GOVERNMENT PUT IT INTO A POSITION WHERE IT IS JUST ABOUT TO GO BANKRUPT.

I RESPECTFULLY SUBMIT THAT THE FEDERAL GOVERNMENT SIMPLY CAN'T LET THAT BE THE END RESULT OF ITS WORK IN THE NORTHEAST.

IT SEEMS TO ME THAT THE D & H GOT INTO THIS MESS WITH GOVERNMENT HELP AND THE GOVERNMENT OUGHT TO HELP GET THEM OUT OF IT.

THERE IS ANOTHER ASPECT OF THIS MATTER WHICH WE THINK CONGRESS MUST VIEW QUITE SERIOUSLY IN CONSIDERING FUTURE AID TO THE RAILROADS OF THIS COUNTRY. I AM TALKING ABOUT THE CRITICAL FUEL SHORTAGE WHICH CONFRONTS THIS NATION AND WHICH WORSENS EVERY DAY. AS A LAYMAN, I CAN'T UNDERSTAND WHY WE PURCHASE OIL FROM THE OPEC NATIONS AT WORLD MARKET PRICES AND PUMP IT INTO SALT DOMES IN THE GROUND IN REMOTE AREAS OF OUR NATION FOR FUTURE USE; WHILE AT THE SAME TIME WE VIRTUALLY GIVE AWAY THE OIL WE ARE PUMPING OUT OF OUR GROUND ON THE NORTH SLOPE OF ALASKA. WHILE THAT POLICY SEEMS TO ME TO BE ILLOGICAL AND HARMFUL, I DO NOT KNOW ALL OF THE REASONS WHICH HAVE PROMPTED OUR GOVERNMENT TO PERMIT THAT TO OCCUR. I DO KNOW, HOWEVER, THAT OUR RAILROAD'S SYSTEM IS THE MOST ENERGY EFFICIENT TRANSPORTATION SYSTEM AVAILABLE AND THAT WE MUST PRESERVE IT. WE CANNOT PERMIT IT TO DISINTEGRATE IN TOTAL OR PIECEMEAL. IT SEEMS TO ME THEREFORE, FOR THAT REASON ALONE, THE DELAWARE AND HUDSON MUST NOT BE PERMITTED TO FAIL.

I AGREE WITH THE CHAIRMAN THAT THE FEDERAL GOVERNMENT "HAS A MORAL OBLIGATION TO KEEP THE RAILROAD FROM BANKRUPTCY AT LEAST UNTIL SUCH TIME AS IT HAS COMPLETED ITS RESTRUCTURING STUDIES."

BUT I WOULD GO SOMEWHAT FURTHER. I AM CONVINCED THAT THE FEDERAL GOVERNMENT HAS AN OBLIGATION TO THE NATION TO PRESERVE ITS RAIL SYSTEM IN THE FACE OF AN ENERGY CRISIS WHICH WORSENS WITH EVERY GALLON OF OIL CONSUMED IN THIS NATION.

THE RAILWAY LABOR EXECUTIVES' ASSOCIATION, ITS TWENTY LABOR ORGANIZATION MEMBERS, AND THE HUNDREDS AND THOUSANDS OF RAILROAD EMPLOYEES THEY REPRESENT STRONGLY SUPPORT FEDERAL FINANCIAL AID TO THE D & H TO KEEP THAT RAILROAD FROM BANKRUPTCY.

AGAIN, I WISH TO EXPRESS TO YOU OUR APPRECIATION FOR THE OPPORTUNITY TO PRESENT OUR VIEWS ON THIS MOST IMPORTANT SUBJECT. THANK YOU.

Mr. ROONEY. That concludes the testimony.

[The following statements were received for the record.]

Statement of the
Honorable Eugene F. Hickey,
Mayor of Scranton, Pennsylvania.

Before a
Special Hearing on the
Financial Condition of the
Delaware & Hudson Railway

Conducted by the
Subcommittee on Transportation and Commerce
Committee on Interstate and Foreign Commerce,
House of Representatives.

August 15, 1978,
Rayburn House Office Building,
Washington, D.C.

* * * *

Honorable Chairman and Members of the Subcommittee - - -

I wish to express my appreciation to
the Chairman and the Subcommittee for ^{allowing me to present testimony} ~~your kind invitation~~
~~to appear here today~~ while your Subcommittee is reviewing
methods of financial support so critical to the future of
the Delaware & Hudson Railway.

Very importantly, I would like to
compliment your colleague and my Congressman, Joe McDade,
~~for arranging my appearance before your Subcommittee.~~ As you
are well aware, Joe has been very aggressive in portraying
the distress of northeastern Pennsylvania over the recent
erosion of rail service in our area. On behalf of the citizens
of Scranton and our region, I want to personally thank Joe for
his very positive leadership.

I do not want to burden your Subcommittee with any lengthy testimony on the background of the present crisis confronting the Delaware & Hudson.

Coming from a railroad family, I am intensely aware of the transportation mission of the D & H.

Consequently, I join Congressman McDade in urging this Subcommittee to provide passage for this railroad over the critical days immediately ahead and assure the new management of the D & H a full opportunity to realign its financial system.

I am very impressed with President Kent Shoemaker's determination to restructure the line which contributes so much to the economy of our northeastern states, most particularly our region in Pennsylvania.

There are many who believed that the D & H should have been made part of ConRail at the time that the United States Railway Association was recycling several of our bankrupted systems. I was glad that the USRA preserved the independence of the D & H to provide basic competition. Also, their action forestalled for our area a fate now inflicted upon it by ConRail's poor service.

But, some of the factors forced on D & H by the reorganization act have mitigated against the system's financial and operational position.

So, the City of Scranton is appealing to this Subcommittee to insure the future independence of the Delaware & Hudson through a reasonable loan program, through the preservation of traffic that historically belongs to D & H and through other assistance which in the judgment of the Congress will contribute not only to the survival of this great rail system but to the future general health of D & H. For, the economic health of several northeastern states is inseparable from the health of the D & H.

So, in summarizing my appeal to this Subcommittee, I beg of you to formulate some affirmative plan which will save the D & H for generations as this gallant railroad performed for past generations.

This Congress, through your distinguished Subcommittee, by enacting a positive assistance program can bring to our people a new hope for national growth and area economic development by your affirmative support of the great Delaware & Hudson Railway.

I thank you.....

INTERNATIONAL PAPER COMPANY

STATEMENT TO THE HOUSE
OF REPRESENTATIVES SUBCOMMITTEE ON
TRANSPORTATION & COMMERCE

AUGUST 15, 1978

HEARING ON DELAWARE & HUDSON RAILWAY

My name is Fred M. Zitto and I am Manager - U.S. Distribution Operations for International Paper Company.

The forest products industry is the single largest industry user of rail transportation. Forest products account for 31% of the tonnage transported by the Delaware & Hudson Railway.

International Paper Company (IPCO) is the largest paper company in the forest products industry. In 1977 IPCO's gross sales revenues were \$3.7 billion. Our bill for transportation exceeded \$450 million. International Paper ships over 8,000 cars per year via the Delaware and Hudson. We are one of the largest, if not the largest, user of the Delaware and Hudson.

International Paper Company's mills at Corinth and Ticonderoga, New York are totally dependent on the Delaware and Hudson for rail service. These mills represent an investment of \$80 million and employ 1,785 people with an annual

payroll of \$32 million. Considering support activities in the surrounding area, we estimate that these mills generate a total payroll of some \$95 million.

For many years the Delaware and Hudson was a profitable railroad and provided reliable railroad service. We will not burden the Committee by again describing the origins of the Delaware and Hudson's problems, the formation of Conrail, the doubling of the D & H's lines in the hope of providing a competitive alternative, etc. Suffice it to say that Delaware and Hudson's volume has remained static despite the doubling of its lines; the expansion has been a financial failure.

We can well understand USRA's reluctance to authorize additional loans to the D & H. In the absence of some major restructuring the financial outlook for the D & H looks bleak. However, limited additional funding to assure the D & H's survival until the USRA/FRA studies seeking longer term solutions are completed would appear to be justified. Bankruptcy and the untested provisions of the current law for "directed service" by another railroad would appear to offer more risks and greater expense. The problem would only be postponed since "directed service" is limited to 240 days. Limited additional funding would probably cost the taxpayer less in the long-run.

We do not presume to offer pat answers to problems that

have been years in the making. We do offer the following suggestions that may be helpful in eventually producing a solution.

1. The authorization of sufficient government funding to assure the survival of the D & H until the recommendations of the USRA/FRA studies can be implemented. We would urge the USRA to authorize the drawdown of the remaining \$2.5 million of loan funds already authorized as the lowest cost alternative.
2. Redesign the FRA restructuring study to give immediate priority to assisting the D & H to develop a short term action plan to cut losses by January 1, 1979. The USRA/FRA studies are designed to restructure the New England rail system and include the search for a longterm solution to the D & H problem. These studies are likely to take up to eighteen months to complete. An immediate mini-study of actions that the D & H can take independently to improve revenues and reduce expenses in the short term could be completed by the FRA by year end.
3. The drawdown of any loan funds approved beyond the \$2.5 million already authorized be subject to USRA acceptance of the short term plan and monitoring for progress. In our opinion this would provide the D & H with the means to survive until longer term solutions can be found and it would give the taxpayer some assurance that the funds were prudently invested.

The Delaware and Hudson represents the last hope that some competitive alternative to Conrail will survive in the Northeast. Bankruptcy, with all the risks and expense of "directed service" will destroy this hope and make the D & H a permanent government ward. Limited interim funding with reasonable conditions for D & H performance would be a much better alternative.

[Whereupon, at 4:35 p.m., the subcommittee adjourned].

