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RAIL RESTRUCTURING ASSISTANCE ACT OF 1979

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HEARING

BEFORE THE

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SUBCOMMITTEE ON SURFACE TRANSPORTATION

OF THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION

UNITED STATES SENATE

NINETY-SIXTH CONGRESS

SECOND SESSION

ON

S. 1151

TO IMPROVE THE QUALITY OF RAIL SERVICE IN THE
UNITED STATES THROUGH FINANCIAL ASSISTANCE WHICH
ENCOURAGES RAILROAD RESTRUCTURING

MARCH 31, 1980

Serial No. 96-92

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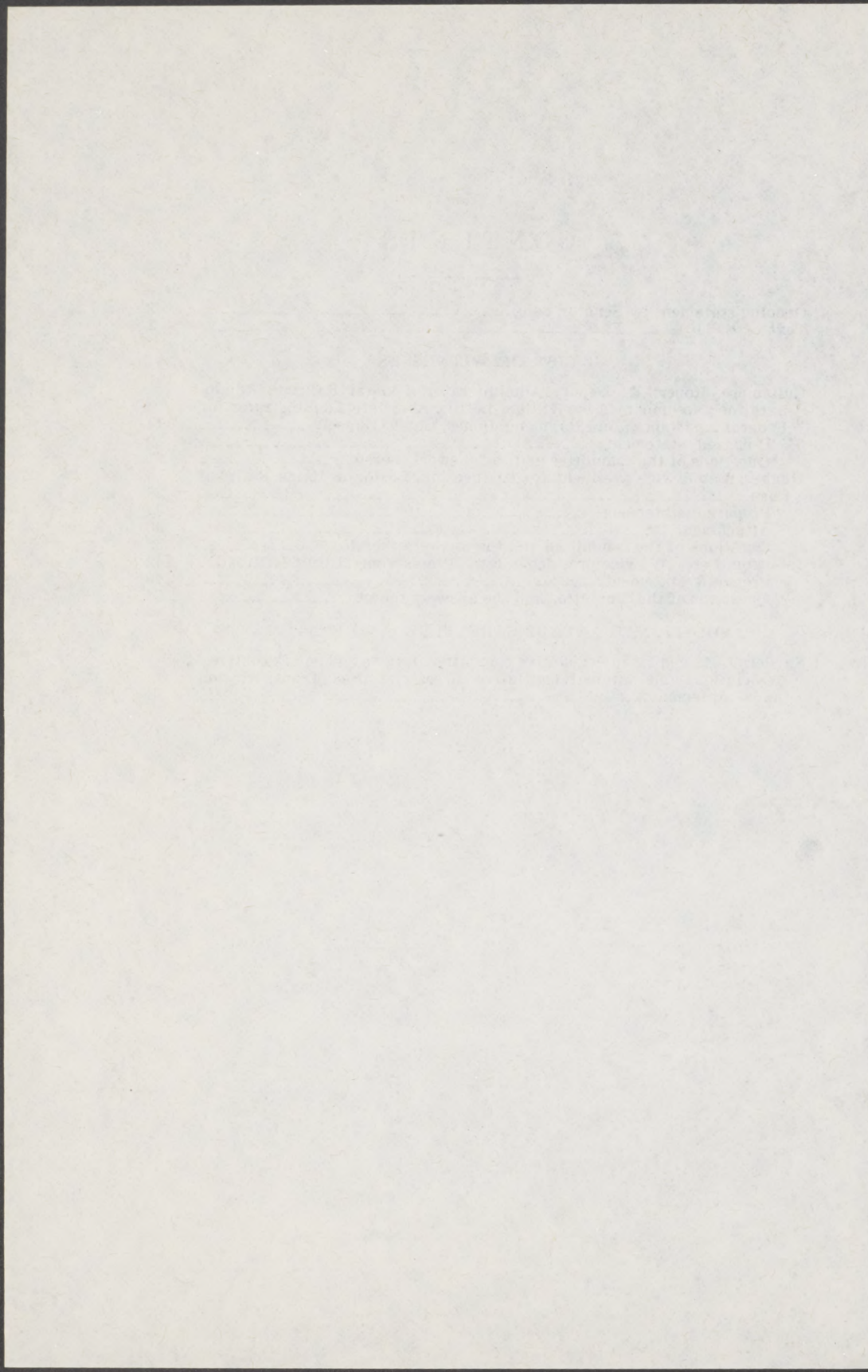
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RAIL RESTRUCTURING ASSISTANCE ACT OF 1979

MONDAY, MARCH 31, 1980

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
SUBCOMMITTEE ON SURFACE TRANSPORTATION,
Washington, D.C.

The subcommittee met at 10:05 a.m. in room 235, Russell Senate Office Building, the Hon. Russell B. Long (chairman of the subcommittee) presiding.

OPENING STATEMENT BY SENATOR LONG

Senator LONG. This hearing will come to order.

Today's hearing is on S. 1151, a bill introduced in May 1979 at the request of the Department of Transportation to facilitate railroad restructuring and to improve employment efficiency. The legislation provides for two 5-year programs authorizing a total of \$1.475 billion in financial assistance. This new program of railroad assistance would replace the present title V program established under the 4R Act of 1976, which terminates September 30, 1980.

The existing program has not been used by a number of railroads because of the restriction which requires that in determining whether a request for financial assistance is in the public interest, the Secretary of Transportation shall evaluate and consider the availability of funds from other sources at a reasonable cost. This requirement has had the effect of eliminating all but the financially weakest railroad from eligibility under this program.

Although the bill would resolve one problem by expanding the program to include solvent railroads, it has been suggested that it would create another problem by possibly excluding certain public interest projects currently eligible for funds. In other words, while there may be a continuing need to provide Federal financial assistance to the railroad system, it is not clear that all such assistance should be tied to a "restructuring" as provided in this legislation. This, it appears to me, is the key question, which I hope our witnesses will address in their testimony today.

[The bill follows:]

1 (1) the national interest requires a rail transporta-
2 tion system in the private sector which is capable of
3 moving the Nation's freight safely and efficiently; and

4 (2) the railroad industry faces significant capital
5 needs which it must meet through a reduction in
6 excess facilities and through improvements in asset and
7 manpower utilization.

8 (b) It is declared to be the purpose of the Congress in
9 this Act to foster a safe and efficient rail transportation
10 system by providing transitional financial assistance which
11 facilitates—

12 (1) restructuring of railroad facilities and related
13 projects that emphasize higher density operations and
14 the elimination of uneconomic plant; and

15 (2) improved asset and manpower utilization.

16 RESTRUCTURING ASSISTANCE

17 SEC. 3. Title V of the Railroad Revitalization and Reg-
18 ulatory Reform Act of 1976 (45 U.S.C. 821 et seq.) is
19 amended by inserting the following new sections at the end
20 thereof:

21 “RESTRUCTURING ASSISTANCE

22 “SEC. 518. (a) The Secretary is authorized to provide
23 financial assistance through repayable credits constituting a
24 debt or equity financing to any class I railroad (as determined
25 by the Commission in accordance with 49 U.S.C. 11145(a)),

1 other than the Consolidated Rail Corporation, or any subsidi-
2 ary of such a class I railroad to pay any share of the cost of
3 restructuring its facilities, including related labor protection
4 costs, and acquiring securities pursuant to a restructuring.
5 The Secretary shall make debt or equity financial assistance
6 available under this section only if the Secretary determines
7 that—

8 “(1) the assistance will result in significant rail-
9 road restructuring and this restructuring would not be
10 likely to be achieved unless such assistance is provided;
11 and

12 “(2)(A) the railroad has agreed to restructuring
13 under a plan submitted in accordance with subsection
14 (h) of this section; or

15 “(B) the assistance will be used to fund a project
16 approved by the Secretary under section 5 (a)–(d) of
17 the Department of Transportation Act (49 U.S.C.
18 1654 (a)–(d)), and the railroad shows that the project
19 will result in significant restructuring.

20 “(b) The Secretary shall provide financial assistance
21 under subsection (a) of this section by purchasing a fixed debt
22 obligation issued by a railroad or where the Secretary deter-
23 mines that an equity financing is essential to a restructuring,
24 the Secretary may provide financial assistance under this sec-
25 tion by purchasing Senior Preferred Stock. The Secretary

1 may purchase a fixed debt obligation issued as a trustee
2 certificate by the trustee of a railroad in reorganization under
3 chapter 11 of title 11 of the United States Code or under
4 section 77 of the Bankruptcy Act in the form of a trustee
5 certificate. The Secretary shall purchase a trustee certificate
6 only if the Secretary finds that the restructuring is necessary
7 for the establishment of a self-sustaining railroad.

8 “(c) A fixed debt obligation which the Secretary pur-
9 chases under this section shall provide that on the fifth anni-
10 versary of the date of original issuance, interest (at three-
11 fourths of the rate established by the Secretary of the Treas-
12 ury as of the most practicable date immediately preceding
13 execution of a financing agreement and taking into account
14 the current average yield on outstanding marketable securi-
15 ties of the United States having comparable maturities) shall
16 begin to accrue. Beginning on the sixth anniversary of the
17 date of original issuance, accrued interest and principal shall
18 be payable annually in equal aggregate installments such that
19 on a date not later than the twentieth anniversary of the date
20 of original issuance, the principal and all accrued interest
21 shall have been repaid. Consistent with subsection (f) of this
22 section, the Secretary may require a railroad or a subsidiary
23 receiving assistance under this section to convey to the Sec-
24 retary a security position which accords the Secretary a lien
25 and priority of payment which are subordinate to those of the

1 railroad's present and prospective secured creditors (and any
2 claims having a priority of payment senior to secured credi-
3 tors) but are first in time and right to those of all present and
4 prospective unsecured creditors.

5 “(d) Where the Secretary makes a determination under
6 subsection (b) of this section, the Secretary may, in purchas-
7 ing trustee certificates or at any time thereafter, agree with
8 the trustee of a railroad in reorganization under chapter 11 of
9 title 11 of the United States Code or under section 77 of the
10 Bankruptcy Act to exchange trustee certificates for Senior
11 Preferred Stock issued in connection with a plan of reorgani-
12 zation approved by the reorganization court.

13 “(e) Senior Preferred Stock shall be an equity security
14 issued by a railroad or its subsidiary. Each share of Senior
15 Preferred Stock shall—

16 “(1) in accordance with the laws of the issuer's
17 state of incorporation governing dividends on and re-
18 demption of preferred stock—

19 “(A) be subject to redemption at par com-
20 mencing no later than the sixth anniversary of the
21 date of original issuance and ending not later than
22 the twentieth anniversary of the date of original
23 issuance in amounts which will aggregate the ini-
24 tial par value of the share and return the aggre-
25 gate of dividends cumulated and due;

1 “(B) have dividends payable annually (at
2 one-half the rate established by the Secretary of
3 the Treasury as of the most practicable date im-
4 mediately preceding execution of a financing
5 agreement taking into account the current aver-
6 age yield on outstanding marketable securities of
7 the United States having comparable maturities)
8 beginning on the sixth anniversary of the date of
9 original issuance and computed on the average
10 outstanding par amount of the share for the
11 twelve months preceding each payment; and

12 “(C) have dividend and redemption declara-
13 tions and payments which are cumulative and not
14 subject to the discretion of the issuer’s board of
15 directors or shareholders;

16 “(2) be optionally redeemable by the issuer, and
17 upon any optional redemption, shall return the out-
18 standing par value plus the aggregate of dividends cu-
19 mulated and due (pro rata for any part of a year after
20 the fifth anniversary of the date of original issuance) as
21 of the date of an optional redemption;

22 “(3) be nonvoting and have an initial par value of
23 \$10,000;

24 “(4) be senior in right with respect to dividend
25 and redemption payments and in case of any liquida-

1 tion or dissolution of the issuer only to all of the issu-
2 ing corporation's equity securities whenever issued;
3 and

4 “(5) be issued by the company either then owning
5 all of the facilities to be rehabilitated or improved or
6 which will, at the completion of an acquisition, own all
7 of the facilities acquired in whole or in part with assist-
8 ance provided under this section; such company having
9 a capitalization at the time of issuance which consists
10 solely of equity.

11 “(f) Before providing any financial assistance under this
12 section, the Secretary shall require the railroad, its subsidiary
13 or both receiving assistance to agree to such terms and condi-
14 tions as are sufficient, in the Secretary's judgment, to assure
15 that significant restructuring will occur, that all financial as-
16 sistance provided under this section will be used as pre-
17 scribed by the Secretary, and that there is a reasonable likeli-
18 hood that the financial assistance will be repaid.

19 “(g) Whenever a railroad or its subsidiary receiving as-
20 sistance under this section defaults on any provision of a fi-
21 nancing agreement or a security purchased pursuant to this
22 section, the Secretary shall be entitled (but not required) to
23 appoint from time to time two members to the board of direc-
24 tors of the railroad or the subsidiary or both, at the Secre-
25 tary's option, who shall serve until the financial assistance

1 or work rules and which the Secretary determines will sig-
2 nificantly improve manpower effectiveness. In making such
3 determination, the Secretary shall consider the relationship of
4 the railroad's labor costs to its revenues and any evidence of
5 efficiency gains that the railroad and labor organizations may
6 demonstrate.

7 “(b) The Secretary shall make financial assistance avail-
8 able under this section by purchasing a fixed debt obligation,
9 including a trustee certificate, which shall be unsecured but
10 otherwise have the terms and conditions of fixed debt obliga-
11 tions under section 518(c) of this title.

12 “(c) Before providing any financial assistance under this
13 section, the Secretary shall require the railroad receiving as-
14 sistance to agree to such terms and conditions as are suffi-
15 cient in the Secretary's judgment to assure that the railroad
16 has, through a long-term change in operating practices or
17 work rules, improved its manpower effectiveness.

18 “(d) Whenever a railroad receiving assistance under this
19 section defaults on any provision of a financing agreement or
20 security purchased pursuant to this section, the Secretary
21 shall be entitled to exercise all remedies in law or equity and
22 may request the Attorney General of the United States to
23 commence a civil action for damages, specific performance or
24 any other available remedy in any appropriate court.

"AUTHORIZATION

1 "SEC. 520. There is authorized to be appropriated to
2 the Secretary for purposes of providing financial assistance
3 under sections 518 and 519 for fiscal years 1980 through
4 1984 without fiscal year limitation such sums as are neces-
5 sary, not to exceed \$1,475,000,000 of which no more than
6 \$275,000,000 in the aggregate shall be used for the payment
7 of related labor protection costs under section 518 and for
8 section 519, to be available until expended. Assistance is au-
9 thorized for any fiscal year only to the extent provided in
10 appropriation Acts."

TECHNICAL AMENDMENTS

12 SEC. 4. (a) Section 501 of the Railroad Revitalization
13 and Regulatory Reform Act of 1976 (45 U.S.C. 821) is
14 amended by—

15 (1) renumbering paragraphs (2) through (7) as (4)
16 through (9) and adding the following new paragraphs:

17 "(2) 'consolidation' means the combination of sep-
18 arate rail facilities into fewer facilities and the aban-
19 donment of the excess facilities, except that 'consolida-
20 tion' does not include the combination by a single rail-
21 road of multiple tracks into fewer tracks where the
22 tracks do not constitute separate physical and operat-
23 ing lines of railroad;

1 “(3) ‘coordination’ means the combination of rail
2 freight traffic flows through the use of joint facilities
3 arrangements or internally that result in a reduction of
4 service on at least one facility and includes (but is not
5 limited to) arrangements for joint use of tracks or other
6 facilities and the acquisition or sale of assets.”; and

7 (2) striking “and” after renumbered paragraph (8),
8 striking the period after renumbered paragraph (9) and
9 inserting in its place a semicolon and adding the fol-
10 lowing new paragraphs:

11 “(10) ‘restructuring’ means any activity, including
12 consolidations, coordinations, mergers and abandon-
13 ments, involving rehabilitation or improvement of any
14 facility or its transfer, which activity improves the
15 long-term profitability of any railroad or railroads and
16 which results in the enhancement of the national rail
17 freight system through the achievement of higher aver-
18 age traffic densities and improved asset utilization.

19 “(11) ‘subsidiary’ means any corporation in an un-
20 broken chain of corporations beginning with a class I
21 railroad, if each corporation other than the last corpo-
22 ration in the chain owns voting securities possessing
23 more than 50 per centum of the total combined voting
24 power in one of the other corporations in the chain.”

1 (3) revising renumbered subparagraph (5)(E) to
2 read as follows:

3 “(E) shop or repair facilities or any other
4 property used or to be used directly in rail freight
5 transportation services or for originating, termi-
6 nating, improving, and expediting the movement
7 of freight by rail;”

8 (4) revising renumbered paragraph (8) by adding
9 after “note,” “trustee certificate,” and by striking
10 “or” before “improvement” and by inserting “, or to
11 facilitate a restructuring” before the semicolon.

12 (b) Section 510 of such Act (45 U.S.C. 830) is amended
13 by inserting “, obligations and Senior Preferred Stock” after
14 “shares” and “to the Federal Government” after “rail-
15 roads”.

16 (c) Section 511(i) of such Act (45 U.S.C. 831(i)) is
17 amended as follows:

18 (1) by revising clause (1)(A) to read as follows:

19 “(A) will not make any discretionary divi-
20 dend payments except as provided for in the Sec-
21 retary’s agreement to guarantee its obligation;
22 and ”; and

23 (2) by striking paragraph (2) and renumbering
24 paragraph (3) as paragraph (2).

Senator LONG. Now I will call on our first witness, Mr. Robert Gallamore, Deputy Administrator of the Federal Railroad Administration.

STATEMENT OF ROBERT E. GALLAMORE, DEPUTY ADMINISTRATOR, FEDERAL RAILROAD ADMINISTRATION; ACCOMPANIED BY WILLIAM LOFTUS, ASSOCIATE ADMINISTRATOR FOR FEDERAL ASSISTANCE; AND RAYMOND JAMES, CHIEF COUNSEL

Mr. GALLAMORE. Mr. Chairman, Senator Cannon, I am pleased to appear before this committee to testify on the importance of swift enactment of S. 1151, the proposed Rail Restructuring Assistance Act. As you mentioned, Mr. Chairman, this bill would establish new programs to provide Federal assistance to promote restructuring and improved labor efficiency. With me are William Loftus, FRA's Associate Administrator for Federal Assistance, who would oversee the bill's implementation; and Raymond James, FRA's Chief Counsel.

The Rail Restructuring Assistance Act is an improvement over existing financial assistance programs. The bill authorizes a total of \$1.475 billion in financial assistance over a 5-year period. The bulk of the funds would be available in the form of low-cost debt or equity financing for projects which promote restructuring by consolidating main line facilities and yards through mergers, acquisitions and joint trackage arrangements. A maximum of \$275 million of the total authorization would be authorized for two purposes—labor protection payments in connection with restructuring and the promotion of innovative changes to work rules and operating practices which improve productivity.

The Secretary's report to Congress, mandated by sections 504 and 901 of the Railroad Revitalization and Regulatory Reform Act of 1976, emphasized two major changes which we believe are necessary if the railroad industry is to become healthy again. The national railroad system has to be restructured in order to consolidate operations into economic, high density railroad routes, eliminating unneeded main lines and, through reinvestment in profitable lines, reducing substantially the system's current deferred maintenance. At the same time, the industry has to be relieved of the economic regulation which handcuffs the industry's ability to respond to changing market conditions. The administration has now transmitted to the Congress two major pieces of legislation to implement these two initiatives, the Railroad Deregulation Act of 1979 and the Rail Restructuring Assistance Act, which we are discussing this morning.

Federal funds cannot and should not be expected to meet more than a small share of the estimated \$13 to \$16 billion 10-year shortfall in the industry's, excluding Conrail, cash requirements. We believe that railroad restructuring and lessening regulation are the most productive ways to get maximum benefits from whatever Federal funds are to be available as a contribution to meeting the shortfall. We simply do not believe the Federal taxpayer can be expected to fill that entire shortfall we have identified in our report.

The Rail Restructuring Assistance Act would provide us with a tool to encourage railroad restructuring by conditioning low-cost assistance on significant actions to restructure the industry. This proposal contrasts with the original section 505 program which emphasized the reduction of deferred track maintenance without regard for changing the underlying economics of the system. Those economics are the conditions which may have caused those railroads to let their tracks deteriorate in the first place.

The 4R Act established two new aid programs: section 505 preference shares and section 511 loan guarantees, both providing needed capital to the railroads. Section 505 of the act provides attractive Federal assistance and has been successful in achieving its purpose, but its ability to promote restructuring has been limited in three respects: First, the solvent railroads which might have undertaken significant restructuring with financial incentives were not eligible under the present law until the recent enactment of the Milwaukee Railroad Restructuring Act last November; second, the Secretary was not permitted to condition assistance on a railroad's agreement to restructure its system or to provide low-cost funds except for deferred maintenance projects; and third, there was no express labor protection feature.

Marginal railroads generally cannot afford to undertake large-scale restructuring without this type of Federal assistance. Their facilities and financial prospects have continued to deteriorate at least in part because they have tried to provide service that is not compensatory in the long run and will not support reinvestment without greater traffic density but nonetheless produces short-term positive cash flow. Meanwhile, profitable railroads which might have been interested in merging with a restructured marginal railroad or buying line segments if rehabilitation requirements were minimal, now have little reason to risk their financial positions on such speculative opportunities. It would be far better to restructure the properties, develop new service patterns based on operational advantages of adjacent railroads, and thus preserve valuable lines as part of the private railroad system.

We have in the Midwest today two examples of railroads that are cashless—the Milwaukee and the Rock Island. The Rock Island is being liquidated. Many of the Rock Island and Milwaukee lines are clear candidates for acquisition by healthy railroads. Because capital is scarce, however, and the risks are great, some of the stronger railroads are reluctant to finance purchases of major lines of the two bankrupts' systems. If substantial low-cost Federal assistance were available—and particularly with labor protection flexibility—I believe many healthy railroads would be much more likely to acquire these lines and preserve service on them. The rehabilitation that faces some of those stronger railroads considering the possible purchase of Milwaukee or Rock Island lines is one of the items that may tend to cause those railroads not to be as interested as we would like them to be.

Some railroads have favored continuation of the existing section 505 program with minor modifications, to promote restructuring but with continued emphasis on overcoming deferred maintenance. This view, we believe, gives inadequate recognition to current budgetary realities. We can no longer afford to subsidize rehabilitation

of low density track where there are ample other railroad main lines. That is why we want to encourage restructuring.

The bill also includes a program to improve the effective employment of labor in the railroad industry. The Secretary would be authorized to loan funds to a railroad to pay up to 100 percent of payments to employees who suffer financial loss due to changes in work rules or operating practices which are designed to improve system productivity. These funds would serve as seed money to enable railroad labor and management to cooperate in projects to determine whether new operating practices will improve operating efficiencies. Successful projects would then be implemented on a full scale basis. By indicating ways to reduce operating costs, this program, too, would help improve a railroad's cash flow when it implemented a successful project on a full scale basis.

With two major Midwestern carriers selling off vast amounts of railroad, we have an opportunity, however unwanted, to reshape the Midwest railroad system. If the Rail Restructuring Assistance Act were to be enacted shortly, the positive aspects of that effort could be addressed nationwide. Specifically in the Midwest, the availability of low-cost financial assistance will make the acquisition and rehabilitation of key Milwaukee and Rock Island lines more attractive to acquiring railroads and thereby help to establish permanent service arrangements.

That concludes my testimony this morning and we would be pleased to answer any questions you may have.

Senator LONG. S. 1151 was originally introduced as a companion bill to S. 796. S. 796 is no longer a viable bill. To what extent does that fact change your need for S. 1151?

Mr. GALLAMORE. The current authorization for the preference-share section 505 program runs out in September, so we would need the program reauthorized for that reason.

We believe additional funding of the amount I have noted in the testimony, the \$1.475 billion, is going to be needed and we would like to change the ground rules for the program in the ways I have outlined.

We do believe this effort is a companion effort to the efforts to bring about some lessening of the regulatory burden that the industry faces. So we still regard this as a companion for the efforts that are underway. In fact, at this time we expect to see some change in the regulatory framework.

Senator LONG. As I understand it Conrail has been excluded from the proposed program. Why has Conrail been excluded? Are you contemplating a separate package for Conrail?

Mr. GALLAMORE. That's under consideration. At the present time Conrail is not requesting additional authorizations and we have not sought to force any additional authorizations upon Conrail. We would consider whether Conrail in the future should be eligible for a program of assistance similar to this, if not identical; but we do not at this time favor adding Conrail eligibility to the funds that we have discussed this morning.

Senator LONG. Well, do class II and short line railroads have a role in this legislation?

Mr. GALLAMORE. Not really. We are looking more at high density projects. By and large, the short lines in class II railroads would

seek financial assistance from public sources and would be better served going to the state or local rail service program. It would be very hard I think for short line railroads to come up to the density levels that we have in mind for this main line program.

Senator LONG. I have other questions which I am going to submit and let you answer in writing if you would. Senator Cannon.

The CHAIRMAN. S. 1151 authorizes \$275 million for labor costs over a 5-year period. In line with that request, what would be the budgetary impact in fiscal year 1981?

Mr. GALLAMORE. Mr. Loftus will help me answer that question.

Mr. LOFTUS. We anticipate that of our request for \$250 million, in fiscal year 1981, \$25 million would be used for labor productivity purposes.

The CHAIRMAN. And what would be the figure budgeted for each of the fiscal years over the total period for labor costs?

Mr. LOFTUS. We can provide the 5-year projection for the record, Senator, but I believe it peaks at \$75 million on the basis that restructuring has its major impact in the year 1983.

The CHAIRMAN. Has DOT considered cutting back this figure in light of current budget constraints?

Mr. LOFTUS. We have not reduced the \$250 million in the fiscal year 1981 request.

The CHAIRMAN. Under the proposed bill, financial assistance would only be available pursuant to a restructuring plan. In this regard, has the Department projected an overall plan for the restructuring of the Nation's rail network?

Mr. GALLAMORE. No, Senator Cannon, we have not attempted to develop that plan yet. Our policy has been that we would like to see the private railroads come forward with their own plans for restructuring and we do not have a plan that we want to impose upon them. We do believe the process is an important one—the railroads identifying projects and us reviewing them in the context of Federal financial assistance.

The CHAIRMAN. In other words, you would rely solely on industry initiative?

Mr. GALLAMORE. We would like to rely primarily on industry initiative. We will be conducting some major studies of our own—they are underway in fact—to identify heavily trafficked lines, to look at forecasts of traffic for the future, and to look at how the railroad system might be better integrated. We will from time to time take positions with respect to mergers or restructuring programs. So we are interested in restructuring, but until we reach a point where we think the country would be better served by the Government proposing a plan, we would prefer to rely on private initiative.

The CHAIRMAN. Have you established criteria and priorities in assessing the validity of the restructuring plans which may be presented?

Mr. GALLAMORE. Let me ask Mr. Loftus to respond, again partly in the context of the existing program.

Mr. LOFTUS. Initially, Senator, you will recall the 4R Act required the Government to publish an analysis and designation of all major line segments of the Nation's rail system, which we did. That study identified about eight corridors of excess capacity. In

our development of the use of the section 505 funds and in the discussions with the restructuring railroads, primarily Milwaukee and Rock Island, we did use the study in working toward the restructuring of those railroads into the larger railroads and in reducing excess capacity.

The CHAIRMAN. You stated that restructuring can take place if profitable railroads have available to them some type of Federal assistance. What aspects of this bill create assurance that profitable railroads will avail themselves of the program?

Mr. GALLAMORE. In the future, providing for a substantial interest subsidy should be a major incentive. We are proposing debt funds that are used at three-quarters of the prevailing cost of money to the Government, and equity funds at one-half of the prevailing cost of the funds to the Government. So in this year of high interest, this is a substantial incentive.

The CHAIRMAN. So you think that would be an adequate incentive for railroads to move in the direction of restructuring rather than deferred maintenance the basis for the 505 program?

Mr. GALLAMORE. Yes; plus the terms of the financing are also advantageous to large-scale projects of this sort, with no accrual of interest during the first 5 years.

The CHAIRMAN. Has the 505 program been successful in remedying the problem of deferred maintenance?

Mr. GALLAMORE. There is still a substantial amount of deferred maintenance in the system, but we believe it has been successful in achieving a major contribution to bringing down the level of deferred maintenance. We have been able to bring up some very important lines to provide quality railroads. We have been able to weather the storm of the last few years on a few railroads partly with the assistance of these funds. I would say, that if we had had the restructuring act available to us 10 years ago, we might have been able to prevent some bankruptcies. At least the Rock Island and Milwaukee bankruptcies may have been put off into the future or we might have been able to avoid them altogether because of this fund. Perhaps that's true of the 4R Act funding, if it had been available a bit sooner. I think with the kind of ground rules we are talking about with our new proposal, we would have been able to encourage the restructuring of the industry that might have prevented those bankruptcies.

The CHAIRMAN. Now this bill would apply to restructuring rather than rehabilitation of track and other facilities. Two railroads will be testifying today that projects which are essential to their survival would not be covered under the new program. What is your response to that statement?

Mr. GALLAMORE. I'd like Mr. Loftus to respond.

Mr. LOFTUS. Picking up on Mr. Gallamore's last response and your last question, Senator, the level of deferred maintenance, in terms of the marginal railroads which the 4R Act restricted funds to, largely was accomplished. All the railroads were not rehabilitated, but on the Chicago and North Western we have agreements for \$150 million to restructure and rehabilitate their main line between Chicago and Fremont, Nebr. On Illinois Central Gulf, we have \$164 million obligated to rehabilitate their main line from Chicago to Jackson, Miss. On the Boston & Maine, we have \$25.6

million obligated to rehabilitate from the Boston area through Mechanicsville. We also have provided funds to the Milwaukee for its essential main line, Milwaukee to Minneapolis.

We believe that, as to applicants who were eligible to come forward, we have solved the main problems they had on their key lines.

The CHAIRMAN. Well, isn't the assistance for track rehabilitation a very important part of restructuring?

Mr. LOFTUS. It is. The issue really is whether you are going to rehabilitate track without having any basic design in mind or whether you're going to invest your track rehabilitation dollars where they will produce the most good, not just for a single-rail system but for the national rail network.

Mr. GALLAMORE. The point you're perhaps making, Senator Cannon, that we haven't commented on is that these funds are primarily intended for track rehabilitation. They are not intended to buy or repair freight cars. We believe that the 511 program itself, also a 4R Act program of loan guarantees, will continue to be the major source for rehabilitation of locomotives and freight cars and for purchase of lines. If one railroad should specifically acquire another property, the loan guarantee program is very well adapted to that type of project, and it has, I believe \$395 million left in funding available for that program. So the funds we are talking about today in the Restructuring Act are those that are specifically directed to rehabilitation of track. The conditions that we would like to see placed on those funds are primarily to make more efficient use of the track in the country.

Mr. LOFTUS. May I add one more comment, Senator? The restructuring definition in the bill we believe is sufficiently broad so that an individual railroad that wants to restructure internally, particularly the Illinois Central Gulf which may not be a quickly available merger partner, could indeed be eligible to restructure its own system. The Chicago North Western is also a very critical railroad in restructuring the Midwest area. The Boston & Maine will become an important railroad in restructuring the Northeast. So the bill as we have presented it does not eliminate these railroads from consideration based on the restructuring definition.

The CHAIRMAN. I will submit the balance of my questions for the record.

[The statement and answers to questions of the committee follow:]

STATEMENT OF ROBERT E. GALLAMORE, DEPUTY ADMINISTRATOR, FEDERAL
RAILROAD ADMINISTRATION

I am pleased to appear before this Committee to testify on the importance of swift enactment of S. 1151, the proposed Rail Restructuring Assistance Act, which would establish new programs to provide Federal assistance which promotes restructuring and improved labor efficiency. With me are William Loftus, FRA's Associate Administrator for Federal Assistance, who would oversee the bill's implementation and Raymond James, FRA's Chief Counsel.

The Rail Restructuring Assistance Act is an improvement over existing financial assistance programs. The bill authorizes a total of \$1.475 billion in financial assistance over a five-year period. The bulk of the funds would be available in the form of low-cost debt or equity financing for projects which promote restructuring by consolidating mainline facilities and yards through mergers, acquisitions and joint trackage arrangements. A maximum of \$275 million of the total authorization would be authorized for two purposes—labor protection payments in connection

with restructuring and the promotion of innovative changes to work rules and operating practices which improve productivity.

The Secretary's report to Congress, mandated by sections 504 and 901 of the Railroad Revitalization and Regulatory Reform Act of 1976, emphasized two major changes which are necessary if the railroad industry is to become healthy again. The national railroad system has to be restructured in order to consolidate operations into economic, high density railroad routes, eliminating unneeded main lines and, through reinvestment in profitable lines, reducing substantially the system's current deferred maintenance. At the same time the industry has to be relieved of that economic regulation which handcuffs the industry's ability to respond to changing market conditions. Two major pieces of legislation have been transmitted to the Congress as the Administration's recommendation to implement the 504/901 findings. These companion legislative proposals are the Railroad Deregulation Act of 1979 and the Rail Restructuring Assistance Act, which we are discussing today.

Federal funds cannot and should not be expected to meet more than a small share of the estimated \$13-16 billion ten-year shortfall in the industry's (excluding Conrail) cash requirements. We believe that railroad restructuring and lessening regulation are the most productive ways to get maximum benefits from whatever Federal funds are to be available as a contribution to the shortfall.

The Rail Restructuring Assistance Act would provide us with a tool to encourage railroad restructuring by conditioning low-cost assistance on significant actions to restructure the industry. This proposal contrasts with the original section 505 program which emphasized the reduction of deferred track maintenance without regard for changing the underlying economics of the system—which may have caused railroads to let their tracks deteriorate in the first place.

The 4R Act established two new aid programs; section 505 preference shares and section 511 loan guarantees, both providing needed capital to the railroads. Section 505 of the Act provides attractive Federal assistance and has been successful in achieving its purpose, but its ability to promote restructuring has been limited in three respects: (1) the solvent railroads which might have undertaken significant restructuring with financial incentives were not eligible under the present law until the recent enactment of the Milwaukee Railroad Restructuring Act; (2) the Secretary was not permitted to condition assistance on a railroad's agreement to restructure its system or to provide low-cost funds except for deferred maintenance projects; and (3) there was no express labor protection feature.

Marginal railroads generally cannot afford to undertake large scale restructuring without Federal assistance. Their facilities and financial prospects have continued to deteriorate at least in part because they have tried to provide service that is not compensatory in the long-run and will not support reinvestment without greater traffic density but nonetheless does produce short-term positive cash flow. Meanwhile profitable railroads which might have been interested in merging with a restructured marginal railroad or buying line segments if rehabilitation requirements were minimal, now have little reason to risk their financial positions on such speculative opportunities. It would be far better to restructure the properties, develop new service patterns based on operational advantages of adjacent railroads, and thus preserve valuable lines as part of the private railroad system.

The Rock Island and Milwaukee are cashless and the Rock Island is being liquidated. Many of the Rock Island and Milwaukee lines are clear candidates for acquisition by healthy railroads. Because capital is scarce however, the risks are great, some of the stronger railroads are reluctant to finance purchases of major lines of the two bankrupts' systems. If substantial low cost Federal assistance were available—and particularly with labor protection flexibility—I believe many healthy railroads would be much more likely to acquire these lines and preserve service on them.

Some railroads have favored continuation of the existing section 505 program with minor modifications to promote restructuring but continued emphasis on overcoming deferred maintenance. This view, we believe, gives inadequate recognition to current budgetary realities. We can no longer afford to subsidize rehabilitation of low density track where there are ample other railroad main lines.

The bill also includes a program to improve the effective employment of labor in the railroad industry. The Secretary would be authorized to loan funds to a railroad to pay up to one hundred percent of payments to employees who suffer financial loss due to changes in work rules or operating practice which are designed to improve system productivity. These funds would serve as seed money to enable railroad labor and management to cooperate in projects to determine whether new operating practices will improve operating efficiencies. Successful projects would then be implemented on a full scale basis. By indicating ways to reduce operating

costs, this program, too, would help improve a railroad's cash flow when it implemented a successful project on a full scale basis.

With two major Midwestern carriers selling off vast amounts of railroad, we have an opportunity, however unwanted, to reshape the Midwest railroad system. If the Rail Restructuring Assistance Act were to be enacted shortly, the positive aspects of that effort could be addressed nationwide. Specifically in the Midwest, the availability of low cost financial assistance will make the acquisition and rehabilitation of key Milwaukee and Rock Island lines more attractive to acquiring railroads and thereby help to establish permanent service arrangements.

As a final note I should say that the operating and pricing flexibility which would be provided under the Administration's deregulation proposals is also essential if we are to avoid future railroad bankruptcies. We must act now, and for the above reasons I urge quick enactment of this bill.

I will be happy to answer your questions.

QUESTIONS OF THE COMMITTEE AND THE ANSWERS THERETO

Question 1. Why is it necessary to provide for a Federal program to encourage consolidations and reductions in duplicate tracks and facilities and to promote operating efficiencies? Are these not goals any prudent business management would be seeking to accomplish notwithstanding the availability of Federal assistance?

Answer. Absent a restructuring obligation or a solvent partner, financially-weak railroads have been unwilling to undertake restructuring voluntarily because they believe that significant restructuring will have an immediate, adverse affect on cash flow, regardless of long term benefits. There are, however, segments of such weaker railroads which would make economically attractive additions to the systems of stronger carriers if the systems were restructured. Under the proposed program, high priority would be accorded to projects which enable stronger carriers to rehabilitate segments of weak systems. The program would encourage solvent railroads to undertake such restructuring with the aid of low cost Federal assistance. The availability of the assistance should help considerably in overcoming the railroad's reluctance to initiate restructuring negotiations while making the benefits more consistent with their corporate goals and priorities.

Question 2. You have proposed a financial assistance program which would replace the current 505 program. Some have suggested that instead of replacing the 505 program, it would be more advisable to expand the present 505 program to cover restructuring projects and labor costs, and to include solvent railroads, but maintain the equity nature of the financing and the present conditions for repayment. What is your reaction to this proposal? In this regard, the Illinois Central Gulf & the Boston and Maine have proposed amendments to the present 505 program. Please explain in detail your reaction to these proposals.

Answer. I believe the current 505 program has been successful in achieving its primary purpose of stabilizing the condition of the railroad industry's physical plant while the Secretary studied and proposed solutions for the industry's problems. In the process of effecting this primary purpose, however, three separate legislative changes were made to the 505 program to bring it to its current state. First, there was the Rail Transportation Improvement Act (RTIA), enacted in October 1976, which required that any regulations promulgated include specific and detailed standards on, among other things, the availability to an applicant of capital from other sources, and the priorities of project consideration, giving the highest priority to public benefits derived in providing essential freight services. In addition, the RTIA set a minimum preference share term of 20 years and mandated certain yield restrictions for deferred maintenance on facilities. Next came the Local Rail Services Assistance Act of 1978 which amended the 505 program to permit the Secretary of Transportation to purchase a bankrupt railroad's trustee certificates at a specified security position without making the liquidation value finding originally prescribed for bankrupts. Finally, the Milwaukee Railroad Restructuring Act (MRRA), signed into law on November 4, 1979, permitted the 505 program to fund projects involving significant railroad restructuring without considering the availability to the applicant of other capital sources as long as the restructuring benefits would not otherwise be likely to be achieved. The MRRA also amended the 505 program to require that assistance be given to facilitate the rehabilitation of Milwaukee Railroad properties that have been transferred to others or retained by a restructured Milwaukee Railroad.

The above-mentioned changes in the original program, coupled with the need for strong policy direction for use of the many dollars involved, requires an entirely new program. New legislation should emphasize restructuring to reduce the total

capital needs of the industry. This restructuring will produce something of a "multiplier effect"—making the Federal investment go farther than it would if we were simply trying to overcome past investment shortfalls.

With respect to the proposals of the Illinois Central Gulf (ICG) and the Boston and Maine (B&M), both railroads appear to be concerned that (1) they would not be eligible for restructuring assistance; (2) the increase in the loan rate would go far beyond the present 2 percent; and (3) that the financing instrument would be a debt issue (except in those cases where the Secretary agreed to an equity issue), and could overburden their debt structure.

We have advised both the B&M and ICG, as well as other Title V railroads, that the Rail Restructuring Assistance Act does not eliminate them from eligibility for low cost funds. The essential difference between the preference share program and the RRAA is that the basic purpose of the funding is to accomplish restructuring of multiple rail systems or single rail line systems. Many of the projects to be funded would entail work to reduce deferred track maintenance. However, all funded work would be in the context of renewal of rail facilities and services rather than just maintaining the status quo for a few years. Therefore, either the B&M or the ICG would be eligible for continued assistance if it were to restructure in conjunction with other railroads in its region or if it were to restructure as a core system such as the Milwaukee Railroad proposes to do.

We have proposed financing rates of 3/4 of the current cost of borrowing to the government for debt issues and 1/2 of the government's cost for equity issues. These rates do not add substantially to the effective interest rate of the preference share program. Under the RRAA no interest costs accrue for the first five years. Therefore, the effective rate beginning the sixth year would be approximately 4 percent, if the current cost of money to the government is 12 percent. The payback period has been shortened primarily because the borrowing of these low-cost funds by marginal or strong roads should produce an early and significant improvement in the restructured entity and should permit quicker payback in order to minimize the cost to the taxpayer.

With respect to the debt versus equity issue, we believe the low cost aspect of the program will continue to make it attractive even to railroads with substantial debt burdens. However, inasmuch as the major borrowers are intended to be stronger railroads, the program is designed to meet their needs and preference for debt.

Finally, the ICG and B&M clearly intend that the section 505 program be continued for marginal railroads only while the new program should be related to both marginal and stronger roads with restructuring as the basic purpose. We cannot agree. In our view funding provided Title V railroads to date adequately covered their priority need to cure deferred maintenance on the most critical facilities. The best use of any additional funds would be to help railroads restructure internally or as part of other systems. To continue a program aimed only at curing track problems on marginal or bankrupt railroads would not be in the best interest of the taxpaying public.

Question 3. DOT has stated that the deferred maintenance problem in the rail industry is under control. How much of the Department's previous estimate of \$5.4 billion in deferred maintenance has been eliminated? How should the remaining deferred maintenance be dealt with?

Answer. Of the \$592.7 million in agreements that have been executed under Title V, approximately \$500.0 million applies to the curing of deferred maintenance on main line tracks and equipment of marginal and bankrupt carriers. Under the new program proposed by the Administration further rehabilitation is tied in with restructuring. The program proposes a limited program of financial assistance to be coupled with a phase-in of deregulation. The deregulation proposals attack the problems of a rigid rate structure and retention of unnecessary, uneconomic rail services. The assistance legislation focuses on the problem of restructuring a redundant rail system into a more efficient and economic network and it also seeks to stimulate improved labor productivity. By thus improving the efficiency and profitability of the railroad industry, the industry should be better able to assume the total responsibility for meeting its rehabilitation and restructuring needs and in effect reduce the need to correct all deferred maintenance.

Question 4. You have stated that the present 505 program gives "inadequate recognition to current budgetary realities" by subsidizing rehabilitation of low density lines. Particularly in light of the testimony of the Illinois Central Gulf regarding its mainline rehabilitation program, has the 505 program been used for many low density lines? Could not the 505 program be limited to use above a certain density, thus responding to your concern? Is the current 505 program limited in this regard?

Answer. The 505 program has been directed toward high density, interstate lines. Under the standards the Federal Railroad Administration has adopted in regulations, the public benefits of a proposed project under section 505 are gauged as justifying the public costs in accordance with a set of public benefit priorities, expressed in four groups or categories on a descending scale of importance, namely: Essential Freight Service, which includes a series of eight designations of main line trackage based on density carried, with higher consideration given to projects that combine or coordinate facilities if two competing projects have similar densities; Competitive Freight Services, which includes projects that strengthen railroad competition where that competition is economic; Special Projects, which primarily includes projects that solve public safety hazard problems needing quick resolution; and Equipment Rebuilding, which includes limited locomotive and car rebuilding projects.

All of the section 505 funding to date, with the exception of that for the Columbus and Greenville Railway (Competitive Freight Service), has been provided under the Essential Freight Services category. The densities involved in each case were 20 million gross ton miles per mile or more, except for the Rock Island, in which the segments varied from 2-20 million gross ton miles per mile. A summary by carrier follows:

SUMMARY BY CARRIER

Carrier	Essential freight services category	Millions of gross ton miles per mile
Milwaukee Road.....	7	20
Chicago & North Western.....	7, 1	45
Rock Island.....	7, 8	2-20
Illinois Central Gulf.....	3	20
Boston & Maine.....	3	21

¹ Or more.

Now that the most critical needs on the high density lines of the marginal and bankrupt carrier have been provided for, continuation of the current section 505 program could tend to move the rehabilitation program to lower density lines which qualify under the existing regulations. By extending the financing to stronger carriers, and by emphasizing the restructuring of high density lines, as the new program proposes, however, the downward trend would be avoided and the opportunity to realize the maximum public benefits from the available Federal funding would be ensured. The 505 program could be limited to use above a certain density, but we believe a rigid restriction would be unnecessary under the new standards of S.1151. The policy of restructuring establishes a more important goal and will lead to more effective implementation than a rigid density criterion would.

Question 5. The Boston & Maine has testified that future projects in which it might be interested would not be considered priorities under the present 505 program. What are the current priorities established under the 505 program? To what extent would these priorities remain under the S. 1151 program?

Answer. Approval of a project for section 505 financing requires a determination that the requested assistance is in the public interest. This involves finding (in part) that the public benefits, including any significant railroad restructuring, in relation to the public costs of the proposed project justify funding that project with available funds before funding other eligible projects, either of the applicant railroad or other railroads.

The public benefits of a proposed project are gauged as justifying the public costs in accordance with a set of public benefit priorities, expressed in four groups or categories on a descending scale of importance, namely: Essential Freight Services which includes a series of eight designations of main line trackage based on density carried (at least 2.5 million net revenue tons to 20 million gross tons or more), with higher consideration given to projects that combine or coordinate facilities if two competing projects have similar densities; Competitive Freight Services, which includes projects that strengthen railroad competition where that competition is economic; Special Projects, which primarily includes projects that solve public safety hazard problems needing quick resolution; and Equipment Rebuilding, which includes limited locomotive and car rebuilding projects.

The proposed program would require applicant railroads to undertake significant restructuring as a condition to Federal financial assistance. While no priorities have

yet been established for that program, it is likely that such priorities, if any, would direct funds to track rehabilitation projects with a high traffic density similar to the "essential rail services" category now in place.

Question 6. Certain railroads claim that projects in which they are currently involved would not be eligible under the S. 1151 program. Would you please enumerate which projects currently funded under the 505 program would or would not potentially be covered under S. 1151? How would these projects fit in under the definition of "restructuring" in S. 1151? Would certain criteria regarding traffic density, essentiality, or costs covered be established to determine which projects would be funded?

Answer. A list of projects funded under section 505 is attached. These projects provide for substantial rehabilitation of facilities but only isolated restructuring, which would involve a consolidation and reduction of duplicate tracks and facilities, discontinuance of uneconomic service, rationalization of routes and terminal facilities, and improvement in operating efficiencies. In the case of the Chicago and North Western, the Federal funding decision was instrumental in achieving a line consolidation involving another railroad—the Milwaukee—in a corridor of consolidation potential. Also the Illinois Central Gulf funding justification was based partly in the railroad's plan to restructure its system from 9,000 miles down to 6,000.

In the new program, we would expect to continue to direct Federal funds to track rehabilitation projects with a high traffic density. The current regulations move the applicants in that policy direction, and we would continue to follow that policy.

RAILROAD REVITALIZATION AND REGULATORY REFORM ACT OF 1976 AGREEMENTS EXECUTED AS OF MARCH 31, 1980

(Dollars in millions)

Railroad	Sec. 505 preference shares/trustee certificates	Description of project
Chicago, Milwaukee, St. Paul & Pacific Railroad Co.....	\$33.8	Rehabilitation of track and installation of CTC between Milwaukee, Wis. and Newport, Minn.
Chicago & North Western Transportation Co	147.5	Rehabilitate main line between Chicago, Ill. and Fremont, Neb.
Columbus & Greenville Railway.....	4.1	Various rehabilitation and improvement projects on main line in Miss.
Illinois Central Gulf Railroad Co.....	166.4	Track rehabilitation on portions fo Chicago-New Orleans main line.
Boston and Maine Corp.....	26.0	Rehabilitation of Willows-Mechanicville main line.
Chicago, Rock Island & Pacific Railroad Co.....	9.5	Materials for track project. Study of economic and financial potential of R.I. system.
Total.....	387.3	

Question 7. Major rail restructuring is being planned for the midwest region in light of the bankruptcies of the Rock Island and the Milwaukee, and similar plans have been proposed for Conrail in the northeast. The Illinois Central Gulf and the Boston and Maine are important to the restructuring in each area, but they have testified that many aspects of S. 1151 would make financial assistance for restructuring unattractive, even assuming their projects were to be covered under the definition of restructuring, and, without assistance for track rehabilitation, would make purchase of lines much more difficult and even impossible. How do you respond to their analysis? Is there not a serious question as to whether such restructuring would indeed be promoted as intended?

Answer. As stated earlier, the main concerns of the B&M and ICG can be properly met within the provisions of S. 1151, as submitted by the Administration. We do not believe that emphasis on restructuring and on achieving higher density track systems will have a negative impact on a prospective purchase of either railroad or on a merger situation for them. On the contrary, if Federal funds were used to generate a much smaller ICG mainline system, for example, it would indeed be a more attractive merger or acquisition partner than it is today because of the unnecessary multiplicity in its system of mainlines, secondary mainlines and light

density lines. The B&M can become the basis for a New England merger once it is reorganized and rehabilitated.

Question 8. You mention that class II and short-line railroads would be better served to use assistance under state programs and the local rail assistance programs and need not be included under S. 1151. Are those programs sufficient to complement S. 1151 and its restructuring goals?

Answer. We believe that the Local Rail Service Assistance program under Section 5 of the DOT Act is sufficient to complement S. 1151 and its restructuring goals. Section 5 is an ongoing Federal assistance program which provides grants to States for local rail freight projects. States may subsequently grant or loan funds to railroads for rehabilitation of non-abandoned light density lines. Lines carrying less than 3 million gross ton miles of traffic per mile annually are eligible; lines carrying from 3 to 5 million gross ton miles of traffic per mile annually are eligible; lines carrying from 3 to 5 million gross ton miles of traffic per mile annually are eligible if the Secretary finds the project would benefit rail restructuring.

The Local Rail Service Assistance program is funded at approximately \$85 million annually. Short lines and Class II railroads are prime candidates for assistance because they generally meet the light density test. Branch lines of Class I railroads are also candidates for assistance from States under the Section 5 program; fifteen Class I carriers received aid for branch line rehabilitation efforts.

Question 9. You have stated that DOT would depend, at least for the time being, on industry initiative in restructuring. Do you feel that isolated undertakings by individual railroads would lead to an overall sound restructuring of the Nation's rail network as envisioned under S. 1151?

Answer. The Department has consistently taken the position that innovative solutions to the problems of the railroad industry can best come from the source most capable of producing those solutions—the railroads themselves. The role of Government is to encourage the solutions by providing a framework for industry initiative, including appropriate financial assistance.

Section 401 of the 4R Act granted the Secretary of Transportation special authority to work with rail management, shippers and labor (under anti-trust immunity), including negotiating and effecting the rationalization of the Nation's rail facilities. The Department has initiated a 401 restructuring process in the Midwest which could become a pattern for how the industry will reshape itself.

We in the Department are analyzing future freight flows over a main line railroad network using new freight traffic forecasts, updated cost and capacity information, and computer simulation techniques. Most likely the railroad system will never look just like the network that will be produced in this analysis. As our analytic tools are developed, however, in the future the main line network plan should be part of the basis for evaluating various restructuring proposals. Clearly the plan should help ensure that individual restructuring actions by separate railroads will be part of an overall system that makes sense.

Our Local Rail Services Assistance program will continue to assist state and local governments in ensuring that branch and feeder railroad lines fit local interests. We will work with state and local officials and also with labor organizations to ensure that restructuring actions are implemented as smoothly as possible.

Question 10. Under S. 1151, assistance would be in the form of a loan unless the Secretary deems it necessary to provide equity financing. Under the present program, the question of whether the assistance is debt or equity created much confusion. Has it indeed been resolved, and if so, how? What advantage does the government have in characterizing assistance as a debt under S. 1151? In what situations would DOT fine equity "essential" to restructuring?

Answer. No, although railroad auditors have allowed preference share classification as equity, reservations about this treatment, and in general the equity treatment of all mandatorily redeemable preferred stock issues have been expressed by the Securities and Exchange Commission.

By characterizing assistance as debt, it permits the immediate tax advantage to healthy railroads which can deduct interest and thereby further reduce their cost and a long-term advantage to marginal railroads which, through their restructuring plans, should move toward a taxpayer position and interest expense deductions.

Equity would be "essential" to a restructuring in situations where a railroad, healthy or marginal, acquires marginal properties of another railroad with the highly speculative prospect that there may be eventual benefits, benefits perhaps supported solely by DOT analyses. In this case, the acquiring railroad could insulate itself from the immediate downside risks by creating a wholly-owned subsidiary, equity capitalized primarily with Senior Preferred Stock, and proceed to turn the

property around with the subsequent intention of integrating the property with its system.

Question 11. Some concern has been expressed over the restrictive nature of the payment terms under S. 1151, specifically the accelerated payment schedule and the characterization of the assistance primarily as debt, and the detrimental effect which such conditions would have on marginal railroads. For the record, would you please briefly describe, compare and contrast the debt and equity terms under the 505 program and under S. 1151? How do the elements of the "redeemable preference shares" under the present 505 program compare with those of the "senior preferred stock" under S. 1151? How do you respond to the concern voiced by certain railroads that the assistance terms under S.1151 would make the funding unattractive to both solvent and marginal railroads, giving the Department the flexibility to adjust timetables and yield depending on the financial positions of the applicant carrier.

Answer. The debt and equity securities under S.1151 would be essentially similar to the preference shares under the 505 program except for repayment. Under the 505 program, preference shares are subject to mandatory redemption beginning not earlier than the sixth or later than the eleventh anniversary of issuance and ending no later than on the thirtieth anniversary of issuance. Annual redemption payments must be no less than fifteen, creating a minimum twenty year term. The shares yield 2.03 percent to maturity for projects that reduce deferred maintenance, or the cost of money to the government for projects that do not reduce deferred maintenance. The 505 preference shares have been treated as equity securities in all cases except bankrupt railroads where trustee certificates (in two cases convertible into preference shares on reorganization) have been issued.

Under S. 1151 either debt or equity securities could be issued by the railroad. In either case, repayment of principal and interest or dividends (as appropriate) begins on the sixth anniversary of issuance and ends on the twentieth. Debt securities would pay interest at $\frac{3}{4}$ the rate established by the Secretary of the Treasury based on the cost of money to the government for comparable maturing securities while equity securities would provide dividends at one-half that rate.

We believe that the low interest and dividend rates of S. 1151 coupled with the five year payment moratorium should provide for a very attractive program to both healthy and marginal railroads which will encourage restructuring. While it is natural that marginal railroads would prefer longer moratorium and repayment periods and a lower yield to maturity, we believe that the moratorium and repayment periods correspond with the anticipated cash flow benefits from restructuring projects and that a greater Federal subsidy (lower yield) is not warranted in light of the significant benefits which restructuring will provide these railroads.

With respect to flexibility on timetables and yields, we have learned from the 505 program (which has that flexibility) that we are invariably drawn to the maximum maturity and lowest yield in order not to be arbitrary in exercising our discretion. In the new program, therefore, we seek maturity and yield provisions which are clearly consistent with maximum program objectives, in order to avoid the undue benefits which longer maturities or lower yields might afford railroads carrying out the typical shorter term projects.

Question 12. Under both section 505 and S. 1151, the Department has discretion to impose financing agreements with such terms as would be necessary. Would this discretion be exercise under S. 1151 according to criteria established under section 505? How would the criteria relate to the provision in S. 1151 allowing the Department to take a security position if necessary?

Answer. There are a number of differences between section 505 and S. 1151 which would require the S. 1151 financing agreement to be somewhat different from those negotiated to implement section 505. Section 505 is an equity funding program (except in the case of bankrupts where trustee certificates are purchased by the Secretary) designed principally to reduce deferred maintenance on marginal financial condition of the applicant railroads, the section 505 of financing agreements have imposed strict financial controls on the applicant railroads to insure repayment and the achievement of program objectives.

S. 1151, by contrast, is open to healthy carriers and, in most cases, calls for funding through debt instruments which may be secured. Consequently, in many cases the government's security interest rather than a carrier's financial health will protect the government's investment, and strict financial and operating controls will not be necessary. On the other hand, in the case of unsecured equity financings with marginal railroads, the requirement that the applicant have only an equity capitalization at the time would also reduce the complexity of the financing agree-

ment as was inherent in the section 505 financing agreement which could convert to debt.

Another difference between section 505 and S. 1151 is the purpose of the assistance. Agreements to implement S. 1151 will have covenants designed to insure the realization of public interest benefits of railroad restructuring while section 505 financing agreements contain promoting a normalization of maintenance on project lines.

Question 13. In providing assistance as equity under the bill, DOT must find that the receiving railroad has a "capitalization at the time of issuance (of the stock) which consists solely of equity." Would you please explain this finding and its implications?

Answer. This provision is aimed at protecting the Federal investment in the public benefits arising from Federally-assisted projects. Only if a railroad has no senior debt which can claim rights ahead of ours to the benefits our assistance provides, can we assure the public of those benefits. The bill's provision would generally require a railroad to set up a subsidiary company which would own the facilities involved in the project. As the senior equity holder in the company and with control over the movement of long term debt, the government would be able to insure that no other party without good cause obtain a security position in the project's benefit senior to our unsecured equity.

Although section 505 provides for unsecured equity financings and does not contain a similar capitalization restriction, the Federal investment is protected because our financings provide that on the occurrence of certain events of default the securities convert to debt precluding the railroad from incurring new debt that would be senior to ours. Because S. 1151 would preclude a similar provision under its finance agreements, the provision in question is needed to protect the Federal interest.

Question 14. In the case of a default under S. 1151, the Department would be able to appoint two members to the board of the defaulting applicant railroad. What criteria would be used in determining what constitutes default and what would trigger such appointments?

Answer. A default would occur upon the railroad's failure to make a payment, the discovery that it had misrepresented a material fact while negotiating the financing agreement, or upon the railroad's breach of an affirmative or negative covenant in the financing agreement. Unlike the default provisions of the 505 program which are triggered by overdue payments, DOT has proposed that a railroad's failure or inability to pursue its restructuring covenants (and not payment) should trigger default, and that concept is incorporated in S. 1151. This provision should be applicable to all defaults in order to provide the Department with maximum leverage to influence the achievement of the legislation's restructuring objectives. With respect to board appointments in the event of default, the Secretary's discretionary right to appoint members to a railroad's board of directors would be likely to be exercised when the Secretary felt that a voice in the railroad's management was needed to achieve the legislation's restructuring objectives and protect the government's investment.

Question 15. Under S. 1151, funds would be provided for labor costs resulting from changes in operating practices which could "improve manpower effectiveness." What specific programs might be included pursuant to which costs would be eligible for coverage?

Answer. Two programs would be eligible for coverage under the labor cost provisions of S. 1151: (1) labor protection costs associated with restructuring and (2) manpower effectiveness programs designed to enhance manpower utilization.

1. *Labor protection costs.*—Loans would be made available to carriers to help defer the immediate impact of labor protection claims arising as a result of rail line restructuring. This would induce management to more aggressively pursue restructuring efforts because it would relieve them of the immediate financial impact of underwriting traditional labor protection costs imposed by the ICC. The loans would cover, for some defined period (probably 3 years maximum) such labor protection costs as separation payments, supplementary unemployment insurance programs, job placement techniques, retraining capabilities, and guaranteed wage provisions as applicable.

2. *Manpower utilization improvement.*—Changes in operating practices brought about by restructuring can provide an opportunity to test innovative methods to improve manpower utilization and effectiveness. Also, irrespective of line restructuring there are many operational improvements which need to be instituted which will dramatically improve railroad performance. Specific examples include consolidating seniority rosters in terminals, merging road and yard seniority, elimination

of unnecessary yards and car handling procedures the adaptation of work rules to more closely correspond to revised traffic patterns and coordination of interchange and deliveries between connecting carriers. This program would focus on the non-capital aspects of railroad operations which accounts for forty to sixty percent of the average railroad's revenue dollar. It would provide loans to carriers to help underwrite the planning/administrative procedures necessary to identify these problem areas and would help defer the cost of implementing these improvements. The carrier would be repaying the loan over a period as the improvements produce savings and generate additional revenue.

Question 16. You have mentioned that some of the projects involving purchase of facilities could be funded under section 511 of the 4R act. To what extent have 511 funds been used for such projects to date? Would you please comment on what projects you would consider to be part of "restructuring" under S. 1151 as compared with those projects eligible under section 511? Would projects under section 511 include "purchase of assets", which S. 1151 would not?

Answer. None of the section 511 agreements executed to date have involved funds for acquisitions.

Under S. 1151, the section 511 loan guarantee program would be maintained substantially unchanged. The "restructuring" consideration, per se, would not affect section 511 financing decisions.

Acquisitions would be eligible for financing either under S. 1151 or section 511 depending on the circumstances in each individual case and the availability of funding in the two programs.

Question 17. For the record, would you please provide a breakdown of the projected costs associated with the assistance program under S. 1151 for each of the five fiscal years covered under the bill, totaling the \$1.475 billion requested to be authorized?

Answer. The projected costs associated with the S. 1151 proposal are as follows:

	<i>Millions</i>
Fiscal year 1981.....	\$250
Fiscal year 1982.....	400
Fiscal year 1983.....	325
Fiscal year 1984.....	250
Fiscal year 1985.....	250
Total.....	1.475

Senator LONG. Thank you very much, gentlemen.

Next, let's hear from Mr. David Hughes, vice president for engineering, Boston & Maine Railroad Corp.

STATEMENT OF DAVID HUGHES, VICE PRESIDENT FOR ENGINEERING, BOSTON & MAINE RAILROAD CORP.

Mr. HUGHES. Good morning. I'm going to omit some portions of my written testimony in reading it this morning to save time.

I am David Hughes and I am vice president for engineering of the Boston & Maine Railroad. The planning and execution of the work done under the Federal financial assistance programs has come under my direct supervision. I will be glad to answer any questions you may have about how the present 505 program has worked and have attached to my testimony a portion of the testimony given by Alan Dustin, president of the Boston & Maine, to the House Interstate and Foreign Commerce Committee last year reviewing the frustrations of the application process for the funds.

However, I know that your interest here today is not in the past but in the future of Federal assistance to the railroad system. The need is clear. The railroads are basic to the economy of the Nation, but there is an enormous capital shortfall in the rail industry. The administration has recognized the public interest in rail rehabilitation and restructuring and I commend them for proposing major

legislation which attempts to grapple with the problem of railroad decline.

The administration proposal is a good beginning, but it has two serious flaws. First, it ties all Federal assistance solely to restructuring, ignoring other vital needs for rail upgrading. Under the terms of S. 1151, the important work to our essential main line on the Boston & Maine could not have been undertaken because we are not restructuring. Rather, we are improving the main spine of our railroad system and ending deferred maintenance which resulted from the economic decline of Northeast railroads. The essential services language of the 4R Act, which allows the curing of deferred maintenance, is vital if the program is to meet the real needs of the railroads.

The second flaw of S. 1151 is that the terms and conditions placed on the money are so stringent that railroads like the Boston & Maine and others in our region, such as the Delaware & Hudson, would find it impossible to afford it. Our railroads simply would find themselves unable to take on additional debt for projects that are in the public interest, but for which the ROI is not high. Private markets for this purpose are already foreclosed. Government financing is the last remaining source of rehabilitation and restructuring capital, other than internally generated cash.

The Boston & Maine is very optimistic about our future. We were the only one of the bankrupts in the Northeast to stay out of Conrail. While we have not made a profit for over two decades, our financial prospects are getting brighter. During the last few years we have shown steady improvement, both in our financial picture and our physical condition. We are confident that within the foreseeable future—perhaps even within the next year or two—we will be able to finalize an income-based reorganization—the first such private reorganization of a railroad in this half of the century.

Nonetheless, even after the reorganization, our financial condition will remain fragile for some time. On major capital projects we may need help. In addition, we may be engaged in substantial Northeast restructuring. Presently, the U.S. Railway Association is studying the New England railroads, including the Boston & Maine; and the Federal Railroad Administration is studying the Delaware & Hudson. Both USRA and FRA are deeply involved in Conrail restructuring concepts. All of this may result in substantial rail consolidation and change throughout the Northeast. All of this will require a great deal of money which cannot be raised in the private markets.

The basic difficulty with S. 1151 is that it is aimed at making money available to the financially strong large railroads to acquire and rehabilitate pieces of weak railroads. The Federal money will be the inducement for the rich partner to play the game of restructuring with the weak partner.

It is not possible to know whether the Boston & Maine will engage in restructuring as defined in the legislation. Who is to say that after nearly a decade in bankruptcy preceded by a decade of losses that we will attract a viable partner? This much is clear. With or without restructuring, we are the largest railroad headquartered in New England. Unlike the Midwest, there are not excess parallel routes crisscrossing our service area. Service over

our lines is essential. Whether or not we restructure we will need to continue our strong railroad rehabilitation program. Yet, under the terms of S. 1151, we would be completely foreclosed from the Federal program if we did not restructure. Further, even if we did restructure with another marginal carrier in our area, it is most unlikely that either of us would be able to borrow money under the terms of S. 1151.

We want to make it clear that we do not oppose the administration's concept of the rich taking the poor with Federal aid. The problem is, in the areas of the greatest need, the have railroads are simply not that interested in picking up major pieces of have not railroads, except where major market extensions are involved. Simply put, as the Midwest experience is showing us today, profitable railroads simply do not want to pick up long lines of railroad that have driven other carriers into bankruptcy and liquidation.

The interest in the Midwest, with notable exceptions, seems to be coming from the less well-off carriers. The reason is not that these carriers have greater interest in picking up losers, but rather it is because they are located in the service area and the restructurings make good sense to them.

The Boston & Maine is in New England. This is our service territory. It is our home. There is no rich benefactor railroad that is going to come in and solve our problems. We, along with the Maine railroads, the Central of Vermont, the Delaware & Hudson, Conrail, and some others, are going to have to do it ourselves. We are going to need financial help. But it cannot be on the terms and conditions intended for a Union Pacific.

I want to make it very clear, I am not suggesting that marginal carriers should apply for cheap dollars to undertake restructuring projects that wealthier carriers would reject. The project itself must stand on its own merits both in terms of the project's integrity and its essentiality to transportation needs. The financial strength of the applicant corporation, so long as that corporation is responsible, should not be the critical factor in an approval. The critical factor should be whether the project itself is essential to transportation needs regardless of the corporation that may operate over the track in the future. Whether the applicant itself is a have or have not railroad should make little difference except in the terms and conditions of the financing instrument.

The Boston & Maine therefore propose additions to the administration bill which will provide practical financing. The two programs we would propose are: First, a true Government equity program with dividends tied to profitability; and second, a grant program patterned after the successful New England Regional Commission project funding rail jobs on rights-of-way improvement.

Concerning the equity program, we believe Congress should reform the redeemable preference share concept and create a true equity program under which it would purchase shares of nonvoting, preferred stock in a railroad. These shares would not be in the convoluted form or debt/equity which we have under the redeemable preference share program under the 4R Act, but would be a true equity issue. The dividends to the Government would accrue upon the profitability of the carrier and would stand before divi-

dends to common shareholders. The dividends or payback mechanism would give the Government reasonable protection. Perhaps there should be an option to transfer this stock to employees once the Government investment has been recaptured and in exchange for productivity gains.

Concerning railroad jobs, our second proposal is based on an extremely successful grant program undertaken by the New England Regional Commission. Under this program and regional commission, through its individual States, supports the employment costs on specific rail upgrading projects. This program, designed to provide constructive jobs for the unemployed, has proved to be very effective. Unlike the leaf raking and make work aspects of many Government unemployment programs, this money provides employment and contributes to meeting the need for good rail service as well. For the unemployed individuals involved, the program has provided on-the-job training in a useful profession. A very high percentage of the individuals involved have been retained by the railroad as part of our regular work force.

The Commission funds support only the costs directly related to employment, that is, the salaries and direct fringe benefit costs. The railroads make the investment in all the equipment, ties, ballast, rail, and other supplies. During the 4 years the program has been in existence, the Boston & Maine has done \$15.6 million work on the rehabilitation of our track. Of this, the New England Regional Commission has provided \$5.9 million in support for employment while the railroad has provided \$9.7 million for supplies, equipment, et cetera. Of the program, \$9.3 million has gone into our mainline, \$3.5 million into yards, and \$2.7 million into branch lines that the railroads and the individual States agreed were worthwhile. None of this work would have been possible for our railroad had the jobs funds not been available to us.

You may recall that this committee approved a program similar to this proposal 5 years ago. The bill, while passed by both the House and Senate, broke down in conference because of a dispute between two labor unions. It is my understanding that the dispute between unions has now been resolved for the purpose of this proposal.

We believe this jobs program would make an enormous contribution at a time when the economy is beginning to falter and when high levels of unemployment are expected to occur. It would improve rail service and would redress some of the intermodal inequity that has occurred over the past 30 years. It will meet a social objective as well.

The administration has proposed a \$1.5 billion authorization for the Rail Restructuring Assistance Act of 1979. This is a substantial commitment during a difficult budget period. We would recommend to the committee that the Congress adopt the \$1.5 billion ceiling for appropriations and divide the money between the administration restructuring assistance, the equity for marginal carriers, and rail jobs grant programs. Some consideration might be given to staking a claim to the windfall profits fund for the railroad jobs program.

In conclusion, we want to commend the administration for their program and for their continuing interest in the financing of vital

rail programs. We want to note particularly their interest in providing funding for labor productivity and feel strongly that any financing bill should contain such a provision.

We also want to note, as Alan Dustin did in the attachment, that the Federal Railroad Administration was both fair and cooperative in their administration of the title V program. They negotiated toughly but in good faith, and we have been very satisfied with the program and its contribution to the increasing health of our railroad.

Thank you.

Senator LONG. Thank you very much.

In your testimony, you state that one of the flaws in this bill is the stringent conditions which it establishes before assistance is available. Would you please elaborate upon that statement?

Mr. HUGHES. Yes. The provisions that require an absolute pay-back provision independent of earnings create an element of risk both I believe to the railroad and the Government which is something that should be reconsidered. In the case of the types of rehabilitation programs that we believe should be undertaken, many rehabilitation programs have a good return on investment but produce no additional income. That is, in the case of the removing of some deferred maintenance, it may be that avoiding the future costs of operating losses due to deferred maintenance may be a good investment through avoidance of declining earnings. It still may not produce enough additional earnings to retire a debt. Now that's a condition that exists in any situation where restructuring involves removal of deferred maintenance.

Senator LONG. Now do you agree with DOT that the low density lines should not be eligible for funds under this program?

Mr. HUGHES. I'm not sure where they draw the line for low density and high density lines. There are some lines that are not in the 30, 40, or 50 million gross ton category which are absolutely essential. One example of a line of that kind is one of our main line into the State of Maine. It carries about 10 million gross tons. It is the primary, indeed the only major domestic route to and from the State of Maine and for that line to be excluded from eligibility for rehabilitation would ignore its transportation significance, independent of the density on the line.

Senator LONG. In your testimony, you state that the problem with the concept behind the bill is that it doesn't work. Is this your thought because the new program would not continue to address the problem of deferred maintenance?

Mr. HUGHES. It does not comprehensively address the problem of deferred maintenance. The inducement to profitable railroads to undertake restructuring projects has to be based on an increase in earnings. Now in general that means the acquisition of new markets as a means of acquiring new earnings. In many cases there simply is not enough incentive to induce a railroad to make major investments of the level required to obtain new earnings that may be available through market extension and in some cases the cost of the elimination of deferred maintenance is so high that the payback may be one that simply is unjustified even with interest subsidies.

Senator LONG. Senator Cannon.

The CHAIRMAN. Assuming that the 505 program remains intact, how would you foresee using future assistance?

Mr. HUGHES. There are no lines on our railroad presently with a priority that would make them eligible for future assistance as we now understand the program. There was a hierarchy of priorities established in the regulations administering section 505 of the program, one of which created a threshold of 20 million gross tons as a primary cutoff point for track rehabilitation. There's a good deal of railroad track in the country which is quite essential as trunk lines which doesn't have a density as high as 20 million gross tons. It, nonetheless, is essential to the transportation network.

The CHAIRMAN. Well, to what extent has deferred maintenance on your lines been corrected now?

Mr. HUGHES. We have made a major start. We still have a long way to go. One of the problems that we face is that a great deal of railroads purchases of new rail were in the 1939 to 1945 period on our railroad and in railroads in general. The war years were a time of great investment in the railroad business. We're facing now the time when that rail is reaching the end of its life all at one time. It's obviously been consumed over the past 30 or 35 years. Rail at \$175,000 a mile is a very expensive commodity, one that if we were to make an investment in it over the next 10 years would generate no new earnings. It would only eliminate additional drains on earnings as a result of train slow orders, and so forth. Today that rail is satisfactory. Over the next 5 to 10 years it needs to be replaced.

The CHAIRMAN. Did you have any overall restructuring plan in mind when you received assistance for deferred maintenance?

Mr. HUGHES. Restructuring is something that's difficult to think about from the point of view of a bankrupt railroad soliciting others. I know that—I believe that we are enthusiastic about considering restructuring projects. However, as long as the Boston & Maine is not in the position to contribute to the earnings—significantly contribute to the earnings of a consolidated railroad, we are not particularly attractive. There simply has to be an opportunity for additional profits before a railroad is going to be interested in restructuring with us or any other marginal railroad.

The CHAIRMAN. Thank you, Mr. Chairman.

Senator LONG. Thank you, sir.

[The statement and answers to questions of the committee follow:]

STATEMENT OF DAVID HUGHES, VICE PRESIDENT-ENGINEERING, BOSTON & MAINE RAILROAD

I am David Hughes and I am Vice President for Engineering of the Boston & Maine Railroad. The planning and execution of the work done under the federal financial assistance programs has come under my direct supervision. I will be glad to answer any questions you may have about how the present 505 program has worked and have attached to my testimony a portion of the testimony given by Alan Dustin, President of the Boston & Maine, to the House Interstate and Foreign Commerce Committee last year reviewing the frustrations of the application process for the funds.

However, I know that your interest here today is not in the past but in the future of federal assistance to the railroad system. The need is clear. The railroads are basic to the economy of the nation, but there is an enormous capital shortfall in the

rail industry. The Administration has recognized the public interest in rail rehabilitation and restructuring and I commend them for proposing major legislation which attempts to grapple with the problem of railroad decline.

The Administration proposal is a good beginning, but it has two serious flaws. First, it ties all federal assistance solely to restructuring, ignoring other vital needs for rail upgrading. Under the terms of S. 1151, the important work to our essential main line on the Boston & Maine could not have been undertaken because we are not "restructuring". Rather, we are improving the main spine of our railroad system and ending deferred maintenance which resulted from the economic decline of northeast railroads. The essential services language of the 4R Act, which allows the curing of deferred maintenance, is vital if the program is to meet the real needs of the railroads.

The second flaw of S. 1151 is that the terms and conditions placed on the money are so stringent that railroads like the Boston & Maine and others in our region, such as the Delaware & Hudson, would find it impossible to qualify. Our railroads simply would find themselves unable to take on additional debt for projects that are in the public interest, but for which the ROI is not high. Private markets for this purpose are already foreclosed. Government financing is the last remaining source of rehabilitation and restructuring capital, other than internally generated cash.

The Boston & Maine is very optimistic about our future. We were the only one of the bankrupts in the northeast to stay out of Conrail. While we have not made a profit for over two decades, our financial prospects are getting brighter. During the last few years we have shown steady improvement, both in our financial picture and our physical condition. We are confident that within the foreseeable future—perhaps even within the next year or two—we will be able to finalize an income-based reorganization—the first such private reorganization of a railroad in this half of the century.

Nonetheless, even after reorganization, our financial condition will remain fragile for some time. On major capital projects, we may need help. In addition, we may be engaged in substantial northeast restructuring. Presently, the U.S. Railway Association is studying the New England railroads, including the Boston & Maine; and the Federal Railroad Administration is studying the Delaware & Hudson. Both USRA and FRA are deeply involved in Conrail restructuring concepts. All of this may result in substantial rail consolidation and change throughout the northeast. All of this will require a great deal of money which cannot be raised in the private markets.

The basic difficulty with S. 1151 is that it is aimed at making money available to the financially strong large railroads to acquire and rehabilitate pieces of weak railroads. The federal money will be the inducement for the rich partner to play the game of restructuring with the weak partner. There is nothing new about this concept in that it has been the basic policy of the Department of Transportation since the Nixon Administration. The premise of S. 1151 was incorporated in the original 4R Act 505 regulations issued by Secretary Coleman and subsequently changed by statute, over the objections of the Administration to allow for deferred maintenance projects on essential lines.

It is not possible to know whether the Boston & Maine will engage in restructuring as defined in the legislation. Who is to say that after nearly a decade in bankruptcy preceded by a decade of losses that we will attract a viable partner? This much is clear. With or without restructuring we are the largest railroad headquartered in New England. Unlike the Midwest, there are not excess parallel routes criss-crossing our service area. Service over our lines is essential. Whether or not we restructure we will need to continue our strong railroad rehabilitation program. Yet, under the terms of S. 1151, we would be completely foreclosed from the Federal program if we did not restructure. Further, even if we did restructure with another marginal carrier in our area it is most unlikely that either of us would be able to borrow money under the terms of S. 1151.

We want to make it clear that we do not oppose the Administration's concept of the rich taking the poor with federal aid. The problem is, in the areas of the greatest need, the "have" railroads are simply not that interested in picking up major pieces of "have not" railroads, except where major market extensions are involved. Simply put, as the midwest experience is showing us today, profitable railroads simply do not want to pick up long lines of railroad that have driven other carriers into bankruptcy and liquidation.

The interest in the Midwest, with notable exceptions, seems to be coming from the less well of carriers. The reason is not that these carriers have greater interest in picking up losers, but rather it is because they are located in the service area and the restructurings make good sense to them.

The Boston & Maine is in New England. This is our service territory. It is our home. There is no rich benefactor railroad that is going to come in and solve our problems. We, along with the Maine railroads, the Central of Vermont, the Delaware & Hudson, Conrail, and some others, are going to have to do it ourselves. We are going to need financial help. But it cannot be on the terms and conditions intended for a Union Pacific. Similarly, I would submit that midwest railroads like the Chicago & Northwestern and the Illinois Central Gulf, who are also testifying today, are going to have to provide the basic solution to Midwest restructuring because they also are there. We all want to be a part of the solution—not a part of the problem. We would hope that this assistance for those in our category will help us to become strong partners in restructuring projects and healthy viable carriers of tomorrow.

I want to make it very clear, I am not suggesting that marginal carriers should apply for cheap dollars to undertake restructuring projects that wealthier carriers would reject. The project itself must stand on its own merits both in terms of the project's integrity and its essentiality to transportation needs. The financial strength of the applicant corporation, so long as that corporation is responsible, should not be the critical factor in an approval. The critical factor should be whether the project itself is essential to transportation needs regardless of the corporation that may operate over the track in the future. Whether the applicant itself is a "have" or "have not" railroad should make little difference except in the terms and conditions of the financing instrument. This point is an important one. From the beginning of the Title V program it has been a point of frustration and controversy between the Department of Transportation on one hand and the Congress and Title V railroads on the other hand. It is a point that I hope will be clearly addressed in this legislation.

The Boston & Maine therefore propose additions to the Administration bill which will provide practical financing. The two programs we would propose are: first, a true government equity program with dividends tied to profitability; and second, a grant program patterned after the successful New England Regional Commission project funding rail jobs on rights of way improvement with railroads providing supplies and equipment.

The equity program.—We believe Congress should reform the Redeemable Preference Share concept and create a true equity program under which it would purchase shares of nonvoting, preferred stock in a railroad. These shares would not be in the convoluted form or debt/equity which we have under the Redeemable Preference Share program under the 4R Act, but would be a true equity issue. The dividends to the government would accrue upon the profitability of the carrier and would stand before dividends to common share holders. The dividends or payback mechanism would give the government reasonable protection. Perhaps there should be an option to transfer this stock to employees once the government investment has been recaptured and in exchange for productivity gains.

This would obviously be a high risk program to the government in terms of repayment but we believe the public need for rail service justifies the considerable government investment and risk that would occur.

The alternative to this program may be more costly in terms of lost service and expense to the taxpayer. Deteriorating track will lead to decline of service, more corporate failures and more liquidations, and loss of jobs. Directed service, we learned on the Rock Island, is one of the most expensive and least effective methods to run a railroad. Much of what is left after a railroad failure is picked up by federal grants through the state with remaining pieces of railroad run by shortline designated operators. Another alternative is the Conrail solution which is also very expensive and a third alternative is nationalization on which I won't even comment. Thus, when we talk about the risk of a track rehabilitation equity program, we should also consider the risks of all the alternatives which may be far greater.

Both as an energy transporter and as the most energy efficient means of transporting other freight, railroads are essential to the nation. Such high risk investment in railroads is justified, as well, by the enormous investment the government has already made in the competing modes of transportation.

I will not rehash the many statistics with which you are already familiar about the disproportionately small contribution other modes make to the maintenance of their rights-of-way. The recent GAO report on trucking and the highways made that point quite clear and we are confident that the intermodal equity study presently being undertaken by the Department of Transportation will also strongly underline that point. Thus, we believe the risks are justified both by the public need and the public fairness.

We recognize that there are difficult questions of government ownership that must be addressed. We would envision that the government would have a right to appoint a member of the Board of Directors of the Corporation issuing the preferred shares, but we clearly believe that the government should not become involved in the day-to-day management of the corporation. By requiring that government dividends stand before those of the private equity holders, we believe that the fear of "enriching" private parties can be avoided. We would envision that the equity program would be used for marginal railroads to end deferred maintenance, to restructure and to fund employee ownership programs.

Railroad jobs.—Our second proposal is based on an extremely successful grant program undertaken by the New England Regional Commission. Under this program and Regional Commission, through its individual states, supports the employment costs on specific rail upgrading projects. This program designed to provide constructive jobs for the unemployed, has proved to be very effective. Unlike the "leaf raking" and "make work" aspects of many government unemployment programs, this money provides employment and contributes to meeting the need for good rail service as well. For the unemployed individuals involved, the program has provided on-the-job training in a useful profession—a profession for which there will be considerable need in the next twenty years as the railroads of the nation are rehabilitated. A very high percentage of the individuals involved have been retained by the railroad as part of our regular work force.

The Commission funds support only the costs directly related to employment, i.e., the salaries and direct fringe benefit costs. The railroads make the investment in all the equipment, ties, ballast, rail, and other supplies. During the four years the program has been in existence, the Boston and Maine has done \$15.6 million work on the rehabilitation of our track. Of this, the Commission has provided \$5.9 million in support for employment while the railroad has provided \$9.7 million for supplies, equipment, etc. Of the program, \$9.3 million has gone into our mainline, \$3.5 million into yards and \$2.7 million into branch lines. None of this work would have been possible for our railroad had the jobs funds not been available to us.

You may recall that this Committee approved a program similar to this proposal five years ago. The bill, while passed by both the House and Senate, broke down in Conference because of a dispute between two labor unions. It is my understanding that the dispute between unions has now been resolved for purpose of this proposal.

We believe this jobs program would make an enormous contribution at a time when the economy is beginning to falter and when high levels of unemployment are expected to occur. It would improve rail service and would redress some of the intermodal inequity that has occurred over the past 30 years. It will meet a social objective as well.

The Administration has proposed a \$1.5 billion authorization for the Rail Restructuring Assistance Act of 1979. This is a substantial commitment during a difficult budget period. We would recommend to the Committee that the Congress adopt the \$1.5 billion ceiling for appropriations and divide the money between the Administration restructuring assistance, the equity for marginal carriers and rail jobs grant programs. Some consideration might be given to staking a claim to the windfall profits fund for the railroad jobs program.

In conclusion, we want to commend the Administration for their program and for their continuing interest in the financing of vital rail programs. We want to note particularly, their interest in providing funding for labor productivity and feel strongly that any financing bill should contain such a provision.

We also want to note, as Alan Dustin did in the attachment, that the Federal Railroad Administration was both fair and cooperative in their administration of the Title V program. They negotiated toughly but in good faith, and we have been very satisfied with the program and its contribution to the increasing health of our railroad.

Thank you.
Attachment.

PORTION OF THE TESTIMONY OF ALAN DUSTIN, PRESIDENT, BOSTON & MAINE RAILROAD

You asked me to address the implementation of the 4R Act Title V program to finance rehabilitation and improvement on marginal and bankrupt railroads. You asked specifically whether in my opinion, provisions have achieved Congressional objectives. This is a complex subject and I will summarize my opinion here. If the Committee wishes, I will be pleased to prepare views and analysis in greater detail than is possible in this oral testimony.

In summary, it is not of course, a simple thing to divine the Congressional objective in the establishment of this program. I think it is fair to say that the objectives that we on the Boston and Maine felt important at the time of enactment were not the same objectives as seen by the DOT at the time. Perhaps former Deputy Secretary of Transportation John Barnum, when he addressed a gathering of financial leaders, summarized it best by saying that deciding on Congressional intent was Washington's greatest cottage industry. Perhaps the most helpful thing that I can do is give you a quick review of how we viewed Congressional intent, how I feel the Administration viewed Congressional intent, and something on our actual experience. Fortunately, the story has a happy ending in that the Boston and Maine is currently making drawdowns on 26 million dollars in Title V mainline rehabilitation borrowing.

In this hearing I am going to only address the 505 redeemable preference share/Title 505 trustee certificate program in which we have experience and not the 511 loan guarantee program with which we do not have any experience.

It should be noted that the 505 redeemable preference share program was a creature of Congress and only reluctantly accepted by the Administration as a part of the price for achievement of the overall legislative package which authorizes funding for the implementation of Conrail. The Administration was not opposed to some rehabilitation financing, but strenuously objected to the mechanism of equity financing contained in Section 505. The original Congressional proposal, as a result of the equity mechanism, would have excluded the Boston and Maine and other carriers in reorganization from participation. The Administration resisted our efforts to open the program to include that bankrupt railroads. With strong leadership from Congressman Silvio Conte and others, we were able to overcome Administration resistance to an eleventh hour amendment which made it possible for the Secretary to issue trustee certificates to railroads in reorganization under Section 77. As a part of a compromise reached with the Administration, Congress accepted some additional findings for railroads in reorganization that must be made by the Secretary. One of those findings was a liquidation finding requiring the Secretary to find that the assets of a railroad in reorganization would protect the interests of the government should that railroad eventually fall into liquidation.

I think that funding was intended as a two year interim measure to put money quickly into railroads to begin curing the worst problems of deferred maintenance for marginal and bankrupt railroads while the Congress and Administration attempted to come to grips with the overall financial shortfall in the industry and to develop a permanent method for financing that shortfall.

Our view on the Boston and Maine was that Congress intended that funding to meet urgent railroad needs for capital to repair and revitalize tracks and equipment. We felt it was intended that the 600 million dollars in redeemable preference share funding be quickly distributed so that important work could get underway. We felt that Congress intended that the primary consideration in making funding available would be the essentiality of track to the transportation needs of the area.

We felt that the liquidation and other requirements and tests were intended to be somewhat permissive, that is, not absolute. We also felt that the question of the specific viability of specific corporations that would operate the line would not be as important a consideration as the long-term service essentiality of railroad line itself. Thus, when we began the application process, we were optimistic that funding would be made available to us for lines on which we maintain essential service.

The Administration took a different view of Congressional intent relating to the program. Their view was rooted in the fear that rail surplus plant would be continued via federal funds and that unless they were extremely cautious, political pressures would build to put money into marginal and bankrupt companies that should be left to die as corporations. Thus, corporate viability rather than line essentiality became a key test. Further, they placed the highest priority on the requirement that the money be repaid and that the government as a banker be fully protected in making the loan. Rigid tests on repayability were most difficult for a bankrupt carrier to meet. The Administration also felt that the government should not subsidize interest unless absolutely required.

I understand that this Subcommittee has raised questions as to why more profitable railroads have not opted for Title V financing. I can of course, only speculate. But, I am certain that the experiences of the initial applicants with the bureaucratic process had a dampening effect. Secondly, there was a clear intent of Congress that this was "bank of last resort" money that would be made available to marginal and bankrupt carriers. Congress included a "poverty clause" that required railroads to certify that private funds are not available for the project. There was a fear by certain profitable railroads that seeking these funds could chill private money

markets and on a reasonable schedule, then it doesn't make any sense to take the loan in the first place.

QUESTIONS OF THE COMMITTEE AND THE ANSWERS THERETO

Question 1. DOT has explained that the termination of the 505 program is based on the reality that the Federal Government can no longer subsidize low density lines without some rationalization of plant. Would you please respond to that statement, answering in light of the projects for which you received financial assistance?

Answer. We are not proposing light density line subsidies nor opposing rationalization, where appropriate and necessary. However, there are worthwhile projects in the public interest which are justifiable apart from restructuring and which may not have a related restructuring opportunity. We believe such projects should be explicitly made eligible for Federal Assistance, subject to appropriate findings by the Secretary. (See later answers.)

The attached map shows the B&M system and the location of our \$26 million project funded under Section 505 of the 4R Act. Sixty-two percent of the B&M's total gross ton miles (GTM) operate between Ayer and Mechanicville over trackage improved with 4R funds. However an additional 25% of our total GTM operates over the extensions shown as dashed lines on the map. These three segments are the heartline of B&M, operating 10 to 30 passenger and freight trains per day with a density at 9 to 22 GTM per year, with the lower densities at the extremities. Of the 296 miles from Portland, Maine to Rotterdam Junction, New York, only the 155-mile segment from Ayer to Mechanicville is being rehabilitated with Federal Assistance. The remaining 141 miles are also in need of substantial attention. However, the 505 regulations and the FRA's administration of the 505 program clearly indicated that funds would not be available for these lines. Therefore our Federally assisted main line rehabilitation program was limited to only half of the route from Rotterdam Junction to Portland.

If the reorganized B&M were included in a restructuring, the most likely combinations would be end to end with the Delaware and Hudson at Mechanicville, New York and/or the Maine Central at Portland, Maine. The feasibility of either of these proposals depends on the condition of our Rotterdam-Portland line and our financial condition. Our Ayer-Mechanicville project would encourage either of these consolidations as would rehabilitation of the remaining 141 miles between Rotterdam Junction and Portland.

Question 2. It has been stated that the deferred maintenance problem in the rail industry is under control and that there is no need to continue the 505 program under its present limits. What is your reaction to this analysis, particularly in light of the deferred maintenance which still exists in your system? You have indicated that anticipated projects for your system would not qualify for coverage under the 505 priorities as established by the Department. Are you saying that the 505 program as it is presently being administered will not have continued usefulness for your needs?

Answer. The October 1978 report "A Prospectus for Change in the Freight Railroad Industry" by the DOT reported deferred maintenance and capital improvements of Class I railroads at \$4.1 billion excluding Conrail. This amount is probably understated somewhat due to the reluctance of some profitable railroads to report any deferred maintenance and due to inflation. With the exception of the \$600 million authorized in Section 505 of the 4R Act, I know of no other significant steps directed toward eliminating the remaining \$3.5 billion in deferred maintenance and capital expenditures.

On the B&M system, the greatest need is to complete the upgrading of the Rotterdam to Portland line. There are a number of other potentially attractive projects which could be considered; however, the others have lower priority and their details are somewhat dependent on any New England restructuring which may eventually take place. Unless the security findings and funding priorities are altered, it appears the 505 Program as it is presently administered would be of no further use to the Boston and Maine.

Question 3. You have indicated that certain important projects which are planned for your system would not be included under S. 1151. The Department indicates that the definition of restructuring is broad enough to cover many such projects. How do you reconcile these two views? How do you perceive the definition of restructuring in terms of your own programs?

Answer. According to the definition of restructuring in S. 1151, any project which improves long term profitability and which results in the achievement of higher

average traffic densities and improved asset utilization could qualify for funding so long as the Secretary makes certain other findings including approval of a satisfactory restructuring plan. Although the definition is appropriately broad, we do believe the Congress should make its own intent and definition clear. There were inordinate delays in the processing of the B&M 4R Act application resulting from FRA regulatory interpretation and requirements resulting from language that had at first seemed rather straightforward and clear. Not only was this time consuming and expensive, but it created frustration between the FRA on one hand and the Congress and Title V applicants on the other.

We believe this authority should extend to projects which are likely to enhance the likelihood of restructuring by eliminating deferred maintenance in an essential property without the requirement for a firm plan of restructuring. The projects which the B&M believes merit further Federal Assistance would be complementary to restructuring; however, they could be justified solely on the basis of their contribution to there organization of the Boston and Maine and establishing the B&M as a sound element of future New England restructuring.

From the perspective of the Boston and Maine, we see restructuring as a two-step process. Step one is to have our physical plant and financial condition improved to the point we could be considered as a desirable element in a restructuring project. Having demonstrated the financial stability we believe is possible for the B&M, we then would expect restructuring through merger or purchase of lines to be a desirable and natural progression of events. Our concern is that if the first step does not occur, the second step may not either.

Question 4. You have mentioned the role which your railroad could play in any future restructuring of Conrail and the Northeast rail network. How would you characterize this role? Would you be purchasing lines? What type of assistance would you need in this regard? It has been suggested by DOT that section 511 funds could be used for the acquisition of lines. As you have not had experience with the 511 program, how would you respond to this proposal?

Answer. Since 1972 the B&M has made very substantial progress toward reorganizing independently on an income basis. This has been a slow difficult process and it is not yet complete. Our physical plant is in much better condition today than it was seven years ago and our locomotive and car fleets are at least as good as those throughout the remainder of the industry. Our management staff is almost entirely new and for the first time in twenty-five years the business outlook is for increasing traffic volumes. In each of the last several years we have decreased our losses while improving our plant and equipment.

We believe the skills that have helped bring the B&M to the improved condition it enjoys today are equally applicable for addressing rail problems in the remainder of New England and the Northeast. However, our work in rejuvenating the Boston and Maine is not complete. We still have not had a profitable year since 1958 although 1979 was essentially a break-even year when all prior period and extraordinary items are removed. We believe our most immediate contribution to restructuring in New England will be to put the Boston and Maine on a sound financial footing, a goal which we believe is reasonably within reach. Federal assistance to expedite our reorganization would be completely consistent with the Administration's goal of encouraging restructuring.

Considering the relatively fragile financial condition of the B&M presently and in the immediate future, we will need to exercise reasonable caution in our analysis of various lines which may be available for sale and rehabilitation. If we were to become a purchaser of line, we would need to have adequate assurance that the return on the investment substantially exceeded the cost of the capital employed. One way to provide that assurance is by acquiring only the most lucrative lines and facilities. However, in a region that has been plagued by mediocre or negative earnings, such plums may be few and far between. A second alternative is to relate the fixed charges associated with a property acquisition to the earnings of the company as is proposed in the answer to your question Number 5.

Before Section 511 funds could be used for the acquisition of properties, the return on that investment would have to be both certain and above the cost of funds to the Government. It is unlikely that there are many such investment opportunities presently in New England.

Question 5. Assuming, as you have proposed that financial assistance were termed "equity" under S. 1151 and the payments tied to the earnings of the applicant, would you be in favor of a program substantially similar to that under S. 1151? If not, what other specific changes in the bill would you recommend?

Answer. We believe two specific revisions to S. 1151 are required. First, the proposed terms of a financing instrument issued pursuant to S. 1151 should be

amended to provide for a distribution of internally generated corporate funds in a manner which protects the public interest in transportation as well as the public investment in the facilities. To do this, we propose that the Equity Program allow for a series of priorities for the distribution of available funds of a Carrier participating in the Program. The priority for the distribution of available funds should be as follows:

After debt service, the highest priority for available funds should be the allowance of a reasonable level of capital investment to preserve the quality of transportation services and minimize the cost of service provided. The extent to which internally generated funds would be applied to capital projects versus the use of debt would be determined by the debt/equity ratio of the company and the availability of funds from other sources.

The second priority for funds distribution would be to pay, to the extent earned, preferred dividends to the Government on its investment.

The third priority would be the distribution of reasonable dividends to Common Stockholders.

The fourth priority for funds use would be redemption of the preferred stock held by the Government at a maximum rate of $\frac{1}{2}$ st of the outstanding stock to be redeemed in any calendar year. It might also be possible for the government to have the option of transferring the stock to employees in exchange for productivity gains the Secretary certifies as in the public interest.

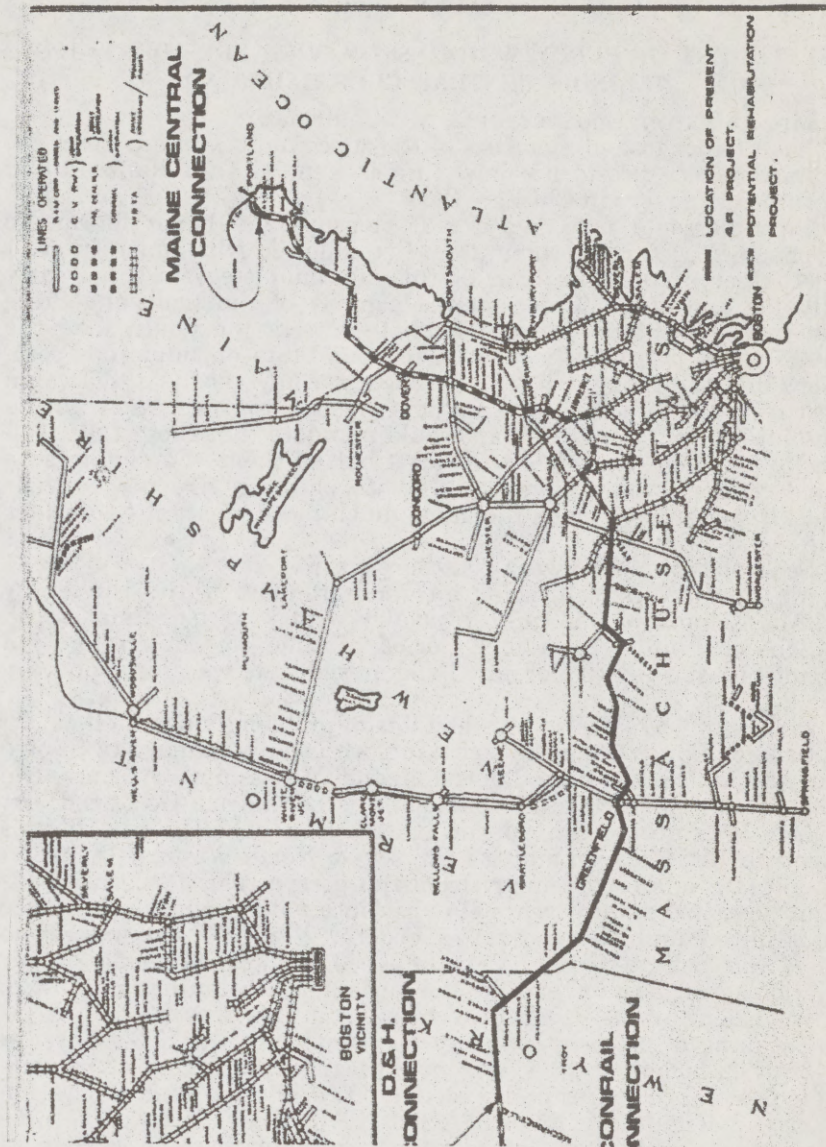
Any balance of funds available after the foregoing have been met would be available for reinvestment by the Company.

The equity program could be experimental to the New England USRA/FRA Study area. The intent of the Equity Program is to permit New England railroads to finance a restructuring on terms commensurate with their present and prospective earning power, recognizing that railroad earnings are directly related to Government transportation policy.

The second change should be to redefine restructuring to include a class of funding eligibility for the rehabilitation of facilities when:

1. There is no reasonable prospect that the line or facility can be eliminated through restructuring.
2. Federal investment would enhance the long term profitability of the operation of the line or facility to be improved.
3. Funds for the project are not available at a reasonable rate from any other source.

The intent of broadening the criteria for funding eligibility is to permit important investments in key facilities prior to formulation of a restructuring plan when the facility is essential and a restructuring plan cannot be defined immediately.



Senator LONG. Next, let's hear from Mr. Percy W. Johnston, vice president—law, Illinois Central Gulf Railroad.

**STATEMENT OF PERCY W. JOHNSTON, VICE PRESIDENT—LAW,
ILLINOIS CENTRAL GULF RAILROAD**

Mr. JOHNSTON. Good morning, Mr. Chairman.

Mr. Chairman and members of the subcommittee: I am Percy W. Johnston, vice president—law, Illinois Central Gulf Railroad Co., with headquarters in Chicago, Ill.

On a personal note, it's a real pleasure and honor for me to appear before this subcommittee. I've followed with much interest the career of the chairman of this subcommittee since his early days as a political leader on the campus of the Louisiana State University. Senator Cannon, football fans in the South take the game seriously and I have been in your State on numerous occasions and the thought has occurred to me, my goodness, if I could just testify before Senator Long and get him to some way secure a resolution from Congress that would mandate that those LSU football players on the field—or at least half of them—I'd give them a good chance—would have to play with one arm strapped to their side, it would have made the game much more pleasant I think for me.

Senator LONG. Who were you there with?

Mr. JOHNSTON. Well, being an undergraduate of the University of Mississippi, we had quite a rivalry with your old alma mater.

Senator LONG. For a long period of time we couldn't hold a candle to you—until Johnny Falk moved out, we didn't do very well.

Mr. JOHNSTON. Well, we've had lots of problems since then.

Senator LONG. Generally speaking, we usually manage to resolve our differences between Louisiana and Mississippi. Of course we call off our alliance until that game is behind us. Go ahead, sir.

Mr. JOHNSTON. I am appearing today on behalf of the Illinois Central Gulf Railroad and the Chicago & North Western Transportation Co. to offer testimony from the perspective of two railroads that have had several years of experience with financial assistance programs administered by the Federal Railroad Administration and who believe strongly in the need for restructuring of our Nation's rail system and in the need for continuing, if limited, involvement by the Federal Government in this process.

Speaking of my own company for a moment, the ICG's physical plant has benefited greatly from the existing program of redeemable preference shares under section 505 of the Railroad Revitalization and Regulatory Reform Act of 1976. Under a total of three agreements, FRA has agreed to purchase up to \$166 million of preference shares issued by the ICG to improve its heavily used main line between Chicago and the gulf. When the preference share work is completed in 1982, the ICG will have installed about 520 miles of new rail and more than 370,000 new crossties, excluding work in the terminal areas around Jackson, Miss., a hub center for our company, and will have surfaced the entire track between Chicago, Ill. and Jackson, Miss.

I would like to refer briefly to the map that is before you to illustrate this program. The company is basically a north-south

line serving the Mississippi Valley. The preference share program funded under the 4R Act covers this area in green, the main freight line from Chicago to Jackson, Miss. The funding consists of the dollars raised through the preference share financing plus internally generated dollars by the railroad.

At Jackson, Miss., with our own funds, we have upgraded a route to serve the port of Mobile, Ala. and the port of Pascagoula, Miss. With our own funds we have improved out from Jackson on down to New Orleans with a line from Hammond over to the chemical complex in the Baton Rouge area.

As a part of this program, we have sought internal restructuring from a system of about 9,300 to 9,400 miles. Our objective is to reduce to a system of approximately 7,000 miles. As an example, the over-the-road business, through business, that 5 years ago would have moved over their north-south line—

Senator LONG. What are some of those cities on that north-south line you're speaking of so I can identify what you're pointing out right now? What are some of the cities?

Mr. JOHNSTON. Pontotoc, northward from Laurel, Miss.

Senator LONG. Fine.

Mr. JOHNSTON. Now we moved through freight over this to this east line in Mississippi and to the main line. Freight that came out of Mobile up this east side of Mississippi is now going over the orange line to Jackson up the upgraded line to the Midwest. And that's the type of program that we are undertaking. A number of lines—for example, a line up to Wisconsin that is a line of very low density, we are seeking to abandon that line, and lines with extremely low density we are in the process of seeking to abandon and our program is to concentrate the freight on this main north-south corridor.

Reaching agreement with FRA to finance this work was a large-scale undertaking. Both sides were plowing new ground.

Preference shares were a new type of security. There were many questions about its precise terms and its effect on a railroad's capital structure. It took the investment community time to fully understand it.

Criteria to determine project eligibility were necessary, and these required extensive rulemaking proceedings and detailed negotiations between the railroads and FRA. Criteria involving engineering standards and traffic density were developed.

But we made it. FRA and the railroads using title V, working together, made the program a success. S. 1151 would replace the preference share program with a complex new program of repayable credits limited to restructuring projects.

Although restructuring is a worthy goal, there are numerous examples of lines whose rehabilitation would serve the public interest, whether or not a restructuring is involved. The preference share program has resulted in the improvement of hundreds of miles of main line track. A list of railroads that have received preference share funds is attached to this statement. Regardless of the form of restructuring assistance, section 505 of the 4R Act should be extended for at least 2 years to permit additional funding on the Nation's railroads.

With respect to restructuring of the railroad industry, the ICG and the C. & N.W. are vitally interested in the development of a mechanism that facilitates this goal. We therefore support the objectives of S. 1151. Currently, we are both involved in negotiations with the trustees of the Rock Island and the Milwaukee Road for the acquisition of essential line segments of those railroads, and have participated with the Interstate Commerce Commission and the Federal Railroad Administration in efforts to assure interim rail service while these negotiations proceed.

Our comments today are made primarily with the objective in mind of achieving a workable solution of the current Rock Island and Milwaukee problem. The Chicago & North Western's role in resolution of the situation is crucial and the ICG's although significant, is more limited. ICG and C. & N.W. are involved in discussions of feasibility of a joint corporation to provide competitive rail service in Iowa. Both railroads would need Federal financial assistance to participate fully in these projects in the Iowa area. Some of our comments might also apply to broader restructuring projects, such as large corporate mergers or transactions involving the relatively profitable Western railroads. Our immediate concern is whether the terms and conditions of financial assistance under S. 1151 will contribute significantly to restructuring, including particularly resolution of the current Rock Island and Milwaukee problems.

We would like to comment on two or three of these problem areas as we see them. First, the issue of equity versus debt. S. 1151 provides for issuance by the railroad of a fixed debt obligation unless the Secretary of Transportation determines that an equity financing is essential to a restructuring. S. 1151 would limit senior preferred stock to companies having a capitalization at the time of issuance which consists solely of equity. In contrast, the preference shares are, by definition, equity securities, and inclusion of a debt on a railroad's balance sheet does not disqualify an applicant from receiving preference share funding.

Now I'd like to comment briefly on that requirement. As I understand, as an example, if railroad A was interested in purchasing railroad B, the transaction could of course take the form of purchase of the common stock of railroad B, but it also might take the form of purchase of the assets—the track, the real properties, et cetera. In that situation, we know that virtually all railroad property in this country is covered by mortgages and with the restriction as we understand placed in S. 1151 the receiving of the preferred stock proposed could not be used in that type of transaction—that type of restructuring. That is, to the purchase by one railroad of the assets of another.

It seems to us that this is a change that the committee might want to consider.

The interest rate or dividend yield under S. 1151 and the preference shares differ significantly. Under section 505 preference shares have a minimum yield of 2.03 percent available and a maximum yield equal to the Government's cost of money. In the case of profits for the correction of deferred maintenance was set at the applicant's rate of return on total capital. This provides a good deal of administrative flexibility and requires the more profitable

railroads to pay dividends commensurate with their earning power. The interest rate of dividend yield under S. 1151 on the other hand is being pegged at three-fourths or one-half respectively of the Treasury rate on a security of comparable maturity. We believe that it is desirable that the FRA have administrative flexibility in negotiating the interest rates on this type financing.

Now the third area of S. 1151 that gives concern is the payback period and the preference share program. In the preference share program the payback period could be up to 30 years. We believe that the committee should consider an amendment to S. 1151 to give this same type of flexibility in S. 1151. There may be restructuring situations that would well warrant the shorter period and others that would warrant a longer payback period with less financial strain on the company involved. It's desirable that the administration have flexibility in tailoring a restructuring project.

One final concern, and this is somewhat technical in nature, S. 1151 does not seem to contemplate transactions involving a sale of assets. It refers in the early part of the bill to purchase of securities. Now the definition of coordination and of restructuring may very well correct that observation that I have just made. However, we believe it would make the bill clearer if the words "purchase of assets" could be added in the early part of the bill.

Having stated some of our concerns with S. 1151, what alternatives do we suggest to the subcommittee?

First, we would reiterate our recommendations that regardless of the form decided upon for restructuring assistance that the preference share program does warrant attention for a limited period for the funding of track rehabilitation and improvement prices.

Second, we believe that many of the goals of S. 1151 can be achieved through a relatively simply amendment to section 505 of the 4R Act. The Milwaukee Road Restructuring Act already permits the authority to finance rehabilitation in connection with a restructuring and make such assistance available to all railroads regardless of the availability of alternative funds.

Attached to this statement is a copy of a proposed bill to amend section 505, together with a section-by-section analysis.

Very briefly, this bill would: (1) Extend the preference share program for 2 years; (2) Provide for acquisition funding; and (3) Set reasonable priorities for funding of restructuring projects.

An alternative to this approach would be retention of S. 1151 substantially as proposed, but with the addition of a third type of security that would make low-cost equity assistance available to railroads that do not have access to other sources of financing but who are engaged in public interest restructuring or essential improvement projects that in the opinion of the Secretary are vital to meeting the needs of shippers.

We would include a stringent alternative funds test so there would be no enrichment of private investors at taxpayers' expense. We do not have specific language to propose today, but will be pleased to work with your staff.

Further, it could be used to purchase assets that could be covered by a security—in other words, mortgage assets.

Thank you very much, Mr. Chairman.

Certainly the needs are enormous in the Midwest and in the railroad industry. FRA is coming forward with innovative programs, and we support the activities in this respect.

Senator LONG. I am curious to know whether coal is a major item of income on the ICG lines?

Mr. JOHNSTON. Coal, I believe, is about—I would say about 12 percent of our volume. We are not holding the coal.

Senator LONG. Twelve percent in terms of dollars? Twelve percent in terms of tonnage?

Mr. JOHNSTON. Ton miles.

Senator LONG. It would be a great deal less than that in terms of dollars.

Where is your principal coal movement?

Mr. JOHNSTON. Our principal coal movements are from western Kentucky, in this area, to the Great Lakes, western Kentucky to the Louisville Gas Electric Co. points in southern Illinois, along this line marked in green, to the Ohio River for transshipment by barge.

One of the major problems that we face is this is principally coal, and the coal movement from western Kentucky and southern Illinois hasn't expanded as it has from Wyoming, the western coal, and coal from east Kentucky, the softer coal.

Senator LONG. I was aware of a proposal which involved moving a great deal of western Kentucky coal down to the Louisiana area—to the Baton Rouge-New Orleans area. It would be by water, I take it, and so it would not do your railroad much good, would it?

Mr. JOHNSTON. That's true.

Senator LONG. You might get involved for a few miles of it. Apparently the project would be mainly a water movement.

Mr. JOHNSTON. That probably would be correct. We are participating in one movement through Memphis down to Mississippi Power Co., down in this area. We get the coal from the Missouri-Pacific and Memphis and move it down this routing in green and down the orange route.

Senator LONG. But you can't very well compete, especially if they are just floating it downstream.

Mr. JOHNSTON. It is pretty tough competition, no question about that.

Senator LONG. It would be tough enough if it moves upstream.

Mr. JOHNSTON. The grain movement has been very interesting, however. As you know, there are new elevators south of Baton Rouge. They have put in a new elevator south of Baton Rouge. Japanese interests are putting in a major elevator south of Baton Rouge. And we are now moving out of Iowa from this area, out around Waterloo, Fort Dodge—this area of western Iowa. We are moving 115 car trains to reserve Baton Rouge-New Orleans and are turning those cars in 11 days.

Incidentally, we are running some experiments with Iowa State University to determine the energy efficiency of rail movement of grain, compared with truck movement, to the Mississippi River and then down the river by barge. It will be very interesting to see the results of those.

Senator LONG. It certainly will be.

Let me ask you, of the items that you find most objectionable in this bill, would you mind pinpointing what it is that you find most objectionable, let's say, what are the two most objectionable parts you find in the bill.

Mr. JOHNSTON. I think there needs to be a clear understanding of the difference between debt and equity in this bill.

Now, the senior preferred stock, which is the equity, can be used only if the company or the subsidiary involved in the restructuring has no secured debt on the property. In other words, the senior preferred stock must come first. To me, that greatly limits the use of equity for restructuring purposes. I think there is a need for that.

There are going to be—I think the example that I tried to give—let's assume a railroad, railroad A, wants to buy railroad B. Railroad B—the transaction may take the form of sale of assets, rail lines, and property of railroad B. That property is going to be covered by mortgages, and those mortgages will follow the property.

Now, this means that the senior preferred stock is—cannot be used under those circumstances. The transaction may be such that the lower interest rate contemplated by the senior preferred stock would be necessary to effectuate the transaction. I think that is a change that is necessary.

I think it should be made clear that senior preferred stock intended as equity will not, by regulation, end negotiation in a financing agreement, be converted later to debt or subject to conversion of debt.

Now, the third thing, the terms would be attractive if the FRA had the discretion to meet the payback period, 30 years instead of 20 years. And the FRA has used, I believe, good judgment in its negotiations with the railroads on the whole. They have certainly done an excellent job of protecting the Government. I think it is wise to give the FRA discretion, because they want to accomplish something in the restructuring area. And some discretion on their part will end an ability to vary the terms to fit the situation will lead to a constructive accomplishment.

Senator LONG. Thank you very much, sir.

I have one more question here. As I understand it, you feel that the existing program should be continued for 2 years to provide for the correction of the deferred maintenance. How much of it remains on your railroad? And how much of it is on your main line track?

Mr. JOHNSTON. Senator, I believe that we have done a very good job. This program that we have, when it is completed in 1982, we will have substantially upgraded that mainland route. It is using both the preference share dollars and our own internally generated funds.

With the abandonment program that we have, I think that we will have gone a long way toward placing our property in reasonably good condition.

Now, there was a bill passed by the Congress in 1978, the Local Rail Service Assistance Act. And I think it is a tremendous development for load density lines that need repair. But that if repair will be viable and we are taking advantage of that program—we

just signed a contract with the State of Missouri to renovate a line. We only have one branch line in the State of Missouri, and it is from Fulton, Mo., up to Mexico, about 25 miles. It has two or three large brick manufacturing plants. The line was not in good condition, but it has substantial potential.

We approached the Missouri Department of Transportation, which suggested a project under this Local Rail Service Assistance Act. They were interested.

We are winding up. The railroads are putting up 10 percent, the shippers are putting 10 percent, and the balance is on the Rail Service Assistance Act.

In your own State of Louisiana, we have a branch line from Slidell, that runs along the north edge of Lake Ponchartrain up to Covington. That line has a good bit of business on it. It is marginal, but the rail was manufactured about 1905 or something like that. The production of the line would not justify our going in and renovating on our own. But with this program we have signed an agreement with the Louisiana Department of Transportation. And, in a 2-year program, that line will be renovated. We believe it will be profitable. We believe that that area is a good site for future industrial growth.

Now, with those types of programs, we are seeking to slim down the property, to have the main lines in top grade condition, and renovate these branch lines to a condition where they can be—

Senator LONG. Why do you think that the department of transportation has excluded the deferred maintenance programs from this new legislation.

Mr. JOHNSTON. I don't understand that they have excluded deferred maintenance programs.

Senator LONG. In certain areas they have, have they not?

Mr. JOHNSTON. I think what they are thinking, that restructuring is desirable, which it certainly is. We are not, in the railroad industry, using each other's tracks as much as we can. Joint facilities, for instance, are something which we should be using more.

I believe what the department is saying is that restructuring is desirable; and if a line has to be upgraded and deferred maintenance secured to permit it to be used under a restructured program, then we would go along to finance the restructuring.

Now, that is my understanding of what they are saying.

Senator LONG. Thank you very much.

Senator Cannon.

The CHAIRMAN. If 505 were to remain intact, would you use it to acquire some of the Rock Island? You have indicated interest in the Rock Island properties.

Mr. JOHNSTON. I believe that we would. We are working with the Northwestern—Chicago & Northwestern for some of the grain lines out in northwest Iowa, about 300 miles of grain lines. We are going to come up with a concept of a jointly owned corporation that would buy those grain lines and operate them jointly, giving shippers a choice of shipping their grain to the Texas ports, to the Louisiana, Mississippi, Alabama ports, and preserving competition in northwest Iowa.

From our studies of the project, it appears as though low-cost financing is needed to bring it off. I think if it is available, we

would go that route. I can't speak for Northwestern precisely, but my impression would be that certainly low-cost financing would greatly enhance its ability to play a really meaningful role in restructuring in Iowa and in operation of essential parts of the Rock Island and Milwaukee.

The CHAIRMAN. Thank you very much, Mr. Johnston.

[The statement and answers to questions of the committee follow:]

STATEMENT OF PERCY W. JOHNSTON, VICE PRESIDENT-LAW, ILLINOIS CENTRAL GULF RAILROAD

Good morning, Mr. Chairman and members of the Subcommittee. I am Percy W. Johnston, Vice President-Law of Illinois Central Gulf Railroad Company, with headquarters in Chicago, Illinois.

I appear before you today on behalf of the Illinois Central Gulf Railroad and the Chicago and North Western Transportation Company to offer testimony from the perspective of two railroads that have had several years of experience with financial assistance programs administered by the Federal Railroad Administration and believe strongly in the need for restructuring of our Nation's rail system and in the need for continuing, if limited, involvement by the Federal Government in this process.

Speaking of my own company for a moment, the ICG's physical plant has benefited greatly from the existing program of redeemable preference shares under section 505 of the Railroad Revitalization and Regulatory Reform Act of 1976. Under a total of three agreements, FRA has agreed to purchase up to \$166 million of preference shares issued by the ICG to improve its heavily-used main line between Chicago and the Gulf. When the preference share work is completed in 1982, the ICG will have installed about 520 miles of new rail and more than 370,000 new cross ties (excluding work in the terminal areas around Jackson, Mississippi), and will have surfaced the entire track between Chicago, Illinois and Jackson, Mississippi.

Reaching agreement with FRA to finance this work was a large-scale undertaking. Both sides were plowing new ground:

Preference shares were a new type of security. There were many questions about its precise terms and its effect on a railroad's capital structure. It took the investment community time to fully understand it.

Criteria to determine project eligibility were necessary, and these required extensive rulemaking proceedings and lengthy negotiations between the railroads and FRA. Criteria involving engineering standards and traffic density were developed.

But we made it. FRA and the railroads using Title V, working together, make the program a success. S. 1151 would replace the preference share program with a complex new program of "repayable credits" limited to restructuring projects.

Although restructuring is a worthy goal, there are numerous examples of lines whose rehabilitation would serve the public interest, whether or not a restructuring is involved. The preference share program has resulted in the improvement of hundreds of miles of main line track. A list of railroads that have received preference share funds is attached to this statement. Regardless of the form of restructuring assistance, section 505 of the 4R Act should be extended for at least two years to permit additional funding on the nation's railroads.

With respect to restructuring of the railroad industry, the ICG and the C & NW are vitally interested in the development of a mechanism that facilitates this goal. We therefore support the objectives of S. 1151. Currently, we are both involved in negotiations with the Trustees of the Rock Island and the Milwaukee Road for the acquisition of essential line segments of those railroads, and have participated with the Interstate Commerce Commission and the Federal Railroad Administration in efforts to assure interim rail service while these negotiations proceed.

Our comments today are made primarily with the objective in mind of achieving a workable solution of the current Rock Island and Milwaukee problem. The Chicago and North Western's role in resolution of the situation is crucial and the ICG's although significant, is more limited. Some of our comments might also apply to broader restructuring projects, such as large corporate mergers or transactions involving the relatively prosperous western railroads. Our immediate concern with respect to restructuring, however, is whether the terms and conditions of financial assistance under S. 1151 will permit a satisfactory resolution of the current Rock Island and Milwaukee crisis.

Among the problem areas are the following:

1. *Equity versus debt.*—S. 1151 provides for issuance by the railroad of a fixed debt obligation unless the Secretary of Transportation determines that an equity financing "is essential to a restructuring." S. 1151 would limit Senior Preferred Stock to companies "having a capitalization at the time of issuance which consists solely of equity." In contrast, the preference share is, by definition, equity securities, and inclusion of a debt on a railroad's balance sheet does not disqualify an applicant from receiving preference-share funding.

Illinois Central Gulf Railroad could not in all probability have gone forward with its government assisted improvement program if the securities had been classified as debt instead of equity, because the impact on financial ratios, particularly fixed charges coverage, would have been unacceptable. Classification of the rehabilitation security as debt would have also been a major obstacle to C & NW's rehabilitation program. The same financial considerations could greatly reduce the usefulness of S. 1151 for the kinds of restructuring that ICG and C & NW are hoping to help accomplish in connection with the Rock Island and Milwaukee Road bankruptcies.

2. *Interest rate of dividend yield.*—The interest rate or dividend yield under S. 1151 would be $\frac{3}{4}$ or $\frac{1}{2}$, respectively, of the Treasury rate on a security of comparable maturity. At present interest levels, this exceeds the minimum dividend yield of 2.03 percent available on redeemable preference shares. Assuming a 12 percent annual Federal rate, debt and equity securities issued under S. 1151 with a 20 year term would have a yield to maturity of 6.67 percent and 4.47 percent, respectively, even with a five year moratorium during which no dividends or interest accrue. Although these rates sound low, our studies to date of Rock Island and Milwaukee Road properties in which we have a potential acquisition interest have revealed that the extra cost of S. 1151 funding, reflecting both a higher yield and faster repayment, is substantial and could prevent a private railroad from going forward on certain acquisitions that, in terms of importance to the shipping public, would appear to be warranted. This observation reflects the long history of marginal earnings from the properties of these bankrupts.

3. *Term and moratorium period.*—The maximum term of assistance under S. 1151 is 20 years, compared to 30 years under section 505. Also, S. 1151 requires repayments to begin by the sixth year rather than as late as 11 years after issuance under section 505. All major preference-share fundings have used the 30-year term with repayments beginning on the eleventh anniversary, even though shorter terms were available. The restructuring transactions contemplated under S. 1151 can be considered very nearly perpetual, and much of the associated rehabilitation would have an anticipated life substantially exceeding 20 years. For the transactions ICG and C&NW contemplate, shortening the term could therefore weaken the usefulness of the legislation by increasing the repayment burden on the railroads.

4. *Security interest.*—In contrast to section 505, S. 1151 provides that the Secretary may require an applicant for debt financing to convey to the Government a security position "first time in right to those of all present and prospective unsecured creditors." This provision may be unattractive to potential applicants.

As one final concern, S. 1151 appears not to contemplate transactions involving a sale of assets. This is probably just an oversight. The section should be amended to cover the cost "... of acquiring securities or assets pursuant to a restructuring ..."

Having stated some of our concerns with S. 1151, what alternatives do we suggest to this Subcommittee?

First, we would reiterate our recommendation that regardless of the form decided upon for restructuring assistance, the preference share program should be retained for funding of track rehabilitation and improvement.

Second, we believe that many of the goals of S. 1151 can be achieved through a relatively simple amendment to section 505 of the 4R Act. The Milwaukee Railroad Restructuring Act (P.L. 96-101) already permits the FRA to finance rehabilitation in connection with a restructuring, and makes such assistance available to all railroads regardless of the availability of alternative funds.

Attached to this statement is a copy of a proposed bill to amend section 505, together with a section-by-section analysis. Very briefly, this will would—(1) Extend the preference share program for two years; (2) Provide for acquisition funding; and (3) Set reasonable priorities for funding of restructuring projects.

An alternative to this approach would be retention of S. 1151 substantially as proposed, but with the addition of a third type of security that would make low-cost equity assistance available to railroads that do not have access to other sources of financing but who are engaged in public interest restructuring or essential improvement projects that in the opinion of the Secretary are vital to meeting the needs of shippers. We would include a stringent "alternative funds test" so there would be

no enrichment of private investors at taxpayers' expense. We do not have specific language to propose today, but will be pleased to work with your staff.

In summary, S. 1151 is based on a premise with which we agree. However, as stated above it has features which may limit its effectiveness in dealing with the current crisis surrounding the Rock Island and Milwaukee bankruptcies.

We are pleased with the level of funding proposed by the Administration. The need is enormous in the Midwest alone. ICG and C & NW will cooperate fully with the Subcommittee and with FRA in achieving the goals discussed herein. Thank you for the opportunity of appearing before the Subcommittee.

Attachments.

RAILROAD REVITALIZATION AND REGULATORY REFORM ACT OF 1976, APPLICATIONS RECEIVED AND AGREEMENTS EXECUTED SEPTEMBER 30, 1979

[In millions of dollars]

	Preference shares		Obligation guarantees	
	Application(s)	Agreement(s)	Application(s)	Agreement(s)
By applicant:				
Chicago, Milwaukee, St. Paul & Pacific Railroad Co.....	\$33.8	¹ \$33.8	¹ \$53.7	\$21.4
Chicago & North Western Transportation Co.....	² 199.9	¹ 147.5	³ 275.5	² 45.0
Columbus & Greenville Railway	4.1	4.1		
Chicago, Rock Island & Pacific Railroad Co.....	² 125.5	9.5	¹ 88.2	33.5
Illinois Central Gulf Railroad Co.....	166.4	² 166.4		
Boston & Maine Corp.....	26.0	26.0		
Peoria & Pekin Union Railway Co.....	3.5			
Missouri-Kansas-Texas Railroad Co.....			22.5	22.5
Delaware & Hudson Railway Co.....			8.0	8.0
Auto-Train Corp.....			4.5	
Indiana Harbor Belt Railroad Co.....	31.2			
Total.....	590.4	387.3	452.4	130.4
By type of project:				
Facilities.....	582.1	387.3	270.2	32.0
Equipment.....	8.3	0	182.2	98.4
Total.....	590.4	387.3	452.4	130.4

¹ 2 applications or agreements.

² 3 applications or agreements.

³ 4 applications or agreements.

⁴ Plus \$28.3 million applied for in December 1979.

AMENDMENTS TO TITLE V OF THE RAILROAD REVITALIZATION AND REGULATORY REFORM ACT OF 1976 TO PROVIDE FINANCIAL ASSISTANCE FOR RAILROAD RESTRUCTURING

Redeemable preference share funding under Title V of the Railroad Revitalization and Regulatory Reform Act of 1976 has proved to be a workable method for providing rehabilitation assistance. Financing agreements already executed between the Federal Railroad Administration and the Nation's railroads are providing about \$400 million in assistance for rehabilitating railroad facilities. The purpose of the accompanying bill is to continue this proven method of assistance for the correction of deferred maintenance, and also to utilize the same type of assistance for railroad restructuring, including the correction of deferred maintenance (as provided through the Milwaukee Restructuring Act amendments to Title V of the 4R Act) and the acquisition of needed transportation assets.

Because preference shares are equity securities and not debt, a railroad's access to private financial markets is enhanced. Problems of administrative interpretation, which could potentially slow or halt needed rail rehabilitation and restructuring programs, have been largely resolved under the preference share approach.

SECTION-BY-SECTION ANALYSIS

Section 2. *Definitions.*—This section amends section 501 of the 4R Act to (1) clarify the definition of "facilities" to include real or personal property so that real estate necessary to restructuring transactions can qualify for funding, (2) define "net liquidation value," used under section 3 of the bill to determine the minimum

acquisition cost which the Government will finance, and (3) refine the definition of restructuring to permit funding of lines that serve major originating areas, such as areas with a heavy concentration of grain elevators. The definition of "net liquidation value" is essentially the definition developed for the Federal Railroad Administration by Day and Zimmermann.

Section 3. *Eligibility.*—This section amends section 505(a) of the 4R Act in two ways. First, it would permit applications by a corporation that is owned by one or more railroads. This would provide flexibility in the restructuring process by permitting the use of certain financing vehicles through which Government financing could flow to facilitate restructuring.

Second, it would make preference share financing available for acquisition of railroad facilities or equipment. Under the current statute, Government financing of acquisitions is limited to loan guarantees, which are costly in today's environment of high interest rates, and therefore inadequate to insure continued operation of some lines whose retention would be in the public interest. Equipment is included as well as facilities because certain equipment, such as maintenance-of-way machinery, maintenance-of-way rolling stock, snow plows, and flangers, is necessary to the maintenance of service on lines involved in restructuring.

Section 4. *Application procedures.*—This section amends section 505(b) of the 4R Act to facilitate applications for financing of facilities and equipment acquisition pursuant to a restructuring.

Paragraph (1) adds a new subsection (2) which sets forth the information to be included in an application.

Paragraph (2) sets reasonable time limits on consideration of applications. The Secretary of Transportation would be required to advise an applicant within 60 days after receipt of the application of any respects in which it is incomplete, and would be required to act upon an application within 120 days after it is complete.

Paragraph (3) retains the alternative funds test for acquisition financing in connection with a restructuring. This provision is to insure that publicly financed acquisition of railroad assets pursuant to a restructuring will occur only when no other source of funds is available to the purchaser at a cost which is reasonable under principles of prudent railroad financial management.

Paragraph (4) requires the Secretary to give priority among restructuring projects to those which satisfy any of the following criteria:

"(i) Contribute toward higher average main-line traffic densities on the U.S. rail system." This goal is consistent with the Secretary's final report under section 503(e) of the 4R Act, which identified nine "corridors of consolidation potential," each of which has three or more main routes between major cities. This section recognizes that it is in the public interest to finance acquisition or rehabilitation of these main-line routes pursuant to a restructuring only where a significant consolidation is thereby effected.

"(ii) If not inconsistent with item (i) above, improve access to major originating areas." This will permit financing of acquisition and rehabilitation of essential grain originating lines in the Midwest.

Section 5. *Financing agreement.*—This section amends section 505(c) of the 4R Act to change certain troublesome provisions of the current law when applied to restructuring projects. These changes will make the preference share program more attractive to potential applicants and stimulate participation in restructuring projects. The revisions will effect two changes.

First, under present administrative interpretation of the preference share statute, the scrap value of reusable materials, although not sold by the railroad, must be deducted from the financeable cost of the project. The premise that reusable materials would be likely to generate cash for a railroad is, however, unrealistic. The contrary, one of the values of the preference share program has been the re-use of materials from 4R-funded projects in other lines; for example, new 136-pound rail will replace 112/115-pound rail, which will be welded, and replace 90-pound rail on a branch line, which in turn will be relaid in a yard or side track.

The second revision would address the remedies available to the Government under the financing agreement. By regulation and terms of the financing agreement, the Federal Railroad Administration has provided that on the occurrence of certain events of default, the preference shares will be converted from equity to debt, payment periods shortened, and dividend/interest rates increased. These provisions have introduced unanticipated uncertainties and complexities into the issuing railroad's financial structure, and may have a chilling effect on a railroad's ability to secure private sector financing.

The revision to section 505(c) expressly provides in the case of a restructuring project for the priority of preference share dividends over a railroad's common or

junior preferred stock and limits dividends on common and preferred stock as provided in section 511 for loan guarantees. This clarifies that FRA has limited discretion to restrict dividends.

Section 6. *Yield*.—This section would require the same dividend yield (or interest rate) for restructuring projects as currently mandated for deferred maintenance projects.

Section 7. *Extension of program*.—This section extends the current preference share program for two years to September 30, 1982.

Sections 8 and 9. *Authorization*.—These sections would increase the authorized amount of redeemable preference shares by \$—.

A BILL To amend Title V of the Railroad Revitalization and Regulatory Reform Act of 1976 to provide financial assistance for railroad restructuring.

Be it enacted by the Senate and House of Representatives of the United States of America the Congress assembled, That this act shall be known as the "Railroad Restructuring Amendments of 1980."

Sec. 2. Section 501 of the Railroad Revitalization and Regulatory Reform Act of 1976 ("4R Act"), 45 U.S.C. 821, is amended—

(1) by striking in paragraph (E) of subsection (3) thereof the phrase "shop or repaid (sic) facilities or any other property" and inserting in lieu thereof the phrase "shop or repair facilities or any other property (real or personal)";

(2) by renumbering subsections (6), (7), and (8), as (7), (8), and (9), respectively;

(3) by inserting a new section (6) as follows:

"(6) 'net liquidation value' means the sum of (i) the estimated market value of and in its highest and best use, excluding use for railroad purposes, (ii) the estimated salvage value of facilities net of cost of removing such facilities from their present site (salvage to be defined as market value of scrap or market value for second-hand use, whichever is higher), and (iii) the estimated value of equipment based on depreciated reproduction cost or salvage as defined in (ii), whichever is higher;" and

(4) by inserting in new subsection (9) immediately after the phrase "average traffic densities" the phrase, "improved access to major originating areas".

Sec. 3. Section 505(a) of the 4R Act, 45 U.S.C. 825(a), is amended—

(1) by inserting after the word "railroad" the phrase "or corporation owned by one or more railroads"; and

(2) by inserting after the phrase "rehabilitation and improvement financing" the phrase, "for acquisition of an interest in facilities or equipment pursuant to a restructuring".

Sec. 4. Section 505(b) of the 4R Act, 45 U.S.C. 825(b), is amended—

(1) by renumbering subsection (2) thereof as subsection (3) and inserting a new subsection (2) as follows:

"(2) Each application for financing for facilities or equipment acquisition pursuant to a restructuring shall set forth—

(A) a description of the facilities or equipment to be acquired showing the net liquidation value for such facilities on equipment and a description of the method employed to determine this value;

(B) for facilities acquisitions, the classification of each main and branch rail line included in such project, as determined in accordance with the final standards and designations under section 503(e) of this title;

(C) a statement as to whether it is presently anticipated that federal rehabilitation financing for the facilities or equipment to be acquired will also be necessary; and

(D) an economic analysis of the proposed acquisition, reflecting any presently anticipated rehabilitation and maintenance costs.";

(2) by striking the first sentence of renumbered subsection (3) and inserting in lieu thereof "The Secretary shall advise applicant within 60 days after receipt of the application of any respects in which the application is incomplete, and shall act upon each application within 120 days after it has been made complete.";

(3) by adding in renumbered subsection (3) after the phrase "the Secretary shall not consider the availability of funds from other sources" the phrase "for rehabilitation (but not acquisition) funding"; and

(4) by adding at the end of renumbered subsection (3) the following:

"For restructuring projects, priority will be accorded those which (i) contribute toward higher average main-line traffic densities on the U.S. rail system, or (ii), if not inconsistent with (i), improve access to major originating areas."

Sec. 5. Section 505(c) of the 4R Act, 45 U.S.C. 825(c), is amended by—

(1) inserting "(1)" immediately after "FINANCING AGREEMENT.—";

(2) inserting after the phrase "Upon the approval of an application for financial assistance under this section" the phrase "except for a restructuring project"; and

(3) inserting a new subsection (2) as follows:

"(2) Upon the approval of a restructuring project under this section, the Secretary shall promptly enter into an agreement with the applicant to provide financing in such amounts and at such times as is sufficient, in the judgment of the Secretary, to meet the reasonable cost, in whole or in part, of acquiring the facilities or equipment and rehabilitating or improving such facilities or equipment; provided, however, that in determining the reasonable cost of rehabilitation or improvement projects the Secretary shall not deduct therefrom the value of any materials removed by the railroad in carrying out the project which are reused for railroad purposes within six years from the completion of the project on facilities owned, used or served by the applicant. Each such agreement shall include only such terms and conditions as are necessary (1) to assure that the financing will be used only in the manner, and for the purposes, approved by the Secretary, and (2) to limit dividends on or purchases of the applicant's common or preferred stocks junior to the redeemable preference shares (a) whenever any dividend or redemption payment which is due on redeemable preference shares remains unpaid, and (b) whenever dividends on all common and preferred stock (including the redeemable preference shares) exceed for any fiscal year 50 per centum of the total additions to the retained income of the applicant (computed on a cumulative basis and giving cognizance to dividends paid) during the period commencing with the fiscal year prior to the earliest issuance of redeemable preference shares."

Sec. 6. Section 506(a)(5) of the 4R Act, 45 U.S.C. 826(a)(5), is amended by inserting after the phrase "deferred maintenance on facilities" the phrase "or to acquire or rehabilitate facilities or equipment pursuant to a restructuring".

Sec. 7. Sections 505(e), 507(a), 507(d) and 509 of the 4R Act, 45 U.S.C. 825(e), 827(a), 827(d), and 829, respectively, are each amended by striking "September 30, 1980" wherever it appears and inserting in lieu thereof "September 30, 1982".

Sec. 8. Section 505(d)(3) of the 4R Act, 45 U.S.C. 825(d)(3), is amended by striking "\$700,000,000" and inserting in lieu thereof "\$ ".

Sec. 9. Sections 507(a) and 509 of the 4R Act, 45 U.S.C. 827(a) and 829, respectively, are each amended by striking "\$600,000,000" wherever it appears and inserting in lieu thereof "\$ ".

QUESTIONS OF THE COMMITTEE AND THE ANSWERS THERETO

Question 1. DOT has indicated that the termination of the 505 program is based on the reality that the federal government can no longer subsidize low density lines without some rationalization of plant. Would you please respond to the statement, answering in light of the projects for which you received financial assistance? In choosing the rehabilitation projects for which you received assistance, did you have any overall restructuring plan in mind?

Question 2. You have described ICG's main-line rehabilitation project, for which it used some 505 money. It seems as though that project involved restructuring as well as rehabilitation. Do you think that this program would qualify for assistance under S. 1151? What specific future projects are you planning which you feel would not be covered under S. 1151 or the state and local rail assistance programs? In this regard, the department has indicated that the definition of "restructuring" under S. 1151 is broad enough to cover many such projects. How do you view the definition of restructuring in terms of your own programs?

Question 3. It has been suggested that section 5411 funds be used for the acquisition of rail facilities. To what extent could and would you use such funds for this purpose in the future? How would the use of this fund impact on your interest in parts of the Rock Island? How do you see section 511 being integrated with the current 505 program or the program proposed under S. 1151?

Question 4. The Boston & Maine has proposed some legislation in the area of financial assistance. What is your view on its proposal for changing the present 505 program?

ILLINOIS CENTRAL GULF RAILROAD,
Chicago, Ill., April 15, 1980.

Hon. RUSSELL B. LONG,
Chairman, Surface Transportation Subcommittee, Committee on Commerce, Science,
and Transportation, U.S. Senate, Washington, D.C.

DEAR SENATOR LONG: Thank you for your letter of April 7 regarding S. 1151. The following are answers to the four numbered questions attached to your letter.

1. The first question addresses the philosophy of the current preference share program. In common with almost all other preference-share railroads, ICG preference-share projects have included only the rehabilitation of high-density heavily used trackage. I am confident that the government can continue to target the preference-share program principally toward heavy density lines, and one of the amendments we have offered focuses on the importance of improving main-line traffic density in restructuring projects. The proposed language states:

"For restructuring projects, priority will be accorded those which (i) contribute toward higher average main-line traffic densities on the U.S. rail system, or (ii), if not inconsistent with (i), improve access to major originating areas."

It is, of course, desirable that line rehabilitation occur in combination with rationalization efforts. However, it is not true that a legitimate need for main-line rehabilitation cannot exist outside of a restructuring ICG's preference-share project is a good example of how rehabilitation may or may not relate to restructuring.

Rehabilitation of ICG's Chicago-Jackson, Mississippi main-line has proceeded in concert with a major line abandonment program. As stated in our preference-share application, both upgrading of main lines and abandonment of little used branches are essential. However, we question whether all of ICG's preference-share program would have qualified as "restructuring" within the meaning of S. 1151. ICG's preference-share program includes very substantial projects both north and south of Fulton, Kentucky, which is the mid-point of our system. Main-line rehabilitation south of Fulton was necessary to facilitate transfer of traffic from lower density, parallel ICG lines. We view this as restructuring even though only one railroad was involved. However, very little of the line rehabilitation between Chicago and Fulton was intended for the purpose of transferring traffic from other ICG lines. There, we were faced with the need to rehabilitate heavily used trackage that did not lend itself to consolidation with parallel facilities. There are no nearby competing railroads north of Fulton that offer significant coordination possibilities, and the only parallel ICG main line, covering only a part of the route, was recognized by both ICG and the Department of Transportation ("DOT") as essential in its own right and not an appropriate candidate for downgrading.

It is possible that even the main line south of Fulton, Kentucky might not have qualified for funding under S. 1151. The bill requires that:

"The Secretary [of Transportation] shall make debt or equity financial assistance available under this section only if the Secretary determines that (1) the assistance *will result in significant railroad restructuring.*" (Italics added.)

In the case of ICG's rationalization plan south of Fulton, a long succession of ICC abandonment cases has been necessary to effectuate the rationalization plan. Approval of all these abandonment cases is not a foregone conclusion.

Therefore, under S. 1151, it could be argued that the assistance would not result in significant railroad restructuring and funding would not be available.

2. The second question also relates to the relationship between rehabilitation and restructuring. As I stated above, it is not at all clear that our current preference-share projects would have qualified for funding under S. 1151. As for future projects, Peat, Marwick, Mitchell & Company is presently conducting a very broad study for ICG, utilizing state-of-the-art computer techniques to answer many strategic planning questions. Among other objectives, the study will evaluate various system configurations to determine if further rationalization of ICG is appropriate. The study is scheduled for completion this fall. Until the report has been completed and its recommendation thoroughly reviewed, management is not in a position to say whether further restructuring of the system's physical configuration should be undertaken. If the study shows that minimal restructuring is required, Federal financing of further rehabilitation efforts would be foreclosed to the ICG under S. 1151.

Lacking regulations, we can only estimate the potential problems with the restructuring criteria under S. 1151. However, even under the preference-share statute, the DOT has carefully monitored the progress of ICG's line rationalization program and, prior to execution of the preference share agreements, expressed some concerns about funding the projects south of Fulton while the outcome of abandonment cases was unknown. We are therefore inclined to think that the DOT would interpret the statute conservatively. Conversely, if projects that do not entail consolidations, coordinations, mergers, or abandonments were also to qualify as restructuring, it would seem that almost any project could be a restructuring. This interpretation would make the term meaningless.

3. ICG considers Section 511 funding of limited usefulness for the acquisition of the Rock Island and Milwaukee properties in which we have expressed an interest. These properties are being sold because the trustees of the two bankrupt estates have not been able to demonstrate that they could be profitable either as contribu-

have not been able to demonstrate that they could be profitable either as contributors to a reorganized company or as the core of a reorganized company. There are limited parts of these properties that we believe could make a modest contribution to ICG, but with the recent escalation of interest rates, it appears that the rate of return of few if any of these projects, discounted for risk, could justify the cost of guaranteed loans.

ICG's most extensive proposal, now under joint study by ICG and C&NW, is to establish a new, jointly-owned corporation that would serve grain shippers located on present Rock Island trackage in northwest Iowa. This plan would open ICG-served Gulf ports and interior grain processors to these shippers as well as preserve service to Houston and other Kansas City-gateway ports. Shippers are enthusiastic about having ICG service, but the financials that ICG's planning group has developed to date indicate that Section 511 guaranteed loans for line acquisition would be inadequate to make the project viable.

We favor retention of Section 511 loan guarantees for locomotive, freight car and other equipment programs. Although ICG has not used Section 511 loan guarantees, several railroads have undertaken substantial equipment programs under Section 511, and we understand the results have been good.

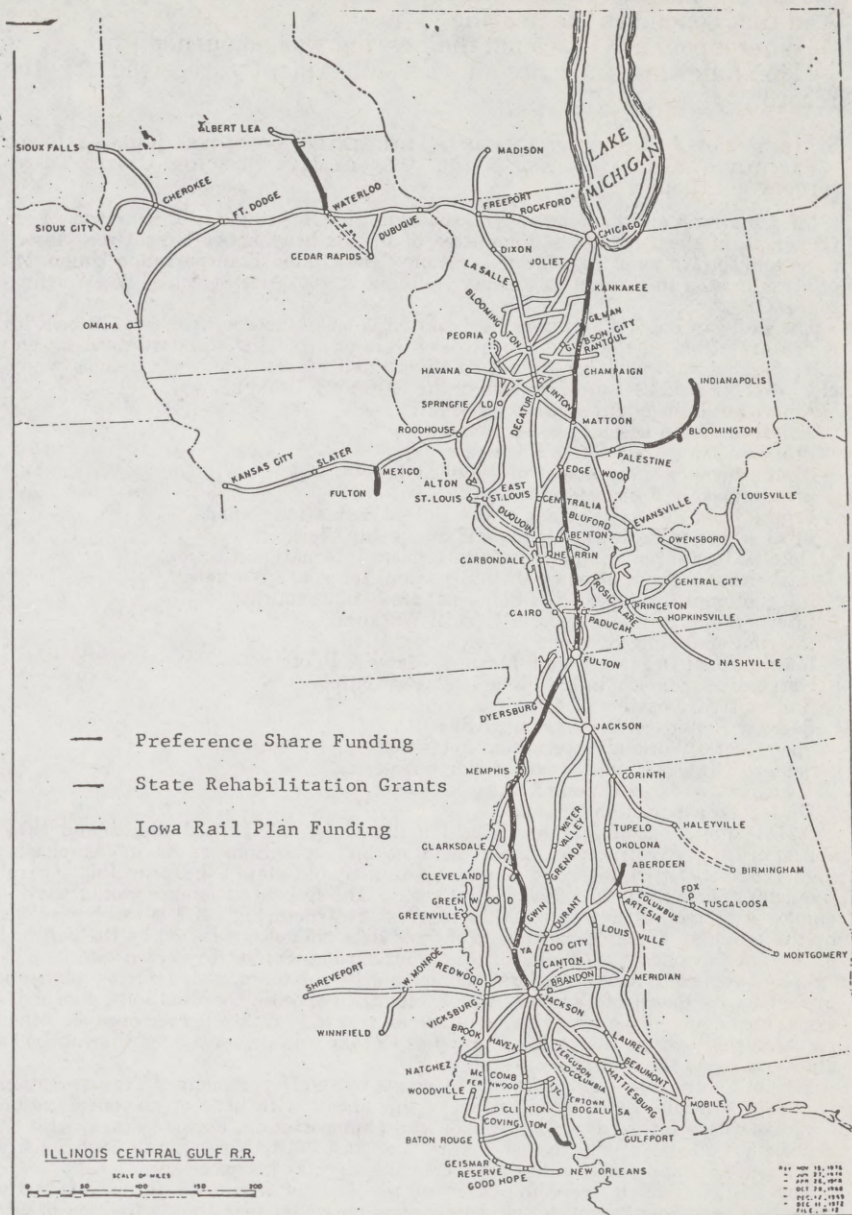
4. My knowledge of the Boston and Maine legislation is limited to Mr. Hughes' comments at the hearing on March 31. Based on Mr. Hughes' statement, it appears that Boston and Maine's basic objective is to clarify certain aspects of the preference-share statute. This is consistent with our own experience and with Section 5 of our proposed preference-share amendments. Although the DOT and the preference-share roads have developed a workable program, certain problems have persisted. While these problems are not critical to the program's success, we believe that their correction through amendment of the preference-share program would be appropriate.

Concerning the jobs concept, ICG would favor any program mutually acceptable to the carriers and to the labor organizations, if such a program would facilitate correction of deferred maintenance and usefully employ persons who would otherwise be unemployed.

I hope that these comments will be helpful in your consideration of financial assistance for the railroads, and would appreciate any further opportunity to assist in this undertaking.

Sincerely yours,

P. W. JOHNSTON,
Vice President—Law.



The CHAIRMAN. That concludes our witness list this morning. And that concludes the hearing

[Whereupon, at 11:28 a.m., the hearing was adjourned.]

[The following information was subsequently received for the record:]

STATEMENT OF J. R. SNYDER, CHAIRMAN, LEGISLATIVE COMMITTEE RAILWAY LABOR EXECUTIVES' ASSOCIATION AND NATIONAL LEGISLATIVE DIRECTOR, UNITED TRANSPORTATION UNION

Mr. Chairman and members of the subcommittee, 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.

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 International Union.
- International Association of Machinists and Aerospace Workers.
- International Brotherhood of Boilermakers & Blacksmiths.
- International Brotherhood of Electrical Workers.
- International Longshoremen's Association.
- International Organization of Masters, Mates & Pilots.
- 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.

S.1151 would encourage the Class I railroads of the United States and their subsidiaries to "restructure" their facilities and operations so as to "emphasize higher density operations and eliminate uneconomic plant;" by providing federal financial assistance to accomplish that result. The federal assistance would pay for employee protection as well as other costs of "restructuring" and is to be provided by the purchase by the Government of fixed debt obligations issued by the railroad or by the Secretary of Transportation purchasing Senior Preferred Stock. The railroad applicant for the federal money must "submit a restructuring plan approved by its Board of Directors which identifies specific coordinations, consolidations, abandonment, sales, joint terminal or trackage rights agreements, or other restructuring actions the railroad proposes to take and demonstrates the railroad's ability to repay the financial assistance.

This bill is the latest in continuing attempts by the Department of Transportation to reduce severely the railroad system of this nation with little or no consideration of this nation's future dependence upon rail transportation. Former Transportation Secretary Coleman's objective of a very few East-West, North-South high-density rail lines is being pursued with ever increasing vigor by his successors.

The RLEA finds it incredible that in the face of a certain future of vastly restricted petroleum supplies, the Administration would seek the decimation of our most fuel efficient form of transportation.

We should be seeking ways to encourage development of business on rail lines, knowing full well we will become more and more dependant upon our rail network. The Administration takes the opposite track and encourages its contraction. Such an objective might have been a defensible theory for a doctoral thesis prior to 1973. It is wholly indefensible and in contradiction of the public good today. S.1151 should be rejected by this Subcommittee.

In addition to provisions which would result in an inadequate future rail system, S.1151 contains a provision which would become Section 519 of the 4R Act and

would provide federal money to railroads that demonstrate they have made "significant changes in operating practices or work rules" there by "significantly improving manpower effectiveness." The federal money would be used to offset 100 percent of the cost to the railroad of payments to employees affected by agreements making such "significant changes in operating practices or work rules."

The RLEA vigorously objects to this section and strenuously urges that it be stricken from further consideration by this Committee. This provision is a blatant interference in the collective bargaining process and an attempt to condemn the railway labor organizations and the railroad employees they represent for retaining in their contracts any provisions which the management of the railroads may not like.

For a number of years, the railroad labor unions of this country have been engaged in a successful process of elimination of many work rules at the request of railroad managements. Many other work rules have not been eliminated because railroad managements have not requested their elimination.

At the appropriate time and in an appropriate manner, rail management and rail labor will resolve their mutual problems.

The representatives of the RLEA wish to aid this Subcommittee in any way they can in developing positive legislation which will protect future citizens of this country against a destruction of what we believe will become the major—if not the only—intercity transport system available in the future. We must, however, oppose those bills, such as S.1151, which we are convinced are detrimental to the present and future public good of this nation.

Thank you.



