TESTIMONY
OF
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DEPUTY ADMINISTRATOR,
FEDERAL RAILROAD ADMINISTRATION
BEFORE
THE SUBCOMMITTEE ON SURFACE TRANSPORTATION
OF
THE SENATE COMMITTEE ON
COMMERCE, SCIENCE AND TRANSPORTATION
May 21, 1979

Mr. Chairman and Members of the Committee:

I appreciate your asking me to be here today to discuss the unfortunate situation facing us in the Midwest because of the proposed embargo of a large part of the Milwaukee Road.

The Milwaukee's problems and the proposed embargo have an impact on a large and important region of the United States. How we respond to the problem will have long-term implications for the national transportation system, especially the freight rail system. Clearly, the Department of Transportation has the responsibility to take a leading role in determining the appropriate Federal policy and then to carry out that policy.

In reacting to the immediate threat of loss of rail service and loss of rail jobs, we could choose to infuse massive amounts of Federal dollars and ignore our coordinated, efficient national transportation system which consists of many alternative elements--other railroads, trucks and barges--and shipper alternatives in production locations and markets.

Or we could simply walk away from the problem, saying that the Milwaukee has, by the test of the marketplace and a third bankruptcy in sixty years, finally proven itself not worth having around. That, of course, would ignore at least in the short run the many people who are dependent on the railroad for their economic livelihood--shippers, employees and consignees.

Neither extreme is desirable national transportation policy, and the Department of Transportation will follow neither path. What the Department will do is use the tools at our disposal--both public and private--to retain essential and economic services within the context of a self-sustaining national transportation system. These tools are, as described below, sufficient for this purpose, and no further Congressional action is needed at this time.

Background

The Milwaukee Road was founded in 1850 and was originally chartered as a local railroad between Milwaukee and Elm Grove, Wisconsin. During the late 19th Century and the early 20th Century the Milwaukee gradually extended and expanded its network of lines as the Midwest was settled.

The Milwaukee participated in the last great expansion of the U.S. rail system by building its Pacific Coast extension in 1909. Many analysts feel that the Milwaukee's extension to the Pacific Northwest was never a viable operation and should not have been built. In fact, an independent analysis determined that in calendar 1977, the Pacific Coast extension contributed an excessively disproportionate share of the railroad's total loss.

The Milwaukee's performance over the past several years has been steadily downward. I have attached to my testimony copies of tables that show carloadings by major commodity groups for the Milwaukee, the Burlington Northern, and the Chicago and North Western. From 1973 through 1978, total Milwaukee Road car loadings were down almost 21% while the North Western's were down 12.5% and the Burlington Northern's only 5.8%. Like other commodities, grain loadings decreased precipitously--by a third from 1972 through 1978. All of this was prior to the Milwaukee's December 19, 1977 filing for bankruptcy.

Because of declining traffic levels and reduced market shares, in recent years the Milwaukee has not been able to properly maintain its fleet of locomotives and cars, to acquire sufficient additional equipment to handle potential new sources of traffic or to maintain its right of way on a regular maintenance basis. The problem of insufficient earnings to support even minimal equipment repair and track maintenance has accelerated during 1979 and will probably continue to do so.

What We've Been Doing

Recognizing that the Milwaukee would not be able to turn itself around without capital to improve deteriorated track and equipment, the Department has, to date, provided the railroad with a total of $55.2 million in financial assistance under Title V of the 4R Act; $9.3 million of this amount was in preference shares prior to the railroad's petition for reorganization and $45.9 million in trustee's certificates after the bankruptcy. Of the total, $33.8 million has been made available under section 505 to finance a track rehabilitation project between Milwaukee and the Twin Cities, which is within the Trustee's "core" system, and $21.4 million has been made available under section 511 obligation guarantee financing for the repair of freight cars and locomotives and the installation of environmental control facilities at the railroad's shops in Milwaukee. Actual expenditures under the agreements amount to $41.9 million to date. No applications by the Trustee for further Title V assistance are pending.

The Title V assistance provides financing for particular projects and does not contribute directly to working capital.

Working capital assistance is available under the Emergency Rail Services Act of 1970. To date, we have provided the Trustee with $5.1 million under ERSA. On May 4, 1979 we advised the Milwaukee's Reorganization Court that the Department of Transportation is prepared to meet its responsibilities under ERSA through additional funding to ensure the continuation of essential transportation services on the Milwaukee's system and to permit necessary restructuring.

Two major causes of the deteriorating condition of the Milwaukee, and of other granger roads, are their failure to abandon excess trackage and to maintain compensatory rate structures. With today's system of hard surface farm to market roads and modern trucks, the current rail system, particularly in the granger areas of the Midwest, is far more extensive that it needs to be in order to service the available traffic. As presently constituted, the Midwest rail system has lost much of its economic reason for being, and too often acts only as a cash drain on healthier parts of the national rail system.

For fifteen months DOT has been conducting an intensive campaign with railroad, shipper and state transportation officials to encourage them to use the tools of section 401 of the 4R Act to develop a healthier rail system through planned reductions in excess plant. Among the types of section 401 unification and coordination projects discussed to date have been coordinated abandonments, coordinations of mainlines through joint use agreements, and the acquisition and sale of assets.

While much of FRA's effort in section 401 restructuring during the past year has been of the missionary type, it is beginning to show some benefits. One package, consisting of three coordinated abandonments and a trackage rights agreement between the Chicago and North Western and the Milwaukee Road, has been announced, and we are well along on restructuring projects involving several rail lines in several states. Passage of the Administration's proposed Railroad Deregulation Act of 1979 will greatly assist this process.

<u>What DOT has done since the Trustee announced he would seek an embargo</u>.

Since the Milwaukee first declared bankruptcy, FRA has monitored the Trustee's cash position closely. This past winter when it became clear that the situation was very serious, we contacted the Trustee and encouraged him to consider applying for additional ERSA assistance.

On April 23, the Trustee announced that he would seek to embargo about 75 percent of the Milwaukee system with service continuing on a small "core" in the upper Midwest. The Trustee also stated that this action was based on a lack of cash and the report of his consultants, Booz, Allen, & Hamilton, that the Milwaukee could be reorganized into a profitable transportation company, but only if substantially reduced to a core system.

Upon learning of the Trustee's intention to discontinue service over a substantial portion of his system, DOT immediately took several actions.

Although the ICC has the primary responsibility to approve permissive service orders or direct other carriers to operate over the Milwaukee's lines, we have offered to work with the ICC to plan for the continuation of essential services. In this regard, on May 1, the Secretary held a meeting with the Trustee and his key officers, Chairman O'Neal of the ICC, and the railroads being considered by the ICC for directed rail transportation on the embargoed lines. The Secretary made a strong case for a private sector solution to the Milwaukee problem through permissive service orders and expeditious acquisitions of Milwaukee lines. At the May 1 meeting, the Secretary discussed with the Trustee the Trustee's goal to shrink the Milwaukee's existing uneconomic system into a core railroad with the potential to be self-sustaining.

On May 3, the Secretary met with representatives of railroad labor organizations who, among other things, expressed their desire to insure that the Trustee's embargo not become a substitute for the normal abandonment process in which the public interest and employees' rights would be protected. We have recommended that the Reorganization Court order the Trustee to file abandonment applications for all lines proposed to be embargoed.

In order to enable DOT and the public to study the consultant's report, which was not yet available, I asked the Justice Department to appear at the May 4 Reorganization Court hearing and recommend a postponement of the embargo decision until we could make a further filing based on an analysis of the report. At that hearing, the Trustee postponed his proposed embargo date until June 1, and the judge scheduled another hearing on the embargo issue for May 15. That hearing continued for the remainder of the week. Because the Booz, Allen report was not available to us until recently, we have not yet been able to do a detailed analysis of its methodology and conclusions. We are, in particular, not yet able to judge whether every line marked for embargo should, indeed, be embargoed.

Recognizing that the Court would have no choice but to order an immediate embargo unless the Trustee secured additional operating cash, DOT has supported the Trustee's petition before the Court for permission to borrow $15 million from escrow accounts and the railroad's land company subsidiary. Although these loans would reduce our security on the $55 million in financial assistance which DOT has recently provided to the Milwaukee under Title V of the 4R Act, our analysis of the Milwaukee's assets and liabilities convinces us that the United States still would be adequately protected should the Milwaukee be liquidated. The Court also found that the public interest required approval of the borrowing. We have also offered to provide ERSA assistance to the Trustee to ensure essential service and permit necessary restructuring. We anticipate that the Trustee will file his application for ERSA funds on May 23, and we will then begin reviewing the application to determine whether the required findings can be made.

<u>Next Steps</u>

During the coming months, FRA intends to use the powers granted to the Secretary under section 401 to assist in the orderly transfer of essential Milwaukee service to carriers that are better able to provide adequate transportation. To a large degree, this activity will expand on the efforts the Milwaukee Trustee has begun in attempting to negotiate sales to some carriers of portions of the Milwaukee. While our primary role under section 401 is largely that of a catalyst, we are, in some cases, in a position to advise interested parties on an objective and quantitative basis which railroad would be the best candidate to acquire portions of the Milwaukee.

Given the possibility that lines that provide essential service but are uneconomic in the hands of the Milwaukee may come under directed rail transportation at considerable taxpayer expense, it is in the public interest to encourage interested parties to reach agreement through a prompt exchange of information and continuous discussion. In order to encourage this activity we intend to use all the tools available, including Title V of the 4R Act, the Emergency Rail Service Act of 1970, and local rail service assistance.

The Administration has submitted proposed legislation, the Rail Restructuring Assistance Act, as part of its railroad transportation legislative program, which also includes the proposed Railroad Deregulation Act of 1979. The restructuring assistance bill would revise Title V of the 4R Act and provide $1.475 billion of assistance to the railroad industry as an additional incentive for restructuring. This restructuring would involve consolidation and reduction of duplicate tracks and facilities, discontinuance of uneconomic service, rationalization of routes and terminal facilities, and improvement in operating efficiencies. The elimination of excess capacity would enable railroads to reduce their maintenance and property tax expenditures and increase their liquidity by the sale of nonproductive property and facilities. By discontinuing uneconomic service and rationalizing routes and terminal facilities, railroads would improve cash flow.

The current financial assistance programs under Title V of the 4R Act have produced projects which involved substantial rehabilitation of facilities but only isolated restructuring. The restructuring assistance bill we are proposing will alter that situation.

By making funds available to all Class I railroads and their subsidiaries, the bill will encourage the larger, profitable railroads to participate in the restructuring of failing railroads. The funds would be available at low cost, on favorable repayment terms, and would cover all or part of the costs associated with acquisition and rehabilitation of rail properties and any labor protection which may be associated with restructuring. In addition, some funds would be available to encourage labor and management to undertake changes in work rules and operating practices which will not necessarily be associated with restructuring. Of the $1.475 billion authorization requested, $275 million would be available for labor protection and programs.

Under section 5 of the DOT Act, the Local Rail Service Assistance Program, States may receive Federal grant funds for a wide variety of rail assistance projects on light density freight lines. In response to the situation created by the Milwaukee crisis, States may apply for Federal funds to rehabilitate a light density line which an acquiring railroad agrees to continue in service.

Alternatively, a State or a local transportation district could purchase a line with or without Federal aid and could subsequently seek Federal rehabilitation assistance if the line carried under 3 million gross ton miles of freight per mile. It will also be possible for a State to seek Federal funds for rehabilitation of a line that Milwaukee petitioned to abandon if the Milwaukee agreed to withdraw the abandonment application and maintain the light density line at the level to which it was rehabilitated.

Federal funds are also available to States to subsidize the avoidable cost of providing service on a line for up to 3 years. Still another possibility is for a State to undertake a substitute service project, again using Federal assistance, to replace the service provided by the rail line being lost. Substitute service could include improvements to alternative highway facilities, construction of intermodal terminals or new rail connections to remaining rail lines which would then handle the traffic formerly handled by the replaced line.

The financial resources available to the States in FY 1979 total approximately $88 million of which $67 million was appropriated for FY 1979 and $20 million was carried over from 1978. With respect to those States affected directly by the Milwaukee crisis individual amounts in State entitlements for FY 1979 are in the range from about $700,000 to $5 million. I have attached a summary of the entitlement figures.

We must recognize that the existing tools at our disposal--Trustee cash and other assets, ERSA, section 401, directed and permissive rail transportation, the Bankruptcy Act, and the cooperation of labor and industry--are sufficient to resolve the immediate problems created by the Trustee's cash crisis. The Administration's deregulation and rail restructuring bills provide the best hope for a long-term solution to the Midwest rail crisis.

We will, within the limited time available, continue to analyze the Booz, Allen & Hamilton report to determine whether a smaller Milwaukee railroad can be financially self-sustaining. We are also taking a look at the proposals advanced by SORE and Mr. Louis Kelso for employee and/or shipper ownership of part or all of the Milwaukee.

Conclusion

I want to emphasize that, unless we are to start the Midwest down the path of nationalization, the financial viability of the lines which are continued either as part of a reorganized Milwaukee system or are transferred to other railroads, is essential. As Secretary Adams emphasized in his statement of April 24, the opportunities for self-sufficiency will be enhanced by, if not be dependent on, some Federal assistance to rehabilitate potentially profitable lines, and a freer and more equitable regulatory climate. Shippers are going to have to assist in the fight to keep essential service. They and the railroad must be able to come together to agree on the type of service needed and a fully compensatory price. The agreements must be enforceable on both sides, and the price must be one that allows the railroad to stay in business in the long run--a price that includes money to fix up track and equipment and keep it in shape. Freedom to negotiate such arrangements will be facilitated by swift passage of the Administration's proposed Railroad Deregulation Act of 1979 as well as the Rail Restructuring Assistance Act. Passage of this legislation will be important to the future of both the Milwaukee and all other railroads.

We will have to give much more thought to what should happen to the current Milwaukee system: how much of it is unlikely ever again to pay its way because traffic has already moved off it to other, more efficient, railroads or modes; how much of it will pay its way, but only after substantial rehabilitation of the lines and with better marketing of a better service; what the rehabilitation cost will be; from where will it be funded; how much of the system has the potential to be useful in the hands of other railroads.

And, we must reassure ourselves that the role we have outlined for the Federal Government is the proper one. The philosophy that propels us toward the marketplace and away from a nationalized system says that our roles should be two: to bring all parties together, especially other railroads in the region and labor, to work with them to develop programs that we and they can agree have the best chance of providing an efficient competitive transportation system in the long run, and to provide seed money to help make those programs work.

These actions will take time, but we believe that careful attention to the problem, cooperation of all parties, and increased flexibility in our ability to provide assistance and in the regulatory climate will enable us all to achieve this goal.