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U.S. DEPARTMENT OF TRANSPORTATION
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STATEMENT OF JAMES M. BEGGS, UNDER SECRETARY OF TRANSPORTATION, BEFORE THE SUBCOMMITTEE FOR SURFACE TRANSPORTATION OF THE SENATE COMMITTEE ON COMMERCE, REGARDING THE PENN CENTRAL RAILROAD, TUESDAY, JULY 27, 1971.

Mr. Chairman and Members of the Committee:

I appreciate this opportunity to discuss the Department of Transportation's views on the current condition and future prospects of the Penn Central Transportation Company (Penn Central).

The complex and deep-rooted problems facing this railroad are of significance not only to the northeastern region of the United States but to the nation as a whole. The impact of cessation of operations by Penn Central was analyzed in detail by this Committee in its report accompanying the Emergency Rail Services Act of 1970, and by the Secretary in his findings accompanying the guarantee of $100 million of Trustees' Certificates pursuant to the Act.

On July 1, 1971 the Secretary submitted to the President and the Congress a report on the financial condition of the Penn Central as required under the Act. That report included a summary of the Penn Central's operations for 1970, discussed the making of the guarantee, including certain of its terms and conditions, and evaluated Penn Central's financial condition as of April 30, 1971.

At the present time, of the $100 million realized from the sale of Trustees' Certificates the trustees have drawn down $75 million, leaving a total of $25 million available for future use. In addition, there is an uncommitted balance of $19 million available for future guarantees under the Emergency Rail Services Act. On the basis of the financial information available at the time that the Secretary's report was prepared, it was projected that the $25 million remaining from the sale of the Trustees' Certificates would be sufficient to carry the Penn Central into the third quarter of 1971. Based upon updated estimates recently made available, it would appear that this amount would now carry Penn Central at least through the remainder of this year.

Let me now review briefly the cash and income conditions of the railroad during the past six months as well as the projections for the remainder of the year. During the first five months of this year, the cash balances of the Penn Central fluctuated around the $20 million mark. The closing cash balance at the end of December 1970 was $18.9 million; at the end of January, after a $15 million draw down under the guarantee, it was $34.4 million; at the end of February, after a $35 million draw down, $23 million; at the end of March, after a $15 million draw down, $14.6 million; and at the end of April, after a $10 million draw down, $20.2 million. The closing balance at the end of May was $34 million.

Recent information indicates that the cash position has definitely improved. For example, cash flow projections of the trustees prepared in early May projected closing cash balances at the end of June and July of $19.3 and $22.8 million, respectively, an actual cash deficit of $3.3 million by September, and a total deficit of $33.4 million at the end of this year. However, figures now available for June and the first two weeks of July show that the actual closing cash balance at the end of June was $51.4 million and project closing balances at the end of July and September of $35.5 and $13.2 million, respectively, and a cash balance at the end of the year of $6.9 million.

At the present time, therefore, it appears that Penn Central's cash position, while remaining at precarious marginal levels throughout the year, has improved during recent months. Based upon these most recent projections, it would appear, as I have indicated earlier, that the trustees will be able to continue operations at least into the first quarter of next year. I must caution, however, Mr. Chairman, that any one of several potential adverse circumstances could undermine these current projections. For example, the spreading of the current railroad strikes to a substantial number of Penn Central's connecting carriers, a steel strike, or other severe economic reverses, bad weather, or other unforeseen circumstances could substantially change the present picture.

This delicate improvement in Penn Central's rail operating position has been in part due to increased revenues generated by the general freight rate increase granted by the Interstate Commerce Commission on March 23, 1971. Moreover, the trustees have taken further action to improve service through the use of shorter trains and tightened operating procedures. Service complaints have declined significantly and on-time performance is reported improving. At this time the trustees are actively pursuing a car control and car acquisition program to the extent financing can be obtained.

The trustees are also in various stages of taking other meaningful long-term actions to improve the financial position of the railroad, including the sale of Executive Jet Aviation, Inc., the proposed sale of the Pennsylvania Company (Pennco), and the offering for sale of the Park Avenue real estate properties. In addition, they have initiated a program for the abandonment of excess and uneconomical lines, including consolidation of duplicate facilities, and the reduction of the work force. Average monthly employment declined from 95,772 in June 1970 to 90,833 in June 1971. Rationalization of the plant and reduction of personnel represent essential steps in any ultimate resolution of the Penn Central's financial difficulties.

At this time I will discuss further the problems related to abandonment of uneconomical lines of railroad, the sale of non-transportation assets, and corporate control of subsidiaries. Actions taken with respect to each of these situations will affect the railroad's income flow and capital structure and its cash flow from operations and from sources other than operations.

As you are aware, as a condition to the guarantee the trustees were required to submit a plan for the sale of non-transportation assets. On March 15, 1971 the plan was filed. Since that date the trustees have announced a plan for the sale of Pennco stock subject to the approval of the reorganization court. The plan involves the transfer of Pennco common stock in exchange for the cancellation of a $300 million obligation of Penn Central and an additional loan of $150 million to the railroad for additional purchases and rebuilding of rolling stock. It must be realized that this proposed transaction would not generate cash for operations, but it would serve to simplify the overall financial position of the railroad and enable the trustees to purchase badly needed equipment.

On June 2, 1971, the trustees announced that they were offering for sale the railroad's real estate holdings located in the area of Park Avenue in New York City. Bids were invited to be submitted by October 15, 1971, and the Department is following this development with great interest. However, these proposed transactions cannot be relied on to satisfy any near term needs for cash by Penn Central due to legal restrictions which may preclude the availability of the proceeds from these sales for operating expenses of the railroad, and the time which will be required to complete these transactions.

Another condition of the guarantee was the requirement for the trustees to submit a program for abandonment of uneconomical lines and services. On March 31, 1971, they filed a report on phases I and II of a three-phase plan. Phase I consists of those applications already filed with the ICC covering a total of 114 miles comprising 16 lines in 4 states and 1 Canadian Province. Phase II of the program consists of 67 lines comprising a total of 705 miles. With your permission, Mr. Chairman, I will submit for the record a report on the present status of these abandonment applications. Phase III is under way to ascertain what portions of an additional 2,662.40 miles is suitable for abandonment application.

A third condition of the guarantee of special interest to the Congress was the requirement for the trustees to submit a plan for taking control of corporate subsidiaries. In developing their plan, however, the trustees found that the employees asked to serve as directors of the subsidiaries would be exposed to personal liability in the event of suit by minority stockholders and others. Therefore, an indemnification plan for the protection of such employees had to be prepared and it is now pending before the reorganization court for approval.

In addition to these proposals and plans for improving the operations and finances of the railroad, the trustees have recommended changes dealing with work rules, including full crew laws. The current dispute between the United Transportation Union and the rail carriers should be extremely instructive with respect to these recommendations. We are requesting the trustees to make a careful analysis of the results of the work rules changes which have been put into effect in connection with the dispute. We are also requesting similar information from a number of other carriers. While we are hopeful that the dispute can be settled quickly, we believe that the results of the work rules changes, preliminary as they may be, would be an invaluable insight into the cost savings which such changes could achieve for the Penn Central in particular and the industry generally.

In addition, Mr. Chairman, we are continuing our review of the financial condition of the Penn Central; and in cooperation with the Interstate Commerce Commission, we are undertaking a comprehensive review of the projections of the trustees for the remainder of this year. In order to assist the Department in its review, and to help assure that policies we develop are based on the most accurate information possible, we are retaining an independent accounting firm. We feel this is a prudent step and expect that this firm will provide us with an independent appraisal of the current operations of the railroad as well as the reasonableness of projections of the carriers' operations and financial situation. If on the basis of this comprehensive review it becomes apparent that the railroad will need additional cash at some future time, we will return to the Committee forthwith with our recommendations.

We are aware of the concern of the trustees and of Judge Fullam with respect to the rights of creditors being further subordinated by additional Federal loan guarantees. However, at the present time we believe that giving the trustees a greater opportunity to attempt to make the railroad viable is consistent with both the national interest and creditor interests. The trustees have been in office less than a year at the present time. While the cash flow has been negative, there has been a number of substantial improvements not only in quality of service but in availability of equipment. Liquidation and dismemberment of the system could produce such protracted litigation that it would take a long time for creditors to recover any reasonable portion of their investments. A look at the New Haven case should be indicative of this. On the other hand, if the cash flow projections realistically show a positive flow within a reasonable period of time--say 12 to 18 months--the Penn Central will have an excellent chance of becoming a viable organization and emerging from reorganization. In that event the creditors would recover on their investments much more quickly than if the railroad was liquidated. Of course, Mr. Chairman, if there are no prospects for viability, and if continuing cash deficits are in sight, there may be no other alternative but to restructure the system. If that event became essential, we would not necessarily support an unscrambling of the Penn Central merger and the re-establishment of the old Pennsylvania and New York Central Railroads as separate organizations. We undoubtedly would first consider a smaller Penn Central with certain parts taken over by other carriers. Before making any recommendations along these lines, we would, of course, have to analize its effects on the entire northeastern rail network.

Let me conclude by saying, Mr. Chairman, we remain hopeful that we will see Penn Central successfully come out of reorganization. We wish we knew the precise mix of remedies that would assure that fact. This is our goal. We are working hard at it. We have extreme confidence in the managerial abilities of the trustees, and with the continued cooperation of the Congress and this Committee in particular, we think we will make it.

This concludes my prepared statement, Mr. Chairman. I will now be happy to answer any questions you or the Committee may have.