

TESTIMONY OF CHARLES SWINBURN, ACTING ASSISTANT SECRETARY OF
TRANSPORTATION FOR POLICY AND INTERNATIONAL AFFAIRS, BEFORE
THE SUBCOMMITTEE ON TRANSPORTATION, COMMITTEE ON COMMERCE,
SCIENCE AND TRANSPORTATION, UNITED STATES SENATE, OCTOBER 29,
1979

Mr. Chairman and Members of the Committee. I am pleased to be here today with Robert E. Gallamore, Deputy Administrator of the Federal Railroad Administration, to discuss the future of the Milwaukee Railroad. There have been several important developments since the Department's September 7 appearance before you. Specific legislative proposals are now before this Committee and the House; the Milwaukee bankruptcy court and a reviewing court have ruled favorably on embargo of some Milwaukee service; and the Congress has modified the Emergency Rail Services Act to facilitate the funding of Milwaukee losses during the month of November.

Specifically, Congress has amended the ERSA Act to permit funding of the entire Milwaukee through November 30th without regard to most of the normal criteria for aid: in particular, we are not required to determine that the railroad in question can be expected to become self-sustaining. However, we are required to subordinate Federal funding only to "such priority in payment as the Secretary deems appropriate to secure repayment." In other words, in this case it is necessary to make the legal finding that the money loaned will be repaid by the bankrupt Milwaukee. On the basis of the Congressional action,

the court authorized the Trustee to request \$15 million in ERSA assistance at a repayment priority subordinate to the claims of all other creditors to fund operations until November 30. Last Friday the Milwaukee Trustee advised the bankruptcy court in Chicago that the Milwaukee could not repay fully subordinated ERSA funding for the entire system and should not undertake the new borrowing. The Federal Railroad Administration, which had been discussing terms of ERSA funding with the Trustee, has thus been unable to make the finding required by the continuing resolution. As a result of these developments the Trustee requested and the court authorized the embargo to take place on November 1st.

Our position regarding the Milwaukee remains as it has been: That the railroad's track condition and traffic base have so far deteriorated that no economic case can be made for continuing it as a transcontinental system. An attempt to establish a smaller, economically self-sustaining, and non-redundant "core" system as proposed by the trustee is now necessary, so that the whole railroad does not either simply cease running or become permanently subsidized by the taxpayer. As you know, our general policy regarding the railroad industry is that management should be permitted to react to market forces and set the terms and conditions of service accordingly. Railroads like the Milwaukee are subject to detailed regulation which inhibits their ability to respond to competition and tailor their service to market opportunities. We look forward

to working with the Committee to develop a strong rail regulatory reform bill so that the Milwaukee situation is not repeated.

Since we first expressed our support for moving forward with the restructuring of the Milwaukee, a number of concerns have been raised regarding this course of action. Within the past two weeks, we have carefully reviewed these concerns, working closely with other Cabinet agencies. I would like to share with you some of the conclusions of our analysis.

First, regarding service, it has been argued that the loss of the Milwaukee's western lines would leave current or potential shippers with an inadequate level of service. We do not share this view.

On a transportation needs basis, our studies show that a continuation of Milwaukee service beyond the core railroad is unnecessary. The Burlington Northern and Union Pacific railroads already service nearly all the areas currently generating significant business west of Miles City. Moreover, these railroads are the dominant providers of transcontinental service. For example, the Burlington Northern operates about 20 trains daily on its two transcontinental routes, while the Milwaukee operates two.

The red markings on the map indicate those Milwaukee lines we would expect to be sold or transferred to other railroads, particularly the Union Pacific and the Burlington Northern, for continued service. In the middle segment of the Milwaukee service areas (Minnesota, South Dakota, North Dakota

and Iowa), application of state rail plans, with some Federal assistance, will, we believe, preserve most other services.

In Minnesota, the lines that appear to be of primary importance are a local service line from Austin to Jackson, and the line west of Jonathan to Miles City, Montana. Under the State Assistance Program, funds for rehabilitation of both of those lines have been granted. Both are to be kept in the core system with state assistance.

In South Dakota, the only significant part of the Milwaukee that has so far been analyzed by the State is the line from Jonathan, Minnesota to Miles City, Montana. As a result of this analysis, \$2.3 million in State assistance was provided for emergency rehabilitation during 1979. Further, the State is committed to assisting the Milwaukee in securing an additional \$23 million to completely rehabilitate this line over the next three years. All other Milwaukee Lines in the State are currently being evaluated by the State DOT to develop recommendations for funding for presentation to the State legislature in January 1980.

Iowa has engaged in extensive rail planning regarding the cessation of service by Milwaukee. We have also conducted Section 401 meetings with all railroads interested in purchasing Iowa properties. We are confident that as a result of both efforts an improved basis for providing economically warranted service in Iowa will result.

Several lines on the western portion of the Milwaukee could lose service, particularly the main line in central Montana, some of the branch lines in the Great Falls, Montana area, and portions of the Columbia Basin in Central Washington, although some of these lines could also continue in operation through existing local rail service assistance programs. Other lines with potential for future service can be "rail banked" through the same program. The combination of these anticipated actions, (including sales to other railroads), should leave less than 5 percent of the traffic now served by the Milwaukee west of Miles City with rail service no longer available.

A specific argument has been made that increased coal traffic from Montana will require preservation of transcontinental Milwaukee service. The Milwaukee Road now receives at Miles City, and in the Twin Cities, coal that originates on the Burlington Northern in the Powder River Basin of Southeastern Montana and Wyoming. This coal moves eastbound, and would continue to be served by the Milwaukee's core system, "Milwaukee II." In fact, there is only one potential source of coal on the Milwaukee transcontinental line, at Roundup, Montana. That site, owned by the Burlington Northern, is undeveloped. A developed mine at Roundup would produce a little over 1 million tons of coal annually, only slightly more than 1 percent of that being shipped from all of Montana. We think "railbanking" by

the State of a small part of the transcontinental line, if justified, would be preferable to continuing to operate the entire Milwaukee system to preserve service to this point.

With respect to grain moving from Montana, the flow is both east and west. Approximately 60 percent moves by rail, 20 percent by truck and 20 percent by truck/barge. In 1977, the Milwaukee carried less than 15 percent of all rail grain movements and that was largely to Seattle and Portland. The Milwaukee grain service is concentrated in the Great Falls--Lewistown, Montana area where the BN is the major rail carrier.

A second concern that has been expressed is that elimination of the Milwaukee's lines west of Miles City will leave a substantial number of shippers at the mercy of the remaining carrier. In answer, an ICC staff analysis submitted to the White House by the ICC Chairman found that the danger of rail monopoly exists only in Montana and that the Milwaukee's market share in that state is too small to affect pricing. The paper concludes that the presence of the intramodal competition provided by the Milwaukee is not a significant factor in controlling rail rates in any state that is likely to lose all or most of its Milwaukee service.

The paper also notes that even if rail rates in Montana for farm products are set at unreasonable levels, maximum rate

relief remains available at the Commission. As you know Mr. Chairman, we have indicated a willingness to work with the Committee to incorporate into regulatory reform legislation such mechanisms as are needed to protect shippers who have no alternatives against unreasonably high rates.

A third argument made is that retention of the railroad is essential for national defense. Particular concern has been expressed regarding service to Malmstrom Air Force Base in Great Falls, Montana. The base is also served by the Burlington Northern and the Defense Department has met with BN to request its purchase of the Milwaukee 6-mile spur into the base. The most recent Defense Department map of rail lines essential to the National defense includes no Milwaukee owned lines west of Miles City, Montana which will not be purchased by other railroads.

Fourth, some have questioned whether retention of the railroad is necessary to provide competitive rail service and rates for Pacific North Coast ports. We expect the impact of the Milwaukee's withdrawal from transcontinental service to be minimal. Service will continue as before by the BN and UP, which already provide the bulk of rail service to midwestern and eastern markets. Only two smaller ports have been served exclusively by the Milwaukee and we expect these services to be continued by another carrier. While some rate adjustments may be made as a result of the Milwaukee withdrawal, these adjustments will not place any of the ports at a competitive

disadvantage for high rated merchandise traffic since rail rates between the ports and inland points are equalized.

Fifth, it has been suggested that large or unforeseen highway impacts will result from abandonment. Working with FHWA, we have analyzed the possible increased traffic and maintenance needs that could result from sale, transfer, or abandonment of Milwaukee lines west of Miles City. From a capacity standpoint, it appears that none of the affected highways would have a problem in handling additional volume by truck. This assumes, in line with the plans for sale and transfer of lines with significant traffic, that most Milwaukee traffic will continue to move by rail. As I have indicated, we expect a combination of private sales and State planned operations of important lines with Federal assistance to continue to provide for most Milwaukee traffic. On this basis, the maintenance of the existing highways system should not be significantly affected either.

A sixth argument that has been made is that cessation of the Milwaukee's services, particularly in Montana, will seriously disrupt the nation's ability to move grain harvests. The Department of Agriculture's recent assessment of the potential impacts of cessation of Milwaukee's western line indicates that 47 percent of Milwaukee's 1978 agricultural carloads originated or terminated at stations also served by another railroad.

Of the 73,000 remaining rail agricultural carloads that would have to be continued by another operator over Milwaukee lines, moved by highway to another rail head, or diverted to another mode of transportation, 70,000 were forest products and less than 3,000 carloads were grain and grain products. For comparison, national statistics for 1978 indicated that all major railroads handled over 1.3 million carloads of grain and almost 1 million carloads of grain mill products. Further, testimony in the Milwaukee line abandonment case indicated that only 2 percent of the wheat and 3 percent of the barley products produced in Montana moved by the Milwaukee.

It has also been argued that we may have significantly underestimated the Federal costs of abandonment of the Milwaukee western lines because there will be severe local economic dislocations which will have to be cushioned through the use of EDA or other Federal programs. In fact, the Department of Commerce estimates that under a worst case situation, where none of the abandoned Milwaukee service is picked up by other railroads, the impact on EDA's programs would be approximately \$42 million. That amount is far less than the amounts of Federal funds needed to keep the Western Lines operational and in practice will be diminished drastically since, by our estimates, about 95 percent of the shippers will continue to receive service.

Finally, it has also been claimed that there will be significant direct and indirect costs associated with the lay-

offs of Milwaukee railroad employees. The Department of Labor has reviewed the labor protection provisions of the pending legislative proposals and has estimated that they would require approximately \$80 million, an amount which is strikingly close to that which is provided in the form of loan guarantee assistance in the several legislative proposals and which the Trustee's Preliminary Reorganization Plan agrees to fund. Further, the Department of Labor expects that because labor protection will be provided, any secondary economic or ripple effects of the layoff of Milwaukee employees will be negligible.

To summarize our assessment of the potential costs of alternative proposals, we believe that the costs of preserving the entire Milwaukee system are far greater than those of moving to a more efficient, restructured system. For operation of the full system from now until next spring, the price tag for the Federal taxpayer would be at least \$55-60 million. Based upon the individual studies of the costs of rehabilitating and operating the Western Lines and the Trustee's core system, our estimates are that attempting to establish most of the Milwaukee system as a going concern could cost up to \$1 billion in total Federal investment, including the costs of restructuring in Iowa and South Dakota, but not including the costs of purchasing the rail assets from the Milwaukee estate. In contrast we estimate that the Trustee's proposal to create a self-sustaining core system would cost less than \$400 million, also including the costs of restructuring in Iowa. Even if

the potential Federal costs of economic dislocation mentioned earlier are added to the costs of a core only solution, it may well cost more than half a billion additional Federal dollars to implement a plan for preservation of transcontinental service on the Milwaukee.

These figures give us all the more reason to object to any further freeze that delays the permanent restructuring which is necessary to make the Milwaukee economically viable. We have often said, and I re-emphasize today, that delay in taking the necessary restructuring steps will impair the chances of establishing a successful core railroad. Since 6,000 jobs and service to Milwaukee's prime territory in Minnesota, Wisconsin and Illinois are at stake, we should avoid further delay. I should note that a de facto freeze has been in effect since last May when the Trustee first petitioned for embargo. We are also concerned that an indefinite continuation of Milwaukee service will discourage sale or transfer of lines to solvent carriers.

In light of these facts, our view is that little legislative change is necessary or desirable to accomplish needed Milwaukee restructuring. Under the bankruptcy court's embargo ruling for Milwaukee noncore lines, the Interstate Commerce Commission will be able to authorize directed service over those lines or portions of lines which are essential. It is likely that this will speed up the sale or transfer of viable lines to solvent railroads, and will minimize the effects on shippers while alternative arrangements are made. The directed service

period will also provide time for the Congress to provide reasonable labor protection for any Milwaukee employees displaced by reduction of Milwaukee service.

The Department will support legislation that improves the chances for a successful reorganization of that portion of the Milwaukee which can become self-sustaining. However, the approaches taken in the two bills before your Committee and the one in the House all tend to slow down the process of restructuring, with the general exception of improved abandonment procedures. We advocate substantial modifications of the bills.

Each of the bills conditions Federal funding beyond a certain date on the successful development of an Employee Stock Ownership Plan (ESOP), converting all or substantially all of the Milwaukee into an employee-owned or employee/shipper-owned company. The basic idea of placing a commercial venture in the hands of those who stand to gain the most from its success is a promising one that has been successful in several cases, and we do not dismiss the concept. However, such a venture must be capable of being self-sustaining as a private enterprise. We have concluded, after careful study, that insufficient traffic and better-equipped competition will make profits impossible for any management operating the Milwaukee lines as a whole, whether or not an ESOP is in place. That conclusion

has been supported by virtually all of the studies done to date. The one exception is a recent study done by Policy and Management Associates for proponents of maintaining Milwaukee's Western Lines. That study purports to demonstrate that the Milwaukee's Western Lines can be made profitable by 1985. We have carefully reviewed that study and find it to be overly optimistic and based upon assumptions that are highly unrealistic. I have attached our review of that study to the copy of my testimony which is submitted for the record. Based upon the evidence, therefore, we think it risky to expose the employees and shippers to a venture based on the success of these lines. While we recognize that the Committee's bill requires that labor contribute to the ESOP's assets in the form of relinquished labor claims and work rule changes, we must caution that an ill-conceived ESOP that failed would deprive labor of the benefits of these contributions. Under S.J.Res. 114 and the House bill, the ESOP venture would replace directed service for a significant time period. When service not operated by the ESOP would cease we could have a chaotic situation in the event of an ESOP failure.

While we do not support any of the three ESOP proposals, the approach taken in Committee bill S. 1905 appears to be the least objectionable. It does not presume the feasibility of the ESOP plan for review purposes, does not require the heavy burden of "clear and convincing" evidence to oppose the plan in bankruptcy court, and includes the most appropriate test

for estimating the financial assets of the ESOP that might come from governmental sources. Under S. 1905, the ESOP plan must be submitted by November 30th. Labor must contribute to the ESOP in the form of work rule changes and relinquishment of claims against the estate. The employees would have to "implement" the plan by March 1, 1980, or Federal funding of the entire Milwaukee could cease 60 days thereafter.

In contrast, S.J.Res. 114 would require submission of the plan by January 1, 1980, and would only require that the ESOP employees "take such steps as may be necessary to implement the plan" by May 10, 1980. This is defined to mean obtaining preliminary commitments for sources of financing and a certificate of public convenience and necessity. It is not clear what responsibility or authority would exist in the Federal Government to assure continued Milwaukee service if this stage of "implementation" is reached but operational control has not been assumed by the ESOP.

We support S. 1905's provisions on labor protection, which would limit Federal responsibility to new career training assistance and the guarantee of up to \$75 million to the Milwaukee estate for moving, relocation and other expenses associated with employee dislocation, with repayment guaranteed as an expense of administration. In general, it is our view that labor protection should be worked out between employer and employees on an equitable basis. We oppose the statutory enumeration of benefits contained in S.J.Res. 114 and the

House bill, including any which suggest a suspension of laws and obligations related to equal employment opportunity. We are particularly concerned with the Federal Government assumption of costs associated with supplementary unemployment insurance coverage for all employees working on a reorganized Milwaukee core. The future liability of the Federal Government under that feature could be sizable.

We support the provisions of S. 1905 that expedite abandonment of rail lines involved in any pending railroad reorganization, including the Milwaukee's. Section 3 of S. 1905 would authorize abandonments under the new bankruptcy law, and would permit actual abandonment to begin while any abandonment appeal is pending. S.J.Res. 114 does not contain the right to abandon during the pendency of appeals, and does not extend the new bankruptcy law to pending railroad reorganizations other than the Milwaukee. The House bill is similar to S. 1905. All three bills delay Milwaukee abandonments until the ESOP matter is resolved.

Because there is a substantial likelihood that expedited sales or transfers will be needed to resolve not only the Milwaukee matter but also the pending Rock Island situation, we recommend that the sale and transfer sections of the new Bankruptcy Act be made applicable to existing bankruptcies. The House bill generally follows that pattern. In addition, the House bill makes a very useful contribution by enabling preliminary approval of a sale and interim service by prospective purchasers. However, additional consideration will have to be

given to protection of employees involved in interim service by another carrier.

S. 1905 contains a requirement that the Secretary guarantee loans under section 511 of the 4R Act for equipment repair for the Milwaukee, or its successor, up to a total of \$30 million during 1979 and 1980. S. 1905 and the other bills contain an amendment of section 505 of the 4R Act which permits (but requires in the House bill and S.J.Res. 114) the Secretary to purchase redeemable preference shares or similar instruments to facilitate the rehabilitation and improvement of Milwaukee railroad property, whether sold or retained, that is used for continuing railroad service. We oppose these provisions as undesirable because of their implication that different standards for determining the merits of Federal funding should be applied to assistance for the Milwaukee. Adequate financing for essential equipment repair and track rehabilitation is available under existing Title V statutory authority, with appropriate protection for the Federal investment. Instead, we strongly urge the Committee to take up the provisions in the House bill that would fundamentally improve the distribution of Federal assistance by channeling 505 funds toward restructuring projects, even where solvent railroads are involved, and by conditioning assistance in other cases on restructuring efforts.

Finally, section 12 of S. 1905 would provide additional operating funds to the Delaware and Hudson (D&H), while requiring that the railroad continue to develop an ESOP. The D&H has

been plagued with financial problems since 1971, and has received \$30 million from the United States Railway Association since 1976 under the 3R Act. In 1978 DOT refinanced \$8 million in locomotive purchases to provide additional working capital from USRA's loan authority. Deferred interest on USRA loans presently totals \$4.7 million, and we expect the D&H to ask for deferral of up to \$4.3 million more in the next year. The USRA forecasts D&H losses of \$12 million for 1980 and indicates that the D&H may require as much as \$5 million in additional Federal assistance.

Section 12 would relieve the D&H of a 1978 legislative requirement to have an ESOP in place in order to gain access to the last \$2 million in working capital assistance from USRA, and would add \$2 million in new funds. This will not reverse the steady downward trend in the D&H's traffic, earnings, and asset base. We do not support additional funding. If bankruptcy is inevitable, we prefer to deal with it directly, rather than by repeated postponement.

In closing, we believe that the necessary restructuring of the Milwaukee Road must occur. We are convinced that the combination of purchase by other railroads and continuation of local services under the state rail assistance program will minimize the loss of rail service so that less than 5 percent of present traffic would be affected. We support expedited abandonment, sale, and transfer of rail lines belonging to

railroads undergoing reorganization. We also support the approach to labor protection for Milwaukee employees taken in S. 1905. However, we do not support the ESOP provision, or the "freeze" of operations through the winter. We do not support the modification of Title 5 assistance programs to favor Milwaukee rehabilitation over worthy projects of other railroads.

This completes my statement. Deputy Administrator Gallamore and I would be pleased to answer any questions you might have.