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BEFORE THE COMMITTEE ON APPROPRIATIONS
SUBCOMMITTEE ON TRANSPORTATION
UNITED STATES SENATE

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Mr. Chairman. I appreciate the opportunity to appear this morning, and actually, this is somewhat of a homecoming for me. It's the first time I've appeared before a Senate committee since I left Senator Durenberger's office to be confirmed as Federal Railroad Administrator. I have vivid memories of being on the Senate floor during debate on the Northeast Rail Services Act (NERSA) three years ago, and I know the contribution that the Chairman and Senator Chiles made to that legislation. This is an appropriate time to review the progress the Department of Transportation has made in implementing the responsibilities it acquired under NERSA, and I'd like to begin this morning by updating the Committee on the status of the Secretary's efforts to return Conrail to stable, private sector ownership.

Let me make clear at the onset that Secretary Dole has no intention of exercising the power the Department acquires on June 1, 1984 to break Conrail into pieces and auction off its lines. Whether one approaches this issue from the perspective of

- A shipper seeking single line service, or
- A government not wanting to sell the best lines and hold the rest

a piecemeal auction of Conrail's lines does not serve the public interest. We believe an entity sale is achievable, and that's the option we intend to pursue.

Last November the Department adopted a new marketing strategy to capitalize on Conrail's improved profitability. It featured three elements:

- 1) A presentation by the Federal Railroad Administrator to the Presidents of all Class I railroads that interconnect with Conrail.

- 2) An intense effort by Goldman Sachs to contact every nonrail company with the capacity to execute a Conrail purchase. We defined that class of companies as those with \$1 billion or more in assets, and \$300 million in net income. There are 64 companies in that category. In each case where a party expressed interest in Goldman Sachs' presentation, follow-up was made jointly by FRA and senior Goldman Sachs officials.

- 3) An intensified follow-up on all contacts received from companies or individuals falling outside categories one and two.

The Secretary believes that the public interest as well as the plain intent of NERSA require us to develop the broadest possible range of options before narrowing to the choice of a single purchaser. And like any intelligent seller, we intend to get all available options on the table before beginning the narrowing process. The contacts made in November and December have helped immensely in moving us toward that objective.

We have received an offer from the Railway Labor Executives' Association (RLEA), and public expressions of interest from three major rail carriers -- Norfolk Southern Corporation, CSX Corporation, and Santa Fe Industries, Inc. We are also meeting with a half-dozen additional parties who have expressed an interest in Conrail, but not yet taken action or public steps toward pursuing a Conrail acquisition.

The Secretary's efforts to locate additional buyers do not imply dissatisfaction with either the RLEA offer or the level of interest expressed by carriers who have made public announcements. They are simply a reflection of the fact that DOT has a duty both to Congress and to the nation's taxpayers to explore every possible purchase option before determining which alternative best meets the public interest.

If we have options -- and I believe that DOT will have options -- we will judge their merit by three criteria:

- First, we will favor the purchase option that leaves the railroad in the strongest financial condition after the sale. The reason is obvious -- we want to insure that Conrail has the greatest financial capability to preserve service for states and shippers over the long-term. To say the same thing another way, we believe that the plain intent of NERSA requires us to pursue the option that offers the least possibility of the railroad returning to the Federal government in the future.
- Second, we will favor the option that best protects service patterns to shippers and communities in the Northeast.

- Finally, we will favor the option that is consistent with the previous criteria, and offers the maximum return to the United States. The Secretary would not favor the plan with the highest rate of return to government if it were seriously at odds with the public interest criteria I've outlined.

The options for a Conrail sale break down into three general categories.

The first, and the best option, is the so-called "deep pocket" -- a purchaser that brings Conrail financial strength or additional resources that improve its chance of sustaining service and profitability over the long-term. You can create that deep pocket effect in a variety of ways:

- By bringing Conrail additional cash or borrowing power.
- By merging Conrail with an adjoining route system that improves its cash flow by strengthening its traffic base.
- By altering work rules or labor contracts in a way that strengthens the company's cash flow.

The median option is the use of a public offering to sell all or part of the Conrail stock. It doesn't bring anything to the railroad, and at least in theory it doesn't take anything away. We have probably spent more time and resources attempting to resolve the legal and logistical problems surrounding a public offering than we have on any other issue. It is an option we are considering either in its own right or as part of a larger transaction. At the same time, I have to tell this Committee we have serious reservations on whether the use of a public offering to sell the major portion of Conrail's stock is consistent with the public interest criteria we are committed to meeting in this transaction. There are several reasons for that concern.

The first is timing. Goldman Sachs has advised us that even under optimal market conditions, it would take at least several years to complete a phased public offering of Conrail stock. If market conditions should change, or the economy should slip into recession, the time frame could grow longer, even indefinitely longer. At best, this is inconsistent with the intent of NERSA that Conrail be returned to the private sector at the earliest opportunity. At worst, it would leave the Federal government a minority shareholder in a publicly held company -- an obviously undesirable situation.

Some have suggested that a buyer could resolve the problem by contracting, say, a billion dollar loan against Conrail's assets, using it to underwrite the entire offer, buying government out up front and reselling the stock to the public over a period of years. The problem with this approach is that it's really nothing more than a leveraged buy out in the cloak of a public offering. Debt service on the loan would destroy Conrail's finances, and any shortfall on anticipated stock yields would create a multi-million dollar financing gap capable of driving Conrail back to the Federal government.

There is a second, and in my opinion, more significant problem with a public offering. I believe that we have a clear public interest obligation to know who we're selling this railroad to. We need to make judgments on the adequacy of the buyer's finances, and place reasonable conditions in the contract of sale to ensure that the railroad will not be looted, cherry picked, or liquidated. That's impossible in a broad based public offering. Any party with access to several hundred million dollars cash can walk up to the counter and buy a controlling interest in the railroad. And because there is no sales contract, we have little ability to write protective conditions into the transaction. We believe we owe the public and the Congress more than that scenario enables us to deliver.

It is true, at least in theory, that one could partially mitigate these concerns by restricting the stock or limiting the format of the public offering. But that leads to the other horn of the dilemma, because Goldman Sachs has advised us that utilizing these types of restrictions would severely diminish the value and saleability of the stock.

We are continuing to work on solutions to these dilemmas and still consider the public offering a potential option.

The final sale option is the so-called leveraged buy out, through which a seller would in effect buy Conrail with its own money by using Conrail's cash or assets as collateral for a mortgage. That option would leave Conrail a significantly weaker company, and we view that option as against the public interest.

Before concluding, Mr. Chairman, I want to outline the procedures the Secretary intends to follow when we do have potentially acceptable offers on the table.

I believe we have a good sense of who the potential actors and non-actors are, and when we have received one or more offers that we believe to be in the public interest, the Secretary will establish a cutoff date for the submission of competing purchase proposals. After that cutoff date, the Secretary will confer with the leadership of both Houses, both Majority and Minority, on those options.

Following that consultation, the Secretary will recommend to the Congress the option she believes to be most consistent with the public interest. It's clear that under NERSA, Congress will have at least 60 legislative days to review the proposal. I also want to tell the Committee that in all our discussions to date with potential purchasers, we have been unable to envision a purchase scenario that would not require some form of implementing legislation -- either to resolve the issue of the contingency notes, or to provide the kinds of protection and definition that normally follow an ICC proceeding.

We are all optimistic that the consultations between the Secretary and the Congress preceding submission of a plan will produce a consensus solution. If they do not, the Secretary will make her best judgment on what is consistent with the public interest, and Congress will have to work its will.

What's the timing? It's difficult to say at this point, since it is really the decision of the buyers to offer or not offer that drives the process. We have no artificial deadline on the sale, and I can honestly tell you that throughout my tenure at DOT, I have yet to hear even a discussion of deadlines, much less election year deadlines. The recent flurry of activity by Norfolk Southern Corporation, CSX Corporation, and a number of other potential buyers has left me optimistic that the process could move fairly rapidly.

If it does, we have no intention of abandoning potential buyers by forcing artificial delays on the process. It's also essential to bear in mind that the Northeastern states lose approximately \$25 million in taxes each year that Conrail remains in government ownership -- that's more than \$2 million a month, a high price to pay for delay. And of course we feel an obligation to do everything we can to resolve the uncertainties now facing shippers, employees, and communities being served by the Conrail system.

Conversely, we have no intention of rushing toward a sale if it does not meet the public interest criteria we've defined. Secretary Dole has had ample opportunity to contrive a quick solution. She has declined to do so. Our interest is to execute the sale that best protects the public interest, and we look forward to working with this Committee to achieve that objective.

Let me close, Mr. Chairman, by restating my standing offer to update any member of Congress, or congressional staff, on the status of Conrail negotiations at any time. I have been on the Hill for briefings an average of every other day since Congress reconvened, and my office is never more than a telephone call away.