

**TESTIMONY OF ELIZABETH HANFORD DOLE
SECRETARY OF TRANSPORTATION
BEFORE THE SENATE COMMITTEE
ON COMMERCE, SCIENCE, AND TRANSPORTATION
CONCERNING SALE OF CONRAIL
FEBRUARY 27, 1985**

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I WELCOME THE OPPORTUNITY TO APPEAR BEFORE YOU TODAY TO DISCUSS THE PLAN I HAVE SUBMITTED TO CONGRESS FOR TRANSFERRING CONRAIL TO THE PRIVATE SECTOR AFTER ALMOST A DECADE OF FEDERAL STEWARDSHIP. IN REACHING MY DECISION, I HAVE KEPT IN MIND THE SACRIFICES AND SECURITY OF CONRAIL'S EMPLOYEES, THE NEEDS OF ITS SHIPPERS AND THE INTEREST OF ITS MAJORITY STOCKHOLDER: THE AMERICAN TAXPAYER. WE HAVE LABORED LONG AND HARD TO REACH A RECOMMENDATION THAT WILL BEST SERVE NOT ONLY THE REGION, BUT THE NATION.

WE HAVE WEIGHED ALL FEASIBLE OPTIONS FOR CONRAIL'S FUTURE, INCLUDING THE OPTION OF NOT SELLING IT. WE RELIED ON THE PROFESSIONAL ADVICE OF OUR INVESTMENT BANKER, GOLDMAN, SACHS AND COMPANY. WE CONSULTED WITH THE CONGRESSIONAL LEADERSHIP AND MANY MEMBERS OF CONGRESS, AND FEDERAL AGENCIES WITH EXPERTISE IN RELEVANT AREAS. WE TALKED WITH STATE AND LOCAL OFFICIALS FROM THE REGION, EMPLOYEE REPRESENTATIVES, SHIPPERS, CONRAIL MANAGEMENT, CONRAIL BOARD MEMBERS, AND OTHER INTERESTED PARTIES. FINALLY, AND MOST SIGNIFICANTLY, WE HAVE HONORED ALL THE DIRECTIVES OF THAT STATUTE THAT GOVERNS THE SALE PROCESS, THE "NORTHEAST RAIL SERVICE ACT OF 1981."

AS CONTEMPLATED BY NERSA, THIS PROCESS WILL ASSURE THE RETURN OF CONRAIL TO THE PRIVATE SECTOR AS A STRONG, VIABLE RAILROAD. GIVEN THAT CONRAIL IS

PROFITABLE, THE STATUTE REQUIRES A SALE OF CONRAIL AS AN ENTITY THROUGH SALE OF ITS COMMON STOCK AND FURTHER REQUIRES US TO SUBMIT A SALE PLAN THAT --

- ENSURES CONTINUED RAIL SERVICE;
- PROMOTES COMPETITIVE BIDDING FOR CONRAIL'S STOCK; AND
- MAXIMIZES THE RETURN TO THE TAXPAYER FOR THE INVESTMENT THAT HAS BEEN MADE TO PRESERVE CONRAIL.

IN HONORING THESE CRITERIA, I AM RECOMMENDING A SALE PLAN THAT ASSURES LONG-TERM RAIL SERVICE TO THE REGION, TRUE EMPLOYMENT STABILITY FOR CONRAIL'S WORK FORCE, AND A VERY HIGH LEVEL OF CONFIDENCE THAT CONRAIL WILL NEVER AGAIN BECOME A WARD OF THE FEDERAL GOVERNMENT. WE CAN NOW GIVE CONRAIL THE OPPORTUNITY TO PROSPER AS A TRULY PRIVATE-SECTOR BUSINESS AND AS A KEY PART OF A STRONGER COMPANY.

LET ME BRIEFLY DESCRIBE WHY I AM RECOMMENDING NORFOLK SOUTHERN AS THE PURCHASER. CONRAIL MUST BE ABLE TO PROVIDE FIRST CLASS SERVICE OVER THE LONG HAUL, REGARDLESS OF NATIONAL OR REGIONAL ECONOMIC CYCLES. ACCORDINGLY, WE ANALYZED WHICH PURCHASE OFFER WOULD PLACE THE RAILROAD IN THE STRONGEST CONDITION AFTER THE SALE. AMONG OTHER THINGS, WE ANALYZED THE FINANCIAL STRENGTH OF THE OFFERORS AND FINANCIAL PROJECTIONS FOR THE COMBINED ENTITY. WE LOOKED AT AVAILABILITY OF FINANCING AND ABILITY TO CARRY RESULTING DEBT, SPECIFIC PLANS FOR REINVESTMENT AND MINIMUM WORKING CAPITAL LEVELS. NORFOLK SOUTHERN'S PROPOSAL IS TO PAY A MINIMUM OF \$1.2 BILLION IN CASH ENTIRELY OUT OF ITS OWN POCKET, A COMMITMENT NOT FOUND IN ANY OTHER PROPOSAL.

THE LONG-TERM STRENGTH OF THE COMPANY IS ESSENTIAL TO ITS SHIPPERS, THE COMMUNITIES IT SERVES, THE PEOPLE IT EMPLOYS AND THE TAXPAYERS WHO MUST NEVER AGAIN BE ASKED TO BAIL IT OUT. ANY MEASURE THAT WOULD WEAKEN CONRAIL FINANCIALLY THREATENS EACH OF THEM. THE SALE TO THE NORFOLK SOUTHERN WOULD LEAVE CONRAIL IN THE BEST POSSIBLE CONDITION.

IN ADDITION, WE WEIGHED EACH OFFER IN TERMS OF PROTECTING SERVICE TO SHIPPERS AND COMMUNITIES THROUGHOUT THE NORTHEAST. WE LOOKED IN DETAIL AT REDUCTIONS OR ENHANCEMENTS OF SERVICE THAT MIGHT RESULT, INCLUDING EXISTING SERVICE COMMITMENTS BY CONRAIL. THE CONGRESS IS AWARE THAT THE JUSTICE DEPARTMENT ALSO CONDUCTED AN INDEPENDENT, EXTENSIVE ANALYSIS OF THE IMPACT ON COMPETITION OF THE PROPOSED SALE TO NORFOLK SOUTHERN, AND IT SET OUT A SERIES OF CONDITIONS TO MAINTAIN COMPETITION THAT MUST BE MET BEFORE A SALE CAN BE CLOSED. UNDER THESE CONDITIONS, THE PURCHASE OF CONRAIL BY NORFOLK SOUTHERN WILL ENHANCE COMPETITION IN TWO IMPORTANT WAYS:

- o THE NORFOLK SOUTHERN HAS PLEDGED TO REOPEN MANY GATEWAYS AND REINSTITUTE JOINT ROUTES THAT ARE PRESENTLY UNAVAILABLE AS A RESULT OF CONRAIL'S ACTIONS; AND

- o THE DIVESTITURES, OPENING OF GATEWAYS AND GRANTING OF TRACKAGE RIGHTS NECESSARY TO SATISFY THE JUSTICE DEPARTMENT'S REQUIREMENTS WILL STRENGTHEN THE COMPETITIVE POSITION OF SMALLER RAILROADS IN THE REGIONS SERVED BY CONRAIL.

VIEWED FROM ANOTHER PERSPECTIVE, NORFOLK SOUTHERN INDISPUTABLY INTENDS TO REMAIN IN THE RAILROAD BUSINESS.

LASTLY, WE FAVORED THE OPTION THAT, CONSISTENT WITH THESE CRITERIA, OFFERED

THE MAXIMUM RETURN TO THE UNITED STATES. IT WOULD DO NO GOOD, OF COURSE, TO IN UP THE PRICE, ONLY TO LOSE IMPORTANT SERVICE OR RISK REINHERITING THE RAILROAD AT SOME FUTURE DATE. NEVERTHELESS, WE HAVE A CLEAR STATUTORY MANDATE UNDER NERSA TO MAXIMIZE THE RETURN TO THE TAXPAYERS, AND I BELIEVE WE HAVE DONE SO.

THE NORFOLK SOUTHERN CORPORATION WILL PAY US A MINIMUM OF \$1.2 BILLION IN CASH AT CLOSING. THE ACTUAL DOLLAR AMOUNT WILL PROBABLY BE HIGHER, SINCE THE FINAL PURCHASE PRICE IS KEYED TO THE AMOUNT OF CASH CONRAIL HAS ON THE DAY OF CLOSING. NORFOLK SOUTHERN WILL ALSO SURRENDER CONRAIL'S ACCUMULATED TAX BENEFITS -- \$2.1 BILLION IN NET OPERATING LOSSES AND \$275 MILLION IN INVESTMENT TAX CREDITS. THIS SURRENDER OF TAX BENEFITS REPRESENTS TRUE VALUE TO THE TREASURY AND IS A VERY IMPORTANT ELEMENT OF THE TOTAL COMPENSATION. NORFOLK SOUTHERN HAS ALSO AGREED TO BE BOUND BY A STRONG SET OF PROTECTIVE COVENANTS THAT WILL SAFEGUARD THE PUBLIC INTEREST FOR FIVE YEARS DURING THE TRANSITION TO PRIVATE OWNERSHIP. ALL OF THESE ELEMENTS ARE PART OF THE CONSIDERATION WE WILL RECEIVE FOR THE GOVERNMENT'S 85% OF CONRAIL'S COMMON STOCK. THOSE WHO FOCUS SOLELY ON THE CASH PORTION OF THE CONSIDERATION ARE OVERLOOKING MAJOR PORTIONS OF THE VALUE FOR WHICH WE BARGAINED.

WE MIGHT HAVE RECEIVED A HIGHER CASH PRICE FOR THE STOCK IF WE HAD BEEN WILLING TO FOREGO THE PROTECTIVE COVENANTS -- CONTROLLING STOCKHOLDERS ARE NOT GENERALLY ACCUSTOMED TO THE SORTS OF RESTRICTIONS WE HAVE NEGOTIATED WITH NORFOLK SOUTHERN, BUT, I BELIEVE THEY ARE ESSENTIAL TO THE PUBLIC

INTEREST. THE COVENANTS WILL PRESERVE QUALITY SERVICE, PROTECT CONRAIL'S SHIPPERS, AND ENSURE CONTINUED FINANCIAL STRENGTH. THE COVENANTS REQUIRE NORFOLK SOUTHERN TO OPERATE CONRAIL AS A SYSTEM MUCH AS IT IS TODAY.

NORFOLK SOUTHERN HAS AGREED TO INVEST HUNDREDS OF MILLIONS ANNUALLY IN CONRAIL'S PHYSICAL PLANT AND TO REFRAIN FROM DEFERRING MAINTENANCE TO ANY LEVEL BELOW NORFOLK SOUTHERN'S OWN STANDARDS, WHICH ARE THE HIGHEST IN THE INDUSTRY. THE COVENANTS REQUIRE CONRAIL TO REFRAIN FROM PAYING DIVIDENDS ON THE COMMON STOCK UNLESS \$500 MILLION IN CASH WOULD REMAIN IN THE BANK AFTERWARD. NORFOLK SOUTHERN IS BOUND BY THE COVENANTS TO MAINTAIN ITS CONTROLLING OWNERSHIP INTEREST IN CONRAIL FOR FIVE YEARS. CONRAIL'S EXPEDITED ABANDONMENT AUTHORITY WILL BE RELINQUISHED, AND ANY LINES THAT ARE ABANDONED WILL BE OFFERED TO SHIPPERS OR SHORT LINE RAILROADS AT 75 PERCENT OF NET LIQUIDATION VALUE. ALL OF CONRAIL'S CURRENT MINORITY BUSINESS ENTERPRISE AND EQUAL EMPLOYMENT OPPORTUNITY PLANS WILL BE CONTINUED. CONRAIL WILL MAINTAIN ITS HEADQUARTERS IN PHILADELPHIA AND WILL CONTINUE TO OPERATE THE ALTOONA SHOPS. ALL OF THESE COVENANTS WILL LAST FOR FIVE YEARS AND ARE ENFORCEABLE BY FEDERAL COURT INJUNCTION.

THERE WERE OTHER APPROACHES SUGGESTED FOR CONRAIL'S FUTURE THAN THOSE OF THE THREE FINAL BIDDERS. I WOULD LIKE TO SPEAK FOR A MOMENT ABOUT RECOMMENDATIONS THAT THE SALE BE DELAYED IN THE HOPE THAT WE MIGHT GET A SOMEWHAT HIGHER PURCHASE PRICE. IN MY OPINION, AND THAT OF OUR INVESTMENT ADVISOR AS WELL, A "BETTER" OPPORTUNITY WILL NEVER ARRIVE. WE SOLICITED OFFERS IN GOOD FAITH, AND WERE REWARDED BY A WIDE RANGE OF CREDIBLE OFFERS BY SERIOUS BIDDERS. THE BIDDERS BELIEVED WE INTENDED TO SELL A RAILROAD. CONRAIL'S CONTRACT EMPLOYEES HAVE ALSO TREATED THE SALE PROCESS SERIOUSLY,

DEALING CONSTRUCTIVELY WITH EACH OFFER PRESENTED AND MAKING THEIR OWN OFFER AS WELL. SINCE PASSAGE OF NERSA IN 1981, CONRAIL HAS BECOME PROFITABLE AT NO SMALL COST IN TIME AND EFFORT. STATE AND LOCAL TRANSIT AGENCIES TOOK OVER COMMUTER RAIL OPERATIONS UNDER NERSA'S DIRECTIVE, CONRAIL'S EMPLOYEES MADE SIGNIFICANT WAGE CONCESSIONS, AND THE STATES IN THE REGION HAVE SACRIFICED TAX REVENUES FROM CONRAIL TOTALING MORE THAN \$25 MILLION ANNUALLY.

A PUBLIC OFFERING OF CONRAIL STOCK ALSO HAS BEEN SUGGESTED. AT MY REQUEST, GOLDMAN SACHS CONSIDERED A PUBLIC OFFERING EARLY IN OUR DELIBERATIONS. IT ADVISED ME THAT THERE WERE PRACTICAL DIFFICULTIES AND SUBSTANTIAL RISKS. THUS, I USED THE COMPETITIVE BID APPROACH, AND I CONDUCTED EXTENSIVE NEGOTIATIONS SIMULTANEOUSLY WITH SIX BIDDERS AND THEN THREE FINALISTS.

LAST MONTH, SOME MEMBERS OF CONRAIL MANAGEMENT SUBMITTED AN OFFER BASED ON A PUBLIC OFFERING. AGAIN, I ASKED GOLDMAN SACHS TO REVIEW IT. MEASURED AGAINST THE CRITERIA I HAD ESTABLISHED, IT ADVISED ME THAT THE CONRAIL MANAGEMENT PROPOSAL IS LESS ADVANTAGEOUS THAN THE NORFOLK SOUTHERN BID IN A NUMBER OF RESPECTS.

FIRST, THE MANAGEMENT PLAN TAKES A MINIMUM OF \$300 MILLION IN CASH OUT OF THE COMPANY, REGARDLESS OF ITS CASH POSITION.

SECOND, THE MANAGEMENT PLAN FORCES THE COMPANY TO ISSUE \$600 MILLION IN PREFERRED STOCK. IN FACT, THIS WOULD BE THE LARGEST PREFERRED STOCK ISSUE IN AMERICAN HISTORY. IN CONTRAST NORFOLK SOUTHERN'S PROPOSAL DOES NOT INVOLVE ANY PREFERRED STOCK.

THIRD, THE MANAGEMENT PLAN CLEARLY VIOLATES THE DIVIDEND COVENANTS THAT
RFOLK SOUTHERN HAS ACCEPTED. BASED UPON CONRAIL MANAGEMENT'S OWN
PROJECTIONS FOR THE 1985-88 PERIOD, THE DIVIDEND COVENANT WOULD ALLOW A
TOTAL OF ONLY \$60 MILLION IN DIVIDENDS ON COMMON STOCK. THE MANAGEMENT PLAN
REQUIRES COMBINED COMMON AND PREFERRED DIVIDENDS OF \$126 MILLION PER YEAR,
AND IT WOULD REQUIRE INCREASED BORROWING BY CONRAIL OVER THE NEXT FOUR YEARS
OF \$422 MILLION.

FOURTH, THERE IS NO INDICATION OF A FIRM COMMITMENT BY MORGAN STANLEY & CO.
OR ANYONE ELSE TO UNDERWRITE THE MANAGEMENT PLAN. I HAVE ONLY BEEN GIVEN
ESTIMATES, OPINIONS, AND PREDICTIONS. IF THE MARKET IS UNABLE TO ABSORB
\$500 MILLION IN COMMON STOCK AND \$600 MILLION IN PREFERRED STOCK IN ONE
OFFERING, THEN EITHER THE GOVERNMENT OR CONRAIL WILL ABSORB THE SHORTFALL.
SINCE THERE ONLY HAS BEEN ONE INITIAL PUBLIC OFFERING OF OVER \$300 MILLION
BY AN INDUSTRIAL COMPANY IN AMERICAN HISTORY, THE RISK IS VERY LARGE. YET
THAT ONE OFFERING BY THE FORD MOTOR COMPANY IN 1956 HAD MANY ADVANTAGES A
CONRAIL OFFERING WOULD NOT HAVE.

FIFTH, DESPITE OPTIMISTIC ESTIMATES MADE BY SOME THAT WE CAN GET MUCH MORE
FOR CONRAIL THROUGH A PUBLIC OFFERING, THE MANAGEMENT PLAN ONLY PROPOSES TO
RAISE \$1.1 BILLION AT BEST. AGAIN, THE BALANCE IS TO BE PAID OUT OF
CONRAIL'S TREASURY.

IN CONSIDERING THE MARKET VALUE OF CONRAIL STOCK, WE MUST REMEMBER THAT
CONRAIL HAS A SHORT HISTORY OF PROFITABILITY. ALTHOUGH CONRAIL REPORTED
ABOUT \$500 MILLION IN EARNINGS LAST YEAR, MUCH OF THAT AMOUNT IS
ATTRIBUTABLE TO SPECIAL CONTRIBUTIONS OR BENEFITS CONFERRED BY THE FEDERAL

GOVERNMENT, CONRAIL'S EMPLOYEES, OR THE STATES DURING THE TIME CONRAIL HAS BEEN FEDERALLY OWNED. CONRAIL WOULD NOT EARN NEARLY AS MUCH IN PRIVATE HANDS, BECAUSE NONE OF THOSE CONTRIBUTIONS OR BENEFITS WILL BE AVAILABLE. CONRAIL PAYS NO STATE TAXES. THE STATES, THEREFORE ARE MAKING, IN EFFECT, A \$25-26 MILLION ANNUAL CONTRIBUTION TO CONRAIL'S PROFITS. CONRAIL PAYS NO LABOR PROTECTION. THE UNITED STATES MAKES THAT CONTRIBUTION TO CONRAIL PROFITS, RANGING FROM \$125 MILLION TO \$23 MILLION OVER THE LAST THREE YEARS. UNTIL LAST WEEK, CONRAIL PAID ITS WORKERS BETWEEN \$120 AND \$130 MILLION LESS THAN THEY WOULD EARN IF CONRAIL HAD BEEN AT NATIONAL SCALE; AND THAT GOES RIGHT INTO THE COMPANY'S PROFITS. CONRAIL HAS BEEN PAYING NO FEDERAL TAXES, AND THAT SAVING GOES TOWARD PROFITS, TOO. CLEARLY, CONRAIL WILL BE FAR LESS PROFITABLE IN PRIVATE HANDS THAN MIGHT APPEAR AT FIRST GLANCE.

IT IS OBVIOUS THAT THE COMBINATION OF CONRAIL AND NORFOLK SOUTHERN IS STRONGER THAN CONRAIL STANDING ALONE. CONRAIL ALONE CANNOT SHOULDER A MAJOR ACQUISITION DEBT OR NEW STOCK ISSUE.

I HAVE MADE WHAT I TRULY BELIEVE IS THE BEST RECOMMENDATION FOR A STRONG CONRAIL IN THE FUTURE. CONGRESS NOW HAS THE IMPORTANT ROLE TO PLAY. THE CONGRESS MUST WEIGH THE RECOMMENDED OFFER AND MAKE THE ULTIMATE JUDGMENT AS TO WHETHER IT SHOULD BE ACCEPTED. I WILL SHORTLY BE TRANSMITTING A LEGISLATIVE PROPOSAL TO THE HOUSE AND THE SENATE THAT WOULD MAKE THE TECHNICAL CHANGES NEEDED TO ENABLE THE SALE. OUR LEGISLATIVE PROPOSAL WILL ASSURE THAT CONRAIL WILL BE TREATED LIKE ANY OTHER PRIVATE-SECTOR RAILROAD; AND THE GOVERNMENT'S INVESTMENT AND ROLE IN CONRAIL WILL BE FULLY TERMINATED TO ASSURE WE DO NOT "RE-INHERIT" THE RAILROAD IN THE FUTURE.

I CONCLUSION, I URGE YOU TO ACT SWIFTLY TO EVALUATE THE PLAN AND TO REPORT THE LEGISLATION NEEDED TO CONSUMMATE A SALE. FOUR YEARS AGO, CONGRESS GAVE US THE OPPORTUNITY TO TAKE THE GOVERNMENT OUT OF A BUSINESS IT NEVER SHOULD HAVE BEEN IN, IN THE FIRST PLACE. I HAVE MADE THE UTMOST EFFORT TO FIND THE BEST POSSIBLE BUYER FOR THIS RAILROAD. IF WE UNDULY HESITATE, THIS HISTORIC OPPORTUNITY MAY BE LOST.

MR. CHAIRMAN, THIS COMPLETES MY PREPARED STATEMENT. I WOULD BE PLEASED TO RESPOND TO QUESTIONS YOU MIGHT HAVE.