

TESTIMONY OF JAMES C. ROONEY  
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BEFORE THE  
SENATE COMMITTEE ON THE JUDICIARY  
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Let me contribute to this proceeding by stepping back in time. I offer a narrative of the events which led to the bidding process in 1984 and to where we are today.

A critical juncture in Conrail's future was reached in 1981 when the Northeast Rail Service Act or NERSA was enacted by the Congress. After years of lackluster performance and mounting losses, in 1981 Conrail had taken its first halting step toward profitability, although only in an accounting sense, rather than a use sense since its profits were derived from the sale of assets under the so-called "safe harbor leases".

Congress determined that two courses of action were available--either to sell all of Conrail as an entity--a going enterprise--by divesting of the Government's stock interest or a demonstrably more draconian measure--to auction

off its lines and equipment piecemeal in a transfer of service. A time of testing was allotted, at the end of which the United States Railway Association was to make a determination of Conrail's prospects for long term profitability.

Against the backdrop of the regulatory freedoms granted by the Staggers Rail Act of 1980, which Conrail was utilizing to concentrate its traffic and shed unprofitable business, Congress took additional measures to unburden Conrail of the heavy mantle of costs it was carrying. For example NERSA provided that:

- o Commuter operations would be shed and placed in state and municipal hands.
- o Labor contracts could be renegotiated and all employees would work at reduced wages.
- o The Act made it easier for Conrail to shed excess employees and tracks, and
- o Conrail was exempted from state taxes until sold.

These ministrations and good management proved effective. On June 1, 1983, the USRA found in a positive, although heavily caveated report, that Conrail would be profitable. Given that Conrail was profitable, NERSA then required the sale of Conrail as an entity through the sale of the Governments 85 percent interest in its common stock and required that the Secretary develop and submit a plan that in the language of the Act:

- o ensures continued rail service;
- o promotes competitive bidding for Conrail's stock; and
- o maximizes the return to the taxpayer for the investment that has been made... .

These mandates and the prioritization of objectives which they dictate formed the framework for all of our subsequent undertakings.

Interest in purchasing Conrail developed slowly as Conrail shrugged off the effects of the recession. Its 1983 financial results became known and 1984 looked likely to exceed them by a wide margin. We and our investment advisor-- Goldman, Sachs and Company--held discussions with all the major railroads and over 100 large firms, partnerships, and individuals who would have the

resources to buy Conrail. As we now look back in time, we must remember that in 1983 a bidder's looking at Conrail in private hands did not see \$313 million in 1983 profits, but rather something nearer \$90 million with room for improvement in 1984.

1984 progressed, it became apparent that some interest in acquiring Conrail was being sparked. By spring of 1984, we had more than a half-dozen serious lookers. The first of these bids to become public was the initial bid received from Alleghany Corporation on April 10, 1984.

We consulted with Goldman, Sachs and they advised us that Alleghany's bid--for some \$1 billion initially--fell within the range of reasonable compensation. This bid could then be used to call other bidders to the table, and we effectuated the competitive bidding process by setting a deadline.

We were both pleased and surprised to receive a total of 15 bids on June 18th -- the deadline for bidding. As with any sampling of bidders, the bids ranged from very responsible, well-backed ones to the leveraged buyouts which have been in vogue, but to which we were predictably very cool.

It was then a matter of choosing the one best bid: To borrow a leaf from Secretary Dole's recent testimony to the Senate Committee on Commerce Science and Technology--to choose and recommend to you that sale plan that assured 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.

As the field narrowed to six bidders and then to three, we scrutinized each aspect of each bid. Financial capacity was examined by Goldman, Sachs. We were working to tighten and expand the covenants we would place on the buyer to assure high levels of plant investment, maximum service, and to prevent dissipation of cash resources. We consulted continuously with Treasury to ensure that what we and the bidders were contemplating was consistent with Treasury's views and the mission of the Internal Revenue Service to administer and enforce the federal income tax laws.

Finally, and very much to the point of today's proceeding, as it became apparent that Norfolk Southern might be a "finalist" we studied the competitive implications of that choice--were it to be made.

Our internal studies in most cases preceded the referral to the Justice Department. They proceeded along three main courses of inquiry.

- o We were interested in knowing the geographic scope of potential problems: that is, where competition was reduced by the loss of one of two or more competing carriers.
  
- o We looked at the gateways at which NS lines met Conrail lines and where other carriers were competing.
  
- o We also examined the generalized hypothesis of bigness per se as a bar to NS' continued candidacy.

Norfolk Southern's current operations, viewed now in terms of traffic tonnages not miles of track, are heaviest along a trunk which is oriented north-south in Ohio along a line running from Portsmouth and Cincinnati northward to Columbus and Lake Erie. The branches emanating from this trunk are

healthier toward the southwest, but the effects of the final system plan railroad restructuring and regional traffic shifts have taken their toll on the branches facing eastward. By virtue of these changes, a number of NS lines which had served its predecessors well in an era when they handled interterritorial traffic were now handling much less traffic. In the Buffalo-Cleveland corridor, for example, NS' market share had fallen to 10 percent of the traffic moving there.

The benefits and detriments of a merger of NS and Conrail can be argued from either the generalized perspective (i.e., bigness per se) or from the particular, (i.e., the effect on specific markets, traffic lanes, and ultimately shippers.

While NS+CR would be larger in physical terms:

<u>Physical Measures</u>	<u>NS+CR</u>	<u>CSX</u>
Miles of Track	66,881	44,697
Locomotive Owned/Leased	6,159	4,093
Cars Owned/Leased	259,560	213,085
Employees	77,550	56,092

Norfolk Southern-Conrail and CSX would be more nearly in balance with respect to indicia of activity such as the tons of traffic each would handle, the carloads they would carry, and the revenue ton miles (the product of the weight of lading in tons and the distance the lading is transported in miles) each system would generate.

	<u>NS-CR</u>	<u>CSX</u>
Tons (millions)	426	412
Carloads (millions)	6.6	6.0
Revenue Ton Miles (Billions)	154	124

We examined those locations--or stations--which absent divestitures would no longer receive multiple carrier service, and we found 34 points. These points and markets were a virtual overlay for those later found within the divestiture region by the Department of Justice.

Based on our preliminary analysis, we determined that, absent any divestitures, the problems associated with Norfolk Southern's acquisition of the Conrail lines and the attendant loss of multi-carrier service were limited in scope to fewer than one percent of the cars moving in the region.

We became increasingly convinced that Norfolk Southern's competitive presence north of the Ohio River did not loom as large as we had initially thought. Neither did the issue of bigness per se lead to the creation of an overwhelming juggernaut in the east and, in fact, CSX would remain relatively stronger than the combined NS-Conrail in the faster growing Southeast. Most importantly it began to appear to us that, at least within the region, competitive problems were being isolated in clusters which might be remedied by an organized, interconnected system of lines rather than finding that problems were so dispersed that no logical set of lines could remedy them.

In early September 1984, we transmitted the matter of Norfolk Southern's acquisition of Conrail to the Department of Justice, to be subjected to their independent scrutiny,

while we continued to negotiate with all three remaining bidders to bring their proposals into conformity with the conditions we and the Department of Treasury were placing on matters other than those relating to competition.

Five months later, at the end of January 1985, the Department of Justice released its analysis of the competitive implications of the proposed sale and produced with it a set of asset divestitures which had to be accomplished in order to remedy the perceived competitive harms and remove its opposition. Norfolk Southern has agreed to be bound by the Department of Justice's strictures and has, as you know, reached agreements in principle with Guilford and Pittsburgh and Lake Erie to convey those lines necessary to cure the competitive problems which Justice found.

As I stated earlier, we have been guided throughout this process by the enacted statutes. Nevertheless, some questions have been posed and concerns raised about our referral of this matter to the Justice Department and about other provisions of the Memorandum of Intent and the proposed legislation.

o The Congress, not the Department of Transportation, spoke clearly and directly to the issue of administrative and judicial review. Section 408(c) of NERSA states unambiguously that no transfer of stock etc., shall be subject to judicial review or to review by the Commission.

o Our referral to Justice and the language presented in the Senate bill are consistent with that directive.

- The Antitrust Division has a well staffed, and independent Transportation Division which routinely participates in ICC cases and scrutinizes mergers of unregulated transportation companies. Our conviction about their impartiality led us to refer the matter to them for resolution. The very wording of their report gives lie to the claim that they proposed to act as mere counselors. A mere counselor does not begin his report to the client with a statement of flat opposition unless his conditions are followed to his complete satisfaction.

- The proposed Senate bill language comports with Congressional intent as expressed in NERSA in that it contemplates affirmative, implementing legislation--leaving the matter of acceptance of the Secretary's recommendation entirely within the volition of Congress.
  
- Once the Congress completes its deliberations and enacts a law, only the sale, the Justice Department divestitures, and the coordination of railroad operations would be immune from review.
  
- These provisions are directly analogous to a railroad merger when conditions are imposed on the merger by the Commission, and are consistent with Section 408(c) of NERSA. This effectively adapts the immunity granted in NERSA to the facts of this sale.
  
- o Finally, there is the allegation that the proposed transaction would seriously undermine the pro-competitive Staggers Act reforms of 1980 by causing Conrail/NS to maintain or re-establish joint rates with small Eastern Railroads and that re-regulation may also result from Justice's prescription that the merged company provide access to other rail carriers so the latter may serve shippers located in markets they do not now reach.

For Consolidated Rail Corporation to come before this and propose that the pro-competitive provisions we and Department of Justice inserted contravene the Staggers Act and invade shipper prerogatives is a serious misconstruction of our intentions and of current events. Mr. Chairman, the facts are these:

- The Association of American Railroads, acting for and on behalf of the Nation's railroads, has just reached accords with a number of shipper's organizations to produce exactly the same results intended by the insertions here. Those accords have been submitted to the ICC to obtain its blessing and the immunity that would confer.
  
- The Commission itself had already concluded it would no longer permit wholesale rate cancellations and gateway closings to occur without intense scrutiny.
  
- Finally, Mr. Chairman, you are about to hear from a group of shippers who will speak for and against this sale proposal. I would speculate that none among them would tell you it would damage their interests to have regional carriers afforded the opportunity jointly to participate in their traffic or to have an additional carrier access their origin and destination shipping points.

Mr. Chairman, that completes my testimony. I would be happy to attempt to answer any questions the Committee may have.