

CONRAIL'S FUTURE

The chairman of Consolidated Rail Corporation is leaning toward a public offering of the federal government's 85% stake in the company.

Opinion by L. Stanley Crane

Our evolving experience over the last 8½ years with Consolidated Rail Corporation demonstrates clearly that government intervention to preserve a pivotal sector of private enterprise – in this case the rail transportation infrastructure of the Northeast and Midwest – can be successful. Success came with substantial government investment, legislative changes (both in the regulation of the railroad industry and to spur needed Conrail structural changes), and employee sacrifices. All helped lead to Conrail's current profitable status.

By now, the Conrail story has been well-documented in the news media and for the public record.

Conrail's story was born out of the domino-like bankruptcies of the major Northeastern and Midwestern rail systems in the late 1960s and early 1970s. As the ashes of the bankrupts smoldered, the government, the railroads themselves, and shippers all recognized the critical rail transportation role these roads played in the national economy. Virtually all parties to the problem agreed that the service had to be preserved. Government intervention and the creation of Conrail was the course chosen. Conrail, with a plan in hand and government investment funds to spend for rehabilitation, launched its operations April 1, 1976.

After five years of hard work, the physical structure (track and rolling stock) had been substantially fixed, but cumulative losses totalled \$1.5 billion. Conrail management and others then confronted the structural problems that made Conrail a money-loser and sought corrective actions needed for a financial turnaround. The result: Conrail employ-



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ees agreed in 1981 to a wage increase concession plan, which demonstrated employees' commitment to making Conrail viable, and in turn proved to be a forceful argument with Congress leading to the passage of the Northeast Rail Service Act (NERSA) of 1981. NERSA permitted Conrail to eliminate from its system unprofitable branch lines; transfer money-draining commuter service obligations to other operators; and reduce its work force in line with traffic levels.

Conrail's success also was the result of another action by Congress – the Staggers Rail Act of 1980. The Staggers Act freed the railroads to market their services in innovative and competitive ways. Antiquated and burdensome regulation – which had denied to railroads the opportunity to earn adequate revenues – was lifted. Conrail and the other U.S. railroads can now compete effectively for traffic, responding promptly to

shipper needs and marketplace challenges. Conrail's financial resurgence is testimony to the vitality and competitive spirit which Congress sought to unleash in passing the Staggers Act.

Through a combination of management taking aggressive Staggers Act and NERSA initiatives, responsible labor willing to make contributions, and timely reforms made possible by enlightened legislators and others, Conrail today demonstrates profitability comparable to other large private-sector railroads in the country.

(In 1981, Conrail earned its first-ever annual profit of \$39 million. In 1982, Conrail's annual net income was \$174 million. In 1983, the railroad earned \$313 million – its highest annual income to date – and for the first six months of 1984, Conrail recorded net income of \$269.8 million. Conrail is projecting a net income for 1984 of between \$450 and \$500 million.)

Conrail's 1983 income of \$313 million came almost exclusively from railroad operations – our only line of business. Many other railroads or railroad holding companies' bottom-lines are attributable in significant part to nonrail business. The fact that our earnings compare so favorably to others in our industry is a source of personal pride for me, and it's a tribute to the dedication and professionalism of our employees. More importantly, it demonstrates Conrail's ability to "go it alone" in a marketplace which has determined that there is a need for Conrail and its service.

Conrail's financial and service accomplishments in the past 3½ years triggered the present phase of

its existence: the government, represented by the U.S. Department of Transportation (DOT), is engaged in an effort to sell its 85% ownership interest in Conrail (15% is retained by employees through an Employee Stock Ownership Plan) and return Conrail to private ownership. The DOT, through solicitation, received bids to acquire Conrail from 15 interested parties in June this year, and on September 11, stated that it was continuing discussions with three: Alleghany Corporation; a group of investors headed by hotelier J. Willard Marriott; and the Norfolk Southern Railway.

Recently, members of the U.S. Congress, including Pennsylvania Senators John Heinz and Arlen Specter, and Congressman Thomas Foglietta, among others, have urged

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Transportation Secretary Elizabeth Hanford Dole to look at another approach: to consider the advantages of a public offering of the government-held Conrail common stock.

Whichever direction Conrail takes, the lessons of the past must be learned to secure a viable future. Regardless of which sale scenario transpires, Conrail needs to be left with these important tools:

- Conrail must be allowed to operate like other businesses, without regulations that stifle necessary competitive actions. That means, among other things, that Conrail must have the freedom to price its service.

- Conrail must retain the ability to make decisions bearing on the corporation's viability.

I believe that Conrail's employees should share in the company's success – this could be in the form of increased employee stock owner-

Crane, left, discusses railroad operations with Alan F. Duncan, superintendent of Conrail's Harrisburg Division, during a recent inspection trip. Crane makes numerous trips to all parts of the Conrail system each month to inspect track and facilities on the 15-state rail network.

ship. But new contracts with rail labor should not undermine Conrail's ability to react to competitive pressures and to utilize advancing technologies, or undermine Conrail's viability by requiring labor costs that the company's revenue levels cannot support.

Having said all of this, there is still the basic question of which avenue gives a maximum assurance that Conrail can be a viable entity over the long term. The avenue, of course, would also meet the key goals of the DOT in a Conrail sale, which are: 1) leaving Conrail in the strongest financial condition after a sale; 2) a solution which best preserves service to the states and shippers Conrail serves, and 3) consistent with these two criteria, a solution which provides the maximum return to the taxpayer.

Questions remain about all of the possible options, including those chosen by the DOT as finalists. The DOT is proceeding with evaluation of the finalists in a prudent and deliberate manner. In her September 11 announcement that she had narrowed the list of prospective Conrail buyers to three finalists, Transportation Secretary Dole stated, "I am now taking the next step, which is to ask the Justice Department to review the competitive impact of the Norfolk Southern offer, and the Treasury Department to review tax or financial questions raised by any of the three." Mrs. Dole went on to say: "I will move the process as rapidly as possible to determine the final bidder. But, as I have said before, there is no artificial deadline. I will make a recommendation to the Congress as soon as I am satisfied that the criteria for a successful sale have been met."

Sen. Heinz noted in a September 25 letter that "since the rail freight business undergoes major ups and downs with the business cycle, sur-



vival in the industry requires an enduring and profound institutional commitment to being – and wanting to remain – in the railroad business. Leaving aside the Norfolk and Southern [sic] Railroad, the question I must ask is whether anyone on 'the short list' has a commitment or corporate strategy that makes a lasting place for operating a railroad significantly important to the purchaser's long-term future."

In a September 7 letter to Mrs. Dole, Sen. Specter questioned what he called "the relatively low offers which have been received considering the value of Conrail's assets."

As to the Norfolk Southern interest in acquiring Conrail, I have noted in the past my very real concern that such an acquisition would reduce railroad competitive service to shippers and probably result in a substantial reduction of jobs.

Within the context of the bids made, it is important to consider how much Conrail may really be worth and the interest of the potential buyers. Conrail's sale to the "wrong" party – someone having, as Sen. Heinz puts it, "... a middleman's interest in buying then reselling Con-

rail at the earliest date allowed. . . " — would prove counterproductive to the government's goals.

As to Conrail's value, by the end of 1984, we expect to have cash or cash equivalents of at least \$800 million. The company had total assets of \$5.7 billion at the end of 1983 and has an equity book value of \$3.5 billion. If in fact the Conrail debt to the government is forgiven (which, in the DOT scenario, would be offset by the surrender of tax-loss carry-forwards by the purchaser), our debt to equity ratio would drop to 22%, pro-

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viding substantial debt leverage for a purchaser of Conrail. Earnings and cash flow would allow the ability to recover a purchase price of \$1.2 billion rather quickly from Conrail. Additionally, a buyer would acquire the ability to borrow substantial sums against Conrail's credit rating and lean toward the use of debt rather than equity for financing. This would create a future burden for Conrail. Finally, the tax treatment of a buyer is uncertain. It is possible that income tax obligations of a buyer could be reduced or virtually eliminated for several years after purchase.

Given the concerns raised by offers being reviewed by the DOT, it is not surprising that members of Congress and others have begun seriously considering a public stock offering in which interested parties could participate.

Sen. Heinz, in his September 25 letter, said "There are many advantages to a public offering, including simplicity, effectiveness, expeditiousness, and equity. Among the numerous virtues of a public offering is the fact that wide dispersal of Conrail stock will avoid the kind of ill-advised concessions often required

in private negotiations with interested parties." He went on to state: "A public dispersal of Conrail stock will virtually guarantee the continuation of Conrail's current policies and the continuity of management, operations, maintenance, employment, service, and competition. These are not ends in themselves, but they do mean that shippers will benefit from continued levels of service and retention of progressive pricing policies; and that employees will be given stable employment, and a greater sense of participation in Conrail's growth and success. Furthermore, the Commonwealth of Pennsylvania will remain host to the Conrail Headquarters, and will retain the jobs, taxes, and industry which will result from the continued use of its shops and facilities."

Sen. Specter said of a public offering: "A public offering would have the significant advantage of returning Conrail to private ownership while maintaining Conrail's management which has been so successful and which has been very solicitous of shippers' interests and the public's welfare generally."

All other major freight railroads in this country-comparable in size and earnings to Conrail-operate successfully as publicly traded companies, with independent management and independent boards of directors.

Ultimately, a consensus will be reached by the key parties to the process. That consensus will be the vital ingredient in determining the form of a Conrail sale. But the important things to remember are:

- Conrail has proven that it can survive and thrive in the marketplace.

- Its management and employees are seasoned professionals and they have made the necessary sacrifices to reach this point. They *have* learned the lessons of past failures.

- Conrail's shippers continue to be highly satisfied with our service and our willingness to compete for their traffic with innovative ideas.

Conrail's success to date lays an important foundation for its private-sector future. Our success is a starting point for building further. I am confident that all the parties to the sale process recognize that fact, and are being guided by it as decisions are made on how best to move Conrail into the private sector. **CM**



L. Stanley Crane, (left), makes a point concerning Conrail's freight transportation by using a computer printout during an inspection tour. Listening to Mr. Crane's explanation are Robert E. Hatton, (center), general manager of Conrail's Western Region, and Richard B. Hasselman, (right), senior vice president—operations.

CONRAIL IN PHILADELPHIA

Consolidated Rail Corporation (Conrail) plays a vital economic role as one of the largest employers headquartered in Philadelphia, as well as a major force as a freight transportation company. Therefore, the federal government's decision regarding how the railroad will return to the private sector will have an important long-term impact on industrial and economic development in the Delaware Valley.

To the regional economy, Conrail makes important contributions by providing vital freight service to shippers and making significant cash outlays for its local payroll and for materials purchases from area vendors. In 1983, Conrail paid more than \$194 million in wages to Delaware Valley area employees. As of mid-March 1984, Conrail employed more than 6,400 workers in the area

—most of them in Philadelphia, with others at various locations from Trenton in the north to Wilmington in the south.

Conrail provides the freight rail service infrastructure supporting a significant portion of the region's commerce. The sprawling 14,200 route-mile railroad system has operations in 15 Northeast and Midwest states, the District of Columbia, and two Canadian provinces. Last year, Conrail hauled about 598,300 carloadings of rail traffic into and out of Delaware Valley and eastern Pennsylvania areas (almost 38.5 million tons of merchandise, bulk commodities, chemicals, steel and automobiles) that generated \$660.2 million in revenue for the railroad.

Conrail's corporate headquarters is located at Six Penn Center in center city Philadelphia. Its complex

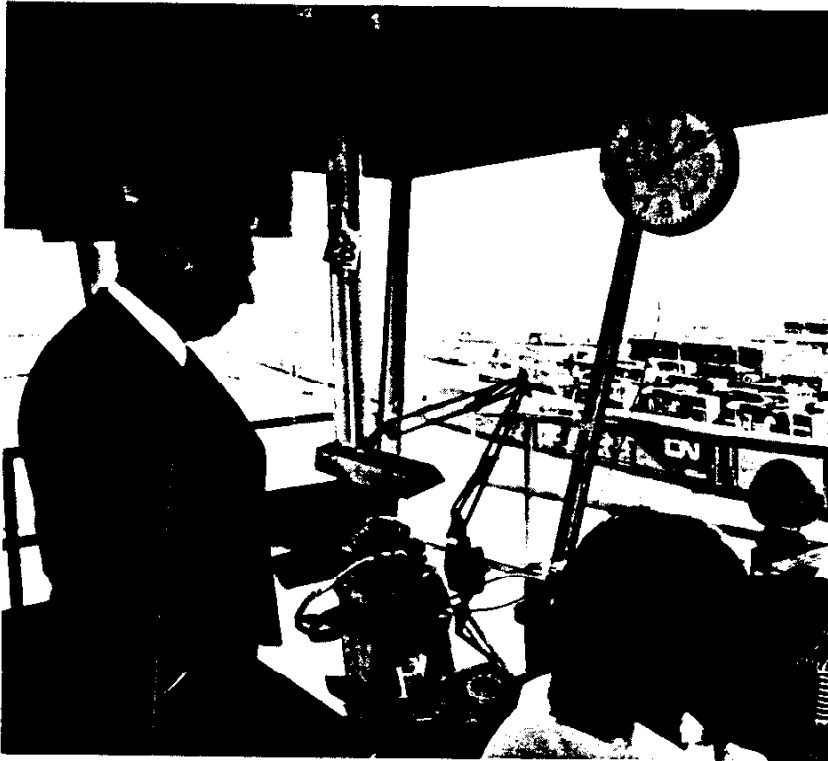
there houses a number of corporate personnel, and is also the home of Conrail's System Operations Center — called the "Blue Room" because of its distinctive paint scheme — where locomotives and trains are directed and monitored across the Northeast quadrant of the nation 24 hours a day. Other corporate offices are located at 15 N. 32nd Street and at 1528 Walnut Street. A regional freight car management center, which monitors and forecasts customer demand for freight car needs, is also located at 1528 Walnut Street.

While the "Blue Room" at Six Penn Center oversees systemwide train operations, Conrail's Eastern Region and Philadelphia Division offices supervise regional and local operations from offices in Philadelphia. The Eastern Region, with offices at 30th Street Station, is one of five operating regions on the Conrail system. The Eastern Region has jurisdiction over the Philadelphia, Harrisburg, and New Jersey Divisions, which together control Conrail operations in New Jersey, Delaware, Virginia, Maryland, and Washington, D.C., as well as eastern Pennsylvania, the Martinsburg, W. Va., area, and along the west shore of the Hudson River in New York State. The Philadelphia Division, with offices in the Delaware River Port Authority Administration Building at 3460 N. Delaware Avenue, near the Tioga Marine Terminal, supervises train operations in southeastern Pennsylvania, southern New Jersey, Delaware, and the eastern shore of Maryland.

While Conrail's corporate headquarters and employee presence in the Delaware Valley are important, so are the facilities and services the railroad offers in support of the area's commerce, particularly for the Port of Philadelphia.

Conrail in the Port

Conrail maintains extensive rail facilities in the Port area, which enable it to serve Port users efficiently with competitive transportation packages.



Crane observes freight cars from the control tower of Conrail's Elkhart (IN) Yard, a key hub for east-west traffic.

Conrail and the Commonwealth of Pennsylvania jointly funded \$41 million worth of improvements at Pier 124 in South Philadelphia that nearly tripled the pier's coal-handling capacity to about 10 million tons annually, and allows Pier 124 to load larger, modern coal-carrying ships. Conrail has aggressively marketed its export coal capacity with rate reductions and loading-time guarantees.

Pier 122, next to Pier 124, has the capacity to off-load about eight million tons of ore a year from vessels, and can handle two vessels simultaneously. Its principal user is a steel manufacturer that imports iron ore.

Conrail serves Piers 124 and 122 and other cargo piers south of Penn's

Landing through its Greenwich Yard facility, which has a capacity of 1,350 freight cars.

Conrail delivers export grain traffic to Tidewater Grain Company at Girard Point on the Schuylkill River, moves imported South American cocoa bean traffic from Philadelphia to inland points, hauls butter from all over the United States to Philadelphia for export, and handles paper products and automobile parts for export through Philadelphia.

The Packer Avenue Marine Terminal has direct rail access via sidings connected to Conrail's Greenwich Yard in South Philadelphia. Conrail can also deliver or receive container-on-flatcar (COFC) carloads at dockside at Tioga Marine Ter-

minal, and Northern Shipping Terminal. Philadelphia is the only North Atlantic port with direct Conrail access to its container ship piers, a feature which eliminates drayage costs. Conrail also serves additional Philadelphia pier facilities and piers in Camden and Gloucester City, N.J., and Wilmington, Delaware.

To achieve maximum efficiency in its "piggyback" freight operation, Conrail in mid-October 1982 opened a new Delaware Valley intermodal terminal in Falls Township, Bucks County. The \$7.4 million terminal handles six of Conrail's high-speed TrailVan trains daily. ("Piggyback" or intermodal freight refers to truck trailers or marine cargo containers carried on railroad flatcars.)

Conrail operates Flexi-Flo bulk commodity transfer facilities at Oregon Avenue near Front Street and at Girard Point at 26th Street and Penrose. Conrail invested \$1 million to expand and renovate the two facilities in 1979 and 1980. Flexi-Flo offers economical transfer of such commodities as powders, grains, plastic pellets and liquids between rail cars and either trucks or marine containers.

Conrail can now move oversized loads (the so-called "high-and-wide" shipments) destined for export via Philadelphia to the Chessie System's East Side Yard, near 31st and Wharton Streets, where shipments can be interchanged with the Chessie. Chessie can transport the cars to Pay Yard, near Delaware Avenue, where the cars can be turned back to Conrail for final delivery to the Packer Avenue Marine Terminal. Large dimension import shipments can be handled by the same routing, in reverse. Engineering work by the two railroads to establish the "high-and-wide" route was funded by the Philadelphia Port Corporation. **CM**