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U.S. Department
of Transportation

**Federal Railroad
Administration**

Recommendations for Northeast Rail Service

March 31, 1981

The Secretary of Transportation

Washington, D.C. 20590

March 31, 1981

The Honorable George Bush
President of the Senate
Washington, DC 20510

The Honorable Thomas P. O'Neill
Speaker of the House of Representatives
Washington, DC 20515

Dear Mr. President:

Dear Mr. Speaker:

The Department of Transportation has prepared this report on the future of rail services in the Northeast in response to the requirements of Section 703 of the Staggers Rail Act of 1980. The Act called for the Department to present initial recommendations at this time and its final recommendations and comments on companion reports of the United States Railway Association and Conrail by May 1, 1981. To provide Congress with timely proposals, the Department has expedited its schedule and is offering recommendations and comments in this report.

In preparing this report, the Department has been guided by an overriding commitment to continuing and improving rail freight service in the Northeast in areas now served by Conrail. I am today recommending to the Congress, on behalf of the Reagan Administration, a solution to problems which will accomplish that continuation and improvement. The solution is possible, practical, and it is consistent with our goal of removing the Federal Government from the railroad business.

To achieve these goals, we are first proposing the resolution of certain problems unique to rail service in the Northeast -- commuter services, labor protection and freight terminal operations. We believe these problems must be resolved to pave the way for a restructuring of the freight rail system.

We will shortly submit legislation that will:

- Separate commuter operations along the Northeast Corridor from freight operations, so as to remove that burden from the freight system and to continue those vital services by passenger-oriented agencies;

- Reform labor protection provisions to provide equitable levels of protection for affected employees, including severance payments, retraining assistance, and hiring priorities for other jobs in the railroad industry; and

- Restructure operating responsibilities for the Northeast Corridor itself, with its mix of freight, intercity, commuter and freight services particularly freight terminal switching operations.

Once these problems are addressed and legislation enacted, we believe the integration of Conrail's physical plant into the national railroad system is the best way to maintain and improve freight service in the Northeast. We are proposing to accomplish this through private ownership by transferring major portions of Conrail's lines to other railroads.

The transfer of lines and services to other railroads will provide important benefits to the economy and shippers in the Northeast, including high-quality service, cost savings from streamlined operations, restoration of long-haul competition, employment of railroad workers under collective bargaining agreements of acquiring carriers, and full participation by rail shippers of the Northeast in the dynamics of the railroad industry.

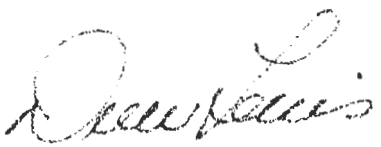
Transfer of Northeast rail lines to profitable railroads has been regarded as an attractive idea in the past, but a handful of unsolved obstacles has prevented its serious consideration. The Department's legislation will eliminate those obstacles to the purchase of the railroad properties by offering fair and thoughtful solutions.

Some propose to give Conrail another chance. They suggest that with unprecedented concessions from labor, untested operating changes, and further Federal funding, a profitable Conrail might some day emerge. I do not accept this speculative and expensive proposal, nor the delay in reaching a permanent solution. No matter how starkly economized, any independent Conrail organization would continue to be a marginal operation, isolated in the Northeast, owned by the Government, and consuming hundreds of millions of Federal dollars. And if Conrail and USRA cannot achieve their labor concessions and efficiences, the cost to the Federal Treasury of a continued Conrail could easily approach $4 billion by 1985. We believe that is a cost the federal government can ill afford.

The nation deserves a better outcome, and now is the time for action to achieve it.

The opportunities available today are too great to overlook. They beckon our pursuit no less than the option of continuing subsidy repels it. We need not accept limp-along nationalization when a private-sector solution is possible. Now is the time to take an entirely new direction--a clear path, true to our fundamental principles, leading directly to our goals.

Sincerely,



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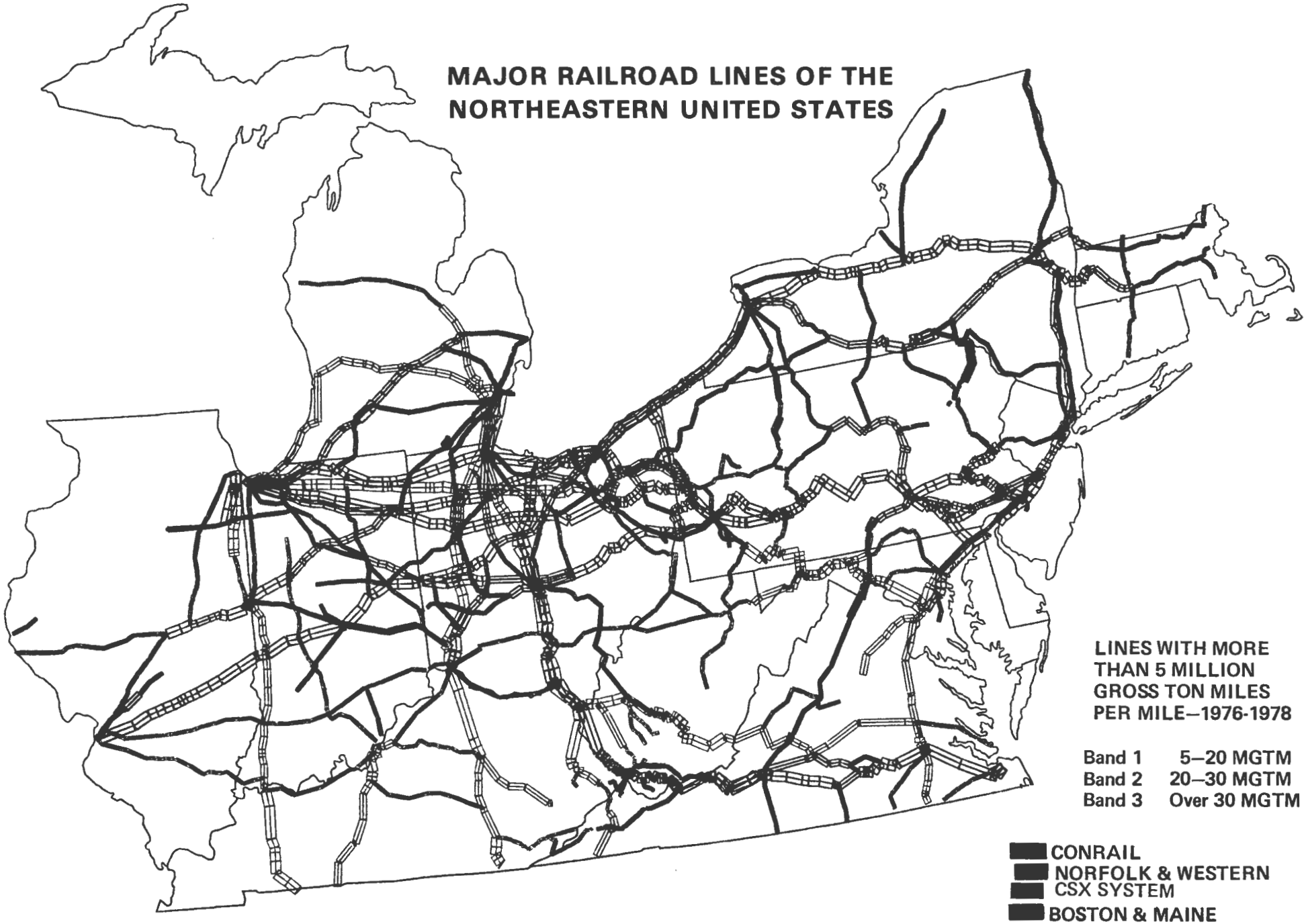
The following firms and individuals assisted the Department in the preparation of this report: Peat, Marwick, Mitchell & Co., Transportation and Distribution Associates, Inc., Railroad Management Services, Inc., Transport Consulting, Ltd., Ernst & Whinney, and Mr. William Richmond.


MAJOR RAILROAD LINES OF THE
NORTHEASTERN UNITED STATES
LINES WITH MORE
THAN 5 MILLION
GROSS TON MILES
PER MILE—1976-1978
Band 1 5—20 MGTM
Band 2 20—30 MGTM
Band 3 Over 30 MGTM
CONRAIL
NORFOLK & WESTERN
CSX SYSTEM
BOSTON & MAINE
GRAND TRUNK WESTERN;
DETROIT, TOLEDO &
IRONTON;

I. THE SOLUTION TO NORTHEAST RAIL SERVICE

In this report, the Department of Transportation has been guided by one overriding consideration: a firm commitment to continued and improved rail service in the Northeast in the areas presently served by Conrail.

In order to achieve that goal, the Department is proposing to address the problems unique to the Northeast region--commuter service along the Northeast Corridor, labor protection, and freight terminal costs--which currently burden the freight services provided by Conrail. These matters should be resolved separately and apart from the question of rebuilding efficient rail transportation, so that they will not impede resolution of the Northeast rail service problem.

The Department will propose legislation which will separate them from the process of reestablishing efficient freight service in the Northeast. This legislation will:

- Separate passenger and commuter services along the Northeast Corridor from the concerns of freight operations;
- Reform the labor protection provision to provide equitable support to affected employees including severance payments, retraining assistance and priority hiring status for other jobs in the rail industry; and
- Restructure operating responsibilities for the Northeast Corridor itself, with its mix of commuter, intercity passenger and freight services (particularly terminal freight switching operations).

Once these problems are addressed and corrective legislation is enacted, then the integration of Conrail's physical plant into the national railroad system is the best way to maintain and improve freight service in the Northeast. The Department believes this can be accomplished best through private ownership by transferring major portions of Conrail's lines to other railroads (as discussed by Conrail in Chapter 11 of its report).

In the past, little serious consideration has been given to service transfer solutions to the Conrail problem because of the impediments identified above. The Department's analysis, confirmed by conversations with major railroads, has determined that resolution of the impediments assures substantial interest in acquiring Conrail's lines--the traffic contributes some $2.6 billion in revenues to other railroads. Moreover, the condition of the track on which much of that traffic moves ranks among the finest railroad facilities in the United States.

The Department's approach provides the best opportunity to achieve real and permanent solutions to the identified problems of Conrail because:

- The integration of Conrail's physical plant into the national railroad system will provide the best way to maintain and improve freight service in the Northeast, and the proper role of the Department of Transportation is to be the catalyst to assure freight service on the lines now operated by Conrail.

- Employees affected by railroad restructuring will be assured equitable levels of protection, including severance payments, retraining assistance, and priority hiring status for other jobs in the railroad industry. Work rules will continue to be set by collective bargaining between labor and management, rather than by the unilateral labor concessions called for by Conrail and USRA.

- Commuter services now operated by Conrail will be assured of continuation by passenger-oriented agencies, while the freight railroads will be relieved of that burden and can concentrate on improving services to shippers.

The Department is proposing to the Congress an action plan. This plan involves resolution of impediments and the voluntary acquisition of Conrail's lines and services by private sector railroads in the East and the West. These railroads would denationalize Conrail's services and lines and make them productive elements of a financially stable railroad system.

INITIAL STEPS NECESSARY FOR A SOLUTION

The Department has carefully considered the problems confronting the Northeast railroads and has determined that three of the problems should be addressed immediately. These problems are a burden to Conrail and present an absolute barrier to the integration of its lines with the Nation's railroad system. This section discusses the Department's solution to these problems.

Commuter Service

Profitable railroads will not assume responsibility for operating commuter services. The diversion of management resources and the uncertainty of reimbursement by local commuter authorities, which have been significant problems for Conrail and its precedessors, are absolute barriers to potential acquisitions by other carriers. No railroad will assume this problem.

The Department recommends that commuter service in the Northeast be operated by one or more passenger-oriented entities, not by freight railroads. There are several options available for implementing this recommendation. Each focuses on the critical,

central point that passenger services should be operated by a full-time passenger management. In addition to removing an impediment to the solution of the Northeast freight problem, this new structure permits improved responsiveness to local commuter authorities' needs. Another principal advantage is the ability to deal with labor issues in a "passenger only" context. In rail freight, the types of issues to be negotiated and resolved are quite different from those that are relevant in passenger service. The separation of the two services would allow the commuter authorities to negotiate directly on those issues which concern them. The commuter issue is discussed in Appendix B.

Labor Costs

A solution for the large number of Conrail employees and the high cost of labor protection under Title V of the Regional Rail Reorganization Act of 1973 (3R Act) is a central part of the service transfer plan. Under existing labor arrangements any employment reductions that Conrail or a successor line makes would be offset by Title V labor protection payments. Savings from the abandonment of unprofitable lines also would be offset by Title V liabilities or other protective conditions. Other railroads simply will not assume the large numbers of Conrail employees currently involved in providing Conrail's service, nor will they assume responsibility for the Title V labor protection payments.

The financial risks of these levels of protection would outweigh any benefits of acquisition. Conversely, it is not appropriate for the burden of lifetime labor protection to be paid by the taxpayer. Accordingly, the existing Title V labor protection provisions should be repealed and replaced by labor protective arrangements based on the concepts embodied in the Milwaukee Railroad Restructuring Act and the Rock Island Transition and Employee Assistance Act.

Protection should include one-time compensation for employees who lose their jobs and incentives for workers to relocate to other railroad positions. Employees offered employment by acquiring railroads should be given a reasonable wage guarantee over a specific period of time by the acquiring carrier. Acquiring carriers and labor would be expected to negotiate an agreement, similar to what was done in the Midwest restructuring process, which would govern the manner in which employees would be hired, their wage guarantee, and the work rules under which they would work. A more complete discussion of the labor issue can be found in Appendix C.

Terminal Freight Services in the Northeast Corridor

The reluctance of profitable railroads to accept entrepreneurial responsibility for terminal operations in and adjacent to the Corridor, between Wilmington, Delaware and the New York-New Jersey port area, has been an impediment to transferring these operations. The Department can offer incentives

for railroads to acquire these terminals. If railroads do not acquire them, a separate entity, either a Corridor service authority or a separate freight terminal company, could operate the freight terminals, providing switching services on a cost-recovery basis. Because the Government is already paying for much of the infrastructure in the terminal areas through its funding of Amtrak and its acquisition of Northeast Corridor facilities, the terminal company's cost structure would be different from that of other terminal switching railroads in the country. The Corridor freight terminal company would be able to operate on a cost-recovery basis by charging the railroads its full operating costs.

THE INTERESTS OF THE OTHER RAILROADS

The principal question associated with the transfer of Conrail services has been whether other railroads would be willing to participate. The rail crisis in the Northeast is as much a railroad industry problem as it is a Government problem, and the railroad industry must be part of the solution. With the three impediments (passenger service, terminal operations, and labor protection) removed, there are no remaining barriers to other railroads' participation. In fact, it is in the railroad industry's self-interest to participate.

Those railroads that realize significant revenue from traffic interchanged with Conrail will be motivated to action by a desire to protect their existing revenue base, particularly if the Government makes clear that it will no longer support Conrail for their benefit.

The Department analyzed the revenues earned by other railroads on Conrail interchange traffic. In 1979, the ten railroads with the largest Conrail interchanges earned revenues of $2.1 billion on that traffic, about 9 percent of their total gross revenues. These are shown in Table I-1. Among these railroads, three operate in the East, two are Canadian carriers, and five are western railroads. Together with Conrail's share, this traffic generated $3.5 billion in gross revenues. Another $500 million in revenues went to railroads other than the ten listed in the table.

The western railroads make heavy use of the Conrail network. The major Western District railroads have $1.1 billion in their revenue share at stake, while the major Eastern and Southern District railroads have $700 million of their own revenues at risk.

Figure I-1 depicts the 1979 volume and routings of traffic interchanged between Conrail and the major eastern railroads, CSX (the merged Chessie and Family Lines Systems) and Norfolk and Western/Southern Railway (analyzed as a unit because of their pending merger application). Figure I-2 depicts the same data for the western railroads, Union Pacific/Missouri Pacific/Western

Table I-1

TRAFFIC INTERLINED BETWEEN CONRAIL AND ITS CONNECTIONS, 1979

Connecting Carriers*	Interline Revenue to Conrail $ Millions	Interline Revenue to Conrail Percent	Interline Revenue to Connections $ Millions	Interline Revenue to Connections Percent	Total Interline Revenue $ Millions	Millions of Tons	Revenue Per Car-Mile Conrail Portion (Dollars)	Estimated Length of Haul (Miles)
CSX	331.9	42.6	446.6	57.4	778.6	41.0	1.95	582
UP/MP/WP*	202.5	36.9	346.2	63.1	548.5	10.8	1.41	1,635
SP/SSW	158.1	32.2	332.8	67.8	490.9	6.8	1.41	2,148
NWS*	193.3	43.7	249.0	56.3	442.3	18.6	1.92	652
BN/SLSF	109.9	40.5	161.1	59.5	271.0	5.4	1.34	1,472
CN	69.3	31.9	147.8	68.1	217.1	5.4	2.48	859
ATSF	98.3	34.2	189.2	65.8	287.5	4.5	1.16	1,853
CP/SOO	61.8	36.6	107.1	63.4	168.9	4.8	2.18	886
ICC	68.5	51.8	63.8	48.2	132.3	4.0	1.33	1,190
CNW	78.1	59.8	52.5	40.2	130.6	3.9	1.79	795
Subtotal	1,371.7	39.6	2,096.1	60.4	3,467.7	105.2	1.62	1,029
Other	492.3	48.7	517.7	51.3	1,010.1	48.2	1.80	702
Total	1,864.0	41.6	2,613.8	58.4	4,477.8	153.4	1.67	935

*For the purpose of analysis, carrier combinations reflect pending merger applications; this is not intended to imply that such mergers will or should occur.

Note: Non-Conrail traffic revenues are assigned to the originating or terminating carrier, depending on the traffic class. Corporate subsidiary relationships are reflected in the identification of carriers. In the case of bridge traffic, the revenues are assigned to the originating carrier.

Source: 1979 Conrail traffic data base as prepared by Tymshare, Inc. for the Federal Railroad Administration.

Figure I-1
Volume and Routing of Conrail's Traffic Interchanged with Major Eastern Carriers, 1979

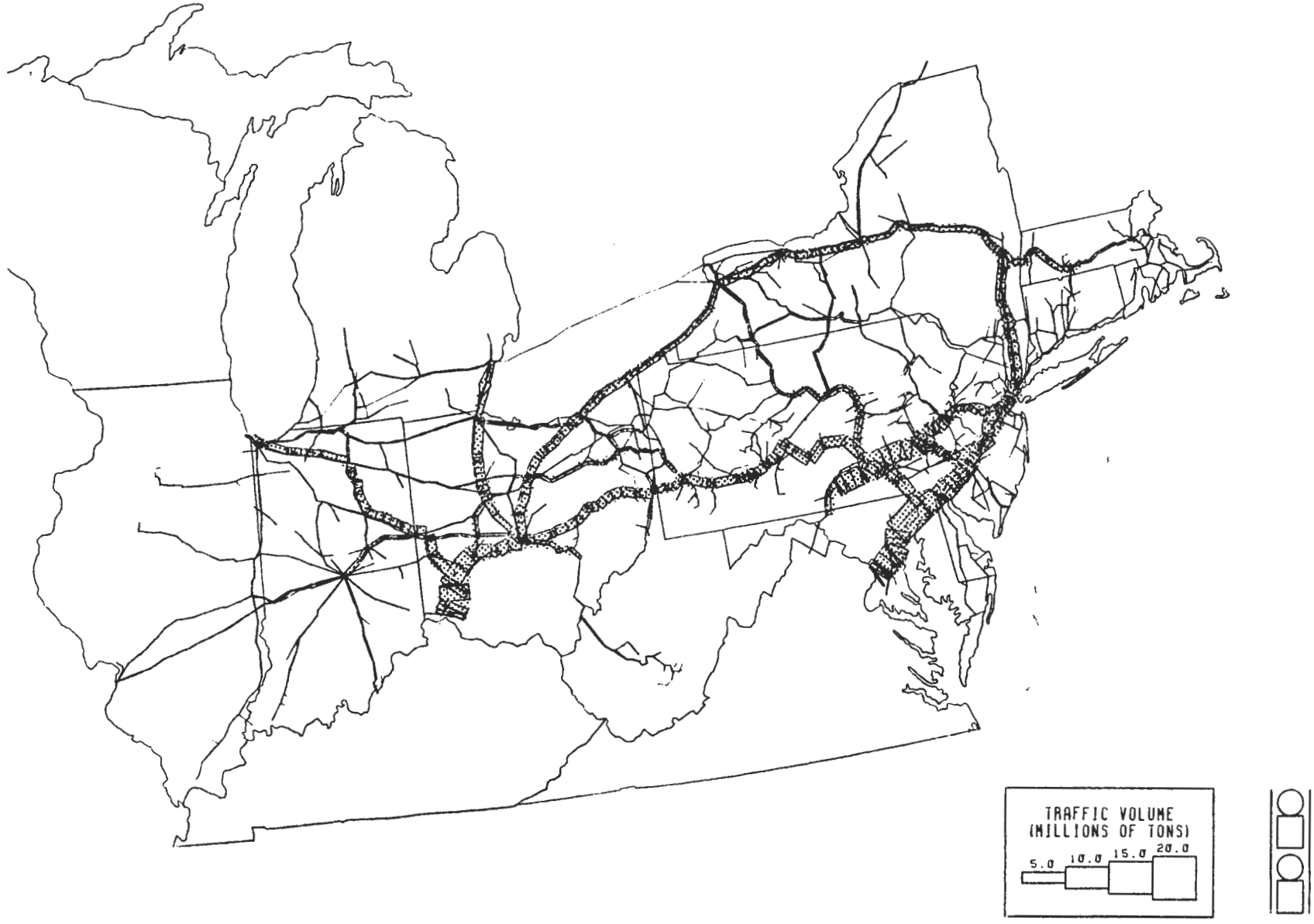
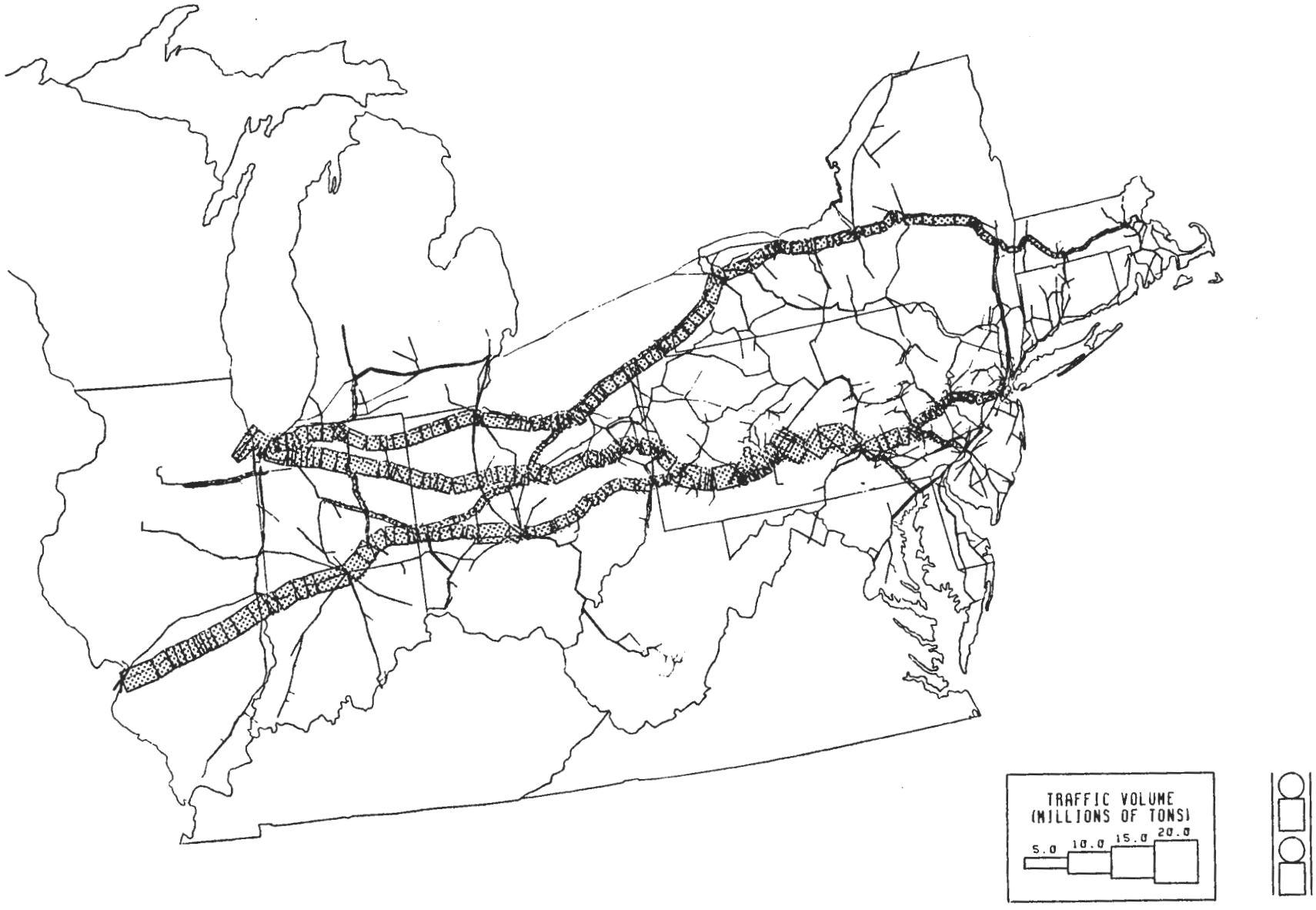


Figure I-2
Volume and Routing of Conrail's Traffic Interchanged with Major Western Carriers, 1979



Pacific (analyzed as a unit because of their pending merger application), Southern Pacific and its subsidiary St. Louis-Southwestern, Atchison, Topeka and Santa Fe, and Burlington Northern (including the recently acquired St. Louis-San Francisco Railway).

The table and the maps demonstrate the magnitude of the other railroads' involvement and self-interest in the services Conrail currently provides. Although the Department cannot predict the outcome of future negotiations, there are several good indicators of the extent to which other railroads are likely to participate. Figures I-1 and I-2 demonstrate the railroad industry's dependence on Conrail's traffic and routes. Figures I-3 through I-11 show the dependence of individual carriers on Conrail's traffic and routes. These maps reflect the data that will go into the individual railroads' decisions. The maps speak for themselves; in their own self-interest, other railroads must acquire significant portions of Conrail's system.

Over the past several years, a number of studies have concluded that other railroads will buy significant portions of Conrail. Moreover, both Conrail and the United States Railway Association (USRA), the Government corporation charged with overseeing Conrail's operations, in their April 1 reports have separately concluded that most of Conrail's existing traffic could be handled by other railroads.

A 1975 report to USRA, Controlled Transfer as a Restructuring Mechanism, by Economics and Science Planning Inc., described the importance of carriers in the Northeast to their outside connections. According to this report, 28 percent of the rail freight revenue in the United States was generated by traffic which moved between the Northeast and other parts of the country. The report identified potential acquirers of both long and short segments of the railroad.

In 1975, the Penn Central Trustees conducted an analysis for the Special Court. The Trustees' analysis related that 15 railroads had expressed serious interest in segments of the Penn Central prior to the formation of Conrail.

Conrail Analysis

Conrail's approach to service transfer, presented in its April 1 report, is both thorough and realistic. It recognizes that unless progress is made toward removing the transfer impediments discussed earlier, prospective purchasers will regard Conrail's properties as financially unattractive.

Figure I-3
Volume and Routing of Conrail's Traffic Interchanged in 1979 with Railroads Now Merged into CSX System (Chessie System, Family Lines, and RF&P)

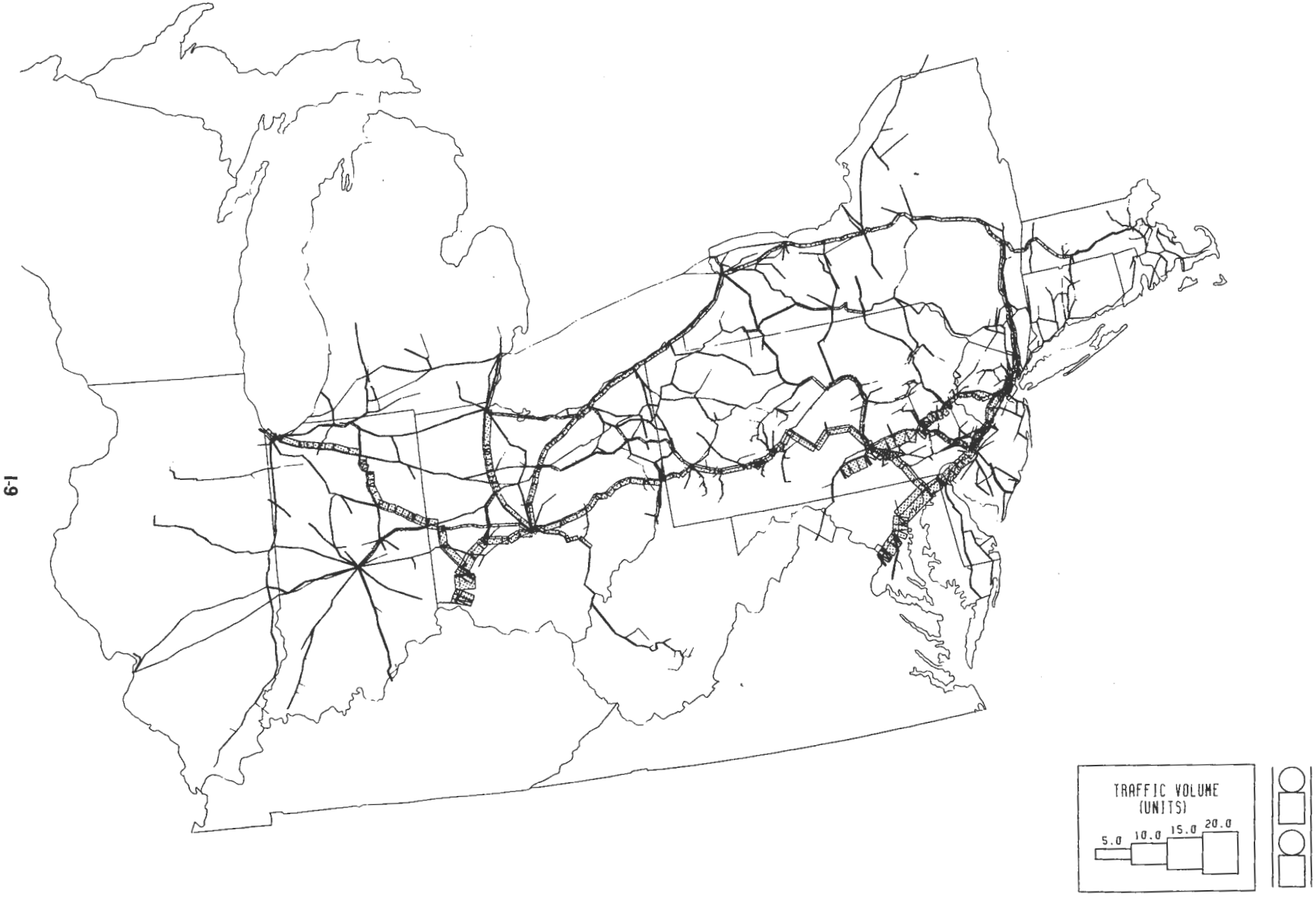


Figure I-4
Volume and Routing of Conrail's Traffic Interchanged in 1979 with Norfolk and Western and Southern Railway, Whose Merger Proposal is Pending Before the ICC

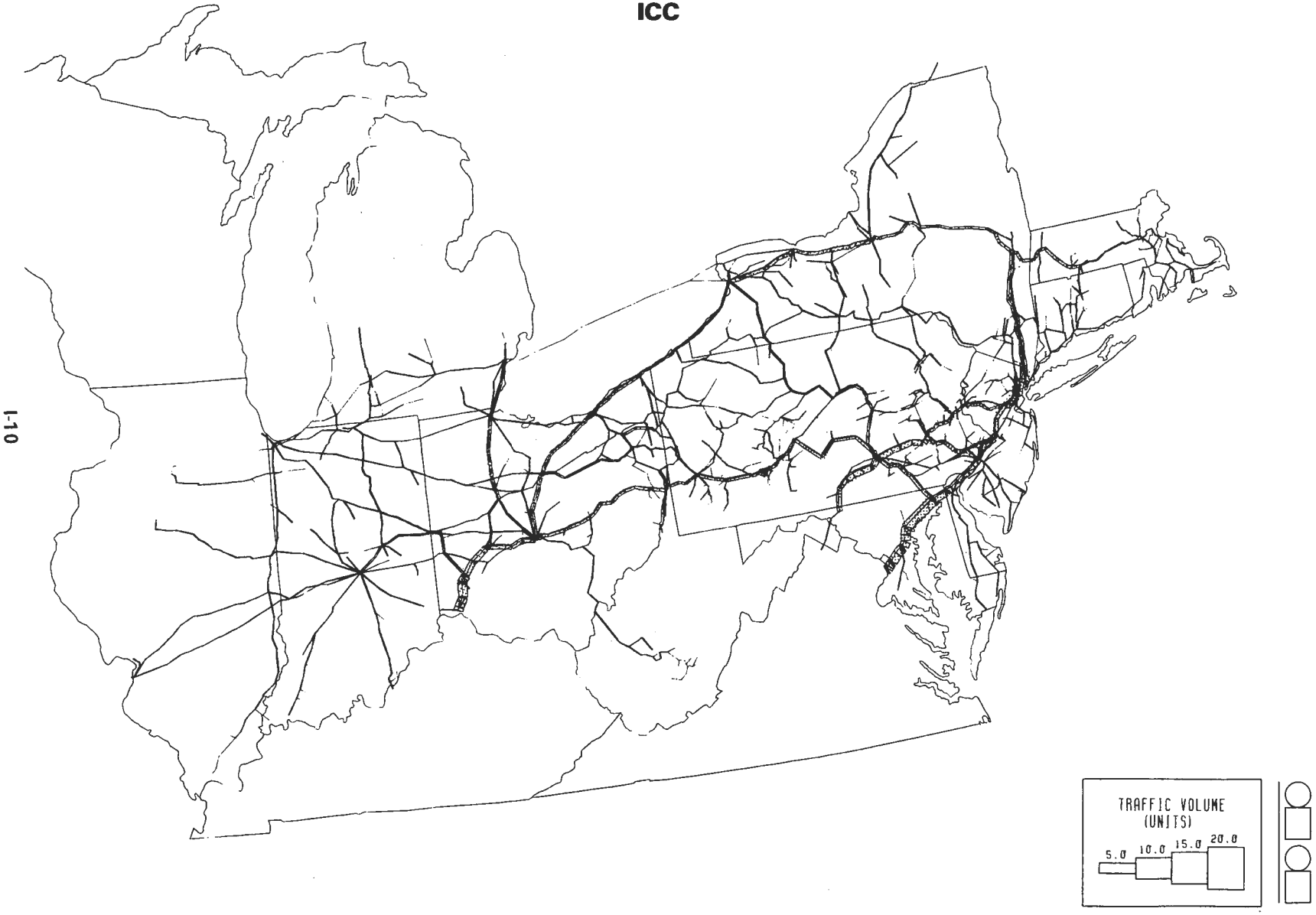


Figure I-5
Volume and Routing of Conrail's Traffic Interchanged in 1979 with the Pittsburgh & Lake Erie

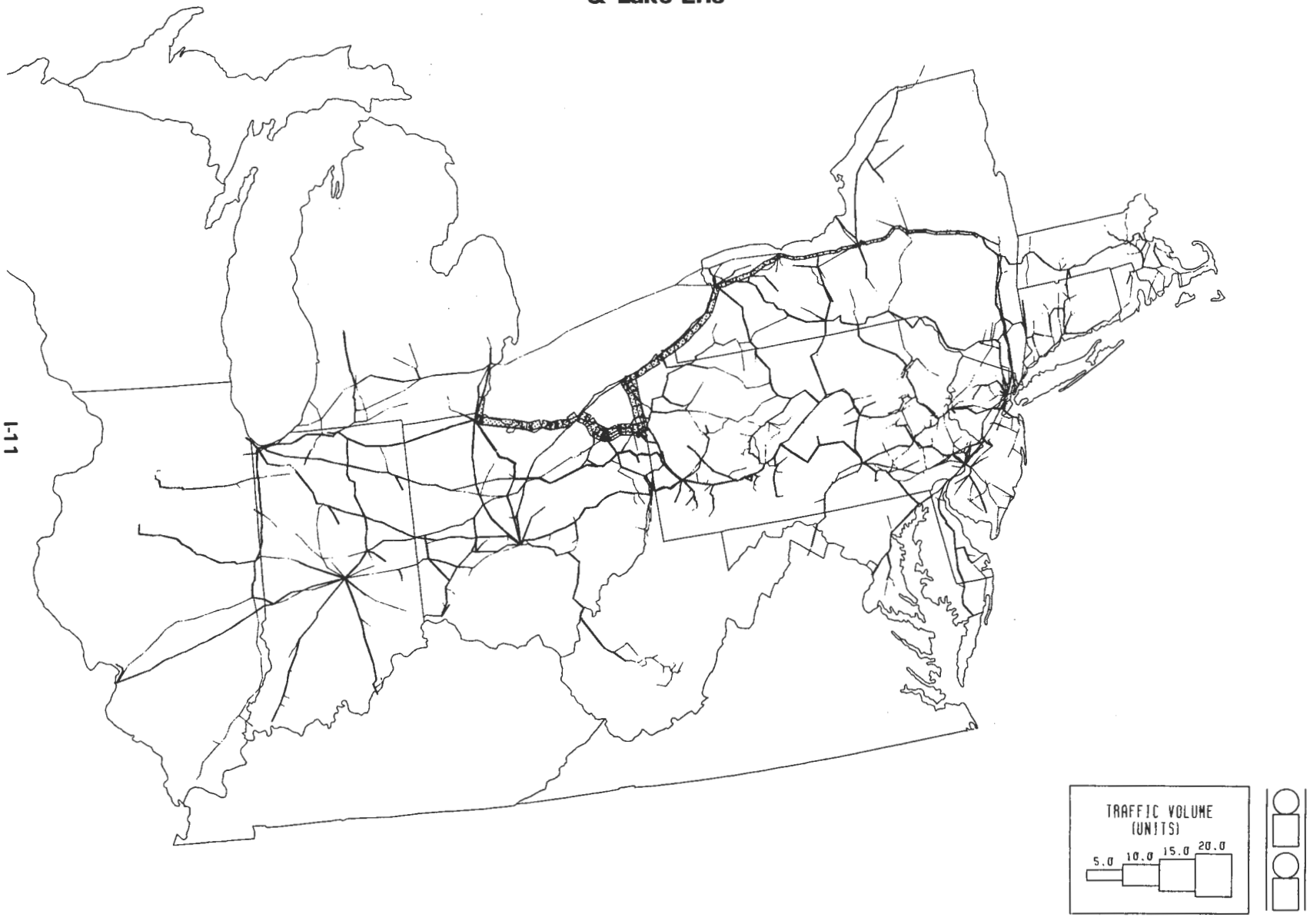


Figure I-6
Volume and Routing of Conrail's Traffic Interchanged in 1979 with the Boston and Maine

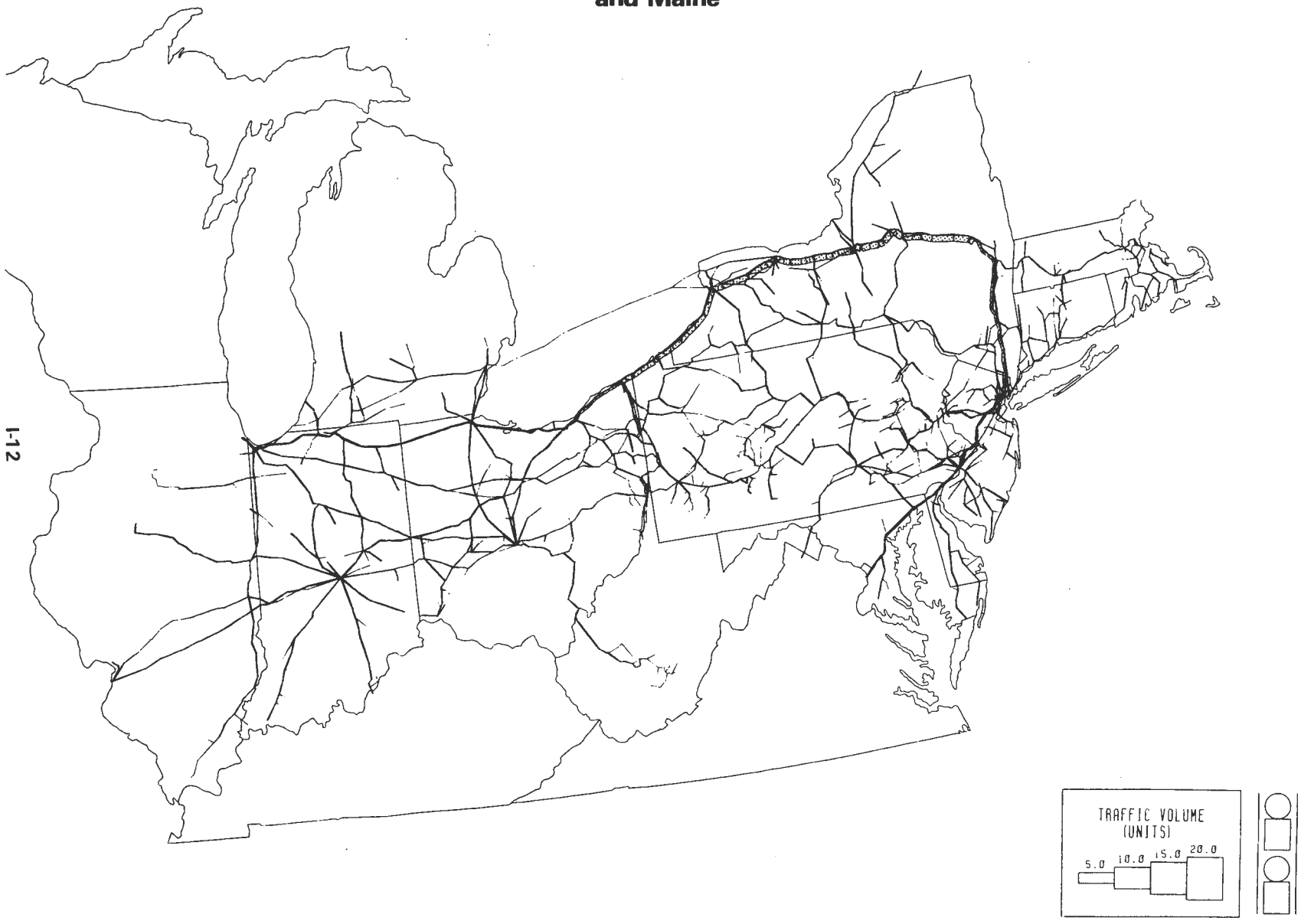


Figure I-7
Volume and Routing of Conrail's Traffic Interchanged in 1979 with the Union Pacific, Missouri Pacific, and Western Pacific, Whose Merger Proposal is Pending Before the ICC

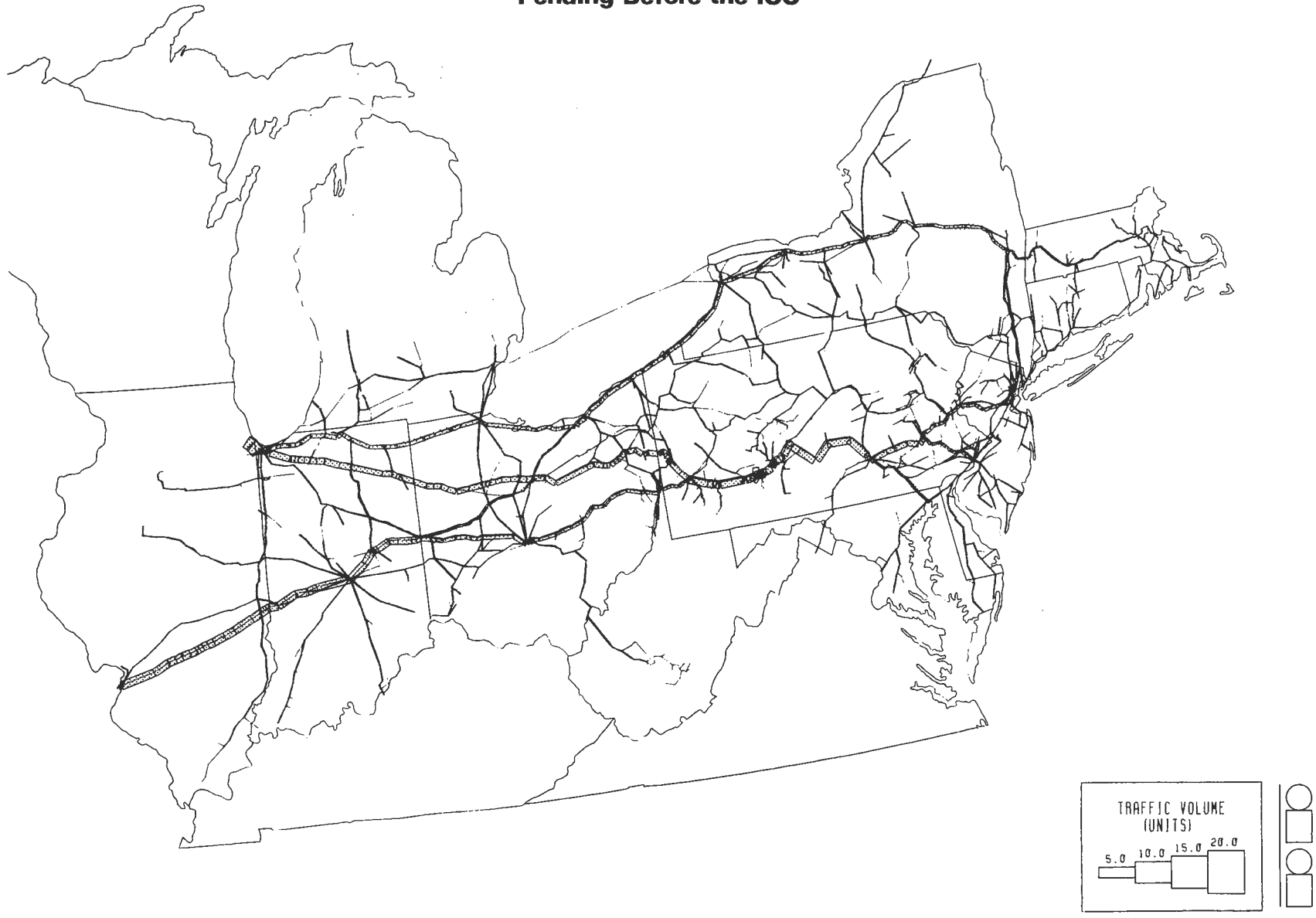


Figure I-8
Volume and Routing of Conrail's Traffic Interchanged in 1979 with the Southern Pacific and Its Subsidiary St. Louis Southwestern Railway

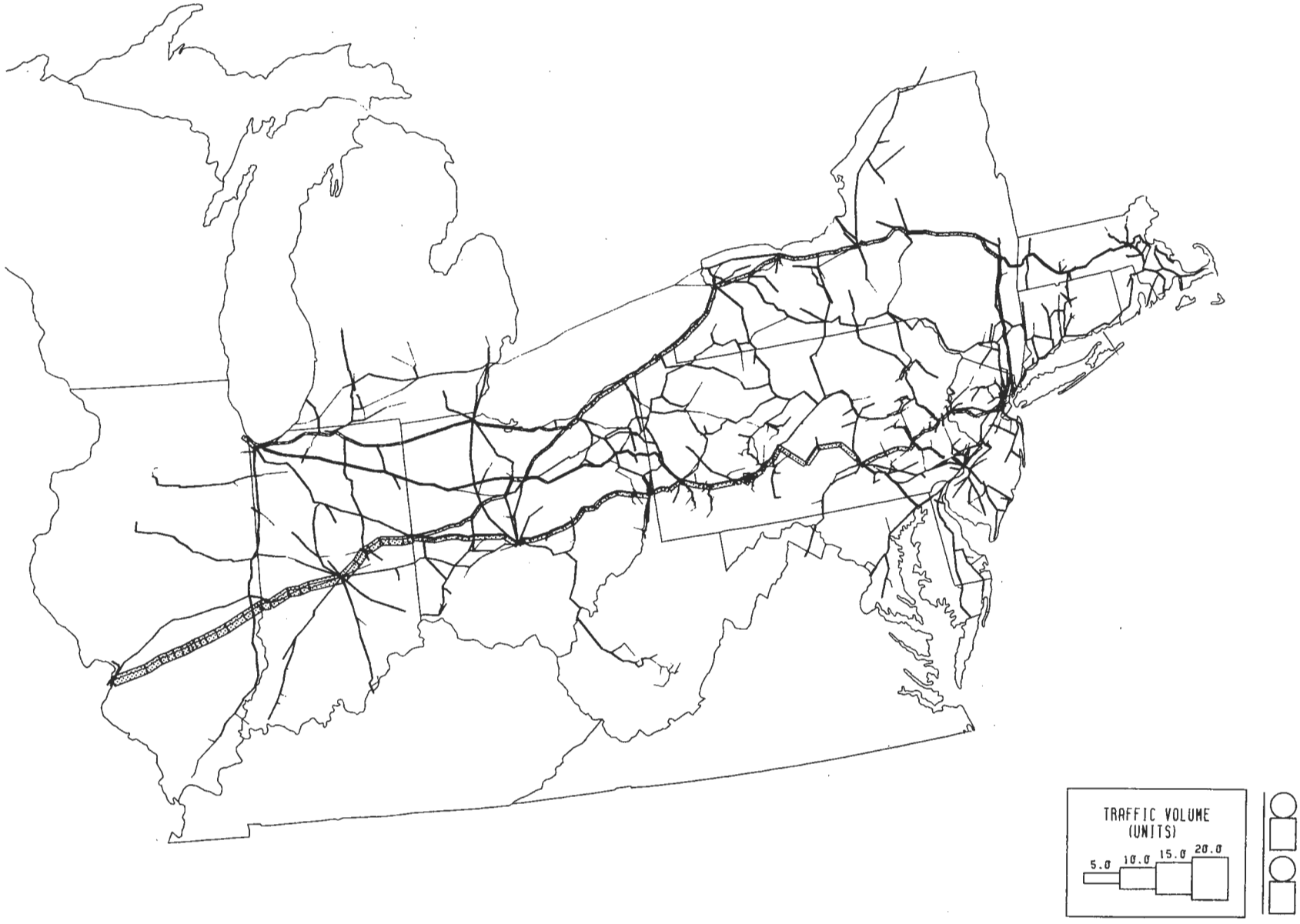


Figure I-9
Volume and Routing of Conrail's Traffic Interchanged in 1979 with the Atchison, Topeka and Santa Fe Railway, Including the Toledo, Peoria and Western Railroad

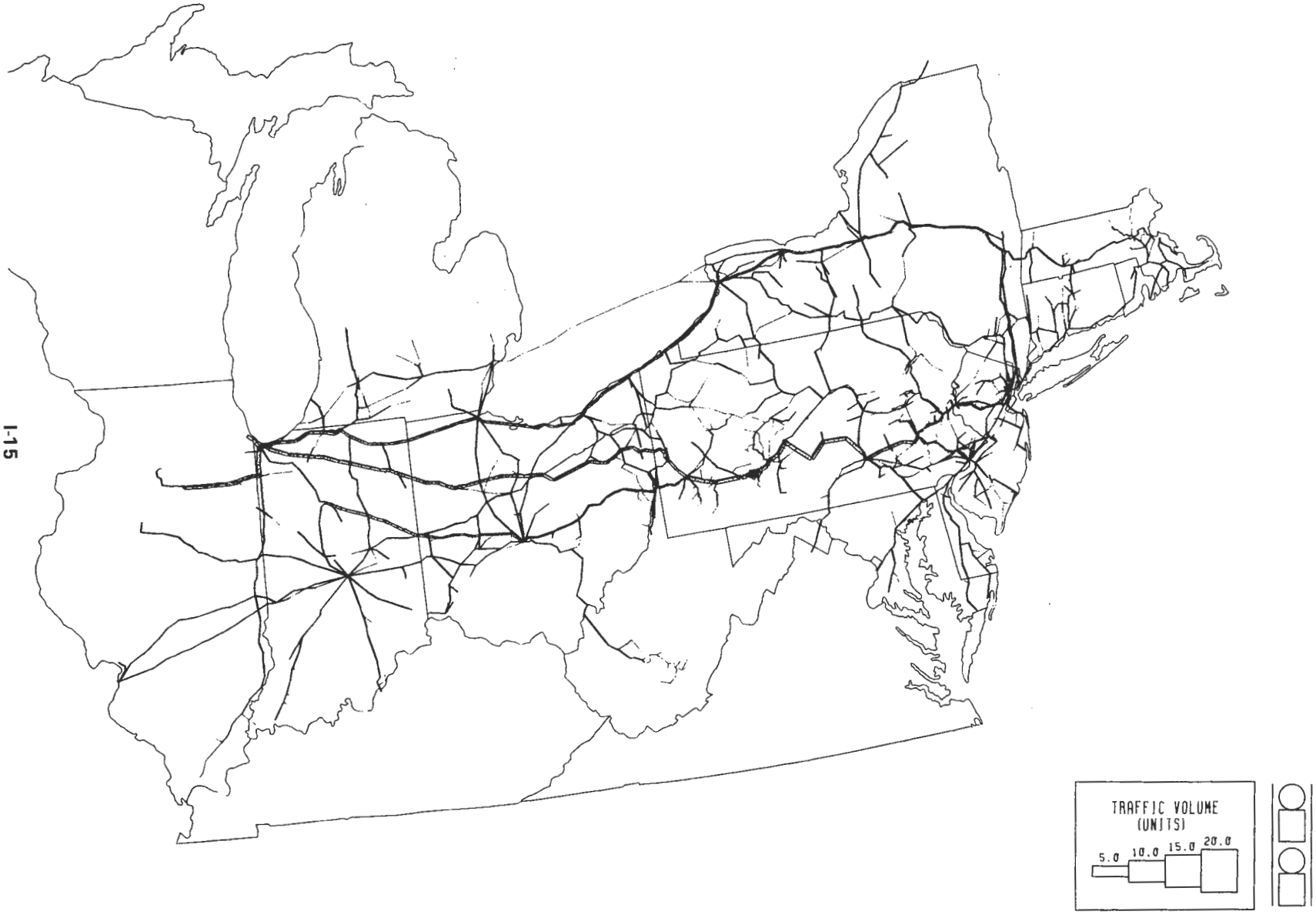


Figure I-10
Volume and Routing of Conrail's Traffic Interchanged in 1979 with the Burlington Northern, Including the Recently-Acquired St. Louis-San Francisco Railway

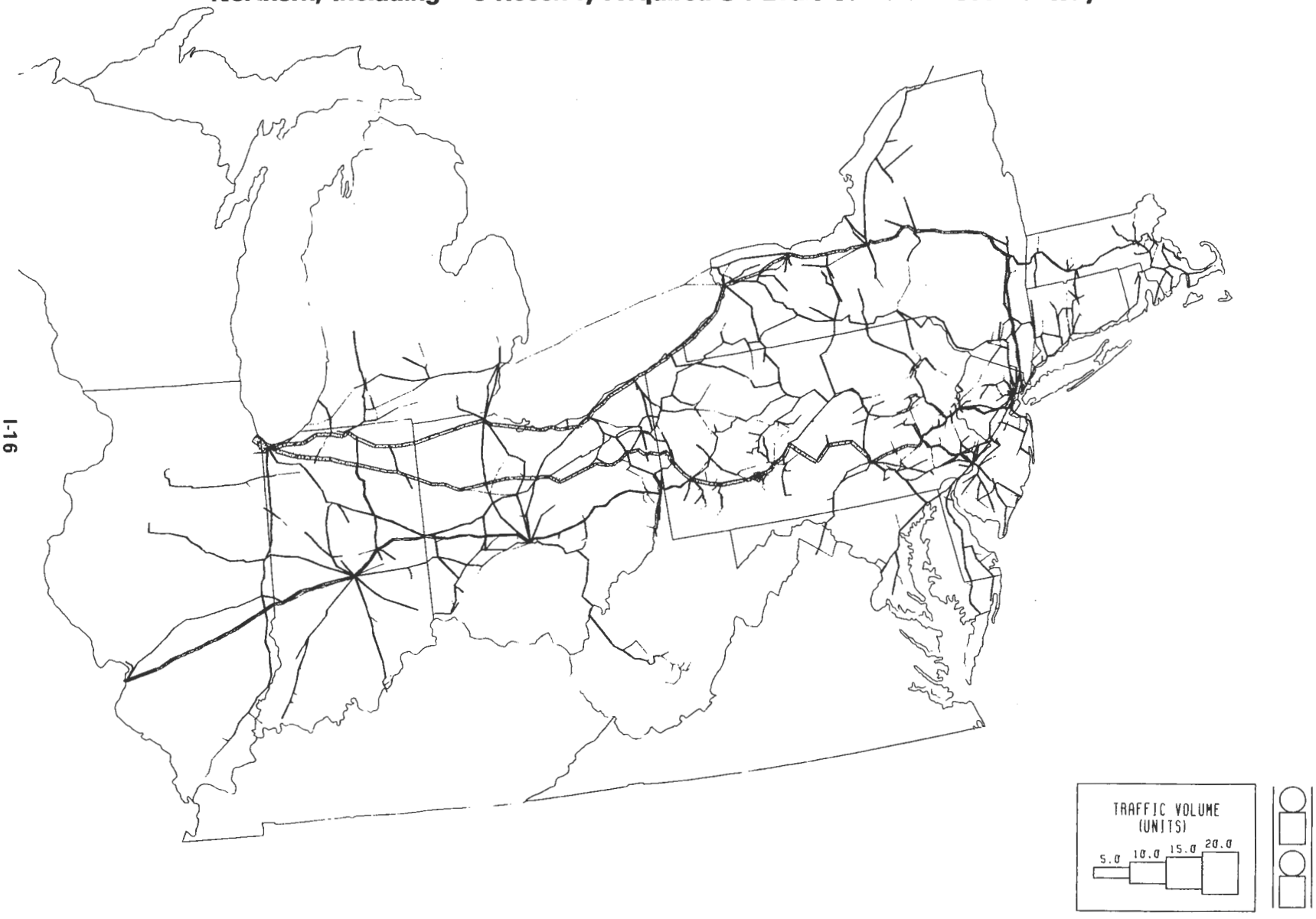
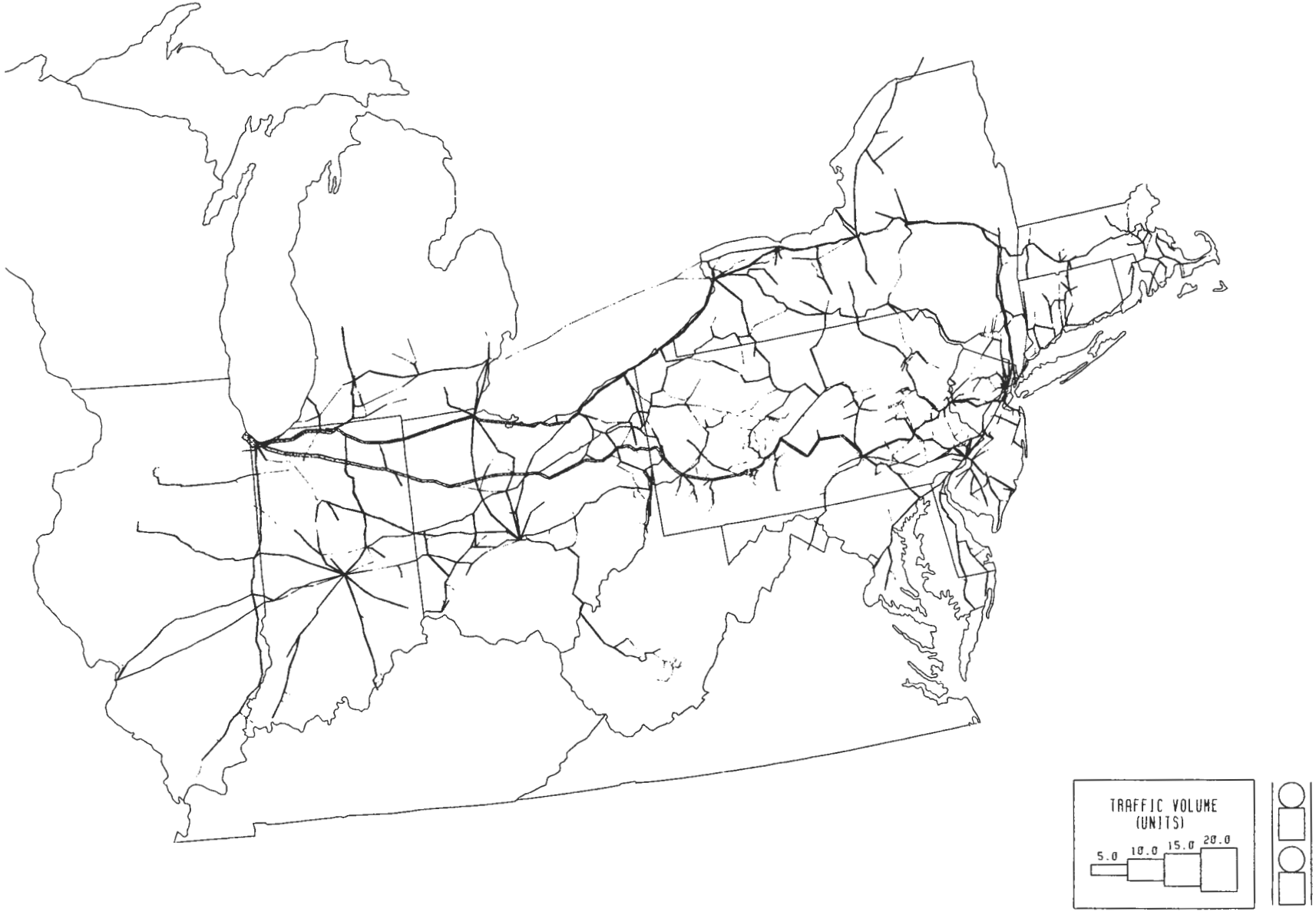


Figure I-11
Volume and Routing of Conrail's Traffic Interchanged in 1979 with the Chicago and North Western



Conrail set three guidelines for its analysis of service transfers. They are:

- o minimal interruption of service;
- o maintenance of competition, where feasible; and
- o improved operating efficiency.

Using these guidelines, Conrail divided its system into two packages. It analyzed what would occur if CSX and the proposed Norfolk and Western and Southern (NWS) system, or two western carriers, or a combination of eastern and western railroads, acquired the packages.

Conrail estimated the benefits the two packages would generate as extensions of these carriers. The annual net benefits ranged from $280 million if the CSX and NWS acquired the packages to $170 million if Atchison, Topeka and Santa Fe and the proposed Union Pacific group were the acquiring roads. In each case, $185 million in net losses attributable to the former Conrail lines were deducted from the gross benefits.

Conrail also created a list of prospective purchasers and their areas of interest should Conrail be liquidated. Although some of the impacts are drawn from 1975 data, the liquidation proposals are relevant today even though they may differ somewhat because of subsequent mergers or pending merger proposals.

The following table summarizes the estimated mileage, employees, and carloads retained in the transfer of Conrail's traffic and lines in Conrail's two-package scenario and in a fire sale liquidation.

	Present Conrail System	Purchases by CSX-NWS	Purchases by Western Roads	Purchases under Fire Sale Liquidation
Route Mileage	17,700	14,150	15,350	8,800
Employees (Freight)	65,000	45,000	48,000	25,000
Carloads (millions)	4.17	4.06	4.09	3.08

The Conrail analysis concluded that most of Conrail's lines, most of its employees, and most of its traffic would be acquired by other carriers.

USRA Analysis

In its April 1 report, USRA analyzed what would happen if Conrail received no funding and collapsed, unable to provide service. Even in this crisis mode, USRA concluded that with modest track acquisitions of approximately 3,000 miles, other railroads would maintain service to 75 percent of Conrail's present traffic.

II. THE MAGNITUDE OF THE NORTHEAST RAILROAD PROBLEM

Conrail began operations 5 years ago. There were expectations then that it would end its need for Federal subsidies by attracting new traffic and cutting costs. Those expectations have not been realized.

- Instead of rising to 344 million tons by 1980 as projected in the Final System Plan, Conrail's traffic has dropped to 237 million tons. The Department believes Conrail's traffic will continue to decline during the next 5 years.

- Despite some improvements, Conrail's costs have remained high. As USRA observed in its December 1980 report: "So high and so pernicious are these costs that there is serious question whether Conrail can ever achieve real profitability." (Page 1)

- The Final System Plan projected that Conrail would begin generating a positive cash flow in 1978, require $2.0 billion in Federal subsidies, and end its need for such aid during 1979. Instead, Conrail has never achieved a sustained positive cash flow, has required $3.3 billion in subsidies--$1.8 million per day--and will, by even the most optimistic assumption, require more than $500 million in additional support from the taxpayers between now and 1985.

- Summarizing these circumstances, USRA wrote in its December 1980 report: "Ultimately, it was concluded that investment in Conrail would help bring the traffic back and produce the necessary efficiencies. Neither traffic increases nor the projected efficiencies have been realized. From a public policy perspective, that is the key point." (Page 16)

This chapter describes Conrail's disappointing first 5 years and its grim outlook for the future.

TRAFFIC AND REVENUES

During 1980, Conrail produced 83 billion freight revenue ton-miles, the lowest traffic level generated on the lines it operates since the Depression. Traffic projections by the Department, Conrail, and USRA all indicate Conrail's traffic will not grow significantly for at least the next 5 years. The Department believes Conrail's traffic tonnage will continue to decline. All of the projections reflect several important facts.

First, most economic forecasts show that growth in the Northeast, particularly among industries using rail service, will be slower than in other regions of the country. In addition, the pricing and plant rationalization actions permitted by the

Staggers Rail Act of 1980 will eliminate some traffic presently carried by Conrail. Offsetting some of this decline is the potential for revenue improvement under the new regulatory environment of the Staggers Act. However, Conrail's gross revenue gains from the price increases will be limited by intensified competition from other railroads, water carriers, and trucking companies. In total, the Department believes Conrail's gross revenue will grow only about 2 percent per year in constant dollars through 1985.

The Department estimates Conrail will carry approximately 234 million tons of freight in 1985, and earn approximately $5.6 billion in gross freight revenue. Conrail and USRA estimate Conrail will carry between 249 and 257 million tons of freight in 1985 and earn between $5.9 and $6.5 billion in gross freight revenue. All three forecasts agree that Conrail's traffic will not return to the 1979 level of 270 million tons of freight. This is consistent with the experience of Conrail's predecessors which, in their final years, did not fully recover traffic lost during economic downturns. Both the Conrail and USRA forecasts, however, presume the long-term traffic decline on Conrail and its predecessors will be reversed. As shown in Figure II-1, while Conrail and USRA have often predicted such a reversal of the past trend, it has yet to occur. Table II-1 shows how Conrail, USRA, and the Department developed their respective traffic forecasts.

Table II-1
Forecasts of 1985 Conrail Traffic
(million tons)

	DOT	USRA[2/]	Conrail[3/]
Base Case Forecast	263.0	277.5	262.8
Staggers Act			
Pricing Action	(5.9)[1/]	(6.2)	(5)
Plant Rationalization	(16.9)[1/]	(17.8)	(6)
Mergers	(6.0)[1/]	(6.3)	(3.2)
Forecast	234.2	247.2	248.6
Traffic retained due to lower unit costs	0	10.0	0
Forecast	234.2	257.2	248.6
Percent of 1979	86.6	95.1	91.9
Percent of 1980	98.9	108.6	104.9

1/ DOT accepts USRA December analysis adjusted for its lower base case forecast.
2/ USRA "Conrail 85-III"
3/ Conrail "Case C - Low" excludes D&H traffic and Long Island Railroad division adjustment.

BENEFITS OF SERVICE TRANSFERS

The service transfer plan will result in a high-quality rail freight system in the Northeast. In making this decisive break with the past, service transfer will:

- Provide Northeast rail shippers and communities with the benefits of efficient, reliable, and competitive single-line rail service;
- Enhance the financial strength of acquiring carriers by expanding their revenue base and enabling them to reduce costs by consolidating their operations with Conrail's, and by using Conrail routes where they are superior;
- Generate the highest economic use of the public's investment in Conrail's rehabilitated rail lines; and
- Permanently stabilize the rail transportation services in the Northeast, thus assuring secure employment to the individuals hired by the acquiring carriers and encouraging major industrial reinvestment in the region.

The service transfer solution will benefit both the shippers and communities in the Northeast and the railroad industry. The benefits today will be greater than they could have been in the past, largely as a result of the competitive flexibilities made available to the railroads by the Staggers Rail Act of 1980. Past impediments to a service transfer solution have been identified and solutions proposed to clear the way for other railroads to acquire Conrail's services and lines without jeopardizing their own financial stability.

The most direct benefits of service transfer to shippers and railroads will be the establishment of an effective, business-oriented and responsive single-line railroad service between the Northeast and the rest of the Nation, the strengthening of the traffic base and financial performance of other railroads on traffic handled into or from the Northeast, and the use of the newly-rehabilitated Conrail plant.

Improved Service

For the first time, many markets in the Northeast will have single-line service to and from Southern or Western District points. This is consistent with the changing dynamics of a railroad industry evolving into a pattern of fewer, larger railroads which cross historic regional boundaries.

By removing the artificial and costly constraint of regional boundaries, the transfer of Conrail lines and services would permit shippers throughout the Northeast to benefit from better

service quality as the acquiring railroads assume complete responsibility for shipments that formerly involved two or more regional carriers. Single line service is faster and less costly, permits maximum implementation of service-oriented Staggers Act reforms such as contract rates, and, over the long term, produces efficiencies which reduce the upward pressure on rates for both Conrail's customers and the customers of the acquiring railroads.

In contrast, even if Conrail were to continue as a separate corporation and achieve financial self-sufficiency, it would at best be a marginal regional railroad, ineffective in competing against the strong interregional systems forming around it. This isolation would leave Conrail's shippers and employees with an uncertain future. Conrail would find itself increasingly locked into a regional cocoon, unable to participate in the dynamics of an emerging rail system, and, for that reason, unable to exist without continued infusions of public funds.

Shared Financial Growth Among Carriers

Service transfers will strengthen the financial viability of other railroads by augmenting the revenue on traffic they now interline with Conrail and providing opportunities for cost reductions. During 1979, about three-fifths of Conrail's traffic was interchanged with at least one other railroad. The other railroads received $2.6 billion from this interchange. Conrail earned $1.9 billion in revenues on this traffic. After the transfer, the connecting carriers will not only protect the revenue on traffic they currently interchange with Conrail, but will also be able to earn Conrail's portion of the revenue. In addition, carriers acquiring Conrail's lines would be able to serve much of the local traffic originating and terminating on the Conrail system, which generated revenues of $1.4 billion in 1979.

In many instances, acquiring carriers will benefit not only from higher revenues, but also from lower costs by consolidating their operations with those of Conrail. The principal savings would result from reducing the switching and accounting costs of the present interchange procedure.

Benefiting From the Public Investment in Conrail

Immediate transfer of Conrail's lines and services will generate the highest economic use of the public's multi-billion dollar investment in Conrail's fixed plant. After a 5-year, $2.1 billion publicly-funded rehabilitation program, the condition of Conrail's main line track, facilities, and equipment is comparable to that of other major railroads. In testimony before the House Subcommittee on Surface Transportation on March 24, 1981, Conrail's Chairman and Chief Executive Officer, L. Stanley Crane, stated, "Conrail's main line or core system is in excellent shape. It is the equal of most railroads in this country." This is in sharp contrast with the deteriorated situation of Conrail's bankrupt predecessors in the mid-1970's.

Although the Conrail system is currently in good physical condition, it faces the risk of significant maintenance deferrals in the 1980's, if Conrail is retained as an isolated regional carrier. The Department's review indicates Conrail's existing and proposed cyclical maintenance program may already be starting to slip below that required to maintain the plant in its present condition, reflecting the tight financial constraints Conrail faces today. Clearly, the time to take advantage of the public's investment in Conrail's plant over the past 5 years is now.

Stability in Railroad Transportation

Service transfer will resolve the chronic uncertainties surrounding rail service in the Northeast, to the ultimate benefit of Conrail's shippers, communities, and employees. Since well before 1968, when the Penn Central was created, railroad service in the Northeast has been in an operating and financial turmoil. The turmoil has bred continuing uncertainty. Although long-term economic forces are primarily responsible for the one-third decline in business over Conrail's lines between 1966 and 1980, uncertainties about the future of Conrail have exacerbated the downward spiral. Such doubts have encouraged shippers to design their distribution systems around competing rail carriers and other modes where possible.

Only decisive action, in the form of service transfer, will yield a permanent, stable solution on which shippers can base their traffic planning and investment decisions. Communities too will be able to formulate industrial development plans with the assurance of permanent service by profitable, efficient inter-regional carriers, and Conrail employees who go to work for the acquiring carriers will be working for private enterprise concerns which can provide incentives and job satisfaction that a marginal railroad cannot.

There will be some adverse impacts on shippers located on lines not immediately transferred to other railroads. Some of these shippers subsequently will be served by short line railroads or other entities, such as a state or local government authorities. In many instances, these short lines and authorities will employ former Conrail workers. Studies of the effects of loss of rail service indicate that most shippers have found acceptable transportation alternatives. A recent study for the Department found that 96 percent of 135 firms located on abandoned lines were able to shift to alternative forms of transportation. Only 2.5 percent (three firms) had to relocate and only 1.5 percent (two firms) closed. Transportation alternatives available to shippers are discussed further in Appendix D.

Obviously, some Conrail employees will not be hired by acquiring railroads. As discussed in Appendix C, the Department recommends separation payments, payment of moving expenses, and a priority hiring program to facilitate the rehiring of trained and qualified Conrail employees by other railroads.

IMPLEMENTATION

The Department will submit legislation to implement service transfer, including provisions to resolve the three traditional impediments to the transfer. The plant and facilities can be transferred in several ways. The Conrail system can be divided into packages, by Conrail or the Government, and offered for sale. Alternatively, packages can be proposed by acquiring carriers. However, an auction of Conrail's traffic in an uncontrolled liquidation would be difficult to implement and would create major disruptions to Conrail employees and shippers. Adoption of the Department's proposal would avoid the need for this approach.

II. THE MAGNITUDE OF THE NORTHEAST RAILROAD PROBLEM

Conrail began operations 5 years ago. There were expectations then that it would end its need for Federal subsidies by attracting new traffic and cutting costs. Those expectations have not been realized.

- Instead of rising to 344 million tons by 1980 as projected in the Final System Plan, Conrail's traffic has dropped to 237 million tons. The Department believes Conrail's traffic will continue to decline during the next 5 years.

- Despite some improvements, Conrail's costs have remained high. As USRA observed in its December 1980 report: "So high and so pernicious are these costs that there is serious question whether Conrail can ever achieve real profitability." (Page 1)

- The Final System Plan projected that Conrail would begin generating a positive cash flow in 1978, require $2.0 billion in Federal subsidies, and end its need for such aid during 1979. Instead, Conrail has never achieved a sustained positive cash flow, has required $3.3 billion in subsidies--$1.8 million per day--and will, by even the most optimistic assumption, require more than $500 million in additional support from the taxpayers between now and 1985.

- Summarizing these circumstances, USRA wrote in its December 1980 report: "Ultimately, it was concluded that investment in Conrail would help bring the traffic back and produce the necessary efficiencies. Neither traffic increases nor the projected efficiencies have been realized. From a public policy perspective, that is the key point." (Page 16)

This chapter describes Conrail's disappointing first 5 years and its grim outlook for the future.

TRAFFIC AND REVENUES

During 1980, Conrail produced 83 billion freight revenue ton-miles, the lowest traffic level generated on the lines it operates since the Depression. Traffic projections by the Department, Conrail, and USRA all indicate Conrail's traffic will not grow significantly for at least the next 5 years. The Department believes Conrail's traffic tonnage will continue to decline. All of the projections reflect several important facts.

First, most economic forecasts show that growth in the Northeast, particularly among industries using rail service, will be slower than in other regions of the country. In addition, the pricing and plant rationalization actions permitted by the

Staggers Rail Act of 1980 will eliminate some traffic presently carried by Conrail. Offsetting some of this decline is the potential for revenue improvement under the new regulatory environment of the Staggers Act. However, Conrail's gross revenue gains from the price increases will be limited by intensified competition from other railroads, water carriers, and trucking companies. In total, the Department believes Conrail's gross revenue will grow only about 2 percent per year in constant dollars through 1985.

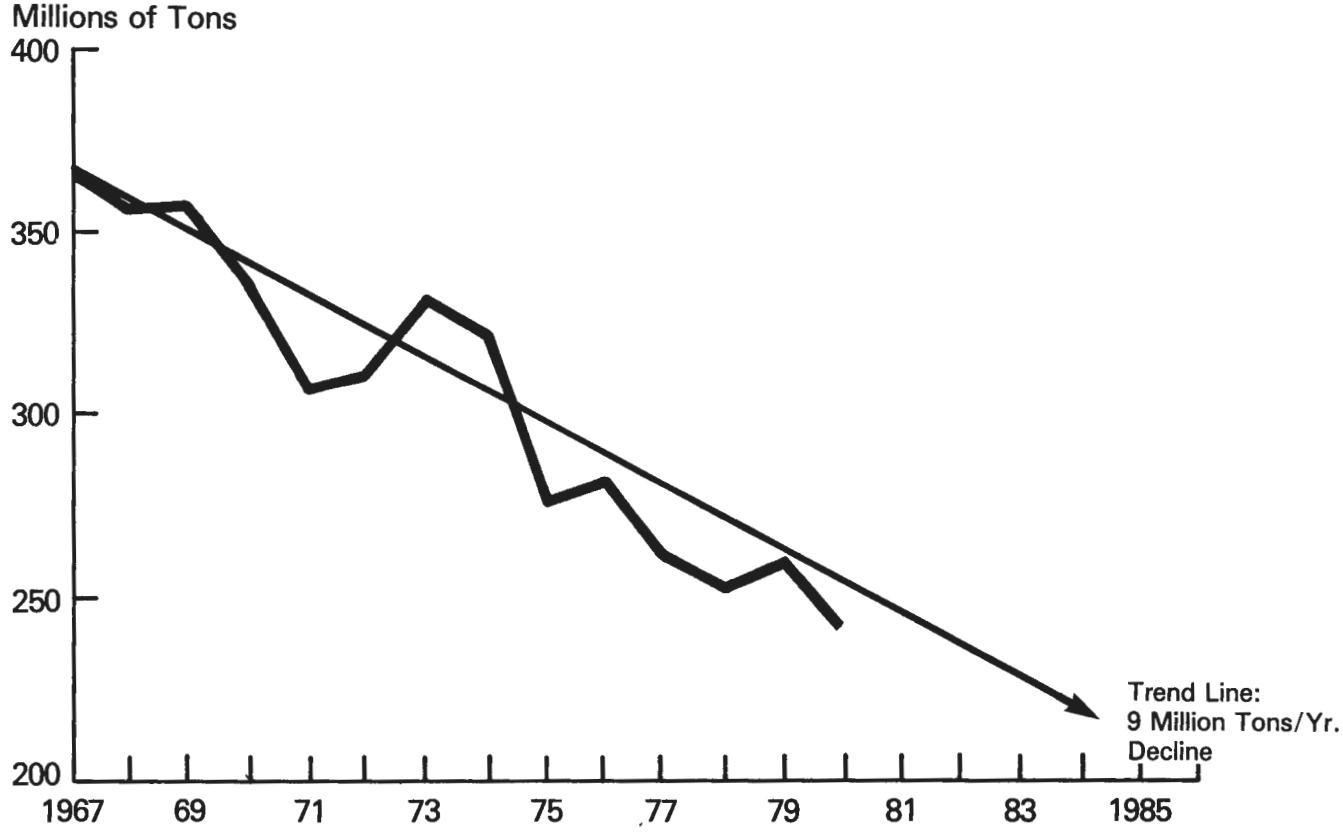
The Department estimates Conrail will carry approximately 234 million tons of freight in 1985, and earn approximately $5.6 billion in gross freight revenue. Conrail and USRA estimate Conrail will carry between 249 and 257 million tons of freight in 1985 and earn between $5.9 and $6.5 billion in gross freight revenue. All three forecasts agree that Conrail's traffic will not return to the 1979 level of 270 million tons of freight. This is consistent with the experience of Conrail's predecessors which, in their final years, did not fully recover traffic lost during economic downturns. Both the Conrail and USRA forecasts, however, presume the long-term traffic decline on Conrail and its predecessors will be reversed. As shown in Figure II-1, while Conrail and USRA have often predicted such a reversal of the past trend, it has yet to occur. Table II-1 shows how Conrail, USRA, and the Department developed their respective traffic forecasts.

Table II-1
Forecasts of 1985 Conrail Traffic
(million tons)

	DOT	USRA[2/]	Conrail[3/]
Base Case Forecast	263.0	277.5	262.8
Staggers Act			
Pricing Action	(5.9)[1/]	(6.2)	(5)
Plant Rationalization	(16.9)[1/]	(17.8)	(6)
Mergers	(6.0)[1/]	(6.3)	(3.2)
Forecast	234.2	247.2	248.6
Traffic retained due to lower unit costs	0	10.0	0
Forecast	234.2	257.2	248.6
Percent of 1979	86.6	95.1	91.9
Percent of 1980	98.9	108.6	104.9

1/ DOT accepts USRA December analysis adjusted for its lower base case forecast.
2/ USRA "Conrail 85-III"
3/ Conrail "Case C - Low" excludes D&H traffic and Long Island Railroad division adjustment.

Figure II-1
Volume Trends and Projections



Source: FSP, Business Plans, USRA, FRA

Table II-2 compares the tonnage and gross revenue forecasts developed by Conrail, USRA, and the Department.

COSTS

Both USRA's Final System Plan and the Five-Year Business Plans subsequently prepared by Conrail assumed that substantial cost reductions could be achieved at the same time that traffic levels would increase. Conrail and USRA now project no significant growth in traffic and gross revenues over 1980 levels in real terms. Cost reduction therefore becomes the principal element in any attempt to make Conrail financially self-sufficient.

Conrail inherited a high ratio of expenses to revenues. In 1975, its predecessors had a composite ratio of freight expenses to revenues of 88 percent, calculated on an Interstate Commerce Commission (ICC) accounting basis, compared to the nationwide ratio of 79 percent. In 1979, Conrail's ratio of freight expenses to revenues was 115 percent on an ICC accounting basis, compared to 92 percent on all other railroads and 87 percent on other Eastern District railroads. Relative to other railroads, Conrail's performance vis-a-vis that of its predecessors must be adjusted to reflect that the bankrupt railroads were forced to low levels of maintenance, driving the ratios down. Furthermore, Conrail's abnormally high track rehabilitation expenditures in 1979 tended to drive its own ratio up. Excluding maintenance of way and structures expenses, however, Conrail's expenses consumed 91 percent of its freight revenues in 1979, compared to 74 percent on all other railroads and 71 percent on other railroads in the Eastern District.

Employment Costs

The most important single factor in Conrail's high costs is its labor expense. In 1980, Conrail's freight labor expenses consumed 56 percent of its freight revenues, compared to about 48 percent for all other railroads. Conrail's March 15, 1981 Labor Report to Congress stated this difference is equivalent to $300 million per year. (Page 1)

Conrail has more employees per unit of output than other railroads, both in the Northeast and in the Nation. During 1979, for example, each Conrail freight train and engine employee produced only 4.0 million revenue ton-miles, compared to the range of 4.6 to 10.7 million ton-miles produced by each freight employee of thirteen other major railroads (Table II-3). The output per Conrail train and engine employee was less than three-quarters that of the balance of the Eastern District, and about one-half that of the rest of the Nation.

Table II-2

ANNUAL CONRAIL TONNAGE AND REVENUE FORECASTS

	1979 (Actual)	1980 (Actual)	1981	1982	1983	1984	1985	Total 1981-5
Conrail[1]								
Tons (Millions)	270.4	236.9	247.5	242.7	241.1	244.7	248.6	1,224.6
Gross Revenues (Millions--Current Dollars)			4,025.0	4,248.0	4,698.0	5,267.0	5,881.0	24,119.0[3]
USRA[2/4]								
Tons (Millions)	270.4	236.9	237.9	245.5	250.5	250.5	257.2	1,241.6
Gross Revenues (Millions--Current Dollars)			3,830.3	4,464.3	5,096.2	5,719.8	6,460.5	25,571.1
DOT								
Tons (Millions)	270.4	236.9	240.7	238.1	233.3	230.7	234.2	1,177.0
Gross Revenues (Millions--Current Dollars)			3,720.6	4,162.7	4,574.6	5,019.9	5,570.2	23,048.0

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1 Forecast for Conrail's Recommended "Case C--Low Traffic."

2 Forecast for USRA's Recommended "Conrail 1985-III."

3 Does not include D&H revenue of $433 million between 1982 and 1985 or $31 million in additional revenue between 1982 and 1985 resulting from adjustments to Conrail's division with the Long Island Railroad.

4 The growth of the USRA's revenue forecast relative to the Conrail and DOT forecasts is due in part to a higher base traffic forecast and a higher assumed rate of revenue inflation.

TABLE II-3

CONRAIL'S FREIGHT TRAIN AND ENGINE EMPLOYMENT VIS-A-VIS OTHER CARRIERS, 1979

Carrier	Train and Engine Employees	Revenue Ton-Miles		Freight Service Revenue	
		Total (Billions)	Per Employee (Millions)	Total ($ Millions)	Per Employee ($ Thousands)
Conrail	23,509	93.1	3.96	3,354	143
Other Eastern District:					
Baltimore & Ohio	5,532	25.5	4.61	916	166
Chesapeake & Ohio	5,772	26.9	4.67	810	140
Norfolk & Western	7,075	49.2	6.95	1,430	202
B&O + C&O + N&W	18,379	101.6	5.53	3,156	172
Southern District:					
Illinois Central Gulf	4,164	29.9	7.18	820	197
Louisville & Nashville	5,420	38.8	7.16	973	180
Seaboard Coast Line	5,639	36.1	6.40	1,050	186
Southern Railway System	7,698	54.6	7.10	1,467	191
Western District:					
Atchison, Topeka & Santa Fe	9,633	72.7	7.54	1,873	194
Burlington Northern	12,043	123.7	10.27	2,419	201
Chicago & North Western	3,176	26.0	8.19	704	222
Missouri Pacific	7,301	56.2	7.70	1,419	194
Southern Pacific	10,223	70.3	6.87	1,923	188
Union Pacific	6,914	73.7	10.66	1,742	252
Nation less Conrail	109,796	809.0	7.37	21,162	193

The Department, Conrail, and USRA have all identified train and engine, clerical, and equipment maintenance services as areas in which cost reductions should be made. Conrail's March 15, 1981, Labor Report to Congress (Page 2) estimated that it has 10,000 excess employees, while USRA's April 1, 1981 report estimates that Conrail has more than 14,000 excess employees.

Excess Plant Capacity

Conrail, USRA, and the Department agree Conrail has substantially more plant than it needs to handle the traffic it is projected to carry. Both main line and yard trackage are excessive, and both incur high maintenance costs.

Main Line Trackage. Conrail operates more multiple track main line and more miles of track per mile of route than any other major North American railroad. Its traffic levels do not justify maintaining this capacity. Among the 14 American railroads carrying the highest traffic volume in 1979, Conrail ranked ninth in revenue ton-miles per route-mile operated and twelfth in revenue ton-miles per running track-mile operated. USRA's April 1, 1981 report states Conrail has 700 miles of unnecessary main line track. Conrail's April 1, 1981 report estimates it could eliminate 1,866 miles. Both studies look to reductions in the capacity of lines remaining in service.

Yards. Conrail has too many yards and some of its yards are too large. In 1979, it generated fewer revenue ton-miles per switching track-mile than any other high-volume carrier. The Southern Railway, which has about the same average length of haul and traffic per route-mile as Conrail, performed its switching services with two-fifths as much switching trackage. Part of Conrail's yard intensity is due to its low-volume customers and traffic flows. Even so, Conrail's yard capacity is excessive, particularly in light of current traffic forecasts. In November 1980, for example, Conrail's largest hump yards were being used at less than two-thirds of estimated capacity. Conrail has eliminated more than 50 yards, but it must eliminate more yards and yard operations.

Cost Implications of Conrail's Traffic

The Department believes that the characteristics of Conrail's current traffic base contribute to its excess employment and plant. A large proportion of Conrail's customers use rail service very infrequently and a large proportion of its station-to-station traffic flows consist of only a few cars per week. During 1978, approximately 90 percent of Conrail's customer locations shipped or received fewer than 100 cars per year. These locations accounted for only 8 percent of Conrail's traffic. In 1979, roughly 90 percent of Conrail's station-to-station traffic flows involved less than 100 cars and accounted for only one-fifth of Conrail's traffic. To service these low-volume customers and

traffic flows, Conrail must maintain an extensive and costly network of small yards and facilities, low-volume branchlines and urban trackage, turnouts and sidings, and local switching trains. Low-volume shipper issues are discussed in Appendix D.

CONCLUSIONS

Since it began operations in 1976, Conrail has been expected to attract more traffic, cut its expenses, and thus end its need for Federal subsidies. It has failed in this effort. Conrail's traffic is lower than it was when it began. Its costs stubbornly resist reduction and its appetite for subsidies continues at a rate of nearly $1 million per day.

This clear picture of decline forms the backdrop against which proposals to make Conrail financially self-sufficient must be judged.

III. ANALYSIS OF ALTERNATIVE PROPOSALS: THE USRA AND CONRAIL REPORTS

The April 1, 1981 reports* of both USRA and Conrail project that Conrail can become financially self-sufficient if it reverses its long-term traffic decline and achieves unprecedented changes in its costs. Both reports recommend that Conrail be granted additional Federal subsidies to give it time to effect these changes. If the experiment fails, both Conrail and USRA recommend that Conrail's traffic then be transferred to profitable railroads.

Although USRA and Conrail have done a thorough and competent job of identifying the problems confronting Conrail, the Department doubts that Conrail can achieve a cash flow from operations sufficient to cover its capital program, equipment debt repayment, and other working capital needs, much less redeem or provide a cash return on the Government's investment. The Department cannot endorse the recommendation that further Federal funds should be invested to determine whether a Government-owned corporation, producing marginal results at best, can become a permanent institution.

Both USRA and Conrail examine several hypothetical cases in their reports. Each report settles on a single, recommended plan. For USRA, the preferred course is its "Conrail 85-III" model, which assumes Conrail's traffic will grow and calls for aggressive management actions and fundamental labor concessions to reduce costs. Conrail management's preferred course is its "Case C," which also projects traffic growth and dramatic cost reductions.

OVERVIEW OF ANALYSIS

The technical analysis of any report is complex. The following overview is meant to clarify the analyses presented in this chapter.

Conrail and USRA each assessed improvements that could be made from Conrail's current financial outlook. These potential improvements fall into two categories, those that are within the control of Conrail's management and those that would require the agreement of others.

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* The Staggers Act does not require the Department to comment on the USRA and Conrail reports until May 1. However, because the time constraints placed on Congressional Committees by the Budget Act preclude a thorough assessment of any report received as late as May 1, the Department has included an assessment of the USRA and Conrail reports in this report. The Department has not been provided with the final reports. Analyses in this chapter are based on available data provided by USRA and Conrail. The Department is grateful to these organizations for their cooperation.

The savings from these potential improvements can be summarized as follows:

	Federal Funding Required (Millions)	
	Conrail Estimate	USRA Estimate
Conrail Without Changes	$3,884	$3,722
Less: Changes Within Conrail Management's Control (Branch Lines, Staggers Act Changes, Car Utilization, Reduction of Main Lines, Yard Reductions)	(1,745)	(2,200)
Less: Changes Needing Agreement From Other Parties (Labor Agreements. In addition, Conrail included improved Long Island Railroad divisions, obtaining Delaware & Hudson traffic, reduced Northeast Corridor trackage rights costs and state and local contributions.)	(1,535)	(865)
Federal Funding Required for Proposed Systems	$ 604	$ 657

The balance of this chapter follows the outline of this summary. In analyzing USRA's proposal, the Department has relied on two reports, one published in December 1980 and the other on April 1, 1981. In analyzing Conrail's proposal, the Department has relied primarily on Conrail's most recent Five Year Business Plan published July 1980, its March 15, 1981 Labor Report to Congress, and its April 1, 1981 report.

CONRAIL WITHOUT CHANGES

USRA and Conrail take very similar--and familiar--approaches. Both reports estimate a Conrail cash shortfall through 1985 that would have to be covered by Federal subsidies if no improvement occurs in Conrail's operations. In its July 1980 Five-Year Business Plan, Conrail estimated this shortfall would be approximately $3.7 billion in current dollars. This is similar to the estimate of $3.844 billion implicit in Conrail's April 1, 1981 report. USRA presented an estimate of $2.6 billion in 1979 constant dollars in its December 1980 report*, which is approximately equal to $3.7 billion in current dollars implicit in its April 1 report. While the potential shortfall cannot be calculated precisely, it exceeds these estimates because neither the Conrail nor the USRA calculations include Conrail's labor protection expenses, now running at nearly $5 million per month. Furthermore, if the Department's less optimistic traffic forecast proves correct, Conrail would realize $2.5 billion less in revenues

* USRA's April 1, 1981, report uses the December 1980 report as its base.

through 1985 than USRA has assumed and $1.5 billion less than Conrail has assumed. After allowing for reductions in costs that are variable with volume, any additional shortfall presumably would have to be made up by the taxpayers.

CHANGES WITHIN MANAGEMENT'S CONTROL

USRA and Conrail both consider that management must move aggressively to implement the Staggers Act and to increase Conrail's efficiency and thus reduce its Federal funding need. In its April 1, 1981 report, USRA estimated that Conrail could save $2.2 billion through 1985 by implementing such actions. These actions include abandoning or applying surcharges on shipments over 6,700 miles of low-volume lines, raising prices on all traffic to at least cover long-term variable costs, and diverting any traffic which would not bear the price. USRA also included the elimination of 700 miles of excess main line tracks, closing yards, improving car and locomotive utilization, and making other operating changes.

In its April 1, 1981 report, Conrail proposes to abandon 2,350 miles of branch line and 1,866 miles of main line. It also proposes to implement the Staggers Act pricing provisions aggressively, although it provides less detail than does USRA on how this would be accomplished. Conrail estimates it can save $1.7 billion through operating efficiences alone.

The Department respects Conrail's top management and believes it could achieve at least some of the projected pricing improvements and cost savings. Conrail faces many difficult challenges, however, in reaching the projected level of efficiencies. Among the most difficult is translating plans made at corporate headquarters into efficiencies in the field. A February 1981 consultant study, conducted for USRA by Canadian Pacific Consulting Services Ltd., noted that Conrail's ability to achieve efficiencies quickly is hindered by a number of serious problems in its lower and middle management. The report concluded:

> "Until all supervisors, regardless of the position they occupy, acquire an attitude that they and everyone else are responsible both directly and indirectly for cost and performance of Conrail and they know that they will receive support from management in their efforts to reduce such costs NO SIGNIFICANT AND LONG LASTING COST REDUCTIONS WILL BE MADE." (Emphasis in original.) (Page 11)

Both reports contemplate dramatic contributions from Conrail's employees. For example, USRA's April 1 report states that:

> "Although Conrail can and should improve profit margins through aggressive use of pricing freedoms of the Staggers Act, appropriate plant reduction, and management efficiencies, those actions alone would not be

sufficient to make Conrail viable. However, given these pricing, plant and operating improvements, Conrail could then achieve viability through the addition of direct unit cost reductions from modifying its agreement labor work rules." (Emphasis added.)

Conrail states in its March 15, 1981 report to Congress that:

"It is clear that Conrail cannot be made self-sufficient unless the proportion of its revenues paid out in labor costs is ultimately reduced to a level typical of other railroads. . . . Conrail is unable to perceive any scenario within which Conrail, or any substitute carrier, can continue a rail system of Conrail's present scale unless labor costs as a percentage of revenues are reduced." (Emphasis added.) Conrail's Labor Report to Congress, March 15, 1981, Page 1.

CHANGES NEEDING AGREEMENT FROM OTHER PARTIES

Implementing these findings would require fundamental and unprecedented changes in Conrail's labor agreements. USRA's April 1 report proposes that Conrail achieve savings of $300 million per year (in constant 1979 dollars) through the following work rule changes.

- Reduce the basic crew of through freight trains to an engineer and a conductor, and the basic crew on local freight and yard assignments to an engineer, conductor, and brakeman.

- Allow firemen on only 10 percent of freight train and yard crews (the percentage USRA estimates is necessary to train new engineers).

- Pay for deadheading on a time, rather than a mileage, basis.

- End agreements under which trainmen and maintenance of way employees originally employed by Conrail predecessors enjoy exclusive rights to work on those properties. These agreements cause otherwise unnecessary train crew changes and duplication of maintenance of way gangs.

- Change work rules governing equipment maintenance employees to permit a single "locomotive maintainer" to perform work now done by several tradesmen separated by craft lines, and to achieve other efficiencies.

- Change work rules governing clerks to allow a single clerk to perform duties now divided among several clerks and to limit frequent "bumping" by clerks from one job to another.

In its analysis, USRA assumed all of these changes would occur at once on January 1, 1983, and that no savings from work

rule changes would be realized prior to that time. The gross direct savings projected from these programs in 1985 exceed $500 million in current dollars. USRA also projected additional indirect benefits from the work rule changes. These benefits would occur because Conrail would lose less traffic if it did not have to cover higher costs with rate increases.

Conrail's labor plan differs from USRA's in three respects. First, Conrail recommends savings totalling approximately $900 million through 1985. Second, Conrail does not propose specific work rule changes, although it proposes a layoff of 10,000 employees, the same number as USRA's estimated reduction resulting from work rule changes. USRA recommends reducing employment by an additional 4,000 persons due to line abandonments. Finally, Conrail proposes to begin its savings earlier than USRA by first imposing wage constraints worth roughly $200 million annually and gradually replacing them with work rule changes of equal value.

The Department notes that specific changes which have been proposed have not been accepted on any railroad whose employees are represented by the national railway labor unions, even though the general issues have been the subject of collective bargaining for many years. The proposed changes would have a large impact on the employees and their unions. For example, the crew size change that accounts for two-thirds of the work rules savings proposed by USRA would cut the United Transportation Union's (UTU) membership on Conrail in half. The through freight crew sizes proposed by USRA have been accepted only on nonunion short lines and the Florida East Coast Railroad, whose employees are not represented by the UTU, and the UTU has opposed them on safety grounds for more than a decade.

USRA relies on the work rule changes for a net of $865 million in direct and indirect cost savings during 1983-85. Conrail estimates savings from work rule changes of approximately $200 million per year during 1981-85. Without savings of this order, neither Conrail nor USRA could predict Conrail will become financially self-sufficient. As Conrail stated in its March 15, 1981 Labor Report to Congress,

> ". . . it is certain that without labor savings of this magnitude [at least $200 million per year] during the period immediately ahead, Conrail cannot generate sufficient funds to pay for its maintenance and capital needs and will require substantial revenue from Federal funds." (Page 4)

In addition to the labor savings, Conrail assumes that heavy contributions to its cash flow will come from other sources. Cumulatively through 1985, these include:

- Realization of $195 million in net revenues from freight now carried by the Delaware & Hudson (USRA's April 1, 1981 report also recommends that Conrail assume traffic now carried on the D&H, but the benefit to Conrail is not included in USRA's calculations.);

- Direct contributions of $200 million from states and communities;

- A $31 million change in Conrail's revenue division agreement with the Long Island Railroad; and

- A $99 million favorable change in Conrail's freight trackage rights agreement with Amtrak for use of the Northeast Corridor. (USRA's April report also recommends that Conrail not incur these trackage rights charges, but the benefit to Conrail is not included in its financial calculations.)

Each of these proposals is highly speculative. If the D&H is driven into bankruptcy, its bankruptcy court might be unwilling gratuitously to turn over the railroad's business. The Long Island Railroad divisions have been disputed by Conrail and its predecessors for decades. Conrail's trackage rights dispute with Amtrak is no closer to being resolved today than it was when it began 5 years ago and a settlement would be offset by increasing Amtrak's subsidy requirement from the Federal Government. There has been little evidence that the states, some of which are prohibited by their constitutions from contributing to railroads, will be willing to pay Conrail $50 million per year in addition to agreeing with Conrail that they should assume responsibility for commuter operations.

FUNDING REQUIRED FOR PROPOSED SYSTEMS

Both USRA and Conrail project that, if all the changes they recommend are implemented, Conrail will not need further Federal assistance by 1985. USRA estimates Conrail will need a total of $657 million in additional Federal aid in 1981 and 1982. It projects Conrail will suffer a cash drain of $35 million in 1983 but suddenly come about and earn a total of $390 million after all expenses in 1984 and 1985. Conrail estimates it will need $604 million in additional Federal aid. It projects that it will break even in 1985. If the savings USRA and Conrail assume are not realized, however, the taxpayers will have to invest billions of additional dollars in Conrail subsidies. The magnitude of the potential burden on the taxpayers is summarized below.

POTENTIAL FEDERAL FUNDING
(1981 - 1985)
(MILLIONS OF CURRENT DOLLARS)

	Best Case	If Conrail fails to get agreements from other parties	If Conrail also fails to achieve the changes within management's control
USRA Proposal	$657	$1,522	$3,722
Conrail Proposal	604	2,139	3,884

USRA recommended that benchmarks be established against which Conrail's progress can be monitored. Presumably, these benchmarks are intended to permit termination of Federal funding if Conrail does not make sufficient progress toward the improvements outlined in this chapter. The USRA report, however, does not particularize any benchmarks. As a result, the Department cannot assess whether they will, in fact, provide appropriate protection for the taxpayer.

CONCLUSION

The plans set forth by Conrail and USRA in their April 1, 1981 reports recommend strategies for attempting to make Conrail financially self-sufficient. While the plans are the outcome of detailed planning efforts by dedicated professional organizations, neither should be accepted as the basis for further commitment of public funds to Conrail for the following reasons.

- Both plans require complete achievement of ambitious programs that call for unprecedented changes in Conrail's labor agreements, reversal of long-term traffic trends, and achievement of operating efficiencies that may well be beyond the reach of Conrail's management. The probability is low that Conrail can achieve even a large portion of those savings.

- Even if the programs were fully achieved, the result would be a financially marginal railroad not strong enough to survive subsequent economic downturns and unable to sustain itself without Government assistance over the long term.

As USRA states in its April 1 report:

> "The path to an improved Conrail is strewn with formidable obstacles. Despite the best intentions and the most diligent efforts, the goal of viability may be beyond Conrail's grasp."

The cost of failing to achieve all of the improvements projected by Conrail and USRA would be borne by the taxpayers. As the Nation learned from Conrail's failure to achieve any of the traffic gains or many of the cost efficiencies predicted in the Final System Plan, that cost can be very large indeed.

Even if Conrail accomplished all of the improvements USRA and Conrail indicate are necessary for financial self-sufficiency, the resulting, perpetually marginal system would be unable to be a part of the dynamics of the railroad industry. Having insufficient earnings to attract merger partners and insufficient financial strength to purchase other railroads or lines, Conrail could not effectively exploit the single-line, shipper-oriented service packages which will be necessary for long term viability in the rail system.

Both the USRA and Conrail April 1, 1981, reports suggest that a service transfer should be activated in the event the Conrail venture fails on its second try. Unlike Conrail, the USRA report does not even attempt to present an alternative to the existing Conrail other than a fire sale approach. The Department recommends that the effort to perpetuate Conrail be recognized as a risky, quixotic venture. Instead, the Congress should authorize the steps necessary to implement an orderly service transfer plan.

APPENDIX A

THE CONRAIL PROBLEM: AN HISTORICAL AND POLICY PERSPECTIVE

This appendix discusses the history of the Conrail problem and the factors that enable the Federal Government to effect a new active policy toward Conrail.

STUDIES OF THE NORTHEAST RAIL PROBLEM

The problems of railroads in the Northeast have been studied and understood for 20 years. Studies of the problems confronting railroads operating in the Northeast region have echoed common themes: a continuing long-term decline in the market for rail freight transportation due to a shift in heavy manufacturing locations from the older industrial cities; the overcapacity brought about by the inability of railroads in the region to reduce their plant and employee levels as demand decreases; and a resulting deteriorating financial performance which in turn shuts off access to new capital needed to maintain and improve plant and equipment and forces poor service and business failure. Table A-1 provides a list of these studies.

These studies and others adequately described the problems confronting railroads in the Northeast. Solutions to the problems, however, consistently have fallen short of the mark. Two reasons for failure have been the tendency to adopt the most palatable instead of the most effective remedies, and the repeated acceptance of excessively optimistic projections of traffic growth in the region. History shows that the remedies were inadequate and that the projections were rarely realized. Examples of the latter include projections offered in support of the Pennsylvania Railroad-New York Central Railroad merger, and the Final System Plan itself which designated the structure of Conrail.

CREATION OF THE PENN CENTRAL

The Penn Central was formed in 1968 by merging two of the largest railroads in the area now served by Conrail, the Pennsylvania and the New York Central. At the direction of the Interstate Commerce Commission, the bankrupt New York, New Haven and Hartford Railroad was included in the merged system. The merger was intended to provide a private sector solution to the rapidly deteriorating financial condition of the railroads involved. It also was given impetus by other mergers in the region, particularly the creation of the Chessie System from the Baltimore and Ohio, and Chesapeake and Ohio railroads, and the merger of the Norfolk and Western Railway Company with the Nickel Plate and the Wabash systems.

TABLE A-1
MAJOR STUDIES OF NORTHEAST RAIL SERVICE

DATE	AUTHOR	TITLE
1961	Senate Commerce Committee	National Transportation Policy ("Doyle Report")
1966	Interstate Commerce Commission	ICC Reports, Vol. 327, Finance Reports, Finance Docket No. 21989: Pennsylvania Railroad Company-Merger-New York Central Railroad Company
1970	America's Sound Transportation Review Organization (ASTRO)	The American Rail Industry: A Prospectus ("ASTRO Report")
1972	Penn Central Trustees	Report of Trustees on Reorganization Planning, February 15, 1972
1972	Penn Central Trustees	Plan for Reorganization (April 1, 1972)
1972	Penn Central Trustees	Trustees' Interim Report of October 1, 1972
1972	Wyer, Dick & Company	Viability Studies: Penn Central Transportation Company
1972	Senate Commerce Committee	The Penn Central and Other Railroads
1972	Senate Banking and Currency Committee	The Penn Central Failure and the Role of Financial Institutions
1973	Council of Economic Advisors	Productivity Report
1973	Department of Transportation	Northeastern Railroad Problem ("45-Day Report")
1973	Interstate Commerce Commission	Ex Parte 393: Northeastern Railroad Investigation
1974	Department of Transportation	Rail Service in the Midwest and Northeast Regions ("Orange Line" Report)

DATE	AUTHOR	TITLE
1975	United States Railway Association	Preliminary System Plan (PSP)
1975	Interstate Commerce Commission/ Rail Services Planning Office	Evaluation of the U.S. Railway Association's Preliminary System Plan
1975	United States Railway Association	Final System Plan (FSP)
1975	Interstate Commerce Commission	Evaluation of the U.S. Railway Association Final System Plan
1975	Citibank	A Capital Markets Analysis of the Final System Plan as Proposed by the United States Railway Association
1978	Department of Transportation	A Prospectus for Change in the Freight Railroad Industry
1979	Peat, Marwick, Mitchell & Co.	Evaluation of Conrail's Importance to the Economies of the Northeast Region and the Nation and the Potential Impact of Reductions in Conrail's Service on those Economies (June and November 1979)
1979	United States Railway Association	Alternatives for Conrail
1980	United States Railway Association	An Evaluation of the Marketing and Competitive Aspects of Limited Access by Other Rail Carriers into Conrail's Region
1980	United States Railway Association	Federal Funding of Conrail; Rail Service Objectives and Economic Realities

Penn Central's management believed the merger would enable it to consolidate duplicate facilities and services, increase efficiency and improve service. The railroad projected annual cost savings of $80 million after 8 years. It then advanced the $80 million projection to 5 years. The Interstate Commerce Commission accepted management's overall assessment, noting "there is no question but that the transaction will permit more economical and efficient use of the applicants' transportation facilities. The economies realized through the merger operations will redound in large part to the benefit of shippers, and thus to the general public, either through the improved service thereby made possible or lower rates."* This optimism was misplaced. After 872 days of operation, the Penn Central entered bankruptcy.

CREATION OF CONRAIL

Under the threat of cessation of rail service in the Northeast, Congress acted to restructure the system. The Regional Rail Reorganization Act of 1973 (3R Act) established USRA as a Government planning corporation and directed that it design a financially self-sustaining Consolidated Rail Corporation for the region while preserving service, jobs, and rail competition.

The blueprint for Conrail was contained in USRA's Final System Plan published on July 26, 1975. In the Final System Plan, USRA identified the rail properties that would be transferred to Conrail and provided projections for Conrail traffic, revenue, operating costs, and net income. The system finally selected by USRA offered, in its judgment, "the greatest potential to rationalize facilities, increase efficiency and minimize Government cost" of any alternative considered.

As with the Penn Central merger, however, Conrail's performance failed to meet expectations. Through December 31, 1980, Conrail incurred a cash loss from operations of $800 million in contrast to the predicted cash profit of $500 million. The company consumed $3.1 billion in Federal funds instead of the $2 billion projected in the Final System Plan. The reason for the variance in Conrail's actual performance from Final System Plan projections was unwarranted optimism about both Conrail's traffic and its ability to achieve operating efficiencies. For example, Conrail's 1980 traffic level was 31 percent less than that projected in the Final System Plan.

The optimistic projections of the Final System Plan were challenged before the Congress in September 1975 by Citibank Corporation. The Citicorp report warned that the economic

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* (327 ICC 475, 491)

forecast in the Plan was too optimistic in its assumption that real growth would average 4.8 percent per year. Citicorp cast doubt on assumptions involving dramatic improvements in Conrail's operating ratio and car utilization, observing that "without these improvements, Conrail would not have a chance of succeeding as an income-based solution to the Northeast problem." These and other warnings were set aside in the planning process.

THE LESSONS OF CONRAIL'S HISTORY

Although the causes of the problems confronting railroads in the Northeast are well known, responses to date have failed to address the problems and establish rail freight operations on a self-sustaining basis.

Today's new set of studies again recites the familiar litany of reasons for the Conrail problem: changes in the composition and strength of the industrial base in the Conrail service region, strong competition from trucks, plant overcapacity, and excessive labor costs. Furthermore, in 1981, two additional factors have become part of Conrail's environment: the advent of interregional rail carriers and relaxed regulation.

Two lessons are clear from history. First, the Conrail issue requires no more studies but an effective course of action. Second, in choosing a course of action, decision makers must respect the complexity of the problem and be skeptical of optimistic predictions of revenue gains, operating efficiencies, and increased earnings.

FEDERAL POLICY: A NEW DIRECTION

Having learned from the Conrail experience that studies and optimistic assumptions will not solve the northeastern freight dilemma, the Government must take effective action in a changed environment that includes new legislative trends favoring private sector solutions to rail problems, experience in the Midwest with private sector restructuring of marginal railroads, and an accelerating trend toward fewer and larger railroads.

Over the past 5 years, there have been several pieces of legislation which have favored private sector solutions to railroad problems. These are described in Table A-2. The Congress has determined, and the Administration agrees, that solutions involving massive Federal funding and control have failed. Attempts to implement private sector solutions to railroad problems, as in the Midwest, show considerable promise for success.

The Government's approach to the railroad problems in the Midwest differed fundamentally from its approach to Conrail. The Government's response to the bankruptcy of the Rock Island in 1975 and the Milwaukee in 1977 was to encourage and assist private sector restructuring.

TABLE A-2

RECENT LEGISLATIVE CHANGES AFFECTING
THE RAIL INDUSTRY

LEGISLATION	PURPOSE RELATING TO AN INCREASED PRIVATE SECTOR ROLE
Railroad Revitalization and Regulatory Reform Act - 1976	To reduce Federal regulation of railroad ratemaking; to encourage rail competition; to reform the Interstate Commerce Commission; to expedite mergers and consolidations.
Bankruptcy Reform Act of 1978	To give reorganization courts, rather than the ICC, final authority in areas such as abandonments; to give courts authority to liquidate a railroad's property after 5 years if no reorganization plan is confirmed.
Milwaukee Railroad Restructuring Act - 1979 and Rock Island Railroad Transition and Employee Assistance Act - 1980	To withdraw the Government from a direct role in providing labor protection; to ratify labor protection provisions consistent with the ability of the estates to pay the costs. (Conditions were much less generous than Title V and New York Dock conditions.)
Staggers Rail Act of 1980	To reduce ICC jurisdiction over ratemaking; to discourage general rate increases; to reduce anti-trust immunity for collective ratemaking; to expedite consolidations and other realignments short of merger.

In dealing with the Midwest bankruptcies, the Secretary of Transportation used the authority provided in Section 401 of the Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act) to facilitate transfer of properties from both the Milwaukee and the Rock Island to other railroads. In addition, a labor-management agreement concluded March 4, 1980 and known as the Miami Accords, authorized a new hiring and protection arrangement. As a result of the Section 401 process and conclusion of the Miami Accords, 96 percent of the Milwaukee's 1978 traffic is being served over 78 percent of its former network. Approximately 75 percent of the Milwaukee's employees will secure jobs either with the restructured Milwaukee or with railroads that have assumed service to former Milwaukee customers. Other railroads are now operating on 63 percent of the Rock Island's lines and serving 82 percent of its 1978 traffic.

The Midwest rail problem is less pervasive than that in the Conrail service area, but the experience in the Midwest indicates the effectiveness of the private sector, with limited Federal financial and technical assistance, in restructuring failing railroad companies. It also demonstrates that service can be maintained to all important traffic centers, jobs can be created for many employees, and essential links to the rest of the railroad industry can be preserved.

Finally, the rail industry itself is changing drastically. There is a trend toward fewer and larger systems, merged end-to-end, which can provide single carrier service. The emerging systems are national in scope and there is a danger that Conrail will remain a regional carrier unable to compete with these national systems. Further, competition is intensifying--both between rail carriers and between railroads and motor carriers. With the passage of the Staggers Rail Act of 1980, railroad managements are becoming more innovative in marketing rail services.

The legislative trends, the Midwest restructuring experience, and the changing nature of the industry, together with Federal experience in assisting other financially troubled companies and Conrail's continued disappointing financial performance, should form the basis for new policy that is active and realistic rather than passive and hypothetical.

APPENDIX B

NORTHEAST COMMUTER SERVICE

Conrail's responsibility for providing commuter service in the major metropolitan areas of the Northeast presents a formidable barrier to the acquisition of Conrail's freight service and related facilities in those areas.

Both the Regional Rail Reorganization Act of 1973 (3R Act) and the Railroad Revitalization and Regulatory Reform Act of 1976 (4R Act) require Conrail to operate commuter passenger service over the lines of its predecessors as long as state, local, and/or regional commuter authorities subsidize the net cost of service. Conrail now operates 1,800 commuter trains per day, carrying a daily one-way average of more than 450,000 persons in New York, Philadelphia, Connecticut, New Jersey, and between Baltimore and Washington. Commuter operations provide about 12 percent of Conrail's gross revenues. Table B-1 details existing Conrail commuter service while Table B-2 presents estimated operating and financial results for Fiscal 1981.

Those lines over which Conrail operates commuter services are characterized by a complex set of management and ownership relationships. These relationships are bound together by an equally intricate system of service contracts and maintenance agreements. For example, of the more than 900 commuter route miles off the Corridor, Conrail owns 15 percent, Amtrak owns 4.4 percent, and state or local agencies own or lease 80.6 percent. Most commuter stations are owned or leased by the agencies (72 percent of the total of 490 stations) and maintained under contract with Conrail; the railroad itself owns 27 stations.

One of the enduring features of the Northeast railroad problem is the complexity associated with joint operation of freight, intercity passenger, and commuter service. Figure B-1 illustrates this complexity, showing the number of daily trains of each type operating over segments of the Northeast Corridor rail line between Washington and New York. The Corridor trackage south of New York is owned by Amtrak, but Conrail and various authorities providing commuter service have operating rights. Although the ownership pattern north of New York is different, all three types of service are operated over portions of the Corridor line.

Both enabling legislation and the Rail Services Planning Office's (RSPO) reimbursement rules have determined that there should be no cross-subsidization between commuter, freight, and intercity passenger rail service. Conrail correctly maintains that its freight revenues cross-subsidize commuter service, contrary to the intent of Congress. RSPO standards cover

Table B-1

Existing Conrail Operated Commuter Service

State	Transit Agency	Service Provided
New York	MTA/CDOT	Serving Grand Central Station from the Hudson, Harlem, and New Haven Lines.
New Jersey	NJ Transit	Serving Penn Station from Northeast Corridor and Bay Head lines; serving Newark from the CNJ West Trenton and Philipsburg lines; and serving Hoboken from the former E-L lines to Port Jervis; Spring Valley, Netcong, and Gladstone.
Philadelphia	SEPTA	Serving two terminals in Center City; the former Reading lines to Norristown, Chestnut Hill, Jenkentown and a number of outlying points, and the former PC lines (on the Northeast Corridor) to Trenton and Wilmington as well as to Paoli, West Chester, Manayunk, and Chestnut Hill.
Maryland/DC	MDOT	Maryland service between Baltimore and Washington, D.C.

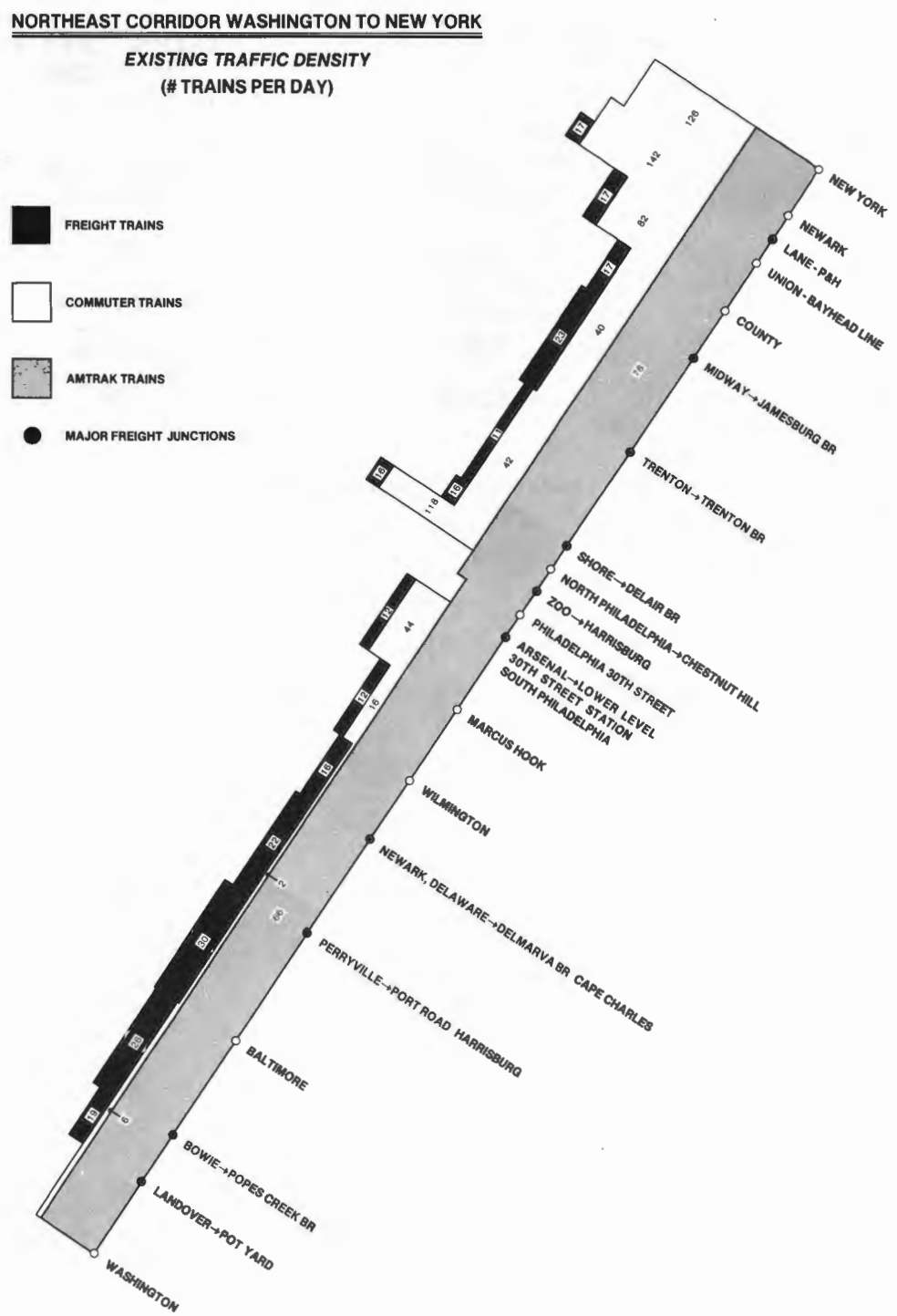
Table B-2

Estimated Operating and Financial Results
Commuter Service Operated by Conrail
FY 1981

	ACTIVITY			ESTIMATED FY 1981 FINANCING ($ in Millions)		
Subsidizer	Avg. No. Weekday Trains	Avg. No. Weekday One Way Riders	Route Miles	Operating Expense	Fare	Public Subsidy
MTA - CDOT	533	184,000	264	256	132	124
NJ - DOT	484	150,000	536	172	56	116
SEPTA	798	126,000	359	107	54	53
MD - DOT	4	2,000	40	1.5	0.5	1.0
TOTALS	1,819	462,000	1,199	536.5	242.5	294

Source: Conrail Subsidy Estimates for Current Year

FIGURE B-1


NORTHEAST CORRIDOR WASHINGTON TO NEW YORK
EXISTING TRAFFIC DENSITY
(# TRAINS PER DAY)
FREIGHT TRAINS
COMMUTER TRAINS
AMTRAK TRAINS
MAJOR FREIGHT JUNCTIONS
NEW YORK
NEWARK
LANE - P&H
UNION - BAYHEAD LINE
COUNTY
MIDWAY→JAMESBURG BR
TRENTON→TRENTON BR
SHORE→DELAIR BR
NORTH PHILADELPHIA→CHESTNUT HILL
ZOO→HARRISBURG
PHILADELPHIA 30TH STREET
ARSENAL→LOWER LEVEL
30TH STREET STATION
SOUTH PHILADELPHIA
MARCUS HOOK
WILMINGTON
NEWARK, DELAWARE→DELMARVA BR CAPE CHARLES
PERRYVILLE→PORT ROAD HARRISBURG
BALTIMORE
BOWIE→POPES CREEK BR
LANDOVER→POT YARD
WASHINGTON

long-term variable costs but not fully allocated costs, and late payments by commuter authorities require Conrail to use its cash resources to cover the costs associated with commuter service.

Conrail correctly contends that the railroad's primary mission is the provision of freight service. Consequently, commuter service constitutes a diversion of management resources. Conrail also contends that the high visibility of its commuter service is a serious public relations problem. Officials maintain that poor commuter service reflects disproportionately on Conrail's image, even though the root cause of the problem is not Conrail's.

Commuters and commuter agencies assert, on the other hand, that the quality of Conrail commuter service suffers because Conrail gives freight service a higher priority than passenger service. The agencies contend that in the area of labor negotiations, for example, there is little incentive for Conrail to negotiate intensely since the commuter authorities, rather than Conrail itself, bear the major portion of the costs. Commuter authorities argue that they have no direct involvement in Conrail commuter operating decisions. There are no commuter representatives on either the Conrail board or that of the USRA, which oversees Conrail operations.

ALTERNATIVE SOLUTIONS

The controvery over commuter service has not changed substantially since the days of Conrail's predecessors. What has evolved, however, is a compelling argument in support of full separation of Conrail's freight and commuter passenger responsibility and a strong case for separate facilities. The Department's proposal to integrate Conrail's lines and services into the operations of other railroads makes a separate organization for commuters a feasible alternative. A requirement for continued commuter operation by Conrail or its successor would be an absolute barrier to the sale of Conrail's lines in this area. The Department therefore supports the establishment of a passenger service entity or entities separate from the Conrail freight operations.

There are several alternatives to Conrail's role as rail commuter operator.

- Each commuter rail authority could operate its own service with its own employees.
- Each commuter rail authority could contract for its own service with a rail management firm.
- A multi-authority corporation either could operate or contract for commuter services. This concept could be expanded to include the operation of Amtrak's Northeast Corridor intercity service by such a corporation under contract to Amtrak.

- o Amtrak or an Amtrak subsidiary could operate commuter service under contract to each commuter authority.

The first two alternatives, those envisioning an authority operating or contracting for service, would have the advantage of affording direct management responsibility to each individual authority. Such an arrangement would recognize that the different authorities in the Northeast have different and distinct operations and may have different perspectives on how the services should best be run and financed. The increased difficulty of coordinating overlapping schedules and operations of independent authorities would be a disadvantage of these options.

The New Jersey Department of Transportation has proposed the concept of a multi-authority corporation to operate the Northeast commuter services. If the commuter rail authorities can fund such a corporation and agree on the terms of its formation and of its operation, the concept could be successful. Important questions to be worked out are the composition of the board of directors and the role of such a corporation in the operation of Amtrak intercity service on the Northeast Corridor.

The use of Amtrak as a commuter operator seems plausible at first glance. This concept has met with some resistance from local sources, however. If Amtrak becomes the principal commuter operator, there would be a serious risk that the Federal Government might end up supporting or subsidizing the commuter operations, an unacceptable result. If the books could be kept separate, and if Amtrak can demonstrate that it will bring good management resources to bear, this option is workable.

The recent action by the Massachusetts Bay Transportation Authority (MBTA) illustrates a potential alternative for commuter authorities. The MBTA recently sought and received expressions of interest in the operation of its commuter rail system, currently operated by the Boston and Maine Railroad. The MBTA plans to evaluate a transportation management firm versus the Boston and Maine versus direct management by its own forces. Such an evaluation should be given serious consideration in the months ahead by the other commuter authorities.

The Department recognizes that the creation of an organizational framework within which the commuter and intercity passenger services can be operated and coordinated properly is not an easy undertaking, and that considerable discussion among the affected parties will be required to bring it about. The Department will submit legislative recommendations to initiate the process and will assist all the parties in reaching a final accord.

APPENDIX C

LABOR

Throughout its history, the railroad industry has struggled to control labor costs in order to generate sufficient earnings. It is thus not unusual that the effective use of labor is a fundamental issue in the survival of Conrail, as well as the central issue in any plan to transfer Conrail's services.

CONRAIL WORK FORCE

By 1980, Conrail had reduced its freight service work force from 76,800 in 1977 to 62,400 (Table C-1). As of February 1981, Conrail had 11,000 furloughed employees who have recall rights if business levels increase.

Conrail faces a critical surplus employment problem. The cause of this employee surplus is twofold. First, Conrail is a carrier with substantial tonnage originating and terminating on its own system. Much of the size of its work force is a product of the railroad's structure, including sizable terminal, repair, and servicing facilities. Because of declining traffic and changes in railroad service patterns, some of the terminal and facility capacity is excess to Conrail's needs. The excess physical capacity is often accompanied by greater than necessary employment.

Table C-1

CONRAIL EMPLOYMENT TRENDS
Average Number of Employees Working

	Freight	Passenger	Capital[1/] Projects	Total
1977	76,800	11,400	6,400	94,600
1978	72,400	11,300	7,600	91,300
1979	68,900	11,200	7,400	87,500
1980	62,400	11,700	5,500	79,600

1/ Employees assigned to capital and special fund projects.

A second major cause of surplus employment is the number of excess positions required under labor agreements entered into by Conrail and its predecessor railroads. In the operating crafts, the problem exists as a result of the fireman manning and the crew consist agreements.

Full-crew laws in several states served by Conrail's predecessors required that the fireman's position be filled on all trains. When these laws were repealed, firemen could be reduced only through attrition. This left many protected firemen on Conrail's rolls. Locomotive engineers generally hold seniority as firemen. When business declines, as it did in 1980, these engineers exercise their seniority rights to occupy fireman positions which otherwise would be vacant. As a result, Conrail operates a high percentage of trains with both a locomotive engineer and a fireman. Even in 1979, Conrail's use of firemen was over twice the industry average in road service, and more than three times the industry average in yard service.

Under a 1978 crew consist agreement, Conrail may operate trains of up to 70 cars with one conductor and one brakeman, provided brakemen's jobs are eliminated only through attrition or voluntary separation. If there are furloughed trainmen in a seniority district, trains in that district must be operated with two brakemen.

Table C-2 indicates that Conrail's overall use of train and engine service employees per unit of output is higher than that of other railroads. As traffic declined in 1980, the number of trains operating with a second brakeman doubled, greatly reducing the benefits expected from the crew consist agreement.

The number of employees in Conrail's clerical, maintenance of equipment, and train and engine service categories is significantly higher than that of corresponding classes on other railroads nationwide. Conrail compares poorly with the Southern in all, and with the Chessie in most, employment categories in Table C-2.

Two factors inhibiting any effort to economize by reducing the Conrail work force are the labor protection provisions of the 3R Act and the requirements of labor agreements. Nearly 45,000 Conrail employees who worked for the predecessor railroads are guaranteed job and income protection until age 65 or as long as they are Conrail employees, and 14,000 others are entitled to such protection for up to 5 years. Most of these protection rights were legislated under Title V of the 3R Act. The monthly wage guarantees for these employees severely reduces savings from furloughing them.

These protected employees, and other employees hired after Conrail began service, benefit from labor agreements which severely limit Conrail's ability to reduce its work force commensurate with traffic reductions. The agreements include the fireman

Table C-2

CONRAIL FREIGHT EMPLOYEES PER UNIT OF ACTIVITY
VERSUS CHESSIE, SOUTHERN, NATION IN 1979

	Conrail[a]	Chessie[b]	Southern	Nation[c]
EXECUTIVES per billion revenue ton-miles:	24	25	17	18
Ratio, Conrail to others:		0.96	1.41	1.33
PROFESSIONAL AND CLERICAL per billion revenue ton-miles	187	128	73	92
Ratio, Conrail to others:		1.46	2.57	2.04
MAINTENANCE OF WAY per thousand track-miles:	372	340	213	326
Ratio, Conrail to others:		1.10	1.75	1.14
MAINTENANCE OF EQUIPMENT per billion equipment ton-miles:[d]	127	150	51	80
Ratio, Conrail to others:		84.8	2.46	1.59
TRAIN AND ENGINE per billion revenue ton-miles:	253	216	141	136
Ratio, Conrail to others:		1.17	1.79	1.86

Notes:

(a) Since ICC employment statistics do not distinguish between freight and passenger employees in most categories, the Conrail ratios are based on approximations of freight employment except in train and engine.

(b) Chessie = C&O plus B&O.

(c) Nation excludes Conrail and the Long Island.

(d) Equipment ton-miles = total gross ton-miles less net ton-miles.

manning and crew consist agreements, discussed earlier, which generally allow for reduction in employment only through attrition, and also give employees the right to fill vacant positions in lieu of remaining on furlough. In addition, long-standing distinctions which separate classes and crafts of employees, seniority district limitations, and work equity arrangements seriously limit the flexibility of management in gaining the most effective and productive use of employees.

LABOR PROTECTION

Labor protection for railroad employees adversely affected by line abandonments and mergers began in the early 1930's. Except for the recent experience of the Rock Island and Milwaukee railroads, protection benefits have been broadened substantially in subsequent years. Labor protection coverage may include separation allowances, the guarantee of earnings for a specified period of time, rights to certain jobs, rules for transfer, reimbursement of moving expenses, and retraining rights.

Labor protection generally has been based both on altruism and on practical considerations. The growth of labor protection through the 1930's not only was a humanitarian response to layoffs occurring in the rail industry, but also demonstrated the collective bargaining ability and political strength of the rail labor organizations at the time.

During the merger movement of the 1960's, railroads seeking merger approval from the ICC typically faced opposition from the labor organizations. In response, the merging carriers typically sought to reach agreement on labor protection in exchange for labor cooperation or neutrality in obtaining ICC approval. The Pennsylvania Railroad and the New York Central, for example, negotiated a "lifetime" labor protective agreement with its labor organizations in order to obtain labor neutrality in the Penn Central merger case.

Title V

The development of legislation to create Conrail from the lines of the Penn Central and other bankrupt railroads again reflected concern for employees and the practical need to obtain organized labor's cooperation in passage of enabling legislation, in this case the Regional Rail Reorganization Act of 1973.

Title V of the 3R Act required that all eligible employees of the bankrupt railroads in the Northeast be offered employment and accorded wage and job protection benefits until age 65, provided they had at least 5 years of seniority with Conrail's predecessors. Employees could terminate their employment with Conrail and receive a maximum $20,000 lump sum separation allowance. Relocation expenses were provided for employees offered jobs elsewhere on the Conrail system.

The key element of Title V compensation is the monthly wage guarantee, known as the monthly displacement allowance (MDA). Under this provision, employees who were offered other jobs on Conrail at lower rates of pay were guaranteed annual incomes equal to their total base period (1974) earnings, as escalated by subsequent wage increases. The deteriorated condition of the predecessor railroads and limited hiring resulted in above normal earnings for those employees who worked in 1974. As a result both of using this high base and other features of the guarantee, an active full-time employee might still collect an MDA over actual Conrail wages and benefits earned. Title V costs have exceeded projections, owing principally to this guaranteed earnings feature. The initial $250 million authorization was exhausted in early 1980 and $181 million was used for MDA payments.

The Staggers Rail Act of 1980 revised the Title V provisions to reduce the level of some monthly wage guarantees. The amendments also increased the Title V authorization by $235 million and set a limit of $180 million for payment of MDA's. If the $235 million proved to be inadequate or the $180 million MDA cap was topped, the Staggers Act required Conrail and the other railroads which acquired trackage from the predecessor railroads to pay the costs.

The fund is still being depleted rapidly, despite the fact that the 1980 amendments have reduced the average number of claims from active employees. Such claimants, who numbered an average of 8,000 to 10,000 per month, are now down to 1,600. At the same time, however, sharp declines in traffic and employment cuts increased the number of furloughed employees entitled to their full wage guarantee. Data available when the Staggers Act amendments were being drafted indicated that historically the number of surplus protected employees on furlough had ranged from 250 to 350. There are now in excess of 1,700 such employees entitled to full earnings. The annual average cost per surplus employee is $28,800, including the cost of fringe benefits. As a result, payments to Conrail from the fund have been averaging nearly $5 million per month since early 1980. Payments covering adversely affected employees on other carriers which assumed trackage of the bankrupt estates add nearly $1 million per month.

The features of Title V make it inordinately expensive. For example, protected employees who are furloughed may be offered the option of receiving MDA's or accepting the $20,000 separation payment. Given the generous MDA formula, few employees have elected to take separation payments. In addition, an employee offered a transfer to a vacant position must accept the transfer, take the separation allowance or go on unpaid furlough. However, the transfer procedures of Title V only permit the offer to be made to the most junior employee, who then has 30 days to make a decision before the job is filled. If the employee declines the procedure must be repeated.

To date, $485 million has been authorized to pay the cost of Title V labor protection benefits, of which $319 million has been appropriated and spent. As of February 28, 1981, an additional $28.6 million in Title V benefits had been paid by all involved carriers, which are awaiting Government reimbursement.

Title V provisions mandate wage protection for any eligible furloughed employee, regardless of the cause of the layoff. Most of the 1,700 surplus Conrail employees are receiving wage protection payments because of a downturn in rail traffic, not because of any adverse impact caused by the creation of Conrail as the statute originally intended. Similarly affected employees on other railroads receive only payments from the Railroad Unemployment Insurance Fund, which is financed by payments to the fund from all railroad companies.

Milwaukee Agreement

The labor protective conditions of the Milwaukee Railroad Restructuring Act (MRRA), passed in November 1979, represented a sharp departure from the trend of steadily increasing protection benefits. The Trustee of the bankrupt Milwaukee Road had determined that the railroad could not be reorganized if the estate had to pay the cost of the standard labor protection provisions imposed under the Interstate Commerce Act, commonly referred to as "New York Dock" conditions. Without relief from the protection liability, liquidation of the entire Milwaukee was likely.

MRRA generated a labor protection agreement between the railroad and labor organizations under which employees, on a voluntary basis, could accept guaranteed but reduced payments, in lieu of the New York Dock level of protection payments which might ultimately be won in a court approved reorganization. Milwaukee conditions include a maximum $25,000 separation payment and, for those employees hired by other railroads, wage protection at 80 percent of base earnings for 3 years, in addition to moving expenses. Similar legislation was enacted to apply to Rock Island employees, but implementation of this legislation has been delayed pending litigation. In the case of each railroad, the limit on employee protection was $75 million, covering 5,000 employees of the Milwaukee in a partial liquidation and 6,000 employees of the Rock Island in full liquidation. Funding was provided through secured Federal loan guarantees to the estates. Retraining was funded directly by the Government.

A NEW APPROACH TO LABOR PROTECTION

Existing labor protection for Conrail employees bars any permanent solution to Northeast railroad problems. Any reduction in employment Conrail makes is negated by the labor protection liability for which it is responsible and for which Federal funding is running out. Savings from the abandonment of unprofitable lines would be offset quickly by accompanying Title V claims, unless the law is changed.

The private sector cannot bear the cost of Title V labor protection in the acquisition of Conrail lines, but neither can the Government be expected to provide continuing income and fringe benefit protection which prefers large numbers of Conrail employees over other railroad and industrial workers. After more than 5 years of coverage, at a cost to the taxpayers expected to reach $400 million by the end of Fiscal 1981, it is time to bring this feature of the legislation establishing Conrail to a close.

To facilitate the reestablishment of private sector rail service in the Northeast and to provide reasonable levels of assistance to displaced workers, the following legislative changes will be proposed to the Congress. They are:

- Termination of the existing Title V labor protection provisions effective October 1, 1981;
- New labor protective arrangements for employees separated permanently through the transfer of Conrail's services to other railroads; and
- Assistance for employees who move to other railroads or who select retraining after separation from Conrail.

The proposed labor protective arrangements will be based on the concepts embodied in MRRA. The Government will fund a reasonable level of one-time payments to separated employees, in addition to moving and retraining expenses. Health and welfare benefits also will remain in effect for a maximum of 6 months.

The cost of such protective arrangements will vary with the number of employees who become surplus or who must relocate to continue their railroad employment. All current employees of Conrail will be afforded protection based on their years of service. As with the MRRA labor agreement, it will be incumbent on labor and management to negotiate an agreement for protection that suits their needs.

In compliance with the preferential hiring clause presently contained in the Staggers Act, an aggressive hiring plan should be implemented which strives to find alternate railroad employment for displaced Conrail employees. An agreement between all Class I railroads and all railroad labor organizations would establish the mechanisms for preferential hiring. Various components of the protection program, such as reimbursement for moving expenses and retraining, would be coordinated with preferential hiring actions.

APPENDIX D

LOW-VOLUME SHIPPERS

Many of Conrail's customers ship in low volumes. Of the 58,000 Conrail users shipping less than 100 cars per year, 51,600 ship an average of only four cars per year. For Conrail, the service presently provided to most of these customers is uneconomic.

Continued service to low-volume customers requires the maintenance of an extensive and costly network of small yards and facilities, low-volume branch lines, and urban trackage. These facilities contain the bulk of the deferred maintenance remaining on the Conrail system. Local trains in these low-volume areas incur high operating costs per car. As deferred maintenance reaches the point at which investment is required to correct it, Conrail presumably will attempt to increase rates to low-volume customers, or will attempt to abandon the service entirely. Those carriers assuming Conrail service are likely to respond similarly.

A recent study for the Federal Railroad Administration examined the impact of the loss of rail service on 135 companies. The study found that in all but two cases the firms were able to shift to alternative forms of transportation. In those two cases, the firms had to terminate operations. In addition, three firms relocated. Of the remaining 130 companies, many had to absorb higher transportation costs but only 20 of the firms lost business. In only seven firms did business reductions require employee layoffs.

The study found that the shippers most likely to be adversely affected by loss of railroad service are those with the following characteristics:

- Firms that receive or distribute bulk commodities on a local basis. In the case of these firms, which include grain elevators, fertilizer dealers, and lumber yards, direct transportation costs represent a relatively high proportion of total costs. If nearby competitors continue to receive rail service, their loss of competitive position can be significant.

- Firms whose shipments are not suitable for trucking. Due to either physical dimensions or the volume of their shipments, some firms have difficulty using trucks. Some firms located near other railroads have established transloading arrangements and absorbed the added costs. The feasibility of such arrangements depends on the length of the truck haul.

- o Firms that ship bulk commodities long distances. Shippers of products such as railroad ties, logs, concrete aggregates, and charcoal face loss of comparative price advantages because long hauls of bulk commodities are significantly more expensive by truck. This category also includes shippers using a nationwide distribution network for standardized products with narrow profit margins.

ALTERNATIVES

To overcome the adverse impact on low-volume customers facing loss of direct railroad service and to retain as much of the traffic they generate as possible, there are several alternatives. The primary alternative is trailer-on-flatcar (TOFC) service. This concept is widely used and well understood and will not be elaborated on here. Less well known are alternatives available for shippers with products unsuited to TOFC service and shippers not located near a high-volume TOFC terminal. These other alternatives are described briefly below.

Pressurized loading. Even though its private siding may no longer be served, a receiver of such bulk materials as cement, chemicals, plastic granules, petroleum, or food oils may continue to receive service via customized loading facilities. These facilities, which transfer material from covered hopper or tank cars to trucks, combine the economies of high-volume rail service and rapid unloading at a central terminal with the convenience of small lot truck delivery direct to job sites, batch plants, or industrial locations. The total dock-to-dock cost often is substantially lower than the origin-to-destination trucking price.

Distribution Centers. Initially developed for lumber and building materials, the distribution center concept concentrates a major inventory in one location near a major railroad terminal. Dealers using the center can order in larger quantities, thereby achieving heavier payloads and lower freight costs per unit. To develop new traffic and eliminate or reduce many costly low-volume urban and rural operations, a New England railroad is actively marketing a multi-customer center. The distribution center arrangement can usually justify somewhat lower rail rates to compensate the customer for the cost of the center's services and the outlay for final delivery by truck.

Rail-Highway Transfer. Building on the distribution center concept, the same New England railroad is constructing a public delivery facility capable of accepting a broad variety of commodities. The center is located adjacent to a main rail line and near a principal industrial yard, thus readily accessible to switch engines serving that yard. The facility resembles a warehouse, with loading docks for trucks on one side, rail cars on the opposite side, and storage bays in between. The facility permits direct flow of products from rail cars to temporary storage, to truck--all handled by forklift. The total cost is significantly

lower than that of a public warehouse. In return for this service, plus an unloading allowance, the low-volume customer is encouraged to accept delivery at the transfer center and allow the railroad to discontinue service at the shipper's private siding.

Shippers' associations, private entrepreneurs or even state or local governments can develop and operate centralized unloading facilities where they are considered an appropriate solution. With this arrangement, shippers losing direct rail service will have an alternative for continued rail service. At the same time, acquiring carriers will be able to serve these smaller shippers efficiently and profitably.

In addition to the service solutions discussed above, some low-volume lines could be attractive for operation as short-line railroads. Although most low-volume lines would not become profitable simply by becoming independent short-line operations, some lines, particularly with strong shipper involvement, could provide viable service.

It is clear that there will be some impact on low-volume shippers--particularly those on lines not acquired by other railroads. The options identified above can substantially minimize the extent of those impacts.