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Issue Brief

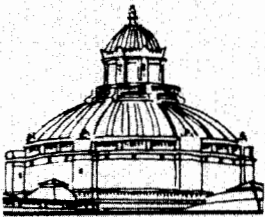
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CONRAIL: SELL TO NORFOLK SOUTHERN CORPORATION OR SELL TO A GROUP OF
INVESTORS?

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ISSUE DEFINITION

The Consolidated Rail Corporation (Conrail) could be approved by Congress during 1985 for sale to Norfolk Southern Corporation, or for sale to a group of investors headed by Morgan Stanley & Company, who would later sell Conrail stock to the public under a proposal presented May 14, 1985. This issue brief discusses that possible forthcoming sale of a large, federally-owned railroad to the holding company of one of the Nation's largest railroads, or sale to a group of investors for later sale to the public through a stock offering.

BACKGROUND AND POLICY ANALYSIS

LEGISLATIVE ACTION LEADING TO A POSSIBLE SALE

The Consolidated Rail Corporation (Conrail) is owned by the Federal Government (85%) and Conrail's own employees (15%).

The now-profitable railroad is available for sale, under authority established by the Northeast Rail Service Act of 1981 (NERSA) (P.L. 97-35, 95 Stat. 357). Under title IV of that law, the Secretary of Transportation was given authority to sell Conrail to one or more buyers, or by a public offering of Conrail stock, without enabling legislation having to be enacted by Congress, unless the Secretary's plan was overturned by Congress. However, when Senate Commerce Committee Chairman Danforth introduced S. 638 on Mar. 7, 1985, he stated: "The enabling legislation requires action by Congress. The original sale provision of NERSA permitted the Secretary to sell Conrail unless both the House and the Senate passed a resolution of disapproval. Not only does Immigration and Naturalization Service v. Chadha et al., 103 S.Ct. 2764 (1983) invalidate the congressional disapproval procedure in NERSA but the importance of the sale and need to ... [bring existing legislation into conformance with the sale] require affirmative legislation to conclude the sale." (Congressional Record for Mar. 7, 1985, S. 2712.) Senator Danforth's bill to sell Conrail, S. 638, was referred to the Senate Commerce Committee, which he chairs. Markup on that bill was held Apr. 18, 30, 1985. On Apr. 30, 1985, the Committee voted in favor of reporting the bill, with amendments, to the Senate with a recommendation that the bill be passed by the Senate.

The Senate Judiciary Committee has held one day of hearings, and more hearings are planned.

The House Energy and Commerce Committee held hearings on Apr. 18 and 30, and July 10, 1985, on the proposed sale of Conrail, and more hearings are expected. The House Ways and Means Committee held hearings on May 1 to consider tax aspects of the proposed sale, and more hearings were expected.

Conrail's Chairman, Stanley Crane, had promoted the idea of a public stock offering, in opposition to Secretary of Transportation Dole's proposed sale to Norfolk Southern Corporation.

On May 14, 1985, Morgan Stanley & Company, an investment banking firm, submitted a proposal for sale of Conrail. Under that plan, as later amended, 32 firms would buy Conrail from the U.S. Government. Later, shares of Conrail stock would be sold to the public, and no firm would retain more than

5% of Conrail's stock. Legislation has been introduced in the House and Senate to authorize sale of Conrail according to the Morgan Stanley proposal.

THE ORIGIN AND LOCATION OF CONRAIL

Conrail began operations on Apr. 1, 1976, as a federally owned, for-profit corporation, comprising the rail properties of six bankrupt railroad companies that had been serving the northeast quadrant of the United States. Other private railroads, most notably the Chessie System and the Norfolk and Southern Railroad, continue serving portions of this same territory.

Although Conrail serves 16 States and the District of Columbia, forty percent of its employees live in the State of Pennsylvania. Conrail's corporate headquarters are in Philadelphia.

Congress authorized the creation of Conrail by enacting the Regional Rail Reorganization Act of 1973 (P.L. 93-236, 87 Stat. 985), usually referred to as the 3R Act. Congress authorized Conrail to begin operating by enacting the Railroad Revitalization and Regulatory Reform Act of 1976 (P.L. 94-210, 90 Stat. 31), usually referred to as the 4R Act. (See title VI of that Act.)

FINANCIAL ASPECTS OF CONRAIL

Conrail invested about \$3 billion in new track and equipment over the period 1976 to 1980. That money came to Conrail from the U.S. Treasury. Approximately an additional \$3 billion of U.S. Treasury money was used to buy rail property owned by the bankrupt railroads taken over by Conrail. Additional Federal money has been used to compensate displaced Conrail employees. From 1976 through 1980, Conrail lost money on its rail operations, but, since 1980, it has been profitable, despite the recent economic recessions in the United States. The magnitude of the turnaround is illustrated by the following numbers: in 1978, Conrail's worst year, it lost \$400 million. In 1984, its best year, it made over \$500 million in net revenues before taxes on revenues of \$3.4 billion. Net income per share was \$18.50 in 1984. This turnaround generally is attributed to the following factors.

First, Conrail reduced its cost of labor by reducing the number of Conrail employees from about 100,000 to about 40,000. This reduction in labor force was financed largely by money from the U.S. Treasury that was used to pay benefits to Conrail employees who were furloughed or transferred to a lower-paying job.

Second, Congress adopted a sweeping reduction in the economic regulation of railroads by enacting the Staggers Rail Act of 1980 (P.L. 96-448, 94 Stat. 1895). This Act allowed Conrail to more closely relate rail costs incurred by the railroad to the rail rates it charges its customers. It also has allowed Conrail to drop unprofitable service, charge rates more closely related to what the customer was willing to pay, and to cancel joint rates and through routes on which Conrail believed it was not receiving a sufficient division of the total revenue that it shared with other railroads participating in the traffic.

Third, Conrail was permitted to drop unprofitable commuter rail service, as a result of the Northeast Rail Service Act of 1981.

Fourth, Conrail employees accepted a temporary reduction in wages of about 12 percent compared to the national rail average. Their wages have now been

restored to the national average. These postponed wages amounted to about \$120 million per year. There is disagreement between Conrail management and Conrail labor as to whether this pay reduction was foregone, or only postponed. Consequently, there are about \$420 million of wage benefits in dispute as to what compensation, if any, Conrail workers will be entitled to when Conrail is sold. Such compensation, if it occurs, could result in a large number of Conrail shares being issued to Conrail employees.

Fifth, management has improved since Stanley Crane, a highly respected railroad manager, became Chairman of Conrail's Board of Directors and Chief Executive Officer on Jan. 1, 1981.

Sixth, the ICC has allowed even greater latitude to Conrail in closing joint rates and through routes with other railroads than specifically authorized by section 217 of the Staggers Act for any railroad.

SELECTING A BUYER FOR CONRAIL

The Department of Transportation (DOT) contacted approximately 110 entities in December 1983 and January 1984, asking them to make an offer to buy Conrail. "This round of contacts produced an offer from Alleghany Corporation, public expressions of interest from NS and CSX Corporation (CSX), and private expressions of interest. At the request of the Secretary [of Transportation], Goldman Sachs evaluated the financial terms of Alleghany's offer. In a letter to the Secretary dated Apr. 8, 1984, Goldman Sachs concluded that Alleghany's purchase price was within the range of providing fair compensation to the Federal Government. Further, Goldman Sachs suggested that it would be an appropriate time for the Secretary to invoke a 60-day time period to elicit other offers.

"After receiving this advice, Secretary Dole established June 18, 1984 as the deadline for submitting additional offers to purchase Conrail." (Conrail Sale Amendments Act of 1985, page 4.) By that deadline, DOT had received a total of 14 bids. Since then, DOT narrowed the number of bids under serious consideration to six, then to three, and then to one -- Norfolk Southern Corporation (NS). DOT did not publicly announce its reasons for rejecting some offers, but it is known that the labor bid included a cash payment of \$500 million, all of which was to be derived from a loan secured by Conrail's own assets. The rest of the offer consisted of considerations, such as a promise not to use or sell some tax credits arising from Conrail losses incurred since it began operating in 1976. Some of the other offers DOT has received for the purchase of Conrail have included a higher cash payment than \$500 million, and the cash would come from outside Conrail itself and not obligate Conrail assets.

DOT sent details of the three bids to the Department of Justice (DOJ) and the Department of the Treasury (Treasury) for an evaluation of the antitrust and tax implications of the three bids. Both DOJ and Treasury have reported back to DOT. DOT then announced in February 1985 that it favored a sale to Norfolk Southern Corporation.

DOJ's report said that a sale of Conrail to Norfolk Southern Corporation would not be opposed by DOJ so long as certain lines were sold to other railroads. DOJ requires a report on sale of those lines before it will be satisfied that its criteria have been met. It is believed that such action could take several months. In mid-July 1985, DOJ awarded a contract to a transportation consulting firm to study whether Guilford Transportation Industries and Pittsburgh and Lake Erie Railroad will likely generate enough

revenues from the rail lines they have agreed to purchase in the event Conrail is sold to Norfolk Southern Corporation, so that Guilford and P&LE could cover their long-term capital and operating costs on these lines. The initial report from the consultant to DOJ approximately Sept. 15 and that report could call for further studies that probably could not be completed before the end of 1985.

CONGRESSIONAL HEARINGS IN 1985 ON SALE OF CONRAIL

Hearings on the sale of Conrail have been conducted by the House Energy and Commerce Committee, the Senate Commerce Committee, and the Senate Judiciary Committee. The Senate bill, S. 638, was referred to only the Senate Commerce Committee, without concurrent or sequential referral to any other committee. On Apr. 30, 1985, the Senate Commerce Committee, by a vote of 12 to 5, decided to report the bill with amendments to the full Senate with a recommendation that the bill pass. On June 27, 1985, S. 638 was reported by the Senate Commerce Committee (S.Rept. 99-98).

Sale of Conrail was included in both the Senate and House budget reconciliation as of June 27, 1985. The result could be legislation from Committees that might prefer to delay action on sale of Conrail for whatever reason.

LEGISLATION

H.R. 787 (Edgar et al.)

Allows Conrail to be sold by an offering of common stock to the public. Introduced Jan. 30, 1985; referred to Committee on Energy and Commerce.

H.R. 1449 (Broyhill et al.)

Transfers Conrail to the private sector. Introduced Mar. 6, 1985; referred to Committee on Energy and Commerce.

H.R. 1930 (Rostenkowski et al.)

Addresses tax implications of the sale of Conrail to Norfolk Southern Corporation. Introduced Apr. 3, 1985; referred to Committees on Energy and Commerce, and Ways and Means. Hearings were held May 1, 1985.

H.R. 2873 (Eckart et al.)

Transfers Conrail to the private sector. Introduced June 26, 1985; referred to Committee on Energy and Commerce and Committee on Ways and Means.

S. 638 (Danforth et al.)

Conrail Sale Amendments of 1985. Permits the sale of Conrail to Norfolk Southern Corporation and brings existing law into conformance with that sale. Introduced Mar. 7, 1985; referred to Committee on Commerce, Science, and Transportation. Markup held Apr. 18, 30, 1985. The Committee voted on Apr. 30, 1985, to report the bill favorably to the full Senate, with amendments. Reported June 27, 1985 (S.Rept. 99-98).

S. 976 (Specter)

Consolidated Rail Corporation Profit Transfer Act of 1985. Requires Conrail profits to be transferred to Amtrak. Introduced Apr. 23, 1983; referred to Committee on Commerce.

S. 1137 (Specter)

Conrail Public Offering Act of 1985. Requires Conrail to be sold by

public offering in accordance with a proposal presented by Morgan Stanley and Company on May 14, 1985. Introduced May 15, 1985; referred to Committee on Commerce.

S. 1361 (Specter et al.)

Conrail Public Sale Act. Transfers Conrail to the private sector by public offering of stock. Introduced June 26, 1985; referred to Committee on Commerce, Science and Transportation.

HEARINGS

U.S. Congress. Senate. Committee on Commerce, Science and Transportation. Sale of Conrail. Hearings on Feb. 27, 28 and Apr. 4, 1985. Senate hearing 99-52. 371 p.

REPORTS AND CONGRESSIONAL DOCUMENTS

- U.S. Congress. Joint Committee on Taxation. Description of Revenue Provisions of H.R. 1930 and background relating to proposed transfer of Conrail to Norfolk Southern Corporation. Apr. 30, 1985. Joint Committee Print JCS-12-85. 24p.
- U.S. Congress. Senate. Committee on Commerce, Science, and Transportation. Conrail Sale Amendments Act of 1985; report to accompany S. 638. June 27, 1985. 147 p.
Report 99-98.

CHRONOLOGY OF EVENTS

- 07/18/85 -- The Journal of Commerce stated today that a public sale of Conrail along the lines proposed by Morgan Stanley Company had received the endorsement of rail labor, including the United Transportation Union (Page 1A). But, an article today in The Washington Post quotes UTU's national legislative director, James R. Snyder, as saying "We haven't officially endorsed anyone."
- 07/15/85 -- The Department of Justice has awarded a contract to R. L. Banks and Associates, Inc., a transportation consulting firm, to determine whether the sale of Conrail properties to Guilford Transportation Industries and to Pittsburgh and Lake Erie Railroad will provide adequate, long-term rail competition in part of Conrail territory by generating enough revenues to cover the long-term capital and operating costs of these lines the NS must divest to satisfy the Department of Justice on sale of Conrail to NS. A preliminary report is due about September 15. If that report calls for further studies, such studies might not be completed before the end of 1985.
- 07/10/85 -- The House Committee on Energy and Commerce conducted hearings on the sale of Conrail. According to one news

account, "If the 11 witnesses testifying are representative of shippers in general, there is absolutely no public consensus on what to do with Conrail."
(Traffic World, July 15, 1985, p. 16.)

- 07/08/85 -- A railroad labor task force on sale of Conrail concluded an agreement in principle with Morgan Stanley & Company to support the investment banker's proposal on the sale of Conrail.
- 06/27/85 -- The Senate Commerce Committee reported S. 638, Conrail Sale Act (S.Rept. 99-98).
- 06/12/85 -- Hearings were held in both the House and Senate to consider the Morgan Stanley proposal.
- 05/14/85 -- Morgan Stanley, an investment firm, announced a plan to buy Conrail from the Federal Government. The plan includes about 24 members of a consortium, including CSX Corporation and Citicorp. Hearings on the proposal were expected to be held before a bill on the sale of Conrail is enacted by Congress.
- 05/01/85 -- The House Ways and Means Committee held one day of hearings on title 1 of H.R. 1930, authorizing the sale of Conrail to Norfolk Southern Corporation. Title 2 of H.R. 1930 has been referred to the House Committee on Energy and Commerce. At the Ways and Means hearings, there were indications that more hearings by that Committee are likely.
- 04/30/85 -- The House Committee on Energy and Commerce held a second day of hearings on sale of Conrail. A third day of hearings is expected later. The Senate Commerce Committee, by a vote of 12 to 5, decided to report S. 638, with amendments, to the Senate with a recommendation that the bill do pass. The sale of Conrail, as of Apr. 30, 1985, was included as part of the Senate budget reconciliation package.
- 04/18/85 -- The House Energy and Commerce Committee held its first day of hearings on the Conrail sale by hearing testimony from DOT Secretary Dole and others. The Senate Commerce Committee began markup of S. 638 to authorize the sale of Conrail to Norfolk Southern Corporation. Further consideration of S. 638 was set for April 30.
- 04/04/85 -- The Senate Appropriations Committee, Subcommittee on Transportation, held hearings on Conrail. The Senate Commerce Committee held hearings today on the proposed sale of Conrail to Norfolk Southern Corporation.
- 04/02/85 -- The Senate Judiciary Committee conducted hearings on the antitrust aspects of the proposed sale of Conrail to Norfolk Southern Corporation.

- 04/01/85 -- U.S.R.A. issued a report on Conrail that stated Conrail probably will be profitable during each of the next 4 years, even if there is a significant recession during 2 of those 4 years.
- 02/00/85 -- DOT announced that it had considered all the bids that had been received, and that it favored a sale to Norfolk Southern Corporation, a holding company that controls Norfolk Southern Railroad.
- 08/13/81 -- The Northeast Rail Service Act of 1981 became law. It is title XI, subtitle E, of the Omnibus Budget Reconciliation Act of 1981, P.L. 97-35, 95 Stat. 357. It allows the Secretary of Transportation to sell Conrail.
- 10/14/80 -- The Staggers Rail Act of 1980 (P.L. 96-448, 94 Stat. 1895) became law. It helped Conrail and others railroads financially by reducing the economic regulation of railroads by the ICC.
- 02/05/76 -- The Railroad Revitalization and Regulatory Reform Act of 1976 ("4R Act") (P.L. 94-210, 90 Stat. 31) became law. It authorized Conrail to begin operating on Apr. 1, 1976.
- 01/02/74 -- The Regional Rail Reorganization Act of 1973 ("3R Act") (P.L. 93-236, 87 Stat. 985) became law. It created the U.S. Railway Association and directed it to determine which rail lines of bankrupt railroads would be included in a new, federally owned railroad that took the name Consolidated Rail Corporation, or Conrail for short.

ADDITIONAL REFERENCE SOURCES

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Conrail: experience, forecast, and national transportation policy implications, by Stephen J Thompson. Washington, October 26, 1978. 23 p.
CRS report no. 78-202E.
- Conrail -- The proposed sale. CRS Information Packet number IP0325C, frequently updated.
- Conrail sale: labor aspects [by] Alice L. Ahmuty. [Washington] 1985. (Issue Brief 85072). Regularly updated.
- Conrail sale: Selected references, 1981-1985, by Kurt Beske. CRS Bibliography number L0424, dated Feb. 28, 1985. 4 p.
- Summary of the Staggers Rail Act of 1980, by Stephen J Thompson. Washington, Jan. 7, 1985. 20 p.
CRS report no. 85-9E

----- Worker protections on Conrail: background and summary,
by Alice L. Ahmuty. Washington, April 14, 1981. 22 p.
CRS report no. 81-99E.

United States Railway Association (USRA). Comparison of Conrail
with ten class I railroads, 1977-1981. Washington, April
4, 1983. 51 pages, plus a separate volume of appendices
with various paginations.