

TESTIMONY OF LINDA HELLER KAMM, ACTING DEPUTY SECRETARY OF TRANSPORTATION,
BEFORE THE SUBCOMMITTEE ON TRANSPORTATION, COMMITTEE ON COMMERCE, SCIENCE
& TRANSPORTATION, UNITED STATES SENATE, SEPTEMBER 7, 1979.

Mr. Chairman and members of the Committee. Robert E. Gallamore, the Deputy Administrator of the Federal Railroad Administration, and I are pleased to be here today to discuss S. 1492 and S. 1286 and the Administration's policy on the future of the Milwaukee Railroad. Our policy, which is based on thorough study and analysis of both the national freight rail system and the Milwaukee, advocates an orderly transition from the Milwaukee's present transcontinental system to a smaller system focused in the Midwest. We also recognize the need to moderate the impact of this change on displaced employees. In that sense, the Administration's policy has the same objectives as S. 1492. On the other hand, we disagree with the policy of S. 1286, which calls for continuation of the entire existing Milwaukee system rather than orderly restructuring.

Administration Rail Policy

Before discussing the Milwaukee specifically, I would like to reiterate this Administration's rail policy. We are committed to maintaining this energy-efficient form of freight transportation, and we think that it belongs in the private sector. To keep it there, we must help the railroads become more efficient by substantially reducing the scope of the regulations governing them, reducing the size of the rail network, improving labor-management relations and facilitating corporate restructuring where necessary. We can't continue to dole out federal money when these funds are not being used to solve the underlying problems.

This Committee has before it the Administration's proposals on regulatory reform, S. 796. We are still firmly committed to the goals of that bill, although we recognize that modifications will be necessary. You are also considering our financial assistance proposal, S. 1151. That bill would direct federal aid toward those railroads that can become more efficient through restructuring. A significant innovation in S. 1151 is the proposal to use some of these funds for labor protection costs resulting from improvements in labor productivity. In addition, S. 1151 would clarify the fact that assistance under Title V of the 4R Act is available for labor protection costs directly related to physical restructuring projects. In the context of this overall Administration policy, let me now turn to the Milwaukee.

DOT Studies of the Rail Industry

In October 1978, the Department issued its study of the freight rail industry, pursuant to sections 504 and 901 of the 4R Act. As we consider the Milwaukee, it is useful to remember what that study said:

The railroad industry must make substantial changes in its economic and physical structure. This is particularly true for financially weak railroads, which must analyze, in cooperation with appropriate public authorities, specific line segments to determine whether such segments are profitable (or can be made profitable) Restructuring should be aimed at preserving cost-effective services.

We stated that the existing bankruptcy laws did not provide an expeditious method for accomplishing these goals in cases where a railroad was already in bankruptcy or undergoing reorganization before restructuring was attempted. We noted that restructuring would be difficult due to lengthy delays and shifting responsibility for decisionmaking from court to ICC to court, as well as the traditional reluctance of both the ICC and reorganization courts to reduce the nation's rail system significantly. Finally, we recommended legislative changes that, I am happy to say, were enacted last session as part of the general bankruptcy law revision. Unfortunately, the bulk of these changes do not apply to railroads now in reorganization, including the Milwaukee.

DOT Studies of the Milwaukee Line

Since October, many of the issues the report discussed have become pressing problems, particularly with respect to the Milwaukee. On July 31, Acting Secretary Claytor transmitted to the Committee four DOT-sponsored studies of aspects of the Milwaukee problem and a summary of their conclusions. I'd like to highlight some of the results:

- o The Reebie Associates analysis, done for the Federal Railroad Administration, shows that in 1977 the Milwaukee's Western lines carried approximately 28% of the railroad's loaded cars--and accounted for about 50% of the system's losses. These lines represent only about half (42%) of the Milwaukee's route miles.

- o The same analysis concluded that, even with an expenditure of \$115 million (in 1977 dollars) for track rehabilitation, the Milwaukee could not match the transit times of the other carriers in the region. The report also found that, except for coal, rail traffic in the region has been declining. These findings make us question whether the Western lines can attract a sufficient traffic base to become profitable.
- o The Reebie analysis concluded that, even if the Western lines were rehabilitated, they would show a loss of \$26.5 million in 1985. And that figure excludes rehabilitation expenses and associated financing costs.
- o The Booz-Allen & Hamilton study, done for the Trustee and reviewed by the FRA, showed similar results. That study found that the Western lines did not contribute to the Milwaukee's income in 1977. It concluded that there was little hope that a railroad built around or including the Western lines would generate sufficient cash flow to justify any investment in rehabilitation, and that even a rehabilitated system would not be competitive.
- o An analysis of a proposal by Save Our Railroad Employment (SORE) to create a separate railroad of the Western lines, which was performed by the Consulting Center, Inc., for the Office of the Secretary, concluded that even with SORE's optimistic

revenue projections, operating the Milwaukee lines west of Twin Cities, Minn., as an independent company would require about \$700 million in external financial support (in 1979 dollars). Of this amount, rehabilitation and coverage of operating losses would cost more than \$300 million. This concluded that the SORE proposal was not feasible.

These studies led us to conclude that the Milwaukee's Western lines could not, as a whole, survive as a useful part of the rail system without the infusion of hundreds of millions of federal dollars. We are convinced that the Milwaukee system as presently structured cannot be reorganized, even with massive federal assistance. More fundamentally, we seriously question whether such assistance is justifiable in the face of the redundancy of the Western part of the Milwaukee, the vastly inferior condition of the Western line's track compared with that of competitors, and the static traffic base in the area for all commodities except coal. Even with respect to coal, the studies show that, based on existing and projected development, regional traffic will not increase significantly before 1985 and that other railroads in the area are available to service future development. In a time of tight budgets, all proposed expenditures of this magnitude must be examined carefully.

Having studied the problem and decided upon a course of action, however, we are faced with the difficulties of implementation highlighted in our

October report on the future of the rail system. As I previously stated, the new bankruptcy laws do not, in general, apply to ongoing reorganizations, such as the Milwaukee's. The Milwaukee's reorganization court has thus far concluded that it has no authority to issue an order for a partial cessation of service without approval of the Interstate Commerce Commission (ICC) unless the railroad is literally without sufficient cash to operate. The ICC, in turn, cannot authorize an abandonment that would be effective before May 10, 1980. Our participation before the reorganization court in support of the Trustee's second embargo request is based on the need to use the court's equitable powers, given the deteriorating cash situation and the onset of winter, to break this impasse.

Regardless of the Milwaukee's actual cash balance, it is clear to all parties that the entire Milwaukee system cannot continue to run until May 10 without substantial additional funds. By forcing the Trustee to attempt this, the court and the ICC may ensure that the entire Milwaukee simply stops operating in January except insofar as the ICC directs other carriers to serve portions of the system. Because of the need to upgrade parts of the system before another carrier can be required to serve Milwaukee customers, directed service, particularly over the system's branch lines, would be difficult to implement starting in the winter. Thus, shippers would suffer more than if Milwaukee service on the Western lines ceased during the fall. In addition, thousands of Milwaukee employees would be furloughed during the season when railroad jobs are hardest to get. Finally, any hope of reorganizing the Milwaukee as an independent railroad would be lost. Unfortunately, we see these same

consequences, given the limited funds available under the Emergency Rail Services Act (ERSA) and Title V of the 4R Act, if S. 1286 were to be enacted. And, given the results of our studies, we think that putting more money into those funds for the purpose of operating the entire Milwaukee system would be unwise.

Steps to Alleviate the Problem

The Administration believes that a winter cessation of service over the entire Milwaukee system is intolerable, as is continued federal funding of an uneconomic, redundant portion of the rail network. We need, instead, to work toward encouraging a reorganization of the Milwaukee in the private sector, targeting federal resources on those parts of the Milwaukee system that are useful portions of a national rail network, and helping displaced employees find new jobs. These are the steps we are taking toward those goals:

- o We have provided the Trustee with financial assistance through Title V of the 4R Act to improve service on those parts of the Milwaukee that would most likely remain part of the national rail system.

- o We have provided working capital assistance, through ERSA, to give the Trustee time to study and plan a reorganization. However, as Acting Secretary Claytor stated in this July 31 letter to this Committee, "we will require future ERSA assistance to be used only for those portions of the system which are reorganizable."

- o We are supporting the Trustee's recent petition to the reorganization court for an embargo. Dr. Gallamore testified before the Special Master in Chicago on August 28, indicating that an embargo is necessary to preserve future service in a reorganizable core given the fact that FRA is unable to make the legal findings which would permit further ERSA funding for the entire system.

- o We have supported the ICC's expedited abandonment procedure, and have submitted written testimony in support of the Trustee's abandonment application for the lines west of Miles City, Mont.

- o We have, under the authority of section 5 of the DOT Act, participated in meetings in Iowa to bring about the orderly transfer of the Milwaukee's Iowa lines where this is consistent with the state's rail plan. We are ready to provide similar assistance for the lines west of Miles City.

- o We have worked with affected states to help them, through the Local Rail Service Assistance Program, retain essential services. For example, South Dakota's effort to rehabilitate the line east of Miles City so that it continues as part of the Milwaukee system will be partially funded through this program.

New Approach Needed for Milwaukee Reorganization and Displaced Workers

In testimony earlier this year, we stated that we hoped existing laws would provide sufficient tools to resolve the Milwaukee's problems in an orderly fashion. Although we have tried to use those tools to the maximum extent possible, we now find them inadequate in two areas: expediting the reorganization process and protecting displaced workers. What is not in the public interest is a further freeze of service on the existing system, and we will not support such a freeze.

Applying the abandonment provisions of the new bankruptcy law to existing reorganizations might have been sufficient to deal with the Milwaukee's problems if these provisions had been in effect since the reorganization started. At this point, with the railroad fast running out of cash, and with sales as well as abandonments available to assist a reorganization, something more is needed. The Administration studying a procedure that would expedite both sales and abandonments, taking into account the interests of all parties. We are evaluating whether the reorganization court should be allowed to authorize sales and abandonments without ICC approval, but after considering the recommendations of the ICC and DOT.

A recent study done by Mark Battle Associates for the Office of the Secretary indicates that under current law, labor protection costs arising from an abandonment of the Western lines could be between \$83 and \$521 million. Battle's estimate of the most likely figure is

\$321 million. Using a cost estimate of \$325 million, the Trustee has stated that if this amount "must be paid immediately or at any time in cash," it "would prevent reorganization of any portion of the Milwaukee and result in further job losses." The Trustee's own analysis suggests that "first year" entitlements would in any event be limited to approximately \$100 million. However, if payment of that amount, plus that due in future years, would prevent reorganization, the result could well be increased job losses and decreased service. On the other hand, a delay in payment of benefits due does not help tide over the displaced worker until he can find a new job, nor does it help him find that job.

The Trustee has proposed to the court a labor protection settlement program under which \$50 million would be immediately available to pay for deferred back pay, vacation pay and severance pay. The Administration believes that further relief, through legislation, may be necessary. In particular, we think that the federal government should do all it can to enable a displaced Milwaukee employee to move to another railroad job, either with the Milwaukee or with another carrier.

In a May 30, 1979 letter to the Trustee, filed as part of the preliminary reorganization plan, the Association of American Railroads stated that its members were prepared to offer qualified Milwaukee employees about 8,000 positions between June and the end of 1979. The letter also

stated that many of these jobs were in the Western Milwaukee region. The Administration believes that Milwaukee employees should be helped to find and take these and other jobs. We would, therefore, support legislation that provided for federal assistance in matching employees to jobs and retraining them. We would also favor providing some federal assistance to the Milwaukee, through guarantees of loans to be repaid by the estate, for moving expenses and limited supplemental unemployment payments to protect the displaced employee if he or she is furloughed before gaining a reasonable seniority level in a new job. And we would make guarantees available for reasonable separation payments. But we firmly believe that assistance to those who plan to stop working should be limited.

As you know, the Senate passed a 60-day freeze last May to give all concerned parties time to study the condition of the Milwaukee and to develop some reasonable solutions. DOT has done its homework. The issue has been studied long enough. We have told the court, and we want to make it clear to the Committee, that simply continuing the Milwaukee's Western lines is not in the public interest. Now is the time to move forward vigorously to protect the interests of the Milwaukee's workers and to restructure the system.

Once the legislation that we are proposing has been passed, we think it possible to have an orderly reorganization of the Milwaukee that is consistent with national transportation policy goals and that takes

into account the interests of displaced workers. We will continue to work with you and the House committee to secure passage of such legislation.

That concludes my prepared statement, Mr. Chairman. Dr. Gallamore is prepared to answer any specific questions you have on the DOT studies and 401 activities, and we both would be pleased to expand upon this statement.