



GOVERNMENT'S INVESTMENT IN CONRAIL

Q: The figure most often cited as representing the federal government's investment in Conrail is \$7.7 billion. Is this a true accounting of the investment, and if so, why isn't the Norfolk Southern Corporation offering the government more than \$1.2 billion in cash?

A: The frequently cited \$7.7 billion figure represents the aggregate amount that has been expended through Fiscal Year 1984 to maintain rail service in the Northeast in the aftermath of the bankruptcy of the seven Northeast railroads. As a sunk cost, much of which can never be recouped, a bidder is unlikely to place any value on these expenditures. The bankrupt railroads' property was badly deteriorated and a massive rebuilding was essential if adequate rail service was going to be continued in the Northeast. However, more than one-half of the \$7.7 billion never traveled through Conrail's coffers, and is not, nor should it be, represented in any of Conrail's present assets or operations.

Therefore, while the Department can speculate on what it would like to receive as compensation for Conrail, attempting to reconcile the purchase price to \$7.7 billion necessitates an accounting of why and for what these sums were spent:

Valuation settlement.....\$2.777 billion

This figure, set in what is called the "valuation case," was arrived at by negotiations premised on the probable liquidation value of the properties of the bankrupt estates. The government paid this amount (principal only) to Conrail's predecessors for the property Conrail received on April 1, 1976. In addition to bearing no relationship to the properties' earnings potential or "going concern" value, the \$2.777 billion also includes compensation for vast amounts of property never conveyed to Conrail, such as the entire Northeast Corridor which was transferred to Amtrak and significant assets which were transferred to other railroads and commuter authorities.

Related Government Expenses:

Reduction Funding.....\$606 million

These funds have gone to both employees of Conrail's predecessors and Conrail employees who were either fully or partially deprived of employment as a result of the entire reorganization process that had taken place from April 1976 through 1984.

Funding to Conrail's Predecessors.....\$496 million

Provided to Conrail's bankrupt predecessors so they could maintain their operations until conveyance to Conrail and limit deterioration of the property Conrail was to receive.

Local Rail Service Assistance.....\$208 million

Provided to the states in the Conrail region to continue the operation of both lines abandoned under the Final System Plan, which never became part of Conrail, and those later abandoned by Conrail. The funding has been used to subsidize operations, maintenance and improvements. This figure does not include funds provided for state rail planning or acquisition of rail properties by the states.

Commuter Rail Transfer.....\$125 million

Amount used to transfer the commuter rail operations that Conrail had been required to continue to commuter authorities on January 1, 1983.

USRA Administrative Expenses.....\$182 million

Funding used by the USRA to plan for Conrail's creation, administer funding and monitor Conrail.

The remaining \$3.280 billion that was spent on Conrail:

This is the funding that the USRA provided to Conrail through the purchase of Conrail's convertible debentures and preferred stock. These funds were used both as an operating subsidy and to correct deferred maintenance.

Between 1976 and 1980, approximately \$600 million was channeled directly into cash operating subsidies due to losses incurred by Conrail each year of operation until 1981. While these sums arguably supported operations during Conrail's formative period, subsidies are not capital investments and do not enhance the company's value in any way.

The remaining \$2.68 billion was used to correct deferred maintenance of track and equipment, and to replace antiquated and deteriorated locomotives and freight cars. A massive rebuilding program was needed for Conrail to continue to serve its customers and to compete for business both intra- and intermodally.

Between 1976 and 1980, the government bought 18 million railroad ties, 9,413 new freight cars, 5,000 piggyback trailers, and 675 new locomotives. It also paid for 4,320 miles of welded rail, 45,050 pass-miles of surfacing, 85,905 heavy or medium repairs on freight cars, 3,453 repairs and paid \$80 million for modernized freight yards.

Liabilities

Against this \$2.68 billion investment in Conrail's infrastructure and equipment must be subtracted Conrail's real and contingent liabilities.

First, there are trust certificates and future lease obligations due to third parties totalling just under \$1 billion and second, there are contingent liabilities due to legal claims such as those arising from asbestos health problems and for repairing so called orphan bridges which must be borne over time by a going enterprise as they are encountered.

Last, but by no means least, are employee termination costs, resulting from more productive and efficient railroad operations. Notwithstanding the labor savings to be achieved over time, a railroad has to pay these costs of doing business as a function of achieving these savings.