CONRAIL BRANCHLINE REVIEW AND ABANDONMENT PROCESS

by Lawrence A. Huff

Consolidated Rail Corporation is a for-profit corporation incorporated under the Statutes of the Commonwealth of Pennsylvania, and organized pursuant to the Regional Rail Reorganization Act of 1973, as amended, Public Law 93-236, 45 USC Sections 701, et seq. (the "3R Act"). It was organized to take over most of the operating properties and franchises of the six bankrupt Northeast railroads: Penn Central, Erie Lackawanna, Reading, Lehigh Valley, Central of New Jersey, and Lehigh and Hudson River. The bulk of the system, approximately 80%, is made up of former Penn Central property. The combined system consists of 17,700 route miles of right of way in 16 northeastern states and two Canadian provinces. The properties were conveyed to Conrail free of all mortgage liens and remain that way today, a nearly unique situation in the railroad industry.

The 3R Act mandated that the United States Railway Association, a Federal agency, prepare a master plan for the organization of Conrail. This plan, known as the Final System Plan, concluded, among other things, that if Conrail's physical plant (track, roadbed and equipment) was upgraded and service improved, substantial traffic would return which would make the system viable. Conrail has substantially accomplished the upgrading. The maintenance on its fleet and quality of its track and roadbed are equal to the average Class 1 carrier in the industry today and Conrail's on-time performance, which is above 80%, is equal to or better than most Class 1 railroads.

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The fact of the matter, however, is that traffic has not returned. In 1975, the last full year of operation before Conrail, the combined predecessor companies of Conrail hauled approximately 331 million revenue tons of freight. Conrail, in 1981, is expected to carry approximately 230 million revenue freight tons, representing a steady decline averaging about 6% per year in freight handled, despite the upgrading and service quality improvement.

The principal reasons for the decline in rail freight are two-fold. First, and most notable, is the dramatic shift in manufacturing capacity from the northeast United States to the sunbelt states. This is a long-range trend which is not likely to be reversed and must be taken into account in any future rail planning in the northeast. The second factor is the intense competition from unregulated truckers since that industry was deregulated in 1980. Again, this is a long-range factor in the marketplace and not likely to be reversed, notwithstanding the regulatory reforms gained by the railroad industry in 1980.

We are left then with the inevitable conclusion that Conrail is a capital-intensive and labor-intensive corporation with a declining traffic base. Even with the substantial pricing freedoms which the railroad industry has obtained under the Staggers Rail Act of 1980, it is apparent that the name of the game for Conrail for the future is to carefully define its markets and to tightly control its costs.

For the past five years, Conrail has made an intensive effort to control its costs of operations. It has made enormous strides in improving productivity but more still must be done. Before now, however, it has not been successful in reducing the size of its physical plant. The two factors mentioned above have resulted in a number of branch lines with too little

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traffic for economic operation. But due in part to the extraordinary cost and effort required under the traditional procedures of the Interstate Commerce Commission to abandon underutilized track, very little plant reduction has taken place. Based on an earlier analysis, approximately 3500 miles of Conrail's branch lines operated at a loss. This represented 20% of Conrail's total route miles and generated an annual negative contribution of $31 million. In addition, this trackage required over the last five years $143 million (in 1981 dollars) in rehabilitation. If Conrail was to succeed, it had to make these branch lines at least pay their own way or disinvest from those which did not.

The Staggers Rail Act of 1980 approached this problem primarily from the revenue side. Using a carrot and stick approach, it required Conrail to eliminate deficits on light density lines if it was to receive additional Federal loans. At the same time, it authorized surcharges on deficit branch line traffic as one way of generating additional revenue. This tool, however, was often self-defeating. Raising rates on a line frequently only serves to drive the traffic toward the competition, leaving little or no revenue left on the line. The Staggers Act did nothing to amend the traditional abandonment procedure which required extensive filings with the ICC and the virtual certainty that the ICC would require, as a condition of abandonment, that Conrail absorb certain labor protection costs. Frequently, the cost of labor protection, i.e., payment to those employees which would be displaced as a result of the abandonment, would be so great as to eliminate any savings from the abandonment itself, leaving Conrail, and other railroads, with the dilemma of being unable to shed unprofitable branch lines and unable to make them pay. The labor protection typically imposed by the ICC would require that the railroad pay a maximum of 6 years of full pay and benefits for all employees displaced due to the line abandonment.

To further address this problem, Congress passed NERSA, the Northeast Rail Service Act of 1981 (subtitle E of the Omnibus Budget Reconciliation Act of 1981, PL 97-35). This Act attacks Conrail's branch line problem from the cost (as opposed to the revenue) side. The new act *temporarily* relaxes existing law to facilitate Conrail's abandonment of unprofitable lines. It relieves Conrail of labor protection liabilities associated with abandonment until November 1, 1983. It also provides for an expedited abandonment process separated into two phases. Applications filed before December 1, 1981 with the ICC *must* be approved within 90 days of filing by the ICC if there is no *bona fide* offer to purchase or subsidize the line. Applications filed after December 1, 1981 but before November 1, 1983 must be approved by the ICC as above except that Conrail is required previously to file a "notice of insufficient revenues," a term which is not defined in the Act. Since applications filed under this second phase have a clouded future due to the undefined meaning of that term, it was in Conrail's interest to file as many abandonment applications as possible before December 1, 1981, which it did, as I'll describe later.

The abandonment process as described in NERSA is fairly straightforward. Upon the filing of an application for abandonment by Conrail, a 90-day period is triggered during which any responsible party may come forward with an offer to subsidize the line. A valid subsidy offer is one which will cover the difference between revenues and avoidable costs and includes a reasonable return on value. If a subsidy offer is received, Conrail will enter into negotiations with the potential subsidizer for an annual subsidy contract and the line will remain in operation as before. If, at the end of the 90-day period no subsidy offer is received, the ICC is required to place a "net liquidation value" (NLV) on the line.

The method by which this value is derived is described in a recent ICC ruling in *Chicago and North Western Transportation Company—Abandonment Between Ringwood, IL and Geneva, WI,* ICC Docket No. AB-1 (Sub-No. 70F), decided July 22, 1981. This could be described as being the value that the railroad likely would receive if the line were to be sold for nonrail purposes. In most cases, this would mean that the scrap value of the rail would be factored for the cost of removal and the value of the real estate would be valued as individual parcels to be sold primarily to the adjoining property owners, and is to be factored for the cost of removal of bridges and other structures. This value is to be further reduced by the amount of easement or other reversionary title which exists on the line. If the railroad can demonstrate that there is an existing market for a corridor user for the property, the ICC may use an NLV which includes a corridor-enhancement factor, but this is expected to be the exception and not the rule.

Once the NLV is established by the ICC and published in the *Federal Register*, a 120-day period is triggered during which any qualified person may offer to

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