

THE CONRAIL SALE: BACK ON TRACK

(Updating Background Update No. 19, "Selling Conrail: Time for Congress to Name the Buyer," August 6, 1986.)

The sale of Conrail is finally back on track. The House on September 24 passed legislation providing for a public stock sale of the federally owned freight railroad. The Senate passed similar legislation five days before, and a conference committee will meet soon. The House bill is far from perfect--for instance, it still includes a labor protection provision that will make it more difficult for railroads to sell off uneconomic lines--but with appropriate conference action, it will be a good blueprint for the sale.

For almost two years, the Conrail sale had been locked in a seemingly unresolvable stalemate, with Secretary of Transportation Elizabeth Dole advocating a sale to Norfolk Southern railroad, while many key congressional leaders demanded a public stock offering. On August 24, however, Norfolk Southern withdrew its bid for Conrail. Secretary Dole immediately threw her support to the public stock offering idea, leaving virtually no opposition to that method of sale.

Under the House version of the Conrail sale bill, included in the budget reconciliation bill:

- * Conrail stock would be sold by the U.S. government on the stock market for a minimum price of \$1.7 billion.

- * An additional \$300 million would be paid directly to the U.S. Treasury from Conrail before the sale.

- * The Secretary of Transportation would select investment banking firms to be "co-managers" for the sale.

* Several restrictions would be placed on Conrail's management for the first five years, including limits on payment of dividends and required minimum levels of capital expenditures.

* With certain exceptions, no individual or organization would be allowed to own more than 7.5 percent of the company for the first five years.

The Senate measure, included as a single paragraph addendum to the budget reconciliation bill, simply directs the Secretary of Transportation to sell the railroad, providing few other details.

Both houses wisely decided not to tie the sale to legislation to re-regulate the rail industry. In 1980, when the railroad industry was partially deregulated, it was in dismal condition. Constrained by regulation, railroads continually were losing business to their trucking rivals. With the new freedom and flexibility allowed under deregulation, the situation has improved dramatically. Most significant has been the turnaround of Conrail itself. After years of subsidies, the company is now making a healthy profit. A return to regulation could torpedo these advances.

But there are still several problems with the sale plan. First, all railroads will be required to pay up to \$25,000 to employees whose jobs are affected by the sale of unprofitable branch lines. Major railroads often sell off money-losing routes to short-line railroads, which can operate them at a profit, thus ensuring continued service to shippers. Mandating "labor protection" payments when these sales occur would discourage such beneficial transactions.

Second, the sale plan will drain large amounts of cash from Conrail, reducing its market value and future prospects. In addition to transferring \$300 million directly to the Treasury, the bill revalues Conrail assets in a way which will increase the company's tax bill next year alone by an estimated \$200 million. This raid on Conrail's cash could dim investor interest in the public offering--threatening the entire sale.

Lastly, the selection of investment bankers to manage the public offering must be given close attention. The choice should not be influenced by politics, as it is crucial that Mrs. Dole choose the best bankers available. The selection must be made on the basis of the bank's financial expertise and knowledge of Conrail--and its enthusiastic support for a public offering. Foreign experience shows that the choice of an investment bank can make or break a privatization offering. The complex nature of the Conrail sale makes a sound choice almost a precondition for success.

After a long struggle, it now seems that Congress finally will vote to return Conrail to the private sector. Congress and the Administration should be congratulated for their apparent success--but now they must make sure that the railroad is sold professionally and in good financial condition.

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