P&LE – THE FINAL YEARS

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Today we will discuss the P&LE's final years, not from a rail history perspective, but rather from a business perspective, as there has been a fair amount of coverage of the P&LE from a rail history perspective. I want to drive a stake into the ground as far as what really happened internally in its final years. I will briefly cover the P&LE's history; the external environment in which it existed; its internal environment – how the company was structured; the economics of the P&LE; and, in order to eliminate any possibility of bias, I will provide some headlines written by several publications in order to allow you to draw your own conclusions; and finally, the P&LE today. This is a very interesting piece of history, and I think there are still lessons to be learned from the P&LE experience.

Background on RDC – Businesses

Railroad Development Corporation (RDC) is involved with railroads all over the world; however, looking at the fine print, in most cases RDC has a very small percentage of these businesses. For example, in Estonia, RDC owns 5% of 66%. Yes, RDC has participation but we are hardly Dominant Global Entrepreneurs; we always partner with local people and in the case of Estonia, we are minority partners with Ed Burkhardt, the visionary behind Wisconsin Central. I can assure you that a company with five people is not in a position to run this many railroads without lots of help and local partners.

One of the interesting aspects of being in this business is that the reason we are in it is because RDC got thrown out of Pennsylvania. We got thrown out of Pennsylvania in 1990 as a result of our efforts to save the Pittsburgh & Lake Erie Railroad. RDC's global position, however you define it, is not due to Pittsburgh's world-class synergy of educational institutions, high-tech companies, and win-win partnerships between government and the private sector; rather, we are who we are because we got thrown out of Pennsylvania and in our Diaspora we have washed up on some very far-flung shores.

P&LE History

The history of the P&LE is well documented. There is a fine book that came out in 1980, *Pittsburgh and Lake Erie Railroad* by McLean, which truly captures the railroad as it stood on the eve of deregulation. In 1961 John Barriger, the legendary railroad manager, was responsible for the production of one of the largest books I have ever seen, *Region of Opportunity*. It is extremely dry reading but is one of the pioneering industrial development works for railways, remarkable considering that it was produced in the era of regulation. And finally, the most famous P&LE legacy is the series of Howard Fogg paintings commissioned by John Barriger.

External Environment

After deregulation, P&LE's external environment evolved into some major structural weaknesses that ultimately resulted in its going from "The Little Giant" to nothing. There were two primary causes, the first being deregulation, with resultant loss of market share to other railroads. The P&LE's business was not truck competitive – the main competition was in fact other railroads. What happened was that P&LE's competitors offered single-line service. For example, to get from the US Steel railroads in the Pittsburgh area to the West, there were several routes: Conrail direct; CSX direct; and P&LE- Youngstown-Conrail or P&LE-Youngstown-CSX. Needless to say, when railroads were allowed to control their prices, they were not particularly interested in sharing their revenue with another carrier. The result was that the Youngstown gateway effectively ceased to exist as a commercially viable option. In parallel with deregulation was the decline of the steel industry. It is one thing to lose market share, but it is another to see that entire market decline. The decline of the steel industry in the Pittsburgh area is well documented and not necessary to discuss in detail.

So the deck was stacked against the P&LE, but none of these factors were under the P&LE's control. However, internally there were some factors that made the situation even worse.

Internal Environment

P&LE invested in equipment to serve the steel industry right before the industry declined; as a result there was a heavy debt load associated with that equipment. Also there were some extremely generous labor agreements that were reached with the car shop employees in McKees Rocks.

The result of the above was an economic environment for the company, which produced operating losses, not surprisingly. The revenue went down because of the decline of the steel industry, and the costs could not be reduced due to, among other things, lifetime jobs at the McKees Rocks Car Shop. The company was stuck with equipment for which the debt had to be serviced and the result was that the company was "worth more dead than alive." This is not unique, because most railroads are worth more dead than alive. Take for example companies like Norfolk Southern or CSX – if you melted them down for scrap and sold the land, they would probably be worth more than as a functioning railroad, especially since their acquisition of Conrail and the subsequent decline of their stock prices.

However, most perverse was that the P&LE management compensation package was tied to liquidation; it was not tied to running the railroad. This is a result of agreements that had been worked out with the creditors who basically wanted to get paid back. The real objective of the management was therefore to liquidate the company, but to do it in a way that was acceptable from a regulatory perspective.

RDC Involvement, 1990

Against this background, RDC became involved in 1990 after being in business for three years. We had formed the company on the basis that the Short Line industry was revolutionizing America and that innovative, aggressive, market-driven, successful entrepreneurs were rolling up their sleeves, focusing on the customers and waving the magic wand which was revolutionizing the industry. Well, that was not exactly the truth, but the point was that this was an opportunity to save a local company, preserve jobs, and preserve service. RDC felt that this was the right opportunity at the right time. We had a 3-point strategy: (1) serve the on-line customers along the P&LE and serve as a competitive option for coal traffic originating on the Monongahela Railway and destined to CSX, in competition with Conrail; (2) continue to provide trackage rights to CSX for their through trains between New Castle on the west end and the McKeesport area on the east end, which was in fact the P&LE's biggest business; and (3) market the McKees Rocks Car Shop. In order to accomplish this we put a financial package together which consisted of raising the financing to satisfy the creditors and restructure the company in such a way that we would make a profit. Thus, it would be a viable business investment.

Just as importantly, instead of having the Interstate Commerce Commission (now the STB) arrange for us to fire all of the employees and hire some of them back at lower wages, which is how you really make money in the Short Line industry, RDC chose a different path – to see what could be done to sit down with the unions and negotiate 14 labor agreements. This was considered suicide because "everybody knew" that the P&LE's problem was labor. RDC was in fact successful in renegotiating 14 labor agreements because the employees recognized that things had to change and that we were perceived to be local people who were honorable, had a plan and had the financing to make it happen.

However, it did not work out the way we thought. On June 20, 1990 the sale was aborted because RDC had essentially done too good of a job of renegotiating the labor agreements and arranging financing. We found that we had given the incumbent management the opportunity to keep the railroad for themselves. This was the primary reason the sale was aborted.

I must add that there was a secondary cause. Pennsylvania's Department of Environmental Resources (DER) said that if we purchased the company, we would be jointly, severally and personally liable for cleaning up the entire railroad to background levels (In other words, the level of environmental contamination that existed when Indian tribes were the owners of the line along the river.). Needless to say, that caused us some problems and it also caused our financial partners even more problems.

The third cause was the advice that our lenders' lawyers gave them, which was if they lent us the money to save the P&LE Railroad, that they themselves could be jointly and severally liable to clean up the entire railroad to background levels as they existed when Indian tribes were along the river. Thank you, Reed Smith! Needless to say this was a big problem and it gave management the excuse to abort the sale.

By the way, there are some other factors which I would not insert here as causes, but it was amusing that the Pennsylvania Historic Review Commission insisted that we go back out to the field because of our inadequate documentation of our plans for the historic structures on the railroad. Under Pennsylvania law, anything over 50 years old must be documented. So we sent our unofficial company photographer and good friend Bill Metzger out to photograph the 50-plus-year-old concrete pipes which existed along the railroad to provide drainage. So earlier when we discussed win-win partnerships between the government and the private sector, this is not an example of how to foster win-win partnerships.

Selected Headlines

So you don't have to take my word for it, you can read a selection of the headlines for yourself as they appeared in the *Pittsburgh Post-Gazette*.

On February 10, 1990, RDC agreed to buy the railroad and by June 30, 1990, P&LE's President was denying that he had cheated us on the deal. By July of 1991 the P&LE had decided that it was an innovative, aggressive, market-driven, successful railroad and it was going to expand and operate the Meadville line, which was the former Erie Lackawanna main line that Conrail was downgrading. In September of 1992 the lights finally went out as the railroad liquidated piece by piece.

PITTSBURGH POST-GAZETTE – Selected Headlines:	
10-Feb-1990	Local Investors Agree to Buy P&LE
20-Mar-1990	Regulators Back Sale of P&LE Assets
16-May-1990	P&LE, Unions Reach Agreement on Severance
29-Jun-1990	Deal Off for Assets, P&LE Says
30-Jun-1990	Railroad President Denies P&LE Cheated Investment Group
25-Oct-1990	P&LE to Cut 500 Jobs, Trim Wages
2-Jul-1991	Regulators Approve P&LE-CSX Deal
31-Jul-1991	P&LE Agrees to Operate Meadville Shortline
11-Sept-1992	CSX Buys Out P&LE Railroad

Traffic World, which is the major industry publication, had headlines during this period more or less paralleling the headlines of the *Pittsburgh Post-Gazette*. The difference was the last headline on September 21, 1992; "P&LE Sold; Big Environmental Clean-Up Remains." Thank you, DER!

TRAFFIC WORLD – Selected Headlines:	
19-Feb-1990	P&LE Hoping Third Time is Charm as Local Investors Plan Purchase
2-Jul-1990	P&LE, Unions in Holding Pattern as Would-Be Buyers Cast Aside
5-Nov-1990	P&LE Breaks Deal with Organized Labor
8-Jul-1991	CSX Wins ICC Approval for Plan to Acquire & Lease Back P&LE Track
21-Sep-1992	Pittsburgh & Lake Erie Railway Sold; Big Environmental Clean-Up Remains

P&LE Today

What is left of the Pittsburgh & Lake Erie? Basically it is a wide spot on CSX; if you fly into Pittsburgh's International Airport, quite often you can see on the left-hand side what is left of the McKees Rocks shop complex. Usually a CSX train can be seen waiting because there is so much traffic moving up and down the main line. The Monongahela Railway territory continues strong in shipments of coal. But the P&LE's traditional on-line industry has for the most part gone away. Shenango closed its blast furnaces and the LTV Aliquippa Works is closed. So just when we thought things could not get any worse, they did. McKees Rocks today is basically a ghost town; the car shop has been demolished and the environmental problems remain. Of course, if RDC would have bought the railroad, we would have been jointly, severally and personally required to clean it up.

Conclusions

Some people have said that it was so fortunate that the sale was aborted and that RDC did not have the opportunity to lose money. I think people forget that even though on-line business may have declined, the overhead trackage rights for CSX increased. And more to the point, RDC would have preferred to have made that decision itself. RDC's plan was undermined first by management's belief that our financing and labor agreements were transferable; secondly, it was management's economic incentive to see the company liquidated. Basically, that is what happened; they scurried like rats into the darkness.

Another factor, which is still out there, is the DER's inability to deal in good faith. To quote former Governor Tom Ridge during his initial election campaign, he described DER as "a job killing machine." There were 200 people who lost their jobs because of DER and numerous customers whose transportation costs increased as a result of lessened competition, as well as the cost to RDC.

Thank you very much.

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