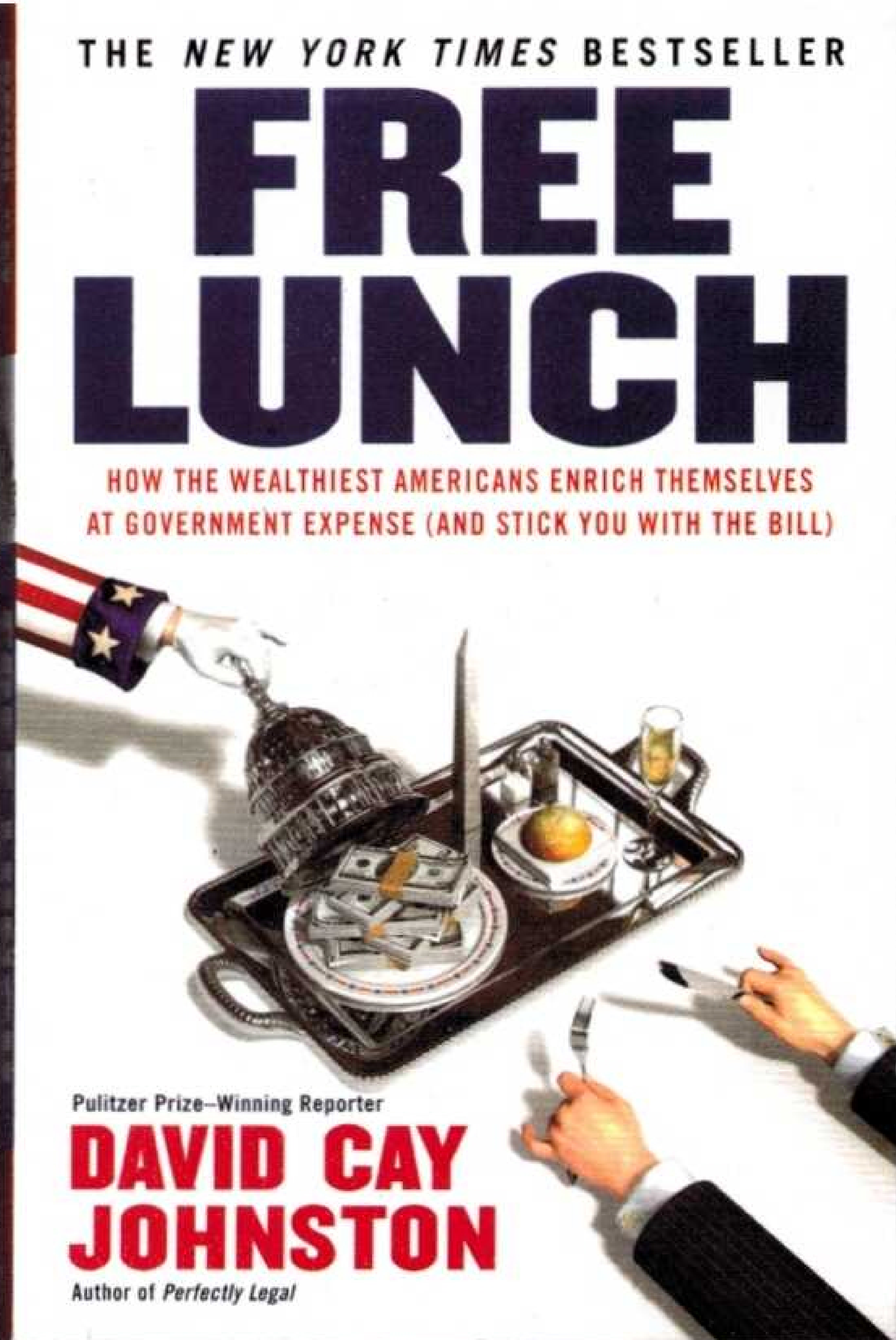
THE NEW YORK TIMES BESTSELLER
FREE LUNCH
HOW THE WEALTHIEST AMERICANS ENRICH THEMSELVES AT GOVERNMENT EXPENSE (AND STICK YOU WITH THE BILL)
Pulitzer Prize–Winning Reporter
DAVID CAY JOHNSTON
Author of Perfectly Legal

Chapter 3

TRUST AND CONSEQUENCES

HALF AN HOUR BEFORE DAYBREAK ABOARD THE AMTRAK SILVER Star heading to New York from Florida, the South Carolina skies were fair. The thermometer hovered comfortably in the low seventies. It was the start of the glorious final day of July 1991.

The clickety-clack rhythm of the rails rocked the 407 passengers as they dozed. Among them was Paul Palank, a Miami police sergeant on his way to meet his wife and children for a family reunion near the nation's capital. Palank loved trains as much as he feared flying.

At a minute past five, the train approached the town of Lugoff, a farming community that the DuPont Company transformed into an industrial center when it built a chemical plant there in 1948. The same tracks that supported Palank and his fellow passengers on their journey north often carried CSX railroad hopper cars filled with chemicals to make Orlon, a synthetic "miracle fiber" that came out of World War II research. On a siding parallel to the Silver Star stood a string of empty hopper cars waiting for a CSX train to haul them away to be refilled. Freight traffic was so much more important, and more common, than passenger trains that railroad companies didn't name the switch Lugoff after the town, or even after the DuPont factory. Railroad engineers called the train switch the Orlon Crossing.

The Amtrak train was traveling two miles an hour below the posted speed limit when the twin locomotives and the first twelve cars passed over the Orlon Crossing. Then the switch broke.

Six passenger cars hurtled off the tracks. The impact flipped over the first hopper car, whose hardened steel wheels cut like a knife through the metal skin of the passenger cars. By the time everything came to a halt,

77 people were injured and 8 were dead, including Sergeant Palank. He was 35 years old.

More than eight hours later, Angelica Palank arrived at the train station in Alexandria, Virginia, to greet her husband. Eager to see him, Angelica pushed her youngest son Taylor's stroller just as fast as five-year-old Josef could move his little legs to keep up. As the family waited on the platform, a woman told Angelica that there had been an accident. Angelica did not believe her. A northbound train approached and she felt relieved. When it blew by the station, Angelica turned anxious. She and the children hurried downstairs, hunting for the arrivals-and-departures board. Train 82, the Silver Star, was not listed. She asked a ticket clerk, who gave her an 800 number to call. The clerk pointed the frantic young mother to a pay telephone. A stranger's voice at the other end delivered the horrible news.

In the weeks ahead the families of the injured and dead settled their claims, discovering in the process how remarkably modest payments are to the survivors of transportation crashes and to the heirs of those less fortunate. Only Angelica Palank refused to go along. She did not believe the crash was an accident. She did not believe her Paul died because of some random bit of misfortune that no one could have seen coming. Determined to learn all she could about how Paul was killed, Angelica sued.

To get the truth Angelica Palank would have to put herself through law school. She could never flinch as she took on one of the richest corporations in America, a personal trial that extracted a heavy toll on her and her children. Ten relatives died in one year, but still she stuck to her cause. Friends and neighbors cut the grass and brought meals. At one point, she nearly lost her home to unpaid property taxes. It was scary and nasty, as is all litigation about real wrongs. When she found lawyers willing to take her case—Christian D. Searcy and F. Gregory Barnhart in West Palm Beach—their work began to peel back layer upon layer upon layer of corporate denials and superficial government inquiries. In time they uncovered a trail pointing not to bad luck, but to policies with a blatant disregard for safety.

The compulsion to increase profits can blind men to risk, especially when those at risk are strangers. Society imposes rules on corporate behavior to protect public safety in the face of baser impulses. These rules require enforcement, though. They also require a corporate culture that appreciates the importance of safety. As Adam Smith wrote, "The object of justice is the security from injury, and it is the foundation of civil government."

For more than two decades, the ideology of blind faith in markets, combined with the view that government is inherently inferior to self-regulation, has caused politicians to trim enforcement funds. Trim long enough and the little cuts sever muscle. Ultimately they slash to the bone. Such was the case in the derailment of the Silver Star. But it took one diligent woman and her lawyers more than a decade to demonstrate how harmful these ideas about trusting all companies to do right can be.

Before Angelica Palank's lawsuit got going in earnest, the National Transportation Safety Board examined the crash. The investigators quickly deduced that the accident was not a chance happening. Rather, it resulted from improperly done repairs. Railroads—like airlines, meat-packing plants, and other businesses where hidden dangers lurk—employ inspectors to double-check what safety workers do. This saves lives and avoids lawsuits. Yet the safety board found that the CSX inspectors somehow failed to notice the Orlon Crossing was in a dangerous state of disrepair.

CSX maintenance crews had used shims to level the crossing, even though the switch "is not designed for adjustment." Granite rock, known as ballast, covered the wobbly switch mechanism. Once the investigators cleared the ballast away, they found this vital switch was without a proper pin to hold the pieces in place. The switch was held together with nothing but a rusty nail. The safety board concluded that CSX inspectors "could have and should have seen the switch deficiencies during a normal inspection and, with appropriate action, could have prevented the accident."

Although businesses complain frequently about excessive government paperwork, neither the railroad nor the Federal Railroad Administration, the agency that is supposed to set and enforce safety standards, required much recordkeeping. CSX's inspection process, the safety board concluded, "lacked an adequate documentation procedure."

The roadmaster and some of the work crew used the jury-rigged shims because their employer never allowed them enough time or money to do their jobs properly. CSX cut corners to inflate its profits, which in turn meant riches for its executives, whose pay packages were tied to reported profits and the price of CSX shares.

John W. Snow, a lawyer and college economics professor who rose to become the CSX chief executive, was an early champion of markets as the most efficient regulator of transportation industries. It was an idea he promoted as an assistant secretary in President Ford's Transportation Department before he joined the railroad. Under his leadership, the railroad aggressively cut costs.

CSX publicists encouraged articles about Snow's drive for efficient capital investment. Typical of the stories was one praising the company's change from four engines to three on some hauls. These trains arrived later, but still on time, while saving the cost and fuel of an entire locomotive. His handlers did not make him available for stories about the bridges that became eyesores after years, and then decades, without painting. And in polishing Snow's image as a champion of efficiency, they certainly did not encourage anyone to look at the systematic shortcuts in safety.

Palank and her lawyers dug deep into the cutbacks in safety, deeper than the National Transportation Safety Board. They looked for systemic changes, for a pattern. Eventually they found CSX workers who would talk: Allen Clamp and Robert Griffith.

For three years, Clamp was an apprentice foreman under Buster Bowers, the roadmaster on the section of track in South Carolina where Paul Palank died. Clamp testified that it should have been obvious to CSX that there were too few men to perform the required safety inspections and maintenance. In the crew's race to cover track as quickly as possible, Clamp testified that Bowers never "performed a disassembly inspection, never walked a switch, and conducted no inspection, or inadequate inspections." Clamp said under oath that Bowers even directed him to fill out false inspection reports.

CSX tried to get this testimony thrown out. Five years had passed between the time Clamp last worked under Bowers and the Lugoff crash. CSX said that made the testimony ancient and unreliable. A Florida state appeals court let the testimony stand, noting that the other rail worker, Robert Griffith, confirmed that Bowers also had instructed him to falsify inspection reports.

At trial, CSX urged jurors to not believe the former employees. One Palank lawyer, Greg Barnhart had a counterargument: "CSX said, 'Why would we do that?' We said it was to save $2.4 billion," the money CSX had saved on maintenance.

In his own way, Barnhart was showing the jury the deadly effects of economic pollution. He explained how CSX benefited because it shifted the cost of maintaining safe tracks off its owners and onto the unsuspecting public, which unknowingly assumed a risk of injury or death.

The first jury that heard the Palank case awarded the family $6.1 million as compensation for their loss. Then came the second trial before a new jury, its purpose to determine whether CSX should be punished on the theory that the Lugoff crash was the result of greed encouraging a corporation to turn a blind eye to danger.

The second jury heard all about the $2.4 billion not spent between 1981 and 1993, most of those the years when Snow was fully in charge of CSX. The jury heard how in 1987 the Federal Railroad Administration had told CSX that its practices were unsafe. They heard how the company stuck to its cost-cutting policies anyway.

Testimony showed that the National Transportation Safety Board findings, alarming as they were, had missed much more damning facts. A panel of three Florida judges later wrote that the Orlon switch was defective and the cross pin

> had been broken for at least seven months prior to the derailment. The Orlon switch had been installed backwards ten years earlier, and part of the broken cross pin was buried under several inches of [granite] ballast placed between the ties more than seven months prior to the derailment. The evidence further shows that a proper inspection would have revealed the broken cross pin. In addition, there is evidence that CSX had actual knowledge that the cross pin was defective because the record shows that CSX periodically greased a plate installed on the switch with graphite to make the switch operate.

What that meant was that for a full decade CSX had escaped paying the cost of repairing the Orlon switch. Every day CSX trains loaded with freight, including toxic chemicals, crossed the Orlon switch. So did Amtrak passengers, unaware they were riding over the equivalent of a bomb waiting to go off.

The jurors were incensed. They awarded the widow and her children $50 million in damages, taking 1 percent of CSX's net worth. The jurors also wrote a note on the verdict form: "It is hoped that CSX trainers will emphasize [the] need to inspect both ends of cross pins."

Judge Arthur J. Franza upheld the punitive damages award. He delivered a stinging rebuke of CSX. "The clear and convincing evidence shows that Silver Star No. 82's tragic derailment was caused by willful, wanton negligence," Judge Franza wrote, adding that he considered the railroad's conduct to be "borderline criminal."

"Clearly," the judge wrote, CSX "knew of the peril created by its reductions and the company chose to proceed on its own course."

Then the appeals began. Three Florida judges who took up CSX's pleas for relief ruled against the railroad. The judges said that testimony by former employees showed that "CSX knowingly endangered public safety."

The judges called CSX's conduct a "flagrant violation of the public trust . . . Keeping with the policy that punitive damages should punish and deter, a jury of six reasonable persons concluded that $50 million would adequately communicate to this defendant that this type of reprehensible conduct should not and would not be tolerated."

The appeals court approvingly quoted Judge Franza, who ruled that while CSX saved more than $2 billion, "society paid with eight human lives. . . . The clear and convincing evidence showed that the price of cost-cutting safety to turn over larger profits is too great of a price."

CSX then appealed to the Florida Supreme Court, saying that its conduct was reasonable. Further, any damage should be based only on the value of the section of track near the crash site, not the company's entire net worth. The Florida Supreme Court rejected CSX's claims.

Finally the litigation came to an end in early 2002, more than a decade after Paul Palank's death, when the United States Supreme Court said that it would not hear CSX's appeal.

Angelica Palank said she felt that she had accomplished her goals. She had proven that the crash on July 31, 1991, was not bad luck but the predictable result of deliberate misconduct that flowed from the top of the company. After paying her lawyers and income taxes on the punitive damages, she donated the rest of the money to a foundation in her husband's memory. Today a few million dollars remain to finance grants for a cause her husband cared about deeply, abused and neglected children in and around Miami.

CSX said it was disappointed that the Supreme Court would not give it a chance to show that the jury and the Florida judges were wrong. CSX even suggested the proper punitive damage was zero. Kathy Burns, one of the CSX publicists, called the punitive damage award "unwarranted and excessive."

Lobbyists from CSX and other companies had, in the meantime, descended on Tallahassee to persuade the state legislature that big punitive damage awards were bad for business. Today Angelica Palank could not get $50 million in punitive damages because of a law signed by Governor Jeb Bush. It severely limited any future damage awards no matter how awful the misconduct.

Even with the award that the courts left standing, the cold calculus that cutting safety is immensely profitable remains in place. The total damages to the Palank family, both to compensate them and to punish the company, came to a bit more than $56 million. The money paid to all of the others, who settled without litigation, was a fraction of this. Viewed in the context of what CSX saved, however, even the total damages were not punishment at all, just a minor cost of doing business. For every dollar CSX saved by cutting corners on safety it only had to give back four cents.

We teach children that crime does not pay, but the grown-up truth is that "borderline criminal" behavior can pay handsomely.

From the perspective of CSX, or any railroad, the economics of shortchanging safety continue to make sense. Two years after the Palank case ended, James E. Hall, a former chairman of the National Transportation Safety Board, told *The New York Times* that the loss of lives in rail accidents reveals "a systemic failure . . . It's been something that has just not grabbed the attention, unfortunately, of the public." He was speaking of deaths at rail crossings, but his point is equally valid across the board.

Although many travelers worry more, as Sergeant Palank did, about dying in a plane crash or being hit by an 18-wheel rig on the highway, since the year 2000 Americans have been dying at the rate of about one per day at railroad crossings. A few of these deaths are suicides by train or the bloody product of fools driving around signal arms. Some are also the result of crossing arms that fail to activate. Others occur because signal arms sometimes bob back up after coming down, endangering even careful drivers and their passengers. At crossings with no signals, foliage that the railroads have not trimmed in accordance with the rules add to the death toll as people drive unaware onto tracks just as millions of pounds of steel bear down on them.

In Britain only about 18 people per year die at rail crossings. Major crossings have fencelike barriers that cars cannot flit around. Even after taking into account that America has five times as many people as the

United Kingdom, the death rate at crossings in America is four times that of Britain.

Between 1995 and 2000 derailments increased 28 percent, nearly triple the 10 percent increase in freight hauled. Yet even with more accidents and more deaths, the economics of cutting spending on safety are compelling from the railroad's perspective. The fines imposed for safety violations in the United States are minor, more like parking tickets than deterrents. The maximum fine is $20,000. The average fine is about $1,600. So the railroads play the percentages, weighing risk versus cost. Risk wins easily.

Most switches are safe. And not every unsafe switch will fail. Keeping every one of the thousands of switches around the country in proper repair is very costly, especially as a competitive market drives transportation prices down. After all, the jury-rigged repair of the backward Orlon switch held for years. Those switches that do fail will probably damage cargo, not kill people. Even killing people doesn't cost the railroads very much. As the CSX case demonstrated, all the injured and the families of the dead except Angelica Palank accepted their modest settlements quickly. So long as insurance costs less than repairs, this dangerous trade-off will continue no matter what the railroad industry says about its commitment to safety.

Since the imperfect rules of the marketplace actually reward dangerous risk taking, the only thing that could prevent this lethal gamble is effective government regulation. In this century just 4 of the first 3,000 rail-crossing accidents were fully investigated because of ever-tighter budgets for government safety offices. One railroad, Union Pacific, even said that federal regulators were so overworked they told the railroad to "stop calling" after every crash, which explained a big drop in minor accidents it reported.

The industry, since 2001, has steadily tried to assure the public that all is fine with the railroads because accident rates are falling. Then came eight CSX derailments in seven weeks as 2006 turned into 2007. That prompted the Federal Railroad Administration to send inspectors out across 23 states. Their inspections of CSX found more than 3,500 violations, 199 of them rated serious cases of failure to comply with the law.

What no one reported at the time is that railroads are by far the most deadly form of commercial transportation in the country, the exact opposite of the industry's carefully orchestrated campaign to deceive with statistics. "Freight rail is by far the safest way to move goods and products across the country," the Association of American Railroads tells the public.

Few people realize how deadly trains are because crashes usually involve one or two deaths and thus get little attention in the news. They also lack the emotional appeal of plane crashes, which fill us with a sense of dread because flying through the air at nearly the speed of sound seems to defy common sense.

Still, airliners are America's safest form of transportation by far. Some 600 million passengers board planes each year, yet often a year and sometimes several years pass between fatal crashes. Big trucks kill about 5,100 people per year, trains about 930, and airliners about 140.

Measure deaths by the distance traveled, however, and trains are 52 times more deadly than trucks. Trains kill 130 people per 100 million miles traveled, compared with 2.5 deaths in big-rig truck accidents and 1.9 deaths in plane crashes, Transportation Department statistics show. It is easy to miss that because the official government statistics use a measure of only a million miles per accident for trains, but 100 million miles for trucks and airliners.

Bad as those official figures are, they severely understate how dangerous trains are. Truckers drive on highways surrounded by cars. Trains run long stretches through rural areas where there are no crossings. In such places a crash would hurt only the engineers on board and perhaps some jackrabbits. If we had a measure of people killed per 100 million miles of travel in populated areas, where roads cross tracks and homes are almost as close by as freight cars parked on sidings, the death rate would be many times greater than the official figures.

Just as the CSX workers found ways to deal with demands that they inspect more track in a shorter amount of time, government agencies also adjust to unrealistic budgets. Some workers in private businesses fake reports and make slipshod repairs. The more noble of them work off the clock if necessary in an attempt to set things right. Some CSX workers testified that they worked extra hours for no pay, but that even these efforts were not enough to overcome the callousness of the railroad's management and its dogmatic belief in market ideology.

The government agencies, without anywhere near enough money to oversee safety, play similar games. They tell Union Pacific to not call, they write superficial reports, and when it comes to accidents at rail crossings, they thoroughly investigate only 4 out of 3,000 cases.

These responses are human nature at work, as predictable as eating when hungry. Give managers more than they can possibly do and they will find a way to redefine their workload to what can be done. When cuts in budget and personnel increase gradually, the public unwittingly accepts unsafe conditions, just as the clickety-clack of the rails lulled passengers into sleep until the Orlon Crossing's deadly repairs gave way.

Even a reliable system of safety rules means nothing, however, if there are no consequences for misconduct. At the end of the day, after litigation that went all the way to the United States Supreme Court, for CSX there were no consequences. CSX paid nothing for its recklessness.

CSX simply sent a bill to Amtrak seeking reimbursement. It sought, and got, the full amount it had paid to the injured and the families of the dead. Amtrak even paid the $50 million that the jury ordered to punish CSX. Since the government owns Amtrak, what CSX did, in effect, was to stick the taxpayers with its bill.

The jurors, though, had no idea. Reporter Walt Bogdanich, who won a Pulitzer Prize for exposing unsafe rail conditions, grows animated when he describes "this sham trial, an absolute sham in which everyone on the jury thought CSX was being punished and CSX knew that no matter what happened it would not cost them one cent."

When Amtrak was formed in 1971, the freight railroads persuaded Congress to let them stop carrying passengers. But they wanted more than to shed that obligation. The freight railroads wanted to be insulated from any claims arising from Amtrak using their rails. The railroads reasonably sought not to be responsible for claims arising out of misconduct by Amtrak. A crash caused by a drunken Amtrak engineer or a badly repaired axle on a passenger train should be paid for by Amtrak.

Congress looked out for the freight railroads, which unlike Amtrak were a vibrant source of campaign support. A federal law shields the freight railroads from claims by Amtrak passengers and anyone hurt by an Amtrak train. Under federal law all claims arising from Amtrak passengers, even in cases where Amtrak was not at fault, must be paid by Amtrak.

Under these rules it does not matter that Amtrak did nothing wrong, its trains traveling below the speed limit, its crew alert and sober, its rolling stock in sound condition. It does not matter that the courts found the cause of Paul Palank's death was CSX's reckless disregard for human life. Under the contract, all that matters is, at the moment the rails or a switch or a shoddy repair job gives way, does the train passing overhead belong to Amtrak? Only if a freight train is overhead when the failure occurs is the freight railroad on the hook for the damages.

What this means is that CSX and John Snow got a free lunch. You got stuck with their bill.

Economists have a term for situations in which someone gets rewards but has little or no incentive to avoid risk: a *moral hazard*. The term is usually applied in insurance cases. A policy that covers every cent with no deductible may cause people to be less vigilant about husbanding their lives or property. A policy may even encourage the unscrupulous to burn down a failing store to collect the insurance money and avoid bankruptcy. We are reminded of this most often by those exposés on local television in which a hidden camera captures a firefighter or construction worker building a brick wall in his backyard at a time when he was collecting workers' compensation. What we seldom see exposed are the roofing contractors whose disability insurance forms list 35 low-risk secretaries and 1 high-risk roofer, allowing them to cheat on their premiums.

Those who occupy the executive suite and gamble millions of dollars on the lives of others are rarely seen as engaged in morally hazardous conduct. Yet reward without risk is a form of moral hazard that blinds us to the consequences of our acts. The trade-off between safety and stock price is an important part of the story of how the ideology of blind faith in markets is remaking America. But the moral hazards of this blind faith are not limited to cutting corners on safety. We also have rules that encourage a new way to make the rich richer at the expense of working people. It is a strategy called *labor arbitrage*.

Chapter 4

CHINESE MAGNETISM

CHINA IS A MAGNET FOR CAPITAL. THE LOW COST OF ITS LABOR force and its nimble entrepreneurial class—aided by a government focused on creating wealth, jobs, and industrial capacity—draw investment at an astonishing rate. The Chinese communist government has created an economy that grows at 8 percent or more a year, more than twice the rate in the United States in good years.

So much capital flows from America to China that in a single year, 2005, Shanghai built more high-rise space than exists in New York City. A few years from now, Shanghai is expected to have 5,000 skyscrapers, more than twice the number built in New York City since Elisha Otis invented the modern elevator in 1853. The Chinese economy is a modern-day miracle, its growing prosperity celebrated worldwide as a victory for the forces of global free trade.

Yet free trade is hardly free. Like everything else, rules govern trade. Our rules encourage and protect trade. Every economist knows that major shifts in trade cause economic disruption. The costs of this disruption are being paid by the millions of Americans whose jobs are disappearing and whose hopes for the future are diminishing. How our government's rules help the rich grow vastly richer at the expense of almost everyone else in America, sometimes in ways that threaten our national security, is illustrated by the story of how one entire American industry, albeit small, succumbed to China's magnetic pull.

In 1982, competing groups of scientists around the world found a way to combine iron and boron with a somewhat rare earth called neodymium to make extremely powerful and lightweight magnets. These magnets quickly found a market in computer hard drives, high-quality