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STATE RAIL DIVESTITURE

House Bill 4328 as enrolled
Public Act 235 of 1998
Sponsor: Rep. John Gernaat

House Committee: Transportation
Senate Committee: Farming, Agribusiness,
and Food Systems

Second Analysis (8-7-98)

THE APPARENT PROBLEM:

As state officials consider various alternatives for raising revenues to finance a huge backlog of transportation infrastructure needs in Michigan, numerous cost-saving measures have been proposed that some people believe should first be pursued before other actions are taken. One of these involves state ownership of and responsibility for more than 700 miles of railroad track--which represents about 20 percent of the nearly 4,000 miles of tracks existing in the state--that the state acquired over the last 20 years following the bankruptcies of two prominent railroad companies. After the Department of Transportation proposed selling outright most of these rails, however, a suit was filed against it by an operator of one of the railroad sections MDOT planned to sell. An injunction was issued preventing MDOT from proceeding further with the matter until the department had promulgated rules to address the sale of the rail lines. Meanwhile, legislation in the form of House Bill 5598 was introduced in the last legislative session to allow instead for the state to enter into long-term (25 years) leases with the current contract operators of the rail lines. Though passed by both the House of Representatives and the Senate, the bill was subsequently vetoed by the governor. (For more information, see BACKGROUND INFORMATION and the House Legislative Analysis Section's analysis of House Bill 5598 dated 1-16-97.)

The department promulgated rules that took effect last year and reportedly the injunction against selling the rail lines has been lifted. However, where the departmental rules would permit the sale or lease of the state-owned rail lines, the rules would also allow the lines to be sold in segments. A concern has been expressed that if the rail lines are segmented, a buyer could abandon a less profitable segment in the future, causing disruption in rail service to areas of the state

and return the state to a situation similar to the late 1970s when these lines were first abandoned. Even worse, a buyer could later "harvest" a segment for its salvage value, estimated to be about \$30,000 per mile. Legislation has been proposed that would, among other things, require that the segments of state-owned rail lines be sold or leased intact and would encourage the continued delivery of service on existing rail lines.

THE CONTENT OF THE BILL:

The State Transportation Preservation Act, Public Act 295 of 1976, provides for the acquisition and management of abandoned railroad property by the Department of Transportation. Among other things, the act permits the department to convey or lease acquired rail property to certain specified entities for appropriate reimbursement.

The bill specifies that, within 180 days of its effective date, the department could offer for sale (or offer a 10 year lease), without partitioning any individual segment of rail property into more than one parcel, the following segments of state-owned rail property in the following order from the smallest segment to the biggest segment:

--The Lenawee County system (between Adrian and Riga, between Grosvenor and River Raisin and Lenawee Junction).

--The Hillsdale County system (between Litchfield and the Indiana state line and between Jonesville and Quincy).

--The Vassar Area system (between Millington and Munger, between Vassar and Colling and at Denmark Junction).

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--The Ann Arbor and Northwest Michigan system (between Durand and Ann Arbor, between Owosso and Thompsonville, between Cadillac and Petoskey, between Walton Junction and Traverse City, between Grawn and Williamsburg, and between Owosso and St. Charles).

Before entering into a sales or lease agreement, the department would have to issue a statement regarding the viability of the segment. Any existing lease or agreement for operation of a segment in effect on the bill's effective date would have to be extended at the same terms and conditions until a sale or lease was executed. The specific terms of a sale or lease would be determined by the department, but would have to include the following:

--The purchaser or lessee would be required to provide, at a minimum, the average level of service adjusted for traffic levels for three years after the date of sale or lease unless otherwise mutually agreed upon between the purchaser and current shippers on the line, and that rates would not increase more than the average percentage increase in the Detroit Consumer Price Index for the 12-month period each year for the base rate in effect on January 1, 1996 for three years after the date of sale or lease. (Currently, the department does not regulate rates.)

--Trackage sold or leased would have to be maintained at the federal railway administration class of track standards for the segment as of January 1, 1997.

--The purchaser or lessee of the Ann Arbor and Northwest Michigan system would have to charge reasonable freight rates for the section between Durand and Ann Arbor and honor all existing freight rate agreements and trackage rights for three years after the date of sale. (Note: In the provision pertaining to lessees, the bill contains a reference to three years after the date of "sale" instead of three years after the date of the lease.)

--If a purchaser or lessee failed to comply with the conditions of sale or lease, the property would revert back to the department and then be offered for sale or lease to the current shippers on the segment, governmental entities, and other railroad companies, in that order.

--A party aggrieved by the performance or failure to perform under the terms of a purchase or lease agreement could bring an action in circuit court for appropriate relief.

--In regards to leases, the lessee would have to reinvest not less than 50 percent of trackage rights revenues in eligible expenditures. "Eligible would include the

material and direct expenses required for the installation of railroad, track, ballast, crossing improvements, ditch and drainage repair or improvements, brush trimming, and track and signal inspections (as specified in federal regulations). (Note: Current leases require a percentage of the rail operator's revenues to be reinvested into the maintenance and upkeep of the rail line segment that it uses.)

--If no acceptable offers to purchase were made, the property would then have to be offered for lease for not less than ten years to the current operator, the current shippers on the segment, governmental entities, and other railroad companies, in that order.

--The purchase price could not be less than the net liquidation value of the rail line or lines.

--If during the first 10 years after purchasing a rail segment a purchaser were to abandon service and sell the segment or any portion that did not involve main line track, or any rails, ties, or ballast (excluding normal salvage), 95 percent of the proceeds from the sale would have to be returned to the state as additional purchase price. A segment or a portion of a segment could be sold with the department's approval.

--A potential purchaser would have to submit his or her most recent financial statement and a proposed operation plan that would include tributary lines and known potential sublease agreements. "Tributary lines" would mean spur rail lines that only intersect with a rail line owned by the state on the effective date of the bill.

The bill would also establish a process for selling the rail segments, including requiring a bidder to complete a prequalification application; requiring the appointment of a bid review committee; permitting a prospective bidder to appeal a review committee decision to an appeal panel and ultimately the state Transportation Commission; establishing a scoring mechanism to evaluate bid proposals; requiring a bidder to be selected based on the score, bid price, and highest compensation; and requiring the approved bidder to enter into an agreement with the Bureau of Urban and Public Transportation.

Further, the bill would delete a sunset clause on the Rail Freight Fund which is administered by the department and would repeal a section that authorizes the department to administer the act and promulgate rules.

MCL 474.52 et al.

BACKGROUND INFORMATION:

House Bill 4328 as introduced was nearly identical to House Bill 5598 of the 1995-96 legislative session that passed both houses but was vetoed by the governor. In his veto message, the governor pointed out that the bill would have prohibited the sale of state-owned rail lines, and stated his objections to the bill's pre-selection of who could enter into the 25-year lease contracts. In addition, the governor stated his belief that a competitive bidding process should be used for all major state contracts.

FISCAL IMPLICATIONS:

According to the Senate Fiscal Agency, the bill would result in increased revenue to the Rail Freight Fund, depending on the amount of right-of-way sold and the actual sale price of state-owned rail property. The agency reports that a current appraisal has not been done, but that a 1994 appraisal estimated the net liquidation value at \$32 million for all four segments. Further, the agency reports that the state would realize up to approximately \$2.8 million in savings from reduced property management costs, depending on the amount of property sold. (6-10-98)

An earlier fiscal report from the House Fiscal Agency (dated 6-10-97) pointed out that any cost reduction from property management would be partially offset by a loss in revenues generated through the lease payments on the lines.

ARGUMENTS:

For:

The bill would move the state toward divesting itself from the responsibility of maintaining about 400 miles of the 700 miles of state-owned railroad tracks, while ensuring that these tracks still would be maintained at appropriate levels so that shippers and industries that depend on the goods shipped over them could still get reasonable access to the lines. It must be remembered that the rail systems in question were privately owned until the late 1970s when two major rail line went

bankrupt. The bill is not so much a move to "privatize" certain rail lines as it is a move to return what was private property back to the private sector. Further, the bill addresses the concerns that the governor expressed in vetoing House Bill 5598 of last session. The enrolled version of the bill would permit the sale of certain state-owned rail lines by the competitive bidding process, or provide for a 10-year lease if an acceptable buyer was not found. By contrast, the departmental rules that recently took effect, however, only allow the Ann Arbor and Northwest Michigan system to be offered for lease or sale to the highest bidder. Under the rules, the other three segments would be offered first to the rail associations currently shipping on the tracks, then to any local governments that were interested, and those segments would only go to an open bid process if the rail associations and local governments were not interested.

For:

The bill provides what amounts to a stiff penalty for a purchaser to later abandon service and sell the segment or any portion of the segment, or to harvest the rails for the salvage value by requiring 95 percent of the proceeds from a sale occurring within ten years of the purchase of a rail line to be returned to the state. If a purchaser or lessee failed to comply with the conditions of sale, the rail line segment would revert to state ownership and could then be resold or leased. This is an important provision because it provides better protection for business owners and shippers dependent on rail lines to move their goods economically. The intent of the department and the bill is to keep the rail corridors intact. It is anticipated that the bill would enable the state to cut its costs related to maintaining these rail properties, while ensuring that these rails would continue to be maintained adequately and to be operated in an equitable fashion by anyone who agreed to MDOT's terms under a purchase agreement.

Against:

The bill departs from the departmental rules on several significant points. First, the rules would retain the trackage between Durand and Ann Arbor under state ownership due to its strategic position relative to the state's rail network. Second, the rules would give an advantage to the rail associations that currently ship on those lines. The shippers have a vested interest in the continued operation of the rail lines, and therefore would be good candidates for first crack at purchasing the lines or obtaining a long-term lease. Third, the state has never regulated shipping rates.

Response:

The bill includes the segment of track between Durand and Ann Arbor for a very good reason. The Ann Arbor and Northwest system extends from Ann Arbor to the Cadillac, Traverse City, and Petoskey area. Where the Ann Arbor/Durand area is highly industrialized, the northern region is not. However, the industries that do exist are just as dependent on good rail service as the urban areas. Unfortunately, the northern, rural segments are not as profitable as urban segments. The result is that it can cost more to maintain a certain segment of track than what can be made in shipping charges. To sell the segment intact, as the bill would require, would make it more likely that profits on the urban segment could offset the losses on the northern segment and so would be conducive to ensuring a continuity of service. Under the rules, it is unlikely that a purchaser could remain in business because it would undoubtedly sustain operating losses. Thus, a future disruption in service may be unavoidable.

As to the second concern, though it is true that the shippers have a vested interest in the continuation of rail service, so do the current contract operators. According to a House Fiscal Agency analysis dated 11-14-96, the operators are required by terms of their leases to reinvest 20 percent of their profits in the maintenance and improvement of the rail infrastructure. These operators have clearly demonstrated by the improvements made both in the physical structure of the rail lines and in improved service that they also have a vested interest in continuing rail service. Therefore, the bill's competitive bid provisions would be more equitable than the departmental rules. Further, if a line segment was leased rather than sold, the bill would continue to require that a lessee reinvest 20 percent of the profits to improve the line. It is only fair that all interested parties have an equal opportunity to purchase a rail segment.

Apparently, the provision to regulate shipping costs would help the shippers to continue to operate competitively. Again, it must be recognized that the main thrust of the bill is to continue rail service to those industries dependent on economical means of getting their products to the public. The bill is far superior to the department rules in achieving that end.

Against:

The bill would delete a provision that authorizes the department to administer the act and to promulgate rules. Under Section 31 of the Administrative Procedures Act of 1969 (MCL 24.231), when a law directing an agency to promulgate rules is repealed and the same rule-making authority is not vested in the same or different agency by a new provision of law, the existing applicable rules are automatically rescinded as of the effective date of the repeal. Therefore, all current departmental rules relating to the administration of this act would be automatically rescinded as of the bill's effective date.

Response:

According to departmental staff, many of the existing rules were incorporated into the bill; other rules would have been superseded by the bill. Therefore, the automatic rescission of the departmental rules would most likely have little effect on the administration of the act's provisions.

Analyst: S. Stutzky

■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.