

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.

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. Rais-

ing 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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NLV (cont. from pg. 20)

buy the branch line at 75% of the NLV. That buyer, however, must agree to continue to operate the branch line for rail service and if, at any time within the succeeding five years, attempts to sell or otherwise dispose of the rail or right of way, all of the proceeds of such disposition in excess of purchase price and rehabilitation costs accrue to the Federal government. This is designed to prevent real estate speculation. Following the 120-day period, Conrail is able to sell the property to anyone, and it intends to pursue these sales as vigorously as possible.

On October 7, Conrail published a list of possible abandonment candidates under the new NERSA procedures. This list was preliminary and all lines were restudied before filing of formal applications. The decision rules for abandonment applications, however, are the following:

- Lines whose revenues do not cover long-term variable costs and which cannot be made profitable by other revenue increases or cost reductions.
- Lines which require immediate rehabilitation in order to remain in operation and where the rehabilitation cost cannot be recovered from revenue generated on the line.
- Marginally profitable lines in rapidly declining traffic markets.

As of December 1, Conrail has filed abandonment applications on 373 lines, accounting for a total of 2,654 route miles of track, or about 16% of the total system. This trackage yielded only 1.6% of Conrail's revenues and produced an annual loss of \$8.8 million. Abandonment of these lines will avoid \$67.7 million in

rehabilitation expenses needed just to keep the lines in service. Table 1 shows the state by state breakdown of the number of branch lines and route miles abandonment applications were filed by Conrail by December 1.

Conrail has an active program of working closely with all state transportation agencies and major shippers affected by this program. Because of the magnitude of the program and the short timeframe involved, there is no effective program of notifying other potentially interested parties and the burden is on these parties to take a pro-active role in this process by contacting Conrail for additional information concerning potential abandonments.

The real estate officers of utility companies and other right of way users may find this abandonment process unsettling because it may pose a threat to the continuity of their lines which use or cross Conrail rights of way. The abandonment by itself would not threaten those users, especially if another railroad assumed service. If the properties are sold, the utilities will be given opportunities to pur-

chase the lines, thus protecting their interests permanently, but a better solution is to petition Conrail now to have those uses or crossings converted from the usual license agreement to a permanent easement.

Conrail has taken this action to consolidate its operations. For further information contact Conrail at 1528 Walnut Street, Philadelphia, PA 19102.

Lawrence A. Huff has been Assistant Vice President-Real Estate at Conrail since December, 1976. Just prior to that appointment, he was General Attorney for real estate matters at Southern Railway Company, having been with Southern during the previous eleven years in various other capacities, including house counsel responsible for all real estate matters.

In his present position, he is responsible for management of Conrail's real estate, including development and implementation of the corporation's real estate policies, negotiations for acquisition or disposal of real estate, arrangements for leases, and preparation of contracts, deeds and other documents necessary for railroad operating properties.

Huff is considered one of the top authorities on railroad abandonment in the country.

Table 1. December 1 Line Abandonments

State	# of lines	Route miles
Connecticut	—	—
Delaware	4	15.2
Illinois	14	305.8
Indiana	27	324.0
Maryland	2	24.1
Massachusetts	17	103.5
Michigan	15	159.5
New Jersey	47	157.2
New York	57	438.2
Ohio	52	399.8
Pennsylvania	137	725.8
Rhode Island	—	—
West Virginia	1	.7



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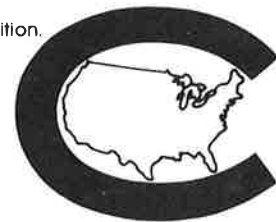
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