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BILL



ANALYSIS

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Senate Bill 263 (as reported without amendment)  
Sponsor: Senator Bruce Caswell  
Committee: Transportation

(enrolled version)

Date Completed: 5-31-13

### **RATIONALE**

As a result of several railroad bankruptcies in the mid-1970s and 1980s, more than 35% of Michigan's total freight rail network was proposed for abandonment. To avoid the potential negative impact of rail service disruption, the Michigan Department of Transportation (MDOT) purchased approximately 900 of the 1,100 affected miles and contracted with private railroad operators to rehabilitate the lines and return them to use. Since then, some of the lines have been returned to private ownership and others have been turned into recreational trails. Today, the State owns approximately 665 miles of rail lines.

Public Act 235 of 1998 amended the State Transportation Preservation Act to authorize MDOT to lease or divest itself of four specific rail lines, with the ultimate goal of returning them to the private sector. The lines include the Lenawee County system, the Hillsdale County system, the Vassar area system, and the Ann Arbor and Northwest Michigan system. The 1998 Act included a prohibition against leasing or selling specific segments of the lines, which was evidently designed to prevent owners from abandoning less profitable segments and causing service disruption.

To date, MDOT has completed the divestiture process for the Lenawee County system. That system was sold in November 2000. According to the statute, the Hillsdale County system is the next line subject to divestiture.

Some people believe that the provisions under Public Act 235 regarding the divestiture of the remaining rail lines have

become obsolete. Evidently, the statutory language has impeded lease negotiations and discouraged operators from making improvements. It has been suggested that the divestiture provisions be deleted.

### **CONTENT**

**The bill would amend the State Transportation Preservation Act to delete provisions that authorize and govern the sale or lease of specific segments of State-owned rail property.**

The provisions that would be deleted are described below.

#### Divestiture Authorization & Required Terms

The Act authorizes MDOT to sell, or provide 10-year leases to the current operators of, specific rail properties. The Department must sell or lease the following properties in the following order: the Lenawee County system, the Hillsdale County system, the Vassar area system, and the Ann Arbor and Northwest Michigan system. The Act defines each system as State-owned rail lines within the respective geographic area.

The Department determines the specific terms of a sale or lease of rail property, but the Act requires some specific conditions.

First, a purchase agreement must require the purchase price to be at least for the net liquidation value of the property. Purchase agreements and leases must require the purchaser or lessee to provide at least the average level of service adjusted for traffic

levels for three years after the date of the sale or lease agreement.

A lessee must reinvest at least 50% of trackage rights revenue in eligible expenditures. ("Eligible expenditures" means the material and direct expenses required for the installation of railroad ties, track, ballast, crossing improvements, ditch and drainage repair or improvements, brush trimming, and the expenses required to conduct track and signal inspections under federal regulations.)

The rates on a purchased or leased segment must not increase more than an amount based on the average increase of the Detroit consumer price index. If a lease or sale involves the Ann Arbor and Northwest Michigan system, the purchaser must charge reasonable freight rates, and honor all existing freight rate agreements and trackage rights for three years after the date of sale.

If, within the first 10 years after a purchase, a purchaser abandons service and sells a segment or any portion of a segment that does not involve main line track, or any rails, ties, or ballast, excluding normal salvage, 95% of any sale proceeds must be returned to the State as additional purchase price. Purchasers may sell segments or portions of segments with MDOT approval.

If there are no acceptable purchase offers, MDOT must offer a lease for at least 10 years to the following parties in the following order: the current operator, current shippers on that segment, governmental entities, and other railroad companies.

If a purchaser or lessee fails to satisfy a sale or lease agreement, the property reverts to MDOT, which then must offer the property for sale or lease to the following parties in the following order: current shippers on that segment, governmental entities, and other railroad companies.

Also, any lease or agreement that was in effect on July 3, 1998, was extended at the same terms until the execution of a sale or lease.

The bill would delete all of these provisions.

Under the remaining provisions, MDOT must consider the individual interest of any

person, public or private corporation, local or regional transportation authority, local governmental unit, private carrier, group of rail users, State agency, or other public or private entity, that expresses a desire to acquire, lease, or secure an easement for real property owned by a railroad company. Any property acquired by MDOT under the Act may be conveyed or leased to certain entities with appropriate reimbursement, as determined by MDOT.

The bill also would retain provisions that govern MDOT's preservation and use of rights-of-way, and that authorize MDOT, as a term of conveyance, to require restrictions on the use of the property to assure that it remains viable for future rail use.

#### Bidding Prequalification, Application Scoring, & Appeals

The bill would repeal sections of the Act that prescribe application requirements, bid evaluation standards, and an appeal process, for bid selection for sales and leases, as discussed below.

Section 10a requires MDOT to issue a statement regarding viability of a segment of rail before entering into a sales or lease agreement.

Section 10b requires the Bureau of Passenger Transportation, with regard to selling the properties listed above, to mail prequalification materials to all railroad companies on file with the Secretary of State and any others who request them. The section prescribes requirements for prequalification, procedures for application, and evaluation standards for review. A committee appointed by the Director reviews and evaluates each bid.

Section 10c allows a prospective bidder to appeal the committee's prequalification determination to the Deputy Director of the Bureau, who must assemble a panel to review an appeal. Section 10d allows the panel's decision to be appealed to the State Transportation Commission.

Section 10e requires the Bureau to develop a scoring mechanism with which to evaluate bid proposals, and requires proposals to include the following:

- Proof of financial ability to lease, operate, and maintain the segment.
- A 10-year plan for operation of the segment.
- The anticipated effect the change would have on shippers, and information on how the bidder would achieve a smooth transition.
- A strategic plan setting forth the bidder's understanding of the business environment of the segment and proposed approach to maintaining current traffic and capturing additional business.
- A capital program plan regarding the bidder's 10-year investment program for the segment's infrastructure maintenance and improvement.
- Ten-year financial projections for the bidder's proposed operation of the segment.
- A sealed envelope containing documentation of the consideration offered by the bidder.
- Other information required by the proposal solicitation.

Section 10f requires the Bureau to apply the scoring mechanism; prescribes the method the Bureau must use in evaluating proposals and selecting a bidder; and requires the approved bidder to enter into an agreement with the Bureau, and take possession of the segment and begin operations within 120 days after being notified of its approval.

Section 10g allows the Director or his or her designee to select a replacement operator for a segment on an emergency basis if an operator under contract with MDOT discontinues service voluntarily or if MDOT removes the operator for failure to comply with its operating agreement.

MCL 474.60

## **ARGUMENTS**

*(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)*

### **Supporting Argument**

Removing the requirements for rail line divestiture would result in more certainty for interested rail companies regarding the ongoing status of State-owned railroad leases, better facilitate future sales, and further the State's interest in preserving and

enhancing its rail lines. The provisions prescribe unrealistic requirements, are outside of industry norms, and are discouraging to some private entities wishing to purchase or lease State-owned railroad property under the Act.

The Act's provision that extends agreements in effect on July 3, 1998, subject to sale or lease, has resulted in contracts of indefinite duration, since the Act sets no end date for these extended agreements. Reportedly, this is a problem for rail operators, since lenders typically want assurance as to the duration of these agreements and the likely future status of the property, and the potential for future administrative changes in State government makes it impossible for rail companies to provide assurance that any contracts and rights will continue. This provision should be removed to improve rail companies' ability to conduct business in conformity with industry standards.

Also, the Act authorizes MDOT to offer a 10-year lease to a current rail operator. However, a 10-year lease is relatively short term in this industry. Reportedly, leases typically are for 99 years. The Act's 10-year limit evidently discourages operators from entering into these leases, since lessees that spend money to rebuild or improve railroad property could make these investments only to have another company step in under a new lease. This limitation deprives lessees of the stability offered by longer lease periods, which can affect their desire and ability to make long-term investments.

Some rail operators find the numerous requirements for divestiture (e.g., requirements for the purchase price, future service levels, rate increases, revenue allocation, and bidding requirements) unrealistic and impracticable. Reportedly, many in the industry viewed the sale of the Lenawee County system as a test of the divestiture process, and ultimately were discouraged from entering into agreements for the remaining rail lines, because the Act's requirements appeared cumbersome. Indiana Northeastern Railroad has been in negotiations with MDOT to purchase a portion of the Hillsdale County system, but has expressed concerns about the difficulties posed by the Act's requirements.

According to MDOT's 2011 State Rail Plan, suggestions for furthering State rail policy

included lifting some of the divestiture requirements, maintaining State ownership of some rail segments, and accommodating future passenger rail activities. Removing the divestiture requirements would give the State the ability and flexibility to pursue its goals for the rail system and rail services in Michigan.

### **Supporting Argument**

The Act's language regarding divestiture of select rail properties has not been enforced, is ambiguous, and should be removed. As noted above, the only divestiture under the Act was in 2000, and further efforts have been on hold.

Reportedly, some of the Act's language has caused confusion in interpreting the law. The Act states that MDOT *may* begin divestiture or offer 10-year leases of the rail systems mentioned earlier. The same provision states that MDOT *shall* accomplish divestiture or create leases, without partitioning a segment or a portion of a segment, in the specified order. The first clause is permissive, so it appears that MDOT is not required to divest or lease these properties. The second clause, however, contains the mandatory *shall*. This could be interpreted as a mandate of *how* divestiture must happen, rather than a mandate that divestiture *happen*, but has caused confusion nonetheless.

Legislative Analyst: Glenn Steffens

### **FISCAL IMPACT**

While the bill would not prevent the State from divesting its ownership of the rail lines outlined in the Act, the Department of Transportation has indicated that there are no immediate plans to sell any of these rail lines. Also, any costs associated with maintenance and improvement of these rail lines is currently appropriated in the Department's annual budget. If the lines were to be sold to eventually a private entity, the revenue would revert to the Rail Freight Fund in the Department of Transportation. The amount deposited would depend on the sale price at the time of purchase.

Fiscal Analyst: Joe Carrasco

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.