The U.S. Short Line Railroad Phenomenon: The Other Side of the Tracks

PAUL STEPHEN DEMPSEY*
WILLIAM G. MAHONEY**

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* Paul Stephen Dempsey is Professor of Law and Director of the Transportation Law Program at the University of Denver. He formerly served as Legal Advisor to the Chairman of the Interstate Commerce Commission. He holds law degrees from the University of Georgia (1975); George Washington University (1978); and McGill University (1986).

** William G. Mahoney is senior principal in the Washington, D.C., law firm of Highsaw, Mahoney & Clarke, P.C. He holds a law degree from the University of Notre Dame Law School (1950).

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I. INTRODUCTION

Short line railroads have always been a part of the U.S. rail network. Nonetheless, their growth during the past decade has been little short of explosive. Much has motivated this proliferation of short lines, including the desire of Class I railroads[1] to eliminate less profitable routes, relieve themselves of maintenance of rights of way obligations thereon and eliminate employees and labor contracts. None of that would have been possible without the extreme receptivity of the Reagan and Bush Interstate Commerce Commission (I.C.C.), which largely swept aside the procedural and legal restrictions.

Much of the literature praises the short line phenomenon. For example, one source notes, "In many cases, the new local carrier can offer more customized, responsive service than its larger predecessor, and often on a more efficient and lower-cost basis."[2] Certainly also, some short lines have been created, and become successful, where the spur lines they replaced would otherwise have been wholly abandoned, thereby saving that finger of the national rail network and benefitting the shippers and communities which rely upon it.

Nonetheless, much of the literature on the subject largely subdues or ignores the other side of the picture — the impact of short line creation on labor, the problems of undercapitalization on safety and stability of service, the overall constriction of the national rail network, the captivity of short lines to the Class I railroads which dominate them, and other problems. This article seeks to fill that gap in the literature.

II. THE HISTORICAL TREND TOWARD RAIL CONSOLIDATION

In earlier periods of United States history, small rail lines were consolidated to form longer systems to provide better service to the public. In 1857, Cornelius Vanderbilt observed that passengers traveling from New York to Chicago were forced to spend 50 hours on trains, making some seventeen connections from one small rail line to another. Commodore Vanderbilt sold his steamboat empire, which had made him the richest man in the nation, and began buying railroads. By 1869 he had consolidated these short rail lines into one huge railroad he called the New York

1. Class I railroads are those which have more than $50 million in annual operating revenue. Most "short line" railroads classify as Class III railroads, with less than $10 million in annual operating revenue. 49 C.F.R. pt. 1201 gen. instruction 1-1(a) (1992).

2. Kelvin Dowd, *The Little Railroad That Could*, 25 TRANSP. L. INST. 67 (1992).

Central.[3] Although a number of large railroads linked the nation by the turn of the twentieth century, literally hundreds of short line and regional railroads made up the bulk of our national rail network.

After World War I, the United States Congress enacted the Transportation Act of 1920,[4] mandating that the Interstate Commerce Commision develop a plan to consolidate the nation's fractured system of short lines regional and large Class I railroads into a unified system of larger and fewer railroads.[5] However, this proposal of merger according to a preconceived governmental plan simply died stillborn.

In 1940, Congress enacted a voluntary merger scheme in the Transportation Act of 1940.[6] Beginning in 1957 with the Norfolk & Western-Virginia Railway merger and continuing with only a brief respite caused by the collapse of the Penn Central merger, railroad consolidations proceeded rapidly in the next quarter century as nearly forty railroads were merged and merged again into seven massive systems.[7] The following chart reveals the major rail mergers which have been consummated since 1960.

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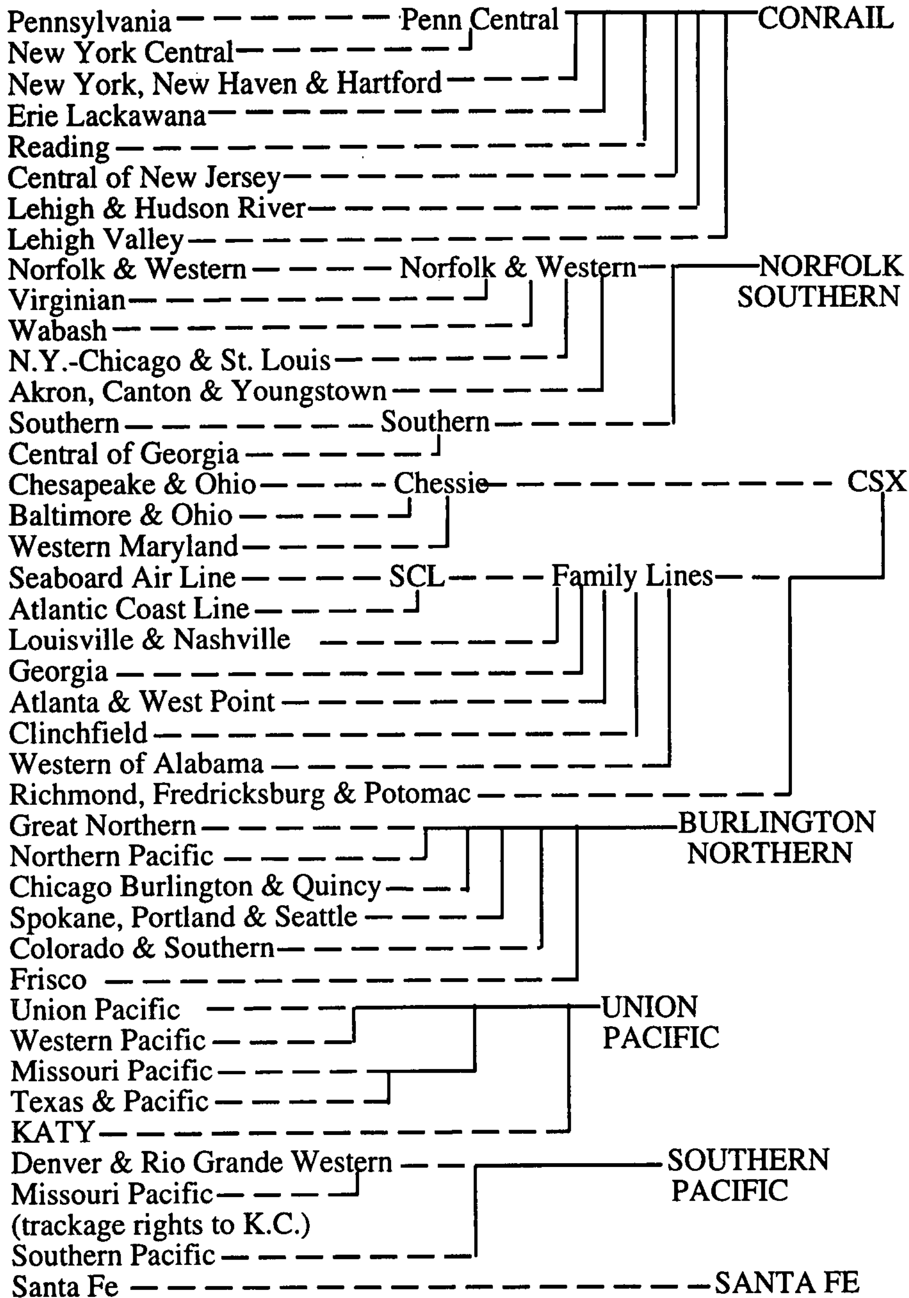
3. PAUL S. DEMPSEY, THE SOCIAL AND ECONOMIC CONSEQUENCES OF REGULATION 8 (1989).

4. Ch. 91, 41 Stat. 456, 481 (1921); Pub. L. No. 66-152.

5. DEMPSEY, *supra* note 3, at 14.

6. Transportation Act of 1940, Pub. L. No. 76-785, § 5(2), 54 Stat. 898, 905.

7. *See* Paul S. Dempsey, *Antitrust Law & Policy in Transportation: Monopoly I$ the Name of the Game*, 21 GA. L. REV. 505, 547-52 (1987).


Pennsylvania
Penn Central
CONRAIL
New York Central
New York, New Haven & Hartford
Erie Lackawana
Reading
Central of New Jersey
Lehigh & Hudson River
Lehigh Valley
Norfolk & Western
Norfolk & Western
NORFOLK SOUTHERN
Virginian
Wabash
N.Y.-Chicago & St. Louis
Akron, Canton & Youngstown
Southern
Southern
Central of Georgia
Chesapeake & Ohio
Chessie
CSX
Baltimore & Ohio
Western Maryland
Seaboard Air Line
SCL
Family Lines
Atlantic Coast Line
Louisville & Nashville
Georgia
Atlanta & West Point
Clinchfield
Western of Alabama
Richmond, Fredricksburg & Potomac
Great Northern
BURLINGTON NORTHERN
Northern Pacific
Chicago Burlington & Quincy
Spokane, Portland & Seattle
Colorado & Southern
Frisco
Union Pacific
UNION PACIFIC
Western Pacific
Missouri Pacific
Texas & Pacific
KATY
Denver & Rio Grande Western
SOUTHERN PACIFIC
Missouri Pacific
(trackage rights to K.C.)
Southern Pacific
Santa Fe
SANTA FE

III. THE ABANDONMENT AND SPIN-OFF PHENOMENA OF THE 1980S

The trend toward consolidation reversed itself sharply in the 1980s when the nation's largest railroads, Class Is, began spinning off branch lines, dead-end spurs and some parallel tracks to newly formed companies which became regional and short line railroads. As one source has noted,

> The railroad industry, built over many decades by constant consolidation and merger, suddenly seems to be scattering itself like confetti across the country. Increasingly, the industry may be evolving into a handful of giant cross-country railroads—the railroading equivalent of interstate highways—augmented by small or regional lines that are mostly spin-offs of the big ones.[8]

Today, short line railroads account for twenty-four percent of United States trackage, up from six percent two decades ago.[9] Between 1950 and 1980, some seventy-five new short line railroads (or two and one-half per year) were created;[10] between 1980 and 1988, some one hundred ninety new short lines (nearly twenty-four per year) began operation—a rate nearly ten times faster than the historical trend.[11]

The trackage operated by Class I railroads declined nearly twenty-six percent, from 177,710 miles of road in 1978 to 132,220 miles in 1987.[12] Of that, 27,971 miles (about sixteen percent) were lost under certificates of abandonment, while 19,083 (about eleven percent) were sold to newly formed corporations that became short line and regional railroads.[13] Since 1980, Class I railroads have reduced employment by more than 200,000 workers or nearly fifty percent.[14] Thus, Class I trackage declined twenty-six percent while employment was cut nearly in half.

IV. THE INTERSTATE COMMERCE COMMISSION'S STIMULATION OF SHORT LINES

The explosive growth of short lines was stimulated by the Interstate Commerce Commision's extreme receptivity to deregulation. It began in

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8. Don Phillips, *Railroads Are Rolling Toward Some Basic Changes*, WASH. POST, June 7, 1987, at H1, H6.

9. Daniel Machalaba, *The Kiamichi Shows How Small Railroads Can Serve Rural Areas*, WALL ST. J., Jan. 8, 1992, at A1.

10. Frank N. Wilner, *Labor Protection Moves Seen Stunting Growth of Short Lines*, TRAFFIC WORLD, Dec. 29, 1986, at 59, 61.

11. Daniel Machalaba, *Once-Booming Sales of Short-Line Railroads Are Stalled*, WALL ST. J., June 3, 1988, at B9.

12. William E. Thoms, *Railroad Spin-offs, Labor Standoffs, and the P&LE*, 18 TRANSP. L.J. 57, 69 (1989).

13. *Id.*

14. Frank N. Wilner, *Railroads and the Marketplace*, 16 TRANSP. L.J. 291, 312 (1988); Graeme A. Lidgerwood, *Railroads Getting in Better Shape for the Long Haul*, WALL ST. J., Feb. 26, 1992, at B4.

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1982 with the ICC's refusal to impose labor-protective provisions in the sale of lines by major railroads to non-carriers[15] and was expanded in 1985 when the I.C.C. promulgated regulations formally exempting short line sales from virtually all regulation.[16] This class exemption effectively relieved the selling railroad of any obligation to compensate the employees for the loss of their jobs as a result of the sale and relieved the short line or regional railroad successor of an obligation to employ the displaced workers. Further, it virtually eliminated all potential opposition by shippers concerned about a potential loss of service.

Former ICC Chairman Heather Gradison once described the short line phenomenon as an "unexpected dividend" of the Staggers Rail Act of 1980. Nonetheless, these exemptions, as well as ICC's liberalized handling of railroad applications since 1982, have been the subject of continuing legal challenges.[17] They were embraced during a period when the ICC was criticized as being excessively infatuated with the ideology of *laissez-faire* and failing to perform its statutory obligations in a responsible manner.[18]

Prior to 1980, virtually all cases involving sales of rail lines were between two existing railroad carriers and arose under section 11343 of the Interstate Commerce Act, which required the involved carriers to agree, as a condition of ICC approval, to an arrangement which would protect the economic interests and collective bargaining agreement rights of employees affected by the sale.[19] The ICC concluded that if it could eliminate the requirement of employee protection (*i.e.*, if it could "deregulate" the railroads' obligation to protect their employees), the sales of short lines would soar. Thus, the ICC decided to employ another provision in the Act dealing with construction of railroad lines and the extension of lines resulting from purchases.[20] By using this provision, the ICC relieved itself of its responsibility to protect employee interests in approving appli-

15. Knox & Kane R.R. Co., Petition for Exemption, 366 I.C.C. 439 (1982).

16. *See ex parte* 392, 1 I.C.C.2d 810, 811 (1985); *see also* Wilner, *supra* note 10, at 61; Thoms, *supra* note 12, at 75.

17. The decision of the U.S. Supreme Court in Pittsburgh & Lake Erie R.R. v. Railway Labor Executives' Ass'n, 491 U.S. 490 (1989) is distinguishable from most short line sales because the sale there was not a true short line spin-off, but the sale of an entire railroad. The seller was not maintaining any contractual or other relationship with the new company and the unions had not requested the ICC to issue labor protective provisions. Thoms, *supra* note 12, at 83.

18. *See* Paul S. Dempsey, *The Interstate Commerce Commission: Disintegration of an American Legal Institution*, 34 AM. U. L. REV. 1 (1984); Paul S. Dempsey, *Congressional Intent and Agency Discretion—Never the Twain Shall Meet: The Motor Carrier Act of 1980*, 58 CHI.-KENT L. REV. 1 (1982); Paul S. Dempsey, THE SOCIAL AND ECONOMIC CONSEQUENCES OF DEREGULATION 229-50 (1989) [hereinafter DEREGULATION].

19. 49 U.S.C. §§. 11343, 11347 (1988).

20. 49 U.S.C. § 10901 (1988). *See* PAUL S. DEMPSEY & WILLIAM E. THOMS, LAW & ECONOMIC REGULATION IN TRANSPORTATION 49-54 (1986).

cations for acquisition. The imposition of such protection was, under section 10901, left to the discretion of the ICC. Although section 10901 explicitly stated that it was to be available to "a rail carrier providing transportation subject to the jurisdiction of the Interstate Commerce Commission," the ICC creatively interpreted the statutory language as applying only to a non-carrier not providing transportation subject to the jurisdiction of the ICC. In short, the ICC limited the use of section 10901 to corporations created solely to buy and operate a particular rail line, *i.e.*, companies that could not "provide transportation" until *after* the ICC approved their purchase of a railroad line.

At first, the ICC held that it would not impose employee protective conditions in such cases unless adverse effects upon employees were significant and could be proved. But when such proof was presented in a case involving the sale of virtually all of what had been the Gulf, Mobile and Ohio Railroad before its merger with the Illinois Central (involving over 700 miles of line), the ICC refused to impose employee protective conditions, holding it would do so only in "unusual circumstances."[21] It has yet to find such "unusual circumstances" to exist.

As a matter of practice and procedure, the ICC has virtually withdrawn from the regulatory arena where short lines are concerned. With its creation of a "class exemption" in 1985, the ICC relieved new corporations of a need to obtain advance approval of the acquisition or to seek prior exemption of that acquisition from such approval.[22] Today, the ICC merely requires the perfunctory filing of a seven-day notice of intent to purchase a line,[23] "thereby ensuring the narrowest window for potential opponents [including shippers] to object."[24] At the end of the seven-day period, approval of the sale is automatic. Further, unless the applicant has lied in its application with respect to a significant material fact, no one can secure revocation of that approval. The filing of a notice permits the non-carrier to proceed without any further action on the part of the ICC except for the publication of a short description of the transactionin in the Federal Register.[25] Under the class exemption, the non-carrier has no obligation to make offers of employment to the employees of the selling carrier, nor does the selling carrier have any obligation to provide compensation for those of its employees who are thrown out of work as a result of the sale. If the employees seek any compensatory protections, they must file an after-the-fact "petition to revoke" the exemption for pur-

21. For a discussion of employee protective conditions, see Oregon Short Line R.R. Abandonment, 354 I.C.C. 76, 78-87 (1987).

22. 49 C.F.R. § 1150.31 to .35 (1991).

23. *Id.* § 1150.32.

24. Dowd, *supra* note 2, at 71.

25. 49 C.F.R. § 1150.31 to .35 (1991).

poses of providing benefits for employees.[26] In order for a trunk line carrier to transfer a line to another entity, the two parties need only agree on a sale or lease arrangement and the transferee or lessee then need only file written notice to that effect with the ICC.

Since beginning its exceptionally permissive approach on these issues, the ICC has imposed labor protective provisions in only one case, and that was because the sale was held to be subject to section 11343 (requiring such a provision), as entire railroads were involved in the sale. On November 10, 1992, the ICC unanimously imposed labor protection on former workers of the Fox River Valley and Green Bay & Western Railroads, whose companies were acquired by the Wisconsin Central Limited (WCL), a 2,500 mile rail system.[27]

Kevin Dowd has identified the *post hoc* remedies available to shippers under the Interstate Commerce Act:

> 1. *Prescription of Rates.* Where a transaction leaves a shipper "captive" to a single carrier, an excessive rate level or surcharge may be challenged as unreasonably high under 49 U.S.C. § 1071a, and, subject to prevailing guidelines, ordered reduced.
> 2. *Terminal Trackage Rights.* Disposition of origin/delivery lines in or around a terminal area under circumstances which restrict service options could be actionable under 49 U.S.C. § 11103(a), which empowers the ICC to require one carrier to give operating rights to another if it is shown to be "practicable and in the public interest."
> 3. *Directed Service.* Section 11125 empowers the ICC to direct that one carrier's traffic be handled over its lines by another, if the first carrier is unable to transport traffic tendered to it due to bankruptcy or a negative cash flow.
> 4. *Reciprocal Switching.* Where necessary to provide competitive rail service, the ICC may act under 49 U.S.C. § 11103(c) to require rail carriers to enter into reciprocal switching arrangements, to ensure timely handling of traffic and preserve access to other carriers serving a terminal area.
> 5. *Financial Assistance.* Under 49 U.S.C. § 10905, a line proposed for abandonment may be ordered sold to a "financially responsible person," including a shipper, in order to preserve service. As an alternative, the abandoning carrier can be required to accept a subsidy to continue operations.[28]

V. The Economics of Short Line Spin-Offs

A. *The Class I Railroads*

The economics driving Class I railroads to spin off lines to new com-

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26. 49 U.S.C. § 10505(d) (1988); 49 C.F.R. § 1150.32(c) (1991).

27. *See* Wisconsin Cent. Transp. Corp. Continuance in Control, Fin. Docket No. 32036, 1992 ICC LEXIS 279, at *31-32 (Dec. 4, 1992); *see also WC Wins a Decision*, TRAINS, Feb. 1993, at 15.

28. Dowd, *supra* note 2, at 73.

panies are powerful. Short lines have become a means whereby Class I railroads have shed themselves of thousands of workers, spinning off feeder lines to low overhead operators while keeping their high-density core routes.[29] The short line phenomenon has also enabled Class I railroads to eliminate obligations to maintain thousands of miles of right of way and to realize significant profits by liquidating major capital assets, while avoiding ICC abandonment proceedings with their compulsory economic protection for affected employees.

Some argue that the creation of short lines is the only alternative to abandonment. Sometimes they are, although not as often as claimed. The fact is that short lines have not been created exclusively from branch or spur lines, but have also been formed from main or secondary main line track, some connecting major cities with significant traffic. Indeed, a number of the "short lines" are acknowledged large regional railroads.

Rail lines have been transferred to short line operators because they were either asserted redundant (e.g., the 631 mile Chicago, Missouri & Western), did not fit into the trunk line carrier's changing operating emphasis (e.g., the 772 mile Chicago, Central & Pacific), a combination of these two factors (e.g., the 2,000 mile Wisconsin Central Limited), or because they served to "punish" labor organizations that were not pliable to a particular carrier's views regarding changes in work rules.[30] Much of the trackage likely could not have been lawfully abandoned even under the ICC's liberal abandonment procedures because it involved profitable main lines connecting major cities with significant traffic.[31]

B. THE SHORT LINE AND REGIONAL RAILROADS

The new short lines have some cost advantages in terms of doing the job with fewer workers earning less pay under less favorable working conditions and milder safety regulation enforcement. But the short lines lose the economies of scale of large railroad operations and are often established with unsatisfactory debt-to-equity ratios causing their operating profits to be squeezed by high interest obligations. Moreover, many of the short lines are "captive" to the Class I railroads they feed, giving the Class I's almost absolute power to dictate unilaterally joint-line rates and conditions of service. Their captivity and, for many, gross undercapitalization, have led to a significant turnover rate and, arguably, a nar-

29. Machalaba, *supra* note 11, at B9; Thoms, *supra* note 12, at 71.

30. *See* Burlington Northern R.R. v. United Transp. Union, 862 F.2d 1266 (7th Cir. 1988).

31. *See generally*, DEMPSEY & THOMS, *supra* note 20, at 58-65. In the case of Wisconsin Central, some of the branch lines included in the transaction were subject to or eligible for abandonment. However, the key assets transferred were the Soo Line Railroad Company's assertedly redundant Chicago to Minneapolis lines and the trunk line from Minneapolis to Sault Sainte Marie that connects with Canada via the International Bridge.

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rower margin of safety. Derailments appear to be a problem with some regional and short line railroads and are of particular concern where they carry hazardous materials.[32] When they go "belly-up," their lines may be abandoned, leaving the dependent shippers without service and further constricting the national rail system.

C. LABOR

For the industry's workforce, the new regime looks particularly grim — fewer jobs, less pay, and dilution of benefits, work rules, and safety standards.[33] One critic has noted, "Railroads are selling off lines merely to circumvent their collective bargaining agreements."[34] United States Representative Thomas Luken described short line sell-offs as a "merely subterfuges" by railroads seeking to avoid their contractual obligations to unions.[35] Indeed, some line sale agreements have been explicitly contingent upon there being no employee protection provisions imposed and no union organizing campaign.[36]

Other such efforts have been more imaginative. For example, the Norfolk Southern's Thoroughbred Program, under which the Norfolk Southern (NS) provides a cashless lease, relieves the operator from the responsibility for paying rent so long as he meets his quota. Norfolk Southern also provides rail cars and helps with marketing. The real change is that service previously provided by the Norfolk Southern is replaced by a new operator employing fewer workers at lower wages.

Unregulated short line sales and leases have resulted in furloughs of the employees of the seller/lessor carriers, decreases in wages for employees of those carriers who were hired by the new carriers, and changes in the work rules in effect on the rail lines involved. Typically, short line railroad companies have employed significantly fewer workers than did the selling/leasing railroads for operations of the transferred lines; usually the employees of the sellers/lessors were not guaranteed rights to transfer with the lines and often were required to relocate great distances. Employees who were furloughed in connection with line sales/leases but were able to obtain positions with the short line railroads generally suffered significant reductions in pay and the loss of contract benefits and protections.

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32. *See* Margaret D. McGarrity, *Freeholders Seek Rail Investigation*, N.Y. TIMES, Nov. 22, 1987, at 10.

33. *See* Phillips, *supra* note 8, at H7.

34. Machalaba, *supra* note 11, at 9.

35. *Railroad Union Head Urges Probe of Short-Line Railroad Sales*, 190 Daily Lab. Rep. (BNA), at A-9 (Oct. 2, 1987).

36. *See* FRVR Corp. Acquisition and Operation Exemption, Fin. Docket No. 31205, 1989 ICC LEXIS 49, at *11 (Feb. 21,1989).

The impact of such transactions on employees is illustrated by several examples. The Chicago and Northwestern Transportation Company (C&NW) had employed approximately 330 employees on the line it sold to FRVR Corporation, but FRVR hired only approximately 200 people at wages fifteen percent below the C&NW pay levels.[37] CSX Transportation Inc. had employed approximately 220 workers on the lines in western New York State which it sold to the Buffalo and Pittsburgh Railroad (B&P), but B&P hired only 160 persons who suffered a fifteen percent reduction in compensation.[38] A fifteen percent reduction also resulted from the sale of the Gulf and Mississippi R.R. Corporation track in Mississippi, Alabama, and Tennessee to Southeastern Rail Corporation. The result of Wheeling Acquisition Corporation's acquisition of 576 miles of trackage rights of the Norfolk and Western Railway Company (N&W) in Ohio, Pennsylvania, West Virginia and Maryland, was the displacement of 425 N&W employees, only 190 of whom were offered jobs with Wheeling Acquisition.[39]

The major Class I railroads employed 458,322 workers in 1980, when the Staggers Rail Act was passed. By 1988, employment had fallen to only 235,880, a loss of more than 222,000 jobs in merely eight years.[40] During this period, job losses totaled nearly 28,000 a year, nearly three times the rate of job losses in the 1970s.

In 1988, Class I railroads employed an average of 1.6 workers per mile of railroad line; regional railroads employed .72 workers per mile; and local (short line) railroads employed .44 workers per mile.[41] In other words, short line railroads employed less than twenty-eight percent of the workers per mile vis-a-vis Class I railroads. Stated differently, more than seventy percent of Class I employees lose their jobs when lines are spun off to short line railroads. Using both conservative and liberal assumptions, the number of workers per mile falls between fourteen percent and twenty-eight percent, while the number of net jobs lost ranged between seventy-two percent and eighty-six percent; the total net jobs lost was

37. Chicago & N.W. Transp. Co. v. Railway Labor Exec.'s Ass'n, 855 F.2d 1277, 1279 (7th Cir.), *cert. denied*, 488 U.S. 966 (1988); FRVR Corp. Exemption Acquisition & Operation, Fin. Docket No. 31205, 1988 ICC LEXIS 19, at *8 (Jan. 28, 1988).

38. Buffalo & Pittsburgh R.R., Exemption, Acquisition and Operation of Lines in New York and Pennsylvania, Fin. Docket No. 31116, 1989 ICC LEXIS 178, at *5 (June 20, 1989).

39. Wheeling Acquisition Corp. Acquisition & Operation Exemption, Fin. Docket No. 31591, 1989 ICC LEXIS 404 (june 20, 1989); Southeastern Rail Corp. Acquisition & Operation Exemption, Fin. Docket No. 31187, 1989 ICC LEXIS 233 (Aug. 15 1989), *aff'd sub nom.* Brotherhood of Locomotive Engr's v. ICC, 909 F.2d 909 (6th Cir. 1990).

40. Labor Bureau, Inc., Analysis of Freight Railroad Operating Expenses and the Role of Labor Costs, Number of Employees and Man-Hours Class I Line-Haul Railroads (1989).

41. *See* Association of American Railroads Statistics of Regional and Local Railroads 3 (1988).

between 20,000 and 29,000.[42]

Those who are lucky enough to find a job at the short line earn wages up to forty percent less.[43] They are often forced to relocate great distances even if seniority permits them to retain a position on the selling carrier. The short lines operate free of work rules and manning levels required of the unionized railroads[44] and the stricter Class I safety requirement enforcement. For example, in 1986, when the C&NW provided the capital and management to set up the Dakota, Minnesota and Eastern (DM&E), it offered existing workers on the 1,000 mile line an ultimatum—if you want a job, resign from the C&NW, waive all your legal rights against it, then you will be *considered* for a job at the DM&E at lower pay.[45] Again, the impact on workers is clear—fewer jobs, more onerous working conditions, and less pay.

Employees of lines sold or leased to short line railroads have been

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42. These calculations were derived from data taken from several sources: LABOR BUREAU, INC., *supra* note 40; Rapid Growth of Short-Line and Regional Railroads: Hearings on H.R. 1128, H.R. 2204, and H.R. 3332 Before the Subcomm. on Transp., Tourism, and Hazardous Materials of the House Comm. on Energy and Commerce, 100th Cong., 1st Sess. 139 (1987) (testimony of Richard Kilroy).

In 1982, Class I railroads employed 378,904 people and operated 173,656 miles of track, or 2.18 employees per mile. In 1987, Class Is employed 235,814 and operated 147,568 miles, or 1.59 employees per mile. Figures on short line railroads are, understandably, less precise. In 1987, the Short Lines employed between 6,536 and 4,600 individuals and operated between 14,534 and 15,400 miles of track, or between 0.45 and 0.30 workers per mile.

The net loss in jobs is derived by taking the number of employees per mile for Class Is and multiplying it by the number of miles operated by Short Lines, then subtracting the number of workers employed by Short Lines. With 2.18 employees per mile in 1982 multiplied by 14,534 and 15,400, we see that between 31,648 and 33,572 employees have been affected. Subtracting from that the number of people employed by Short Lines reveals the net loss in jobs between 25,148 and 28,972.

A more conservative way to calculate it is to use the 1987 Class I employment figure of 1.59 workers per mile. Using the same methodology, this results in a net less of between 16,473 and 19,886 jobs. This is still significant and it must be remembered that these data take us only to 1987, before the recession of 1990-93.

43. Machalaba, *supra* note 9, at A1.

44. *Id.*

45. In 1986, the Chicago & Northwestern Railroad decided to relieve itself of some 1,000 miles of line across the northern tier of the United States. A "paper" corporation named the Dakota, Minnesota and Eastern was created to "buy" and operate the line. C&NW supplied seed money to DM&E for its startup and C&NW middle management officials "retired" from C&NW and were hired by DM&E. They immediately ranged across this 1,000-mile sparsely populated region of the United States informing C&NW employees (some with 40 or more years of service) that they were to be discharged upon consummation of the sale, that their unions could do nothing for them as there would be no unions on the property after the sale, and that if they resigned from the C&NW and waived any and all rights or claims under contract or otherwise they might have against the C&NW, they would then "be considered" for employment with DM&E at lower pay. Take it or leave it. Given their age, their specialized skills, and the lack of any employment within hundreds of miles, these employees had little choice but to accept whatever was offered them.

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adversely affected by explicit provisions in the sale and lease contracts. The CNW-FRVR agreement contained a provision typical in such transactions whereby the sale was voidable if any form of employee protection arrangement was imposed as a condition of authorization of the transaction. The provision went as far as to say that the transaction was voidable if a union organizing campaign was in progress at the time of the sale.[46] Another example of such a restrictive condition in a sales agreement was a provision in the agreement for the sale of 1,200 miles of Soo Line Railroad trackage in Wisconsin to the Wisconsin Central Limited, which was designed to reduce the Soo Line's obligation to its employees under an existing lifetime compensation arrangement. Soo identified those employees as "protected" and offered WCL a bounty of $40,000 per employee for each "protected" employee WCL hired over a 350 base figure.[47]

Employees have also been adversely affected by unregulated short line sales and leases which were specifically designed to nullify union contracts. An example of such an arrangement is the Norfolk Southern Thoroughbred Program, in which lines were leased to reduce labor costs under existing contracts without a loss to NS of long haul traffic.[48]

Perhaps one of the clearest examples of unregulated transactions designed to take advantage of the ICC's abdication of regulatory oversight, so as to avoid existing collective bargaining agreements, is the series of leases among the Guilford Transportation Industries (GTI) family of railroads. Timothy Mellon's Guilford Transportation attempted to lease the Boston & Maine, Maine Central, and Delaware & Hudson to another subsidiary, the Springfield Terminal, a small former terminal rail line in New England.[49]

During the early 1980s, GTI acquired the Maine Central Railroad Corporation (MEC), Portland Terminal Corporation (PT), Boston and Maine Corporation (B&M), Springfield Terminal Railway (ST) and the Delaware and Hudson Railway (D&H) through consecutive acquisitions.[50] In the fall of 1986, in order to reduce its work force, lower wages, and obtain more advantageous work rules, GTI arranged the lease of all the MEC, PT and

46. FRVR Corp. Acquisition and Operation Exemption, Fin. Docket No. 31205, 1987 ICC LEXIS 49, at *12 (Feb. 21, 1989).

47. *See* Soo Line R.R. v. Wisconsin Cent., Ltd., Civ. No. 4-88-900 (D. Minn.) (affidavit of John C. Miller).

48. *See* Railway Labor Executives' Ass'n v. Chesapeake W. Ry., 738 F. Supp. 1544 (E.D. VA.), *modified*, 915 F.2d 116 (4th Cir. 1990), *cert. denied*, 112 S. Ct. 1312 (1991).

49. *See* Railway Labor Executives' Ass'n v. Guilford Transp. Indus., Inc., 667 F. Supp. 29 (D. Me. 1987); Delaware and Hudson Ry. Lease and Trackage Rights Exemption, Fin. Docket No. 30964 (Oct. 4, 1990); Thoms, *supra* note 12, at 75, 81; *see generally*, DEREGULATION, *supra* note 18, at 148.

50. *See* Guilford, 667 F. Supp. 29, at 30-31.

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B&M operations and trackage to ST. Springfield Terminal Railway, a five-mile terminal rail line, had a collective bargaining agreement which provided lower pay rates and gave management greater flexibility in work rules than Class I railroad agreements. The effect of these leases was to transfer the employees from the relatively standard B&M, MEC and PT Class I agreements to the less beneficial ST agreement. The leases followed several unsuccessful efforts by GTI to negotiate significant changes in the work rules of the standard agreements. These changes were accomplished gradually, on a piecemeal basis. They were put into place through seven-day notices of exemption until all of the lines of those railroads were operated by the ST.[51]

In essence, GTI accomplished a restructuring of its entire rail system and the avoidance of existing agreements on the B&M, MEC and PT through short line transactions accomplished without regulatory oversight. Rail labor protested each lease, arguing that the leases were designed purely for labor relations rather than transportation purposes and that many workers were denied the opportunity to follow their work. The ICC refused to block any MEC and PT leases and almost all B&M leases, asserting that it could retroactively remedy any adverse effects on employees, and warning GTI that the leases would be entered subject to revocation and retroactive remedies.[52] When the D&H began leasing its lines to ST and it became apparent that the entire GTI system was being leased to ST, the ICC halted further leases, but did nothing regarding the existing leases.[53] GTI subsequently put the D&H into bankruptcy reorganization proceedings and the trustee of the D&H subsequently filed suit alleging that GTI improperly transferred D&H assets to ST.[54]

As a result of the leases many employees of MEC, PT and B&M lost work. Those who went to work for ST received lower wages under less advantageous work rules. ST also hired some individuals "off-the-street" in preference to the former B&M, MEC and PT workers. In 1988, the ICC finally held that B&M, MEC and PT employees had a right to follow their work and ordered arbitration.[55] In 1988 the employees won under arbitration. In 1989 the awared was affirmed in part, but vacated in regards to the allowance of the employees to work under their old agreements on the leased lines.[56]

51. Delaware and Hudson R.R. Lease & Trackage Rights Exemption, 4 I.C.C.2d 322, 323-24 (1988).

52. *Id.* at 325 n.5, 327.

53. *Id.* at 327.

54. *See* Mellon v. Delaware & Hudson Ry. (*In re* Delaware & Hudson Ry.) 122 B.R. 887 (D. Del. 1991).

55. Delaware & Hudson R.R., 4 I.C.C.2d at 331.

56. Delaware and Hudson Ry. Lease & Trackage Rights Exemption, Fin. Docket No. 30965, 1989 ICC LEXIS 9, at *1 (Jan. 5, 1980) (partially affirming June 1988 award made by Richar R.

A final arrangement governing the rights of MEC, PT and B&M employees was mandated by an arbitration award issued in March 1990 and affirmed by the ICC in October of 1990.[57] In a subsequent decision, the ICC *sua sponte* reduced the make-whole period for employees who had been wrongfully deprived of employment to only seventy-five days.[58] Thus, despite the fact that many employees had lost months or years of work between the leases in 1986 and the ICC decisions, many employees had retired and/or died during the course of these proceedings.[59]

Beyond the direct effects upon employees' jobs and incomes, the short line program is being used as a vehicle to pressure Congress into eliminating a number of employee related statutes because, according to the short lines, the statutes are too expensive for short line railroads to comply with or are inappropriate for application to small railroads. These statutes include the Railway Labor Act,[60] the Railroad Retirement Act,[61] the Railroad Retirement Tax Act, the Railroad Unemployment Insurance Act,[62] and the Federal Employers' Liability Act.[63]

The ICC recently increased the revenue criteria for qualification as Class I and Class II rail carriers. The effect of this change is to place some of the larger short lines in the Class III category which are subjected to lesser safety enforcement by the Federal Railroad Administration. Most short lines are generally Class III carriers with lowered safety standards.

VI. Capitalization and High Failure Rate

Critics of the short line phenomenon insist that short lines have "splintered the railroad system, displaced thousands of workers and left track in the hands of poorly capitalized, poorly maintained railroad companies one disaster from bankruptcy."[64] Yet another commentator

Kasher, Arbitrator). In the meantime, ST's operation of the GTI system involved the use of employees across craft lines which gave rise toallegations that the railroad was not being operated by qualified individuals and ultimately resulted in a strike which was subsequently held to be a lawful safety strike under additional arbitration.

57. *See* Delaware and Hudson Ry. Lease & Trackage Rights Exemption, Fin. Docket No. 30965, 1990 ICC LEXIS 390, at *4 (Dec. 10, 1990) (discussing the ICC's prior approval or March 13, 1990 award made by Robert O. Harris, Arbitrator).

58. Delaware & Hudson Ry. Lease & Trackage Rights Exemption, Fin. Docket No . 30965, 1991 ICC LEXIS 84, at *4 (Apr. 3, 1991).

59. The ICC also allowed modifications of the work rules applicable to the leased lines, including a seniority ranking whereby employees of MEC, PT and B&M furloughed at the time of the leases would have less seniority than employees hired by ST "off-the-street" after the leases.

60. 45 U.S.C. §§ 151-188 (1988 & Supp. 1993).

61. 45 U.S.C. §§ 231-231u (1988 & Supp. 1993).

62. 45 U.S.C. §§ 351-369 (1988 & Supp. 1993).

63. 45 U.S.C. § 51 (1988). (This act permits civil recovery by employees against their employers for negligence causing employee injury.)

64. Machalaba, *supra* note 9, at A1.

notes:

> In the case of a Complete Spin-Off, a principal concern for shippers may be the financial viability and operational reliability of the new carrier. Particularly if the acquiring entity is new to the railroad industry . . . there may be legitimate doubts whether it will have the capacity to maintain—much less improve upon—prior service levels. . . .
>
> Acquisition of these lines by an inadequately capitalized firm, or through a leveraged transaction which leaves the new carrier heavily burdened with debt, could set the stage for abrupt economic dislocations or business failure and eventual abandonment. A shipper dependent on the continued availability of rail service would have a direct interest in the financial wherewithal of the prospective purchasers of the facilities needed to provide that service. Operational reliability also may be an issue, both in terms of adequacy of service and availability of equipment.[65]

Many short lines are inadequately capitalized (some, the product of leveraged buy-outs [LBOs])[66] and therefore have severe cash problems when confronted by unanticipated losses such as a tort liability judgment or a loss of equipment or track in, for example, a derailment.[67] To the financial community, short lines have two values—the "going concern" value as a rail line and the liquidation value of the capital assets, mostly real estate, should the new railroad go "belly up." While the public may have an interest in continued rail service in the geographic region, the bank may see prime residential, commercial, or industrial property over the horizon. Many of these short line rail companies lack sufficient capital for long-term maintenance and cannot take advantage of the economies of scale of larger railroads. Some are mom-and-pop operations, run like family farms with the owners eking out a fourteen hour day hand-to-mouth existence, praying for no derailments the way a farmer prays for rain.[68]

Let us examine several of the poorly capitalized railroads. The Chicago, Missouri and Western Railway Company (CMW) was created as a non-carrier subsidiary of the Venango River Corporation (Venango), a holding company that already controlled another short line carrier, the Chicago, South Shore and South Bend Railway Company.[69] Venango incurred a debt-to-equity ratio of 1,700 to 1 in its leveraged buy-out of the CMW.[70] In 1987, the LBO artists put up only $55,000 in equity for the

65. Dowd, *supra* note 2, at 68.

66. *See* Phillips, *supra* note 8, at H1. ("They often throw every penny they have into their new ventures and usually go deeply into debt with major lending institutions . . . .").

67. *See* Machalaba, *supra* note 9, at A6.

68. *See generally*, Bob Wiedich, *Optimism Rolls On Short-Line Railroads*, CHI. TRIB., June 29, 1990, at 3.

69. DEMPSEY & THOMS, *supra* note 20, at 69-73.

70. Lisabeth Weiner, *Lenders Come Under Fire in Suit Over Failed LBO*, AM. BANKER, Aug. 16, 1989, at 14.

$105 million purchase of the 631 mile line from the Illinois Central Gulf (ICG) running from Chicago through St. Louis to Kansas City by using a section 10901 7-day notice of exemption procedure.

Beginning in 1986, prior to consummation of the purchase, and continuing in 1989, the ICC rejected complaints by labor unions and others challenging CMW's acquisition of the line on grounds that it could not survive due to the highly leveraged nature of the purchase. The new company suffered operating losses from the start, losing $1.7 million in the first two full months of operation. In 1988, one year after it began operation, the new company filed for Chapter 11 bankruptcy, the victim of "operating losses, high debt, rotted track, and traffic levels far below projections."[71] By September 1989, it was virtually cashless. It was broken in two and sold off to two other short line railroads.[72]

Numerous other railroads, including the Chicago, Central & Pacific Railroad (CCP) and the Gulf & Mississippi Railroad, have been restructured.[73] The Cedar Valley Railroad Company (CVAR) was formed in 1984 to purchase 112 miles of rail line in Iowa and Minnesota from the ICG.[74] In 1984, the CVAR reported revenues of $263,000 and expenses of $558,000.[75] In late 1985, the owner of the CVAR purchased another 670 miles of ICG rail line in Iowa for $75 million. The acquisition was effected by a newly created non-carrier, the CCP. The purchase was financed in the form of a $65 million mortgage and $10 million in preferred stock.

When protesting parties questioned the competence of CCP management, the ICC responded that "managerial prowess is not germane to a Section 10901 application."[76] Subsequently, the owner of CVAR sold his interest in CCP, but maintained ownership of CVAR. However, CVAR ceased operations abruptly without ICC abandonment approval in May 1991 when the carrier defaulted on two bank loans exceeding $3 million.[77] As a consequence, fifty-eight outbound rail cars loaded with grain were stranded on CVAR lines. In an emergency proceeding, the ICC approved CCP's operation of CVAR up to January 1992.[78] During that time

71. Machalaba, *supra* note 11, at B10.

72. The purchasers were SPCSL Corp., a short line created by the holding company that controls the Southern Pacific, St. Louis Southwestern and Denver and Rio Grande Western railroads, and Gateway Western Railroad Company, a short line captive of the Atchison, Topeka & Santa Fe Railway Company.

73. Machalaba, *supra* note 11, at B10.

74. Cedar Valley R.R. Exemption, ICC Fin. Docket No. 30544, 1984 ICC LEXIS 277, at *1 (Sept. 18, 1984).

75. Id.

76. Chicago, C. & P.R.R. Purchase, Trackage Rights & Sec. Exemption Rights, Fin. Docket No. 30663, 1985 ICC LEXIS 22, at *17 (Dec. 20, 1985).

77. Chicago Cent. & Pac. R.R. Directed Service, ICC D.S.O. No. 1511, 1991 ICC LEXIS 114 (June 4, 1991).

78. *Id.*

CCP created a new noncarrier subsidiary, Cedar River Railroad Company, that acquired the assets of CVAR.

In 1979, four individuals, each investing between $160 and $255, and Beloit corporation, which invested $11 million through a holding company called PLECO, acquired the Pittsburgh & Lake Erie (P&LE), which had always been a profitable railroad.[79] The acquisition of P&LE was performed through a leveraged buyout in which the funds for the entire purchase price of P&LE were obtained through a loan secured by all of P&LE's assets. As a result, the four individual investors each obtained between 8.4% and 13.4% control of P&LE for their nominal investments of between $160 and $255. With the decline of the steel industry in Pittsburgh, P&LE suffered losses. Pittsburgh & Lake Erie then entered into a debt reorganization plan with its creditors and agreements with its employees for reductions of wages and hours. In 1986, Beloit sold all of its holdings in PLECO to the management shareholders. The following year P&LE sought to sell all of its assets to a short line railroad for $75 million. Because the work force would be reduced by two-thirds without severance benefits and because the wages of retained employees would be reduced by fifteen percent a strike ensued. After many years of litigation and negotiations, portions of the P&LE were sold and the P&LE was reorganized.[80] The restructurings which followed displaced two-thirds of the former workers on the line. Although the P&LE surely would have suffered as a result of the downturn in the Pittsburgh economy, its ability to weather this adversity was severely hampered by the debt assumed to support the leveraged buyout.

The consequences of undercapitalization are significant. Costs must be slashed and maintenance and new equipment purchases must be deferred. Track deterioration and the threat of derailments ultimately result in significant speed reduction. Deterioration of track, road bed, and rolling stock may go so far that the investment for rehabilitation may dissuade another entrepreneur from trying to make another go of it. The banks, of course, will step in at default and liquidate all the assets to recover their investment.

Where the line in question is profitable, its spin off to an undercapitalized short line may well jeopardize its long-term viability. The debt burden has too often crushed operating profits.[81] Capital assets are encumbered by debt owed to financial institutions which often predicate their loans on the liquidation value of the properties. As just noted, a

79. Field v. Allyn, 457 A.2d 1089 (Del. Ch. 1983).

80. *See, e.g.*, CSX Transp., Inc. Acquisition & Lease Exemption, Fin. Docket No. 31827, 1991 ICC LEXIS 148 (June 26, 1991).

81. *See* DONALD BARTLETT & JAMES STEELE, AMERICA: WHAT WENT WRONG? 143-161 (1992).

short line operator on his way to insolvency may be forced to defer track and equipment maintenance. Not only does this jeopardize rail safety, it deprives the line of viability for any successor interested in picking up the pieces of the failed entrepreneur. Thus, should a governmental unit decide that the line is too important to communities which rely upon it to allow its track to be ripped up in abandonment, it may nonetheless find the economic burden of paying off the banks and rehabilitating the deteriorated line to be prohibitive.

The fatality rate of short lines has been quite high. Of the 138 regional or short line railroads created in 1986, twenty-nine failed within one year, a tweny-one percent failure rate.[82] Some maintain the failure rate is between fifteen percent and twenty percent, although these figures precede the recession of the early 1990s.[83]

In the end, the harsh reality of a short line failure shows itself in the permanent abandonment of track and the eventual and somewhat inevitable replacement of switching and maintenance yards to other property uses such as office buildings and malls. Once a track is ripped up it is almost always gone, and gone forever. Recognizing this result, U.S. Senator Tom Harkin noted that the public interest in rail service warranted stronger governmental oversight of undercapitalized short line railroads: "Railroads are crucial to the movement of agricultural commodities, manufactured goods, coal and many other products. Their maintenance and continued operation at a proper level of service are essential for our national productivity."[84]

VII. HOLDING COMPANY ACQUISITIONS

ICC deregulation of acquisitions of portions of large railroads has allowed the formation of rail systems without government oversight. Many transactions which have been presented as acquisitions of small portions of rail lines by new corporations have actually been acquisitions by rail systems under holding companies and composed of affiliated railroad corporations. Through this device, the holding companies have obtained control over hundreds and sometimes tens of hundreds of miles of connecting rail lines. In some instances, this has resulted in the formation of large connecting rail systems without any regulatory oversight. Often these acquisitions are accomplished through leveraged buyouts in which

82. BHD. OF MAINT. OF WAY EMPLOYEES, THE SHORT LINE SELL-OFF, Issue 3 (1988).

83. *See* Peter Anderson, *Closely Watched Trains: An Erratic Romance With Short-Line Railroads*, BOSTON GLOBE, Mar. 12, 1989, at 23; Bob Burgdorfer, *Small Railroads Find Profitable Niche in Rural America*, REUTER BUS. REP., Oct. 19, 1989.

84. *Railroad Labor Leader Kennedy Calls for Tougher Limits on Leveraged Buyouts of Railroads*, BNA DAILY LAB. REP., June 26, 1989, at A-11.

all of the assets of the acquired lines are pledged as collateral to lenders and the parent companies guarantee the loans.

While the absence of regulatory oversight over the acquisition of a small line arguably may not be serious, the consequences can be extremely serious when multiple lines and especially multiple connecting lines are acquired without any governmental assessment of the fitness of the operators or the financial soundness of the conglomerated operations. If the parent corporation or the common enterprise are not competent, or if financial difficulties occur, an entire region can find itself without competitive rail service or with no rail service at all.

Another deleterious consequence is that employees on the transferred lines have no right to continued employment on the lines and no severance pay or other economic rights to cushion their immediate loss of income; indeed, these transactions typically do not involve retention of the existing work force. Let us examine several of these rail conglomerate holding companies.

Itel Rail Corp. which controlled several rail carriers including the 250 mile Green Bay and Western Railroad Company (GB&W) formed a subsidiary, FRVR Corp. (FRVR) to acquire 200 miles of C&NW lines in Wisconsin which connected with the GB&W at Green Bay. Itel provided aproximately twenty-five pecent of the purchase price for the line and financed the balance by a loan secured by the property acquired by FRVR and guaranteed by Itel. The acquisition was accomplished through a seven day notice of exemption.[85] C&NW employees were denied a right of hire on the line and FRVR was operated as a non-union operation even though GB&W employees were unionized. Itel encountered financial difficulties and entered into an agreement to sell FRVR and GB&W, to the Wisconsin Central Ltd. (WCL).[86] WCL, an almost 2,000 mile non-union operator, effectuated the acquisition through its own newly formed subsidiary using the seven day notice of exemption and thereby merging 2,500 miles of rail line without regulatory oversight.

MidSouth Corporation (MidSouth) is another holding company that controls several short line railroads—MidSouth Railroad Company (MRC), MidLouisiana Railroad Company (MidLou) and SouthRail Corporation (SRC). MidSouth now operates 1,215 miles of rail line, formerly a part of the Illinois Central Gulf Railroad (ICG), which it acquired either through direct subsidiary purchase or indirectly by the acquisition of short lines created from former ICG track.[87]

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85. Railway Labor Executives' Ass'n. v. ICC, 914 F.2d 276, 278-9 (D.C. Cir. 1990).

86. Fox Valley W. Ltd. Exemption Acquisition & Operation Exemption, Fin. Docket No.32035, 1992 ICC LEXIS 278, at *4 (Dec. 4, 1992).

87. *See* MidSouth Corp. Continuance in Control Exemption, Fin. Docket No. 32035, ICC LEXIS 287, at *2 n.2 (Dec. 17, 1991)..

MidSouth began this process by creating MRS to acquire ICG lines in Mississippi and Louisiana, which was concluded in 1986.[88] Two years later, SRC was created to acquire the assets of the Gulf & Mississippi Railroad Company (GMRR), a short line created from other ICG rail lines in Mississippi and Alabama.[89] GMRR's lines ran north to south and connected with MSR's east to west tracks at several locations. GMRR was yet another leveraged purchase that had failed to turn a profit and its sale was stimulated by creditor pressure. Both the MSR and SRC acquisitions as well as GMR's acquisition of ICG lines were concluded in a manner that resulted in furloughs of a number of employees formerly working on the line and the retention of the remaining workers at lower pay.[90]

Other examples of the formation of rail systems without regulatory oversight are the GWI Corporation, Kyle Railways Inc., and RailTex, Inc.. GWI, through consecutive transactions, has obtained control over four connecting rail lines in western New York. GWI owned two small connecting railroads; it formed the Rochester & Southern Railroad to acquire 91 miles of a connecting line and then became half owner of the Buffalo and Pittsburgh Railroad, which acquired a 369 mile line which connected with the R&S.[91] Thus, through the notice of exemption process, GWI now controls almost 500 miles of rail lines through four corporations which share many common officers, directors, and executives.[92]

Kyle Railways has obtained control of nine different carriers involving more than 730 miles of track through notices of exemption and it now seeks to acquire control over another 300 miles of track through a tenth subsidiary, the San Joaquim Valley R. Company.[93]

RailTex, Inc. (RailTex) controls and/or manages at least six Class III regional railroads totaling over 1,100 miles of line. Typically, there is an overlap, sometimes complete, in the Boards of Directors and corporate officers between RailTex and the railroads it controls. Also characteristic of RailTex's method of operation is for it to hold at least a controlling interest, and sometimes absolute ownership, in the stock of each railroad in

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88. *Id.*

89. MidSouth Corp. Continuance in Control Exemption, Fin. 31186 (Feb. 12, 1987), *aff'd sub nom.* Railway Labor Executives' Ass'n v. ICC, 869 F.2d 1492 (6th Cir. 1989).

90. *See* Illinois Cent. Corp. Control, Fin. Docket No. 31801, 1991 ICC LEXIS 37 (Feb. 20, 1991). Another twist in the MidSouth story is that the holding company was controlled, in turn, by another entity called the Prospect Group. Prospect subsequently sold its interest in MidSouth and acquired the parent of the ICG. In 1991, there was an abortive attempt on the part of the Illinois Central Railroad Company (the renamed former ICG), to acquire MidSouth's rail system.

91. Genesee & Wyoming Industries, Inc., Continuance in Control Exemption, Fin. Docket No. 31117, 1987 ICC LEXIS 9, at *1-2 (December 21, 1987).

92. Buffalo & Pittsburgh R.R. Inc., Exemption, Fin. Docket. No. 31116, 1989 LEXIS 178 (June 20, 1989).

93. San Joaquin Valley R.R. Co. Lease and Operation Exemption, Fin. Docket No. 31993 (Jan. 23 1992).

return for serving as guarantor on the primary loans used to finance the purchase of the railroad. Additionally, RailTex often requires its subsidiaries to lease equipment, including locomotives, and to contract for management services such as operations, accounting, and payroll from RailTex itself.[94]

VIII. COMPETITION AND THE FREE MARKET

Although much of deregulation was premised on the notion that the eradication of government oversight would allow free market forces to work toward enhanced competition, such has not been the case with many of the short lines. Many, as we have seen, remain "captive" to the Class I railroads which spin them off. Because many of these purchased branch lines do not physically connect with any other railroad, they serve but one master. Sales and leases of other lines create different problems because the lines are dependent on the large railroads for income from "overhead" long haul traffic. Thus, they are subservient to the large Class Is that feed them.[95]

Typically, the sale and/or lease of so-called marginally profitable lines to new corporations involves the sale or lease of a branch or feeder line which connects with a trunk line of the large railroad; the large railroad retains the long haul traffic which is generated by the branch or feeder line, but has no obligation to provide service on that line or maintain it.

For example, when the Montana Rail Link (a 944 mile line formerly belonging to the Northern Pacific) was spun off the Burlington Northern, the Burlington railroad retained the main line section at Garrison, Montana, thereby controlling access to the Union Pacific at Silver Bow, Montana. Similarly, when the Illinois Central Gulf spun off a 600 mile parallel line from Chicago to St. Louis to the Chicago, Missouri & Western, it retained the Chicago connection so that it controlled all Chicago traffic.[96]

The Norfolk Southern Corporation's (NS) Thoroughbred Program serves as yet another example. The standard Thoroughbred transaction is a "cashless lease" which provides that if the new operator maintains the same level of service and carloading on the line and delivers those

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94. *E.g.*, Chesapeake and Albemarle R.R. Co. Inc. Lease, Acquisition, and Operation Exemption, Fin. Docket No. 31617 (Sept. 19, 1991); Railtex Inc. Continuance in Control Exemption, Fin Docket No. 31677 (Sept. 19, 1991).

95. *See* Brian S. Moskal, *Short Lines; The Little Trains That Can*, INDUS WEEK, Nov. 14, 1983, at 71; *see generally*, Dowd, *supra* note 2, at 68 (describing such captivity as a "Tethered Spin-off").

96. Chicago, Cent. & Pac. R.R. Co. Purchase, Trackage Rights & Sec. Exemption. Fin. Docket No. 30663, 1985 ICC LEXIS 22, at *1 (December 24, 1985), *aff'd* 782 F.2d 112 (8th Cir. 1986).

carloads, actual cash payments must be to NS. Moreover, NS aids the operator in marketing rail services and providing rail cars to the operator to handle outbound carloads. The only real change effected is a reduction of employees on the transferred lines. In essence, NS simply has contracted out its common carrier obligations to a lessee.[97]

Because of the market power they wield by virtue of their monopoly access, the Class Is can unilaterally dictate joint-line rate divisions that favor them. Friction has also emerged between short lines and Class Is over surcharges.[98]

Dependent lines are those lines that, while marginally profitable, no longer fit into the corporate plans of the larger railroads. They often consist of main lines on the periphery of the larger system or parallel secondary main track. Some Class I railroads have sold off less desirable parallel track (less desirable in terms of route, grade, maintenance or customer base) to newly formed companies. Severance of these dependent lines from the larger rail system requires the new operator to create a stand-alone "regional" rail carrier out of marginally profitable lines whose capital requirements were subsidized, in part, by revenue from other operations in the larger rail system and without revenue from traffic destined for other parts of the large carrier's system. This need to create a stand-alone operation is often complicated by the highly leveraged nature of the original purchase of the dependent line from the large railroad. If the new carrier is denied access to major transportation markets, is deprived of the feeder traffic enjoyed by the original railroad, loses the long-haul connecting freight previously routed over the line or is discriminated against by the seller in other ways, such as the rerouting of traffic or car supply, the new carrier's continued operation is at risk. In the likely event of financial failure, the options left are disparaging. The new carrier may chose to abandon operations, in which case the result is a loss of service to the area (note that the line would not have been abandonable if it was still owned by the larger carrier); or it may sell the line to another carrier which will then be faced with the contradictory tasks of obtaining new business

97. In a turnabout on this practice, CSX Transportation (CSX) has recently reacquired a rail line which had previously been sold by a CSX component railroad, the Louisville & Nashville R.R. (L&N) to TransKentucky Transportation Railroad, Inc. (TTR). CSX Corp. Control, Fin. Docket No. 31991 (April 15, 1992). This transaction should be beneficial to CSX because TTR is profitable. However, CSX has not reacquired the line directly, but rather through a subsidiary that operates 18 miles of track. This transaction suggests the potential either for large railroad reacquisitions of profitable branch and feeder lines (particularly where profitability results from reduced labor costs through lower wages and elimination of labor contracts) or abandonments by the new owners of branch and feeder lines which are not profitable, even though the lines would not have been abandoned in the first instance by their original owners.

98. Moskal, *supra* note 95, at 71.

for the line, while at the same time, attempting to rehabilitate a physical plant that has deteriorated under its prior owner.

For example, in 1985, the ICG spun off 700 miles of track which parallel its lines between New Orleans and Memphis and Mobile and Memphis to the GMRR. Once severed from the ICG system, most "overhead" long haul traffic was rerouted to the parallel ICG line and the GMRR was forced to meet its financial obligations largely from local traffic. However, the GMRR lines were "light density", in that there was little local traffic originating or terminating on the lines. Once these lines were severed from the ICG system traffic and revenue plummeted. By 1987, GMRR had defaulted on loans totaling $21 million, failed to pay almost $1.5 million in interest payments, and had suffered a net loss of $4.7 million for the year.[99] Moreover, the railroad was in such a state of disrepair because of deferred maintenance that speed was reduced to 10 miles per hour on two-thirds of its lines. By October 1987, the GMRR had defaulted on another $21.9 million in loans. Its $2.5 million line of credit was revoked.[100] Ultimately, it sold out to the SouthRail Corporation which abandoned 75 miles of its track.[101]

As noted above, the CMW was a highly leveraged transaction that ultimately failed. A substantial reason for its failure was its inability to obtain direct access to the Chicago transportation hub. Although the CMW purchased more than 600 miles of rail line from the ICG, CMW could operate over the ICG lines into Chicago only via a trackage rights arrangement that prohibited CMW from serving customers directly in the Chicago area. Instead, CMW merely delivered cars to the ICG and other carriers for delivery to customers. Moreover, CMW's main line between Chicago and St. Louis ran parallel to ICG's existing main line between those cities. While the sale agreement between CMW and ICG required ICG to exert its best effort to help maintain historic traffic routings over the CMW line, CMW ultimately petitioned the ICC to revoke the authority for the transaction because of ICG's alleged rerouting of traffic from CMW's line to the parallel ICG line.[102] Many small railroads also complain that large railroads cancel join-rates and through routings, particularly where they

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99. Southeastern Rail Corp. Acquisition & Operation Exemption, Fin. Docket No. 31187, 1989 ICC LEXIS 233, at *3 (Aug. 15, 1989).

100. *Id.*

101. SouthRail Corp. Abandonment, ICC Docket No. AB-301, ICC LEXIS 131, at *1 (June 3, 1991). The abandonment eliminated SRC rail service to the port of Mobile, Alabama, and left the ICG as the only major north-south rail carrier serving that major port.

102. Rio Grande Indus. Inc. Purchase & Trackage Rights, 5 I.C.C.2d 952 (1989). Although this petition was withdrawn in June 1989, CMW sold its operations to SPCSL and Gateway Western only three months later because of CMW's continuing financial problems.

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serve both origins and destinations.[103]

IX. CONCLUSION

The economic rudder of the United States was guided by *laissez-faire* ideology in the 1980s like no time in American history since the 1920s.[104] The implicit thesis of the theology of *laissez-faire* is that unconstrained human greed will produce a better society. Deregulation and leveraged buy-outs are two consequences of that political movement which have coalesced in the rail industry to cause fundamental changes, some positive and some not. While much of the literature applauds the success stories of the short lines, and indeed there are several as this article has suggested, not all is well on the monopoly board of railroading—not for labor, not for communities and shippers which lose rail service because of the failure of undercapitalized short lines, and not for anemic short lines which find themselves under the thumb of a monopolistic Class I railroad.

The real issues raised by short lining are: who should own and operate otherwise viable lines of railroad which were formerly parts of larger rail systems and how should the public interest in the transfers of these viable rail lines be protected. Some assert that it is appropriate to evaluate a trunk line carrier as simply the sum of discrete parts instead of looking at it as an integrated operation where less profitable branch lines are parts of rail systems in which the trunk lines derive essential revenue from traffic which rolls off the branch lines.

Those branch lines which are transferred to short line operators remain linked to the trunk line carrier in many ways. Operationally, the branch line feeds traffic to and receives traffic from the trunk line. As noted above, in the case of Norfolk Southern's Thoroughbred Program, the trunk line carrier even continues to market service on the transferred line. Financially, the traffic generated from the branch line results in line haul revenue accruing to the trunk line carrier. Therefore, whether or not the trunk line carrier owns the branch line, that line is still linked in a symbiotic relationship with the rest of the trunk line carrier's system. Since the short line will remain linked to the rest of the nation's rail network, the fundamental policy question is whether the decision to create a short line from the trunk carrier's operations should be subject to meaningful governmental oversight or whether such decisions should rest entirely with the trunk carrier. As always, in essential infrastructure

103. Perry A. Trunick, *Rail's Future Requires Oversight and Insight*, TRANSP. & DISTRIBUTION, Jan. 1984, at 26.

104. *See generally* BARLETT & STEELE, *supra* note 81.

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industries such as transportation, the real question is where does the public interest lie.

Because transportation is an essential part of the infrastructure of our nation's commerce, enhanced public scrutiny is warranted. Indeed, the Interstate Commerce Commission was established precisely in order to protect that public interest. Among the factors which arguably should be assessed by the ICC to determine the economic viability of short line railroads are: (a) the existence of a renewable traffic base, (b) the financial ability of the purchaser, and (c) the competence of its management. For equity purposes the impact on labor should also be assessed. Procedurally, sufficient time should be allowed to assess these transactions in terms of their impact upon the public interest. The public interest lies in encouraging the creation and preservation of well managed, adequately capitalized railroads providing safe, adequate, dependable, and reasonably priced rail transportation.

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