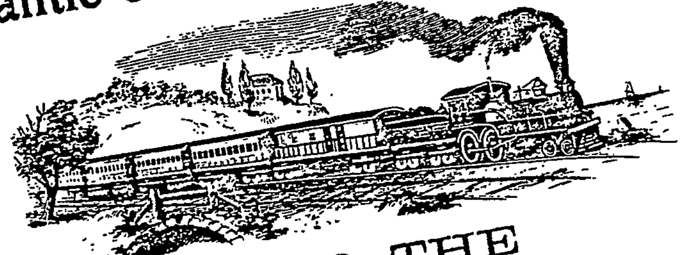
Atlantic & North Carolina Railroad,



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FROM CHARLOTTE,

And all Points on the North Carolina and its Connecting Railroads to the

SEABOARD AT NEW-BERNE AND MOREHEAD CITY.

The State owns three-fourths of the North Carolina Railroad, and three-fourths of the Atlantic and North Carolina Railroad. This is the

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New Berne, N. C.

North Carolina's Railroads:

Which Track for the Future?

by Steve Adams

"There's no way of slowing down the train that got away 100 years ago."
—Joseph Grimsley, 1979
then Secretary, N.C. Department of Administration

The NCRR and the A&NC are no ordinary railroads. Despite their 135-year history their names don't lie on Monopoly boards alongside the Reading, the Pennsylvania, and the B&O. Nor do these acronyms appear on the side of modern freight cars. As little-known private corporations, the North Carolina Railroad (NCRR) and the Atlantic and North Carolina Railroad (A&NC) do not evoke the romance of railways like a "Tweetsie" Railroad does. These railroads go much farther than around a mountain. The NCRR and A&NC run all the way from Charlotte to Morehead City. More precisely, these two companies own the vital rail transportation corridor—the right of way—cutting across North Carolina's industrial Piedmont and on to the Atlantic Ocean.

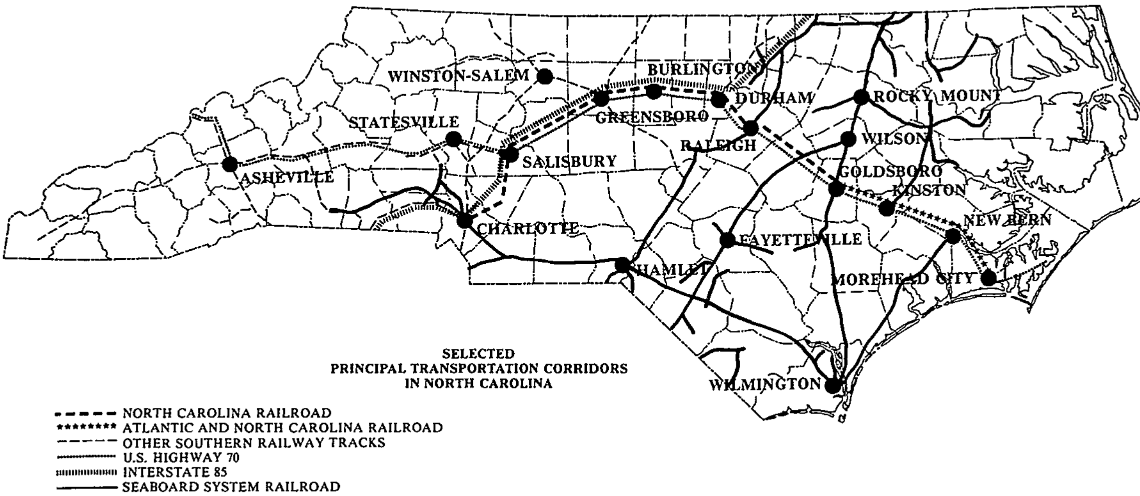
Who controls these extraordinary properties? Built in the middle of the 19th century at a cost of $5.8 million—$4.35 million of it with state funds[1]—these two railroads have increased in value about 12-fold, to about $70 million. Because of the legislature's investment in these railroads in the 1840s and 1850s, the citizens of North Carolina own three-fourths of the companies' stock. That's the good news. In 1895, the NCRR leased its rights-of-way to Southern Railway for 99 years at a *fixed rate of return.*[2] While that may have been a standard contract provision in 1895, times have changed. As a result of this lease, the NCRR—and in turn the state of North Carolina—is today making 2.3 percent per year, at best, on the current value of its assets (see sidebar on page 12). The much smaller A&NC, worth about 1/30th of the NCRR, operates under a 1954 lease to a Southern subsidiary.[3] Under this more modern-day contract, the A&NC in a typical year makes a modest seven percent return for its stockholders. That's the bad news.

The NCRR and the A&NC are private corporations, but the state is the chief engineer. Holding 75 percent of the NCRR stock and 73.5 percent of the A&NC stock, the state of North Carolina functions as a majority stockholder in this family-like, private corporation. But few North Carolinians even know this critical fact: *For 135 years, the citizens of the state have owned three-fourths of these two railroads.*

The NCRR and the A&NC steam through a governmental roundhouse of divergent tracks. The tracks lead to the governor's office, the Department of Transportation, the State Property Office within the Department of Administration, the state treasurer, the Council of State (the ten-member group of elected executive branch officials), and finally back to the General Assembly, where the railroad got its first puff of steam in 1849. (See sidebar on page 5 for details on the responsibilities of each.)

Some of these officials didn't even know they could reach for the throttle until the case of the runaway train began in earnest. If the train "got away 100 years ago," as Joe Grimsley put it in a 1979 memo to the head of the State Property Office, a series of executive branch officials and legislators have been trying to flag it down. When they do, these two railroads may take a different track, one that brings the citizens of North Carolina a 1983-style dividend on an investment made by their ancestors 135 years ago.

Steve Adams is a Raleigh free-lance writer.



Source "North Carolina Rail Plan Update 1981," N C Department of Transportation, 1982, p 2-3, and "1981-82 North Carolina Transportation Map & Guide to Points of Interest," N C Department of Transportation

Flagging Down a Runaway Train

In 1979, A. L. Tucker of the State Property Office in the Department of Administration, then under Secretary Grimsley's supervision, began investigating several railway-related land transactions. In 1975, the city of Charlotte had bought a one-acre tract, paying NCRR $200,000 for the title and Southern Railway $514,000 for leasehold interests. Southern had held a separate lease for this particular acre of land only since 1968, when NCRR and Southern signed a new 99-year lease for a six-acre tract in Charlotte.[4] J. K. Sherron, head of the State Property Office in 1979 (but not in 1968 or 1975), calculated that Southern collected a profit of $458,285 on its "investment" of $55,715, the rent it paid NCRR for the seven years (1968-75) it held the new lease on that parcel—a return of over 800 percent.

Negotiated in 1968, the lease for that Charlotte tract may have appeared at the time the best deal possible for the state. John Alexander, Sr., president of the NCRR board of directors in 1968 (also president today), recalls that the lease brought "top-dollar." But when Charlotte bought the one-acre parcel for $714,000 in 1975, the quality of the lease, in retrospect, didn't appear so high, especially the fact that it ran, like the 1895 lease, for 99 years. Was the state locked into another lease—albeit one covering only five acres—for some 90 years, without being able to adjust the amount of the return?

The investigation by the State Property Office sparked a controversy that four years later has brought the NCRR and A&NC rumbling toward a critical juncture. On February 1, 1979, Grimsley scrawled on his memo pad a message to Sherron. Perhaps better than any document in the foot-tall stack of studies compiled on these two railroads, this one-page memo suggests the heart of the problem:

> Alexander is mad at Tucker's inquiry. Tucker & you need to work with [Transportation Secretary Tom] Bradshaw & John [Alexander] *since NCRR is in DOT* [emphasis added]. Also, John says [State Treasurer Harlan] Boyles & a[n NCRR] board member say their impression is that it's a witch hunt.

Michael Matros

Also, they say Tucker is saying he's an AA [administrative assistant?] to Gov. Hunt. Also, John says it is *not* state property by law. Let's go carefully and quietly on it.

The bureaucratic roundhouse becomes evident in this single memo, which mentions no fewer than five different agencies protecting some portion of the tracks:

- the Department of Administration (Tucker, Sherron, and Grimsley);
- the Department of Transportation (Bradshaw);
- the State Treasurer (Boyles);
- the Governor (Hunt);
- the NCRR itself (Alexander).

The memo also suggests that these officials were boarding separate trains, rather than working together to evaluate how well the state was running the railroad.

Despite Grimsley's admonishment to go quietly, a broader investigation gained momentum, due in large part to another important NCRR and A&NC brakeman, the Council of State. A seldom-noticed 1925 statute requires the Council of State to report to the General Assembly biennially on the state's interest in the two railroads.[5] The legislature, however, provides no staff or funds for preparing such reports. From 1925 until 1979, the Council of State made no formal reports on the state's interest in the railroads. But that was before the case of the runaway train.

In April 1979, the Council of State asked

Who Runs The Railroad?

Explaining who manages the two state-controlled railroads is no easy matter. An impressive cast of characters is involved, with a variety of interests at heart. To place the players in their current roles requires a glimpse backward at North Carolina's railroad history.

In 1849, the General Assembly appropriated $2 million to the NCRR. Three years later, private investors chipped in another $1 million and contruction began. In 1854, when funds were running short, NCRR President John Motley Morehead appealed to the General Assembly for more funds, citing the railroad as the "Tree of Life to North Carolina." Morehead, who had been governor from 1841 to 1845, got another $1 million in state monies, and the citizens of North Carolina found themselves — as they remain today — *stockowners of three-fourths of the Charlotte-to-Goldsboro corridor.* On January 21, 1856, the first steam engine made its maiden run between the two cities.

In 1871, the NCRR leased its tracks to the Richmond and Danville Railroad Company, which Southern Railway subsequently took over. And in 1895, the NCRR signed a 99-year lease with Southern. Under the terms of that lease, still valid today, the NCRR receives a fixed amount of rent each year, $286,000.

In 1852, the legislature extended the state's rail involvement by incorporating the A&NC, which laid tracks from Goldsboro to Morehead City. Completed in 1858, the route cost a total of $1.8 million. *The state owns 73.5 percent of the A&NC stock.* From 1858 to 1938, the A&NC functioned both independently and under lease to various other railroads. In 1939, the A&NC entered a 25-year lease with the Atlantic and East Carolina Railway, now a Southern subsidiary. In 1954, A&NC extended that lease to coincide with the termination of the NCRR lease in 1994. Under the lease's escalator clause, rent varies according to Southern's revenues from the A&NC line (see financial sidebar on page 12 for the escalator formula).

Today the state holds majority control of two private railroad corporations, most of whose assets are under lease to a third, out-of-state corporation. If it sounds confusing, it is. Adding to the jumble is the composition of the two boards of directors. Each of these private companies has a 12-member board — eight gubernatorial appointees and four members elected by the minority stockholders.

Technically, the boards of directors run the railroads, but in reality the state's three-fourths interest means state control: If the governor's appointees didn't do what they're told, they could be replaced by some who did. But whether the state really does control things is another matter, given the number of state agencies helping to run the railroad. With the legislature examining the railroads, the action in this little drama is heating up. To help follow the plotline, here is a *dramatis personae* of the principal actors.

Continued, p. 6

the NCRR and A&NC boards of directors for an inventory of their property and other financial information. The Council also requested the state auditor's office to review annually financial statements of the railroads and the Departments of Administration and Transportation to recommend how the companies should be managed.[6] The Council's requests did prompt more investigations into these railroads—such as financial reviews by the state auditor[7]—but the Council never received a detailed accounting to all their requests.

Eight months later, the Attorney General, himself a member of the Council of State, concluded in an official opinion that sale of NCRR and A&NC property required approval by the Council of State.[8] The Attorney General also found that the NCRR had overstepped the bounds of its charter, which limits its activities to railroad-related matters, by engaging in general real estate business through the Hoke Real Estate Co., an NCRR subsidiary established in 1938. In 1979, the NCRR board voted to liquidate the Hoke subsidiary. Even after the NCRR did close Hoke in 1980, many of the questions about its activities remained.

As these *executive branch* officials began to question the state's interest in the railroads, so did the *legislative branch* become involved. In 1979, Rep. Tom Ellis (D-Vance) introduced a bill calling for a study of the NCRR and A&NC.[9] The legislature defeated the study proposal, in part, Ellis recalls, because of the fragmented bureaucracy. "The boards of directors felt that

Executive Branch

Governor: The governor appoints eight members to the boards of directors of both the NCRR and the A&NC; has final approval over sale or lease arrangements along with the Council of State (N.C.G.S. 124-5); appoints the secretaries of the departments of Transportation and Administration (see below); and may require reports from the railroad presidents on the condition of their companies (G.S. 124-3).

Department of Administration (DOA): The State Property Office within DOA gathers data on railroad property matters for the Council of State. A 1979 Council of State resolution required DOA — with the assistance of DOT — to study the NCRR and A&NC and make recommendations concerning their operation and management.

Department of Transportation (DOT): The two state railroads appear on dotted lines in the DOT organizational chart, but DOT has no direct responsibility for either the NCRR or the A&NC. The Division of Transportation Planning coordinates research on the state rail program, primarily regarding freight. The Division of Public Transportation, through its planning for intercity passenger movement, has pursued possible expansion of passenger service on NCRR rails. Both divisions are under the DOT assistant secretary for planning, who advises other government officials, including legislators, on rail matters.

Department of State Treasurer: Responsible for all state investments, the state treasurer hence reviews the financial return on the state's stock in the railroads. By tradition, the governor directs the treasurer how to vote the proxy for the state's shares in the NCRR.

Department of State Auditor: In 1979, the Council of State required the state auditor's office to review annually the railroads' financial statements and submit a report on the findings.

Council of State: The governor and the ten-member Council of State have "charge of all the State's interest in all railroads..." (N.C.G.S. 124-1); must approve sale or lease of any property owned by a company in which the state owns stock (N.C.G.S. 124-5); and have the power "to investigate the affairs" of any railroad in which the state owns stock (N.C.G.S. 124-7). They must also report biennially to the General Assembly on the condition of the two state-controlled railroads (N.C.G.S 124-4).

Secretary of State: By tradition, the governor directs the secretary of state how to vote the proxy of the state's shares in the A&NC.

Legislative Branch

N.C. General Assembly: The legislature passed the North Carolina Railroad Act of 1849, which helped launch the NCRR. The state cannot sell its interest in the NCRR and A&NC *without approval of the General Assembly* (Chap. 1046 of 1951 Session Laws and Chap. 1372 of 1981 Session Laws), but regarding leases, the legislature *can only recommend* actions to the railroads' boards of directors.

Legislative Research Commission (LRC)

they had not been consulted... and that, being independent corporations, they should be the ones doing it [the study]," Ellis says.

In 1981, Rep. John J. Hunt (D-Cleveland) spotted the NCRR in an appropriations subcommittee on transportation and together with Ellis introduced a bill to establish a railroad study committee under the Legislative Research Commission (LRC).[10] That bill passed, and throughout 1982 the LRC's Committee on the State's Interests in Railroad Properties, co-chaired by Sen. Robert Jordan III (D-Montgomery) and Rep. Hunt evaluated options for future state involvement in these railroads. The committee has made two interim reports to the legislature.[11] Scheduled to end June 30, 1983, the study committee will probably be extended by the 1983 General Assembly.

The legislative study committee has taken charge. It commissioned two financial evaluations of the railroads—one by Isabel H. Benham, president of Printon, Kane Research Inc. of New York and another by Bradshaw, Realtors of Raleigh. These two studies and the committee hearings have sharpened four options available to the General Assembly:

1) do nothing until the NCRR and A&NC leases expire in 1994;
2) buy out the minority stockholders so that these private corporations become entirely state-owned;
3) renegotiate the leases on terms more favorable to the state; and
4) sell the railroads.

Committee on the State's Interests in Railroad Properties: Created in 1981, this LRC committee must evaluate the state's railroad interests and make recommendations to the legislature concerning its sale or retention and management. Chaired by Rep. John J. Hunt (D-Cleveland) and Sen. Robert B. Jordan III (D-Montgomery), the committee also includes among its membership a representative from each railroad. Scheduled to end June 30, 1983, the committee will probably be extended by the 1983 General Assembly.

Regulatory Agencies

Interstate Commerce Commission (ICC): This federal agency oversees the operation of all railroads that have routes that run between states. Actions taken on the NCRR and A&NC tracks would require ICC approval because Southern Railway operates across state lines.

N.C. Utilities Commission: The Utilities Commission no longer sets rate levels for railroads, but it does enforce safety regulations and works with the ICC in cases involving abandonment of rail lines.

Private Sector

North Carolina Railroad Company and Atlantic and North Carolina Railroad Company: The NCRR and A&NC are both private corporations in which the state of North Carolina is the principal stockholder. The boards of directors of these railroads, which are chartered by the General Assembly, have the power to promulgate rules, set rates/fees, allocate funds, hire staff, enter into contracts, buy or sell property (with approval of the Council of State), and sue or be sued. Each board of directors has 12 members — eight appointed by the governor and four elected by the minority stockholders. All 12 serve single-year terms. In the list below, gubernatorial appointees are marked with an asterisk (*):

NCRR	A&NC
*John M. Alexander, Sr., *President*	Edward S. Dixon, *President*
Thomas Barringer	*Thelma B. Edmondson
*Fred Corriher, Jr.	*Geraldine Femia
*Kenneth R. Downs	*E. B. Hale
*Wilton R. Duke	George R. Kornegay, Jr.
Woodrow W. Gunter	*Earl Laughinghouse
*J.M. Lackey	*Raymond A. Morris
*Sarah E. Lefler	*Lonnie Pridgen
*Carra Lyles	Vernon H. Rochelle
*Jack A. Moody	*Lina M. Sanders
Ralph H. Scott	James F. Shine
(one vacancy)	*Josephine S. Taylor

Hoke Real Estate Company: Created as an NCRR subsidiary in 1938, Hoke arranged land transactions for the railroad. In 1980, the NCRR Board of Directors liquidated Hoke. The N.C. Attorney General instructed the directors to take this action, after ruling the NCRR did not have the authority under its state charter to engage in general real estate activities.

Norfolk Southern Corporation: In 1982, Norfolk Southern became one of the nation's largest railroads through a merger between Norfolk and Western Railway Company and Southern Railway Company. Southern Railway leases the NCRR tracks. Southern's subsidiary, the Atlantic and East Carolina Railway, leases the A&NC tracks.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A recent meeting of the legislature's railroad study committee. From left: NCRR General Counsel Thomas Barringer, Rep. Joe Mavretic (D-Edgecombe), and NCRR President John M. Alexander Sr.

Options number one and two appear extremely unlikely to occur, for financial and political reasons. The General Assembly and the executive branch officials have determined that the state has investments worth over $50 million in two railroads that return the state at most some $1.4 million a year (see sidebar on page 12 for more financial details). In a tight fiscal environment, state officials are looking at any and all revenue sources to keep the state budget balanced. The General Assembly will no doubt want a better return on its investment in the railroads. And analysts advise waiting until the end of such a long-term lease to renegotiate. The same fiscal realities, conversely, suggest the legislature will probably not find the $20 million or so necessary to buy out the minority stockholders. That leaves the legislature with two main options: negotiate a new lease more favorable to the state or sell the property outright.

In choosing which track to take, the legislature must consider *new lease vs. sell* in light of several key questions. What is the importance of the railroads to the state? What is the long-term value of the railroads as a capital asset vs. the short-term benefit of selling them during a financial pinch? How can the state use its 75 percent interest to improve transportation —both freight, the chief use now, and (potentially) passenger service? And, if the state does retain control of the railroads, can it manage them more effectively to avoid a similar predicament 99 years hence?

Rail Transportation — What Role for the State?

Transportation opportunities — their availability or the lack of them — lie on the bottom line of the business decision facing the legislature. The NCRR and A&NC network of tracks and rights-of-way forms the underpinning for much of the commerce of the state — from the state's port facility in Morehead City to the Philip Morris plant near Concord, for tobacco farmers down east and for the thousands of businessmen and women who might travel within the Raleigh-to-Charlotte corridor if passenger service develops. In deciding the future of the state's railroads, the legislature must consider both freight and passenger service, and the relative importance of each on the NCRR and on the A&NC.

Freight. The NCRR properties from Greensboro to Charlotte are the backbone of the Southern Railway system in North Carolina (see map on page 4). This stretch of track will undoubtedly remain the state's major freight artery whether the General Assembly decides to sell or continue leasing the NCRR tracks. This rail segment forms part of Southern's main route from Washington to Atlanta, to Birmingham, to New Orleans, and to Jacksonville, Florida. Made of welded track, with computerized switching, the rails accommodate speeds of up to 79 m.p.h. and carry about 35 million tons of freight a year. On NCRR tracks between Salisbury and Spencer — the NCRR's heaviest junction area, like Greensboro for interstate highway traffic — *every day* Southern Railway ships the equivalent of what 2,100, 80,000-pound tractor-trailer rigs could carry. To equal this freight volume, one such rig would have to travel each direction on nearby Interstate 85 every three minutes, 24 hours a day. Building materials, paper, coal, lumber, foods, and grains are the main commodities traveling on this route. Important manufacturers on this stretch include Philip Morris, Cannon Mills, and Louisville Cement.

Southern recently showed how much faith it has in the NCRR tracks. From 1976 to 1979, Southern spent $48 million on a new switchyard, the Spencer Yard in Davie County. This yard connects three of Southern's major divisions, serving as a hub for tracks to Washington, New Orleans, and Knoxville. Without its lease with NCRR, Southern couldn't get to its $48 million Spencer Yard.

The remainder of the NCRR, from Greensboro to Goldsboro via Raleigh, consists of 130 miles of bolted track without a computerized switching system. The maximum speed is 59 m.p.h. In 1980, Southern hauled almost 3.5 times as much freight between Charlotte and Greensboro on NCRR tracks as it did on the NCRR between Greensboro and Raleigh. And freight traffic drops off even more on the Raleigh-to-Goldsboro leg.

Given investments like the Spencer Yard and the volume of freight carried every year on the NCRR, freight service in the industrial Piedmont appears secure. Moreover, freight service on the NCRR tracks makes a good profit for Southern. Hence, no matter what decision the legislature reaches regarding the future of the NCRR, Southern has a strong incentive to continue shipping freight on these NCRR tracks. *Ensuring adequate freight service is, therefore, not a major consideration in the lease vs. sell decision regarding the NCRR.* Such is not the case with the A&NC.

In 1982, the A&NC tracks carried just 1.4 percent of the freight volume that went over the NCRR, 2 million tons compared to 141 million tons (see tonnage table on page 10). The A&NC freight produced only $3 million in gross revenues.[12] Southern, the only railroad company using the Goldsboro-to-Morehead City tracks, carried primarily coal. Other freight included jet fuel (for Seymour Johnson Air Force Base at Goldsboro), asphalt, tobacco, industrial chemicals, phosphates, fertilizers, wood products, lumber, and farm products. Numerous small manufacturers depend on this freight service. And this stretch of track provides the state port at Morehead City its only link to major rail traffic.

In its interim report to the 1982 legislature, the LRC study committee concluded that the A&NC *"is vital to the state's port of Morehead City, being its only connection with the national railroad system* (emphasis added). Competing with such ports as Baltimore, Norfolk, Charleston, Savannah, and Jacksonville (all of which have excellent rail service), to say nothing of Wilmington, North Carolina, the success of Morehead City as a port may be said to coincide with the future of the Atlantic and North Carolina Railroad."[13]

Addressing the possibility that trucks could take over the railroad's share of freight to and from the coast, the study committee report continued, "It is not likely that any worthwhile tonnage, such as would move through a successful port, will be moved exclusively by motor carrier — even if highway access to Morehead City were of interstate standards." Highway 70, the existing major road access, while four lanes, does not meet interstate highway standards.

Southern Railway has no plans to discontinue service on the A&NC, says Arnold B. McKinnon, executive vice-president for marketing for Norfolk Southern Co., which became Southern's parent company after a 1982 merger between Southern Railway and Norfolk & Western. Isabel Benham, the Printon, Kane consultant, in her report to the LRC committee, said that the Interstate Commerce Commission, (ICC), which regulates railroads, would probably not permit such a move. But the railroad industry, like many others, is undergoing deregu-

Ten shares of stock in the North Carolina Railroad Company, issued by NCRR President John Motley Morehead in 1854.

Courtesy N.C. Division of Archives and History lation, and McKinnon says Southern plans only on a five-year basis. Beyond that, he says, "you're blue skying."

The value of the A&NC tracks to Southern may drop even more in the next few years. Since 1981, coal has been the leading freight over the A&NC, primarily because the state port at Morehead City began exporting coal that year. But exports have not increased as expected. Consequently, coal shipments over the A&NC are down. McKinnon admits that the transportation of coal does not look as lucrative as it did a few years ago. "Coal sales have had a downturn," he says, "and it won't come back soon to the early 1982 levels. The bloom is off the rose for all the ports."

Demand for coal is not the only factor affecting freight shipments on coastal rail lines. Southern and Seaboard Coast Line (now Seaboard System Railroad) have targeted some 270 miles of branch lines for abandonment, one of the most prominent stretches running 89 miles from Wilmington to New Bern. None of the nine branch lines being considered for closing is part of the NCRR or A&NC network. Hence, whether the ICC allows Southern and Seaboard to close these nine branch lines will not have a direct impact on the NCRR and A&NC leases.

In 1979, even before the drop in coal shipments, the Department of Transportation had identified the A&NC's predicament. "The situation on the A&NC suggests the value of maintaining state control of the ROW (right-of-way)," the department's "Progress Report" concluded. "This line does not provide a great deal of revenue to Southern ... [T]he A&NC is much more valuable to the state as the only rail link between the port and the Piedmont than to Southern, *and it would seem very unwise to divest ourselves of the guarantee of continued rail service along the line* (emphasis added)."[14]

Such a guarantee can be provided by skillful renegotiation of the leases. The value of the NCRR to Southern gives the state forceful leverage in negotiating with Southern. If the legislature decides to renegotiate both leases, it might, for example, require Southern (or some other company) to continue service to the coast in exchange for getting the NCRR lease. *To preserve state control over the A&NC right-of-way — and thus ensure a lifeline to the Morehead City port — is therefore a primary reason to keep control of both railroads.*

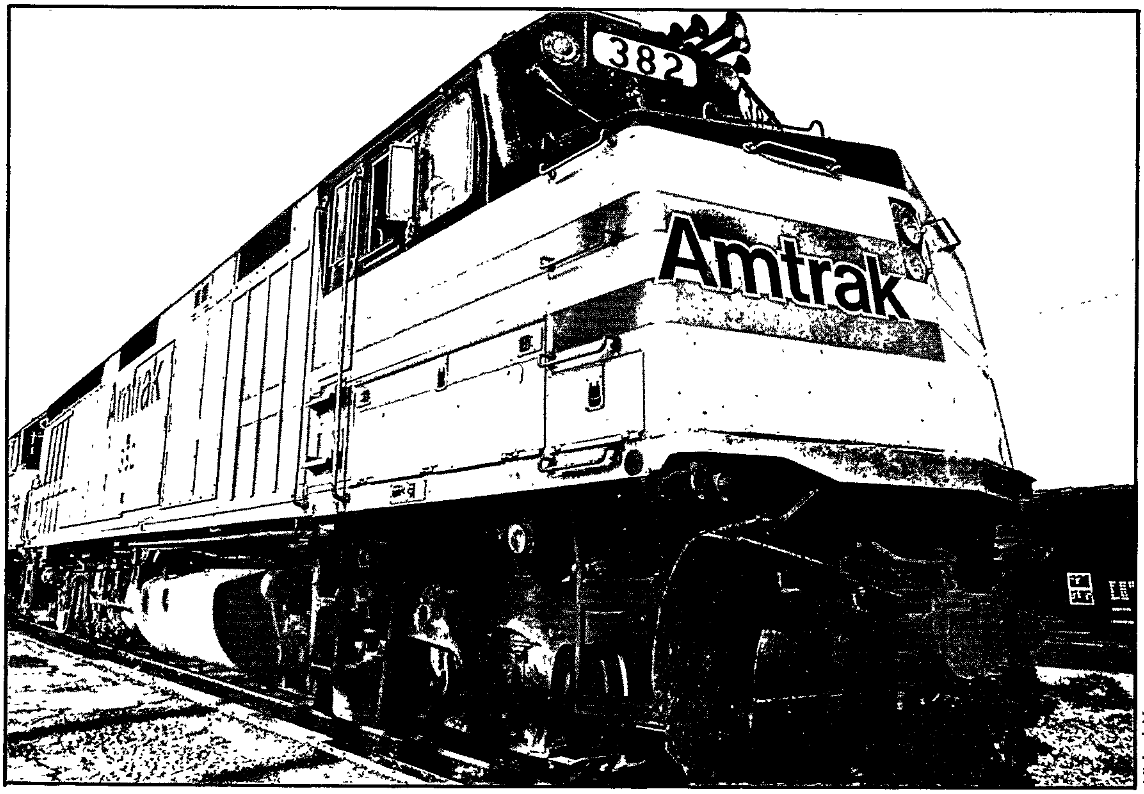
Passengers. If the citizens of North Carolina hope to have passenger service on the NCRR and the A&NC tracks, they better not put their hopes in Southern. Passenger service is unprofitable, says Southern Vice-President McKinnon, and more than an occasional passenger train interferes with their freight service. Southern has

Table 1. Railroad Company Freight Volume By Track Segment, 1981-82

N.C. Railroad (NCRR) and Atlantic and N.C. Railroad (A&NC) (all leased to Southern Railway)	Freight Volume (in millions of tons per year)	Selected Other N.C. Routes	Freight Volume (in millions of tons per year)
NCRR		**Southern Railway**	
Charlotte — Salisbury	35	Salisbury — Asheville	20
Salisbury — Linwood Yard	56	Asheville — Hot Springs	29
Linwood Yard — Greensboro	37	Asheville — Tryon	8
Greensboro — Raleigh	10	Raleigh — Greenville, N.C.	4
Raleigh — Goldsboro	3	Washington — Elizabeth City	2
A&NC		**Seaboard System Railroad**	
Goldsboro — Morehead City	2	Spruce Pine — Bostic (near Forest City)	32
		Raleigh — Hamlet	24
		Raleigh — Henderson	16
		Rocky Mount — Fayetteville	30
		Wilmington — Pembroke	9

Source: Southern Railway, 1982
Seaboard System Railroad, 1981

Prepared by N.C. Department of Transportation, Transportation Planning Division, for N.C. Insight.



Michael Matros

gotten out of passenger service and intends to stay out. The state, on the other hand, works to ensure adequate passenger transportation. In the last 60 years, the state has concentrated its resources and attention on highway travel, but trains appear to be making a comeback.

At present, only Amtrak's "Crescent" carries passengers over the NCRR tracks. In route from Washington to Atlanta, the Crescent serves Greensboro and Charlotte; 47,000 passengers boarded and detrained in these two cities in 1980. The N. C. Department of Transportation (DOT) and Amtrak are exploring the possibility of expanding service over the NCRR rails. On May 3, 1983, Amtrak and DOT officials rode over NCRR rails from Raleigh to Charlotte and made a visual inspection of the switchings, rails, and depots. The trial run was a success, say Amtrak and DOT officials. Amtrak and DOT will soon begin a marketing study of potential passenger interest. If the survey suggests that enough people would make the 3½-hour (one way) trip, Amtrak and DOT would continue with plans to begin the new service. After a 30-year hiatus, passenger service between Raleigh and Charlotte would be re-instituted.

If this new service comes to pass, passengers can thank the state — not Southern. The N. C. Board of Transportation asked Amtrak to consider the new passenger service and agreed to pay the nation's federally financed railroad system up to $5,000 to make the inspection trip. The state would contribute half of the start-up costs for the new service and would have to underwrite about half of operating costs on the route that were not covered by ticket revenues. Amtrak pays the other half of start-up costs and operating subsidies. In 1982, Amtrak generated about half of its operating costs through ticket sales, says Diane Elliot, director of corporate communications-East for Amtrak.

While this latest passenger-related development appears heartening to rail lovers, the new service would have its drawbacks. At 3½ hours each way, the service is slightly slower than a car. Schedules *would allow* people living in Charlotte to travel to Raleigh, conduct business, and return in the same day. The Raleigh-based passenger, however, could not make such a daily commute. "Rail service is fun, enjoyable, if that's enough reason," says Pearson Stewart, assistant secretary of transportation for planning. "But not many of us can afford the time it takes." Still though, businesspersons would be able to work or socialize rather than concentrate on driving. And the load on Interstates 40 and 85 — heavily traveled by trucks and cars — would be reduced.

The verdict is still out on passenger traffic on the NCRR tracks, and certainly the A&NC route. A recent proposal to begin passenger service from Norfolk to Memphis through North Carolina simply could not withstand hard-nosed number crunching.[15] And skeptics think the new Amtrak line from Raleigh to Charlotte would have a difficult time serving commuters in the same way that the trains around New York City function. DOT's "Progress Report" notes that the population densities along the NCRR corridor will probably not support sophisticated passenger service before 2020.[16] But the North Carolina Piedmont is booming, and rail transit systems are going through great technological evolution. The 150-170 m.p.h. Japanese "bullet" trains could one day shoot through the Piedmont. Stewart

What is the Railroad Worth?

The citizens of North Carolina own 75 percent of the N.C. Railroad (NCRR) and 73.5 percent of the Atlantic and North Carolina Railroad (A&NC). Various state leaders (see sidebar on page 5) are now evaluating the leases between NCRR/A&NC and Southern Railway Company and considering either selling the state's shares in these two railroads or renegotiating the two leases. In weighing such a choice, two important financial questions must be addressed:

1) What is the value of the state's investment in the railroads?; and
2) What return does the state get on its investment?

What is the Value of the State's Investment?

In 1981, the General Assembly established the Legislative Research Commission's Committee on the State's Interests in Railroad Properties. A primary purpose of this LRC committee was the need to determine *the value of the state's railroad properties.* The committee commissioned two appraisals — one by Printon, Kane Research, Inc., of New York City and one by Bradshaw, Realtors of Raleigh. Printon, Kane evaluated the corporate worth of the two railroad companies, measuring their value as businesses — i.e., as if a person were considering investing in them. Bradshaw, Realtors estimated the market value of the portion of the railroads that is not used for railroad-related business.

A. *Printon, Kane.* Before the LRC committee commissioned the Printon, Kane report, no independent valuation of the NCRR and A&NC existed. Hence, the estimate of worth made by Isabel Benham, president of Printon, Kane, has become a key starting point for discussions among state officials regarding the state's investments in the railroads. The Benham assessment represents only one opinion, yet it is the only thorough overview on which policymakers can base their decisions.

In her report, Benham includes a "Range of Values — 1982" table in which she presents findings of four assessment methods she calls: 1) physical valuations; 2) market value — pro forma; 3) earnings contribution value; and 4) going concern value. The estimated values for the NCRR and A&NC range from a high of \$137.0 million (NCRR) and \$35.2 million (A&NC) under the "physical valuations" category (cost of reproduction new) to a low of \$33.6 million (NCRR: "market-value — pro forma" category) and \$1.5 million (A&NC: under both "market value — pro forma" and "earnings contribution value").[1]

The valuations that Benham concludes to be the best estimates fall between the two extremes for the NCRR but close to the bottom for the A&NC. The relative amount of tonnage carried over the two lines is the best basis for assessing earnings potential, says Benham (see tonnage chart on page 10). "On this assumption, in our judgment, the state's stock investments might currently be valued at . . . **\$53.7 million**" (see table below).[2]

	Valuation of Company (in millions)	Approx. Mean Value Per Share	No. of Railroad Shares Owned by N.C.	Approximate Value of N.C. Shares (in millions)
NCRR	\$65.0-75.0	\$1,750	30,002	\$52.5
A&NC	1.5 - 1.9	99	12,666	1.2
Total	**\$66.5-76.9**			**\$53.7**

B. *Bradshaw, Realtors.* This group filled another gap by estimating the "non-systems" properties of the railroads — real estate which is not used for railroad-related activities. Bradshaw found such properties to have a market value of \$9.6 million. Like the primary NCRR & A&NC rail properties, these non-railroad properties are leased to Southern Railway. To determine the actual sale value, the value of the leases to Southern (\$7.2 million) must be subtracted. Bradshaw, Realtors found the NCRR & A&NC non-railroad properties to have a net value in 1982 of \$2.4 million (\$9.6 minus \$7.2).[3] The portion of the \$2.4 million owned by the state — about says that distances between Piedmont cities are practical for the "bullet" trains.

Note especially the phrase in the DOT report — *before 2020.* The implication is that densities *may support* rail passenger service in less than 40 years. Remember, the lease now in operation runs for 99 years. Western Europeans and the Japanese consider modern railroad passenger service to be essential. Americans may also feel that way before too many decades pass. If the demand for passenger service increases in the next 20 to 40 years, the value of the NCRR tracks and rights-of-way might be far greater than the current appraisals — some $70 million — which

75 percent or $1.8 million — is not included in the Benham estimate of $53.7 million for the overall value of the state's investment.

What is the Return on the State's Investment?

The NCRR and the A&NC have separate leases with Southern Railway. To determine the return on the state's investment, each lease must be considered independently.

A. *The North Carolina Railroad.* The 1895 lease between Southern Railway and the NCRR set a fixed rate of return to the state for 99 years: $266,000 for each of the first six years and $286,000 per year through January 1, 1995. The NCRR receives other economic benefits from the lease. The lease requires Southern to pay income taxes and property taxes on behalf of the NCRR and to maintain the railroad. Just as improvements made by an apartment dweller accrue to the landlord, improvements made by Southern on NCRR property accrue to the NCRR. Printon, Kane made this calculation of the value of the lease to the NCRR for 1981:

Rental	$286,000
Federal and state income taxes (average 5 years)	101,316
Property taxes	600,000
Average capital expenditures	500,000
Total:	$1,487,316[4]

Besides the $1,487,316 shown above, in 1981 the NCRR received $143,347 in rents from non-railroad real estate (the leases evaluated by Bradshaw, Realtors) and from income earned from cash investments. In 1981, then, NCRR gross income, as calculated by Benham, totaled $1,643,347. Benham says the NCRR is worth $65.0 - 75.0 million (see table above) or $70.0 million (the average of these two numbers). Based on the current estimated worth of the NCRR stock — $70.0 million — the NCRR stockholders received in 1981 a market return on their investment of **2.3 percent** ($1,643,347 ÷ $70.0 million).

B. *The Atlantic and North Carolina Railroad.* The lease between the A&NC and Southern dates to 1939. Initially for 25 years, the lease period was extended in 1954 to terminate with the NCRR lease in 1994. Like the NCRR lease, the A&NC lease provides a fixed rental income to the A&NC. This lease also contains an escalator clause, which ties an additional rent for A&NC to Southern's operating revenues from the A&NC line. The fixed annual payment is $60,500; additional rents accrue according to this formula:

Annual Southern Revenues from A&NC Tracks	Percent Paid in Rent to A&NC
$475,000 to $500,000	1½
$500,000 to $550,000	2
$550,000 to $600,000	3
Over $600,000	4

In 1981, boosted by unusually high coal shipments through Morehead City, this "excess" rental payment amounted to $248,000. The fixed-rate rental of $60,500 plus additional income from warehouse rentals and interests brought the A&NC's gross income for 1981 to $381,000. But unlike the NCRR, the A&NC pays its own taxes. After taxes and other expenses, its net income for 1981 was $180,000, **an 11 percent return** on a property worth about $1.7 million, using Benham's estimate. But 1981 was an unusually good year, especially in light of declining coal shipments since then. In 1980, a more typical year, A&NC posted a net income of $100,000, **a 6 percent return** on a $1.7 million current worth.

FOOTNOTES

[1] *Valuation of North Carolina Railroad Company and Atlantic and North Carolina Railroad Company*, Printon, Kane Research, Inc., New York, 1982, introductory letter, p. 3.

[2] *Valuation of North Carolina Railroad Company . . .*, p. 6.

[3] Letters from Bradshaw, Realtors to Legislative Research Commission, February 15, 1983.

[4] *Valuation of North Carolina Railroad Company . . .*, p. 12.

[5] Lease Agreement Between the Atlantic and North Carolina Railroad Company and the Atlantic & East Carolina Railway Co., dated August 30, 1939, as amended on July 1, 1943. The escalator clause appears on p. 2 of Appendix 2A of *Report on the North Carolina Railroad Company and Atlantic & North Carolina Railway Company for the General Assembly of North Carolina*, N.C. Department of Transportation, 1976. The Atlantic & East Carolina Railway Company is now a subsidiary of Southern Railway.

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are based entirely on freight use. *By retaining ownership and hence control of the NCRR, the state holds open the* **option** *of using these tracks for passenger service. If the state sells its NCRR stock, it loses much of the leverage it now has to increase passenger service between Raleigh and Charlotte.*

Renegotiate the Leases or Sell?

In a year when the legislature is seeing more red ink than black, selling a capital asset for some $54 million has an obvious attraction. Sale to Southern or some other buyer (Seaboard System is the most likely candidate)[17] would produce a windfall, which the Highway Fund could certainly use — not to mention teachers, state employees, and a long list of others. The fiscal crunch is causing the General Assembly to look at sources of funds not normally considered, especially a state-run lottery and an increase in the state sales tax. But a single highway project could easily swallow the entire amount. More importantly, the state would lose control of a transportation corridor it has maintained for more than a century; it would be irretrievably gone. In the view of the LRC railway study committee co-chairman, Sen. Jordan, selling the railroads would be "dumb as hell."

State Treasurer Harlan Boyles disagrees with Jordan. "Selling the state's interest in the railroads is the only way the state could get a good return on its investment this far away from the end of the lease," says Boyles, who has strong feelings about this state investment. "The money *should not go into the General Fund under any circumstances* but rather into a capital reserve fund for re-investment in some income-producing property that would be owned by the state, something like the state ports." Boyles, who as state treasurer has official responsibility for ensuring that the state gets the best return from its investments, believes that the state cannot get a measurable advantage by saying to Southern, "We want to renegotiate."

But more state officials seem to agree with Sen. Jordan than with Treasurer Boyles. In 1979, the N.C. Department of Transportation described the state-controlled properties this way: *"Simply the state is sitting on a gold mine in terms of opportunities.* Even considering certain toll road facilities in the North and Northeast, *we know of no other state in the union that owns (controls) a corridor as significant as the one held by these two companies.* The very thought that the state has ROW [right-of-way] connecting the coast with the industrial core of the state, while at the same time connecting the central portion of the most prominent cities of the Piedmont to each other, is awesome to say the least. To replace this corridor in today's dollars would cost millions. The long-range opportunities could be endless, and only time will tell the true value of this property (emphasis added)."[18]

The value of the properties — to the state and to Southern — appears clear.

For freight service:

- The NCRR route from Greensboro to Charlotte is the backbone of the Southern system in

North Carolina and is critically important to commerce in the state.

- The NCRR route from Greensboro to Goldsboro is important to Southern but is not its key investment. These NCRR tracks, however, serve as a vital rail link between the eastern Piedmont and the coast.
- The A&NC is only marginally profitable to Southern but critically important to the state. It is the only rail link to the port at Morehead City.

For passenger service:

- Southern has no interest in using the NCRR or A&NC routes for passenger service.
- The state has a long-term commitment to providing adequate transportation facilities for its citizens and is now exploring possible extension of existing passenger service on the NCRR tracks.

Southern Railway has a strong interest in keeping control of the NCRR tracks. In 1980, traffic over the NCRR route grossed almost $90 million in revenues for Southern. But Southern has not done as well on the A&NC, and prospects look even worse as coal shipments, the major product going from Goldsboro to Morehead City, rebound slowly. "We see a solid long-range future for exporting coal out of the eastern United States. But it'll be a slow steady climb," says Norfolk Southern Vice-President McKinnon. "Whether Morehead City will share in that as soon as the other ports is a real question."

LRC Study Committee Co-Chairmen Jordan and Hunt say that Southern has not attempted to influence legislative deliberations regarding the future of the leases. But neither has Southern made public its stance on new leases. Southern may be holding its cards close to its chest, but the state has an ace in the hole — control over the highly profitable Greensboro-to-Charlotte route. The NCRR — and hence the state — are in effect subsidizing Southern's freight operation through a lease with terms fixed in 1895. The income on the A&NC lease, with an escalator clause tying rental rates to Southern profits from that line, is more respectable.

Once NCRR and Southern sit down to negotiate — for a renewed lease or for a sale — anything could happen. A properly drawn lease could bring in an equitable return on the state's investment, especially if an escalator clause tied to annual profits is included. A lease period shorter than 99 years and an automatic review clause every eight years or so would build in flexibility. The state could apply the increased lease revenue to current transportation needs. Perhaps more importantly, the state would retain control of the railroad corridor into the next century.

In 1980, the Governor's Blue Ribbon Study Commission on Transportation Needs and Financing recommended that state officials "consider renegotiation of the current leases held by the state-owned railroads in order to assure that current and future property value is reflected and that the state has flexibility to develop innovative concepts within the railroad corridor."[19]

Selling the railroad is only a partial solution to a 1983 budget problem. The proceeds from the sale may not even balance the state's budget for a single year. Budget problems may remain, and the railroads would be gone forever. The inequities in the 1895 lease can be renegotiated. All parties appear ready to negotiate a new lease. Even Southern sees the handwriting on the wall.

At the April 21, 1983, meeting of the LRC study committee, DOT Assistant Secretary Stewart expressed concern over "moving too fast with a solution," as he put it in a DOT handout for the committee. "Appraisal of the property has been a very appropriate first step," he said, "but much more evaluation/consideration must follow." More legislative deliberations might well produce a better negotiating strategy. But the sensible option for the General Assembly

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seems self-evident. *First, make the citizens aware that they own three-fourths of these two railroads. Next, don't sell the railroads. Finally, renegotiate the leases.*

If the state doesn't sell its 75 percent interest in these two private corporations, who will climb into the engineer's seat? Recent assessments by the LRC committee, the Department of Transportation, the State Property Office, the Attorney General's office, and the Council of State have helped to sort out the bureaucratic roundhouse through which the NCRR and the A&NC must travel. But the question remains: Who will run the railroad in the future?

This may, in the end, be the most difficult question to answer. In a 1976 report on the NCRR and A&NC, DOT called for prompt consideration of a new long-term lease but also suggested that the state buy out the minority stockholders and create a separate state agency to run the railroad.[20] While buying out the minority stockholders seems unlikely given the current fiscal environment, limiting the number of state officials wearing the engineer's hat seems a necessary goal. Centralizing authority in a single agency is certainly a beginning point for tighter control of this state property. The Department of Transportation seems the most logical choice for responsibility over the railroads, but sorting out such control issues requires patience and care. Currently, no statutory authority for such a centralized responsibility exists. The General Assembly should consider passing a new statute under Article 8 of Chapter 143B of the General Statutes (the Executive Reorganization Act) that would authorize the Department of Transportation to oversee the two state-controlled railroads. Such a statute would address the transportation-related issues, not the process of selling a piece of property.

The cast of characters involved in the case of the runaway train has grown large indeed. The legislature will, it appears, continue its involvement at least into 1984. And no less than 12 state departments are involved with administering some aspect of the state's railroads. The lengthy legislative investigations have even caused NCRR President Alexander to grumble: "I'm not going to initiate any kind of lease with Southern until the legislature is through meddling."

Alexander says the time to negotiate a new lease is now. Sen. Jordan seems firm in his position on renegotiating new leases. If the General Assembly can make what appears to be a logical choice — to renegotiate leases rather than to sell — the train "that got away 100 years ago" might get back on track. □

FOOTNOTES

[1]*Report on the North Carolina Railroad Company and Atlantic & North Carolina Railroad Company for the General Assembly of North Carolina,* N.C. Department of Transportation, December 22, 1976, pp. 2-8.

[2]*Ibid.,* Appendix 7, p. 2. Most leases between Southern Railway and the NCRR and A&NC are reprinted in this study. The 1895 lease, the NCRR Charter, and other material appear in *The Tree of Life: A History of the North Carolina Railroad,* The North Carolina Railroad Company, Raleigh, N.C., 1972.

[3]*Ibid.,* Appendix 6C.

[4]*Ibid.,* Appendix 7A.

[5]N.C.G.S. 124-4 (2).

[6]Minutes of Council of State meeting, April 3, 1979.

[7]See, for example: "The Atlantic and North Carolina Railroad Company, Kinston, N.C. — Report on Audit for the Year Ended December 31, 1980," Department of State Auditor, March 27, 1981; and "Audited Consolidated Financial Statements and Other Financial Information — North Carolina Railroad Company and Subsidiary, May 31, 1980," Ernst and Whinney, June 17, 1980, Raleigh, N.C.

[8]In their opinion of August 29, 1979, Attorney General Rufus Edmisten and Assistant Attorney General Roy A. Giles, Jr., cited N.C.G.S. 124-5, which reads "No corporation or company in which the State has or owns any stock or any interest shall sell, lease, mortgage, or otherwise encumber its franchise, right-of-way, or other property, except by and with the approval and consent of the Governor and Council of State." The written opinion of Edmisten and Giles raises an interesting point in the law: "This statute, if given its full literal effect, would apply to a disposition of real property by any corporation in which the State owns a single share of stock. Such a construction might give rise to a question of constitutionality ..." See U. S. Constitution, Fifth Amendment: "... nor shall private property be taken for public use, without just compensation."

[9]House Bill 1243, 1979 Session.

[10]Ratified Resolution 61 of 1981 Session Laws, Section 1 (9), originally House Bill 1069.

[11]"Report to the 1981 General Assembly of North Carolina 1982 Session" (May 20, 1982) and "Report to the 1983 General Assembly of North Carolina" (January 6, 1983), Legislative Research Commission/Railroad Operations.

[12]"The North Carolina Railroad and the Atlantic and North Carolina Railroad: Essential Elements in Transportation for North Carolina," N.C. Department of Transportation, January 1982, p. 1.

[13]"Report to the 1981 General Assembly ...," p. A-5.

[14] "Progress Report on Development of Policy Regarding State-Owned Railroad Properties," Systems Planning, N.C. Department of Transportation, January 9, 1979, p. 3.

[15]In 1980, the Greenville (N.C.) Chamber of Commerce proposed beginning such rail service to N.C. Secretary of Transportation William Roberson and to Amtrak. The Division of Transportation Planning within DOT found that such service was not feasible. See "East-West Rail Passenger Service in North Carolina, A Preliminary Analysis," May 1980.

[16]"Progress Report on Development of Policy ...," p. 2.

[17]Analysts agree that Seaboard is the most likely potential buyer, other than Southern. Seaboard has lines that cross or tie into Southern lines at Goldsboro, Selma, and Raleigh.

[18]"Progress Report on Development of Policy ... ," p. 2.

[19]"Report of Governor's Blue Ribbon Commission On Transportation Needs and Financing," December 16, 1980, p. 12.

[20]*Report on the North Carolina Railroad ...,"* pp. 14-16.