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The Alaska Railroad Transfer

*by Susan C. Mitchell**

INTRODUCTION

During the past year, the U. S. Department of Transportation's (USDOT's) efforts to sell Conrail have received considerable attention and critical comment in the press and elsewhere. Less publicized was another set of negotiations taking place at the same time to sell the Alaska Railroad—the only railroad actually owned and operated on a long-term basis by the Federal Government. In this case, the State of Alaska (State) was being sought as a buyer.

The sale process was spelled out in the Alaska Railroad Transfer Act (P.L. 97-468, ARTA), signed into law on January 15, 1983. The purpose of the legislation was to remove the railroad from Federal ownership since it was found that it served principally local needs.

ARTA specified that the State of Alaska and the Department of Transportation should first perform a study describing the rail properties and the assets and liabilities of the Alaska Railroad. The United States Railway Association (USRA) was then to value these assets, taking into account the terms and conditions of the Act. USRA was to have the final say on price, although the terms of payment were to be worked out between the State and the USDOT.

If the State refused to acquire the railroad by July 14, 1984, the Secretary was then free to try to sell it to a private buyer. However, Alaska has accepted USRA's price of $22.3 million, although the transfer itself may occur after the July deadline. It will then be up to the State to administer the railroad and its extensive real estate holdings.

This paper will first describe the Alaska railroad briefly. Second, it will discuss the transfer process itself and the roles of the various parties involved. Finally, it will look at the institutional form that the railroad will take—that of a public corporation.

BACKGROUND

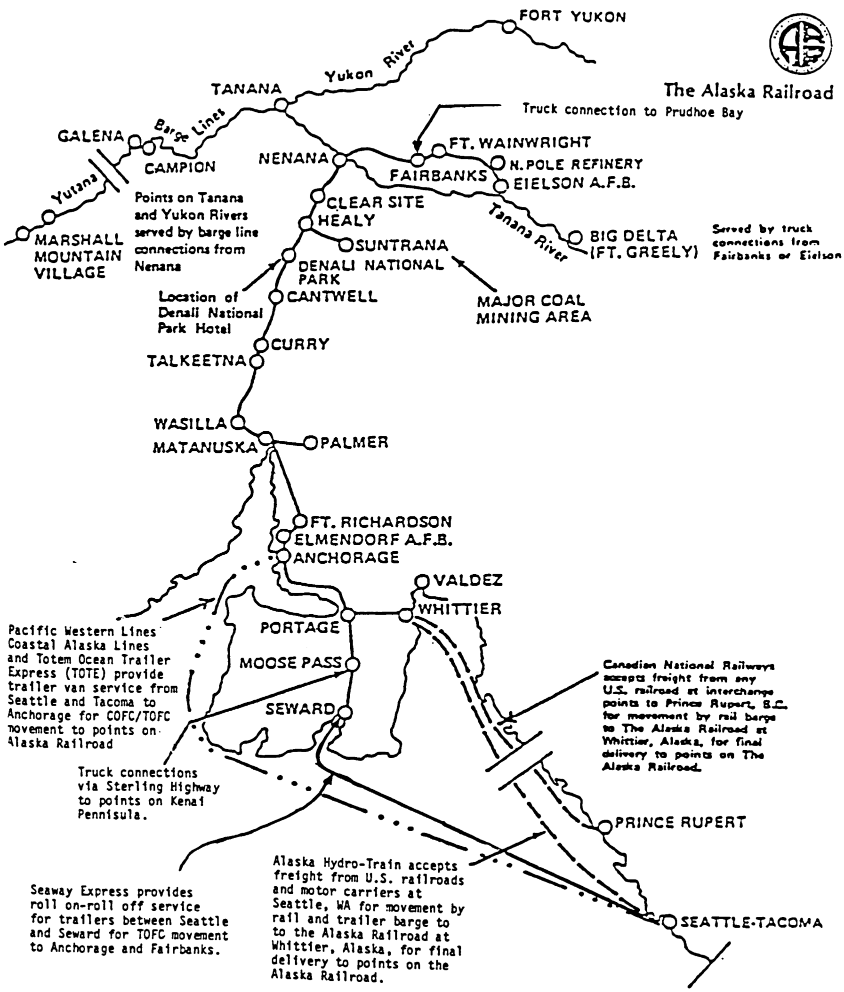
In 1923, President Warren G. Harding drove the golden spike to signify the completion of the Alaska Railroad. From its inception, it has been an enterprise of the Federal Government. In 1914, Congress had authorized its construction after two smaller private railroad companies had failed. The railroad was seen as a way to open up the wilderness of the Alaska interior and to enhance trade with the "Lower 48" states. During World War II, it was also an important supply link for the armed forces. The railroad still serves the Elmendorf and Eielson Air Force Bases, among other military installations. Originally part of the Department of the Interior, it is currently operated by the Federal Railroad Administration and its employees are part of the Federal Civil Service.

As illustrated by the map displayed in Figure 1, the 525-route mile railroad serves the principal cities of Anchorage and Fairbanks, the ports of Whittier and Seward, and Denali (McKinley) National Park. It interchanges in Whittier with railcar barge services operated by the Canadian National Railway and Alaska Hydrotrain, with Seaway Express trailer barges in Seward, Totem Ocean Trailer express ships in Anchorage and several container barge companies in Anchorage. Its principal freight commodities include gravel, coal, petroleum products, pipe, building materials, and piggyback. Passenger service is also an integral part of the railroad's operation as it serves remote parts of the State otherwise inaccessible. During fiscal year 1983, the railroad carried 211,359 passengers and 6,018,000 tons of freight.[1]

The Alaska Railroad has traditionally received Federal appropriations. In recent years, however, they have been used mostly for capital and maintenance projects. Because of the harsh conditions under which the railroad must operate, its capital requirements are correspondingly higher than those of railroads in the "Lower 48". Table 1 gives the financial results of the railroad over the last ten years. A more detailed traffic and operations summary can be found in Appendix A.

It was this continued need for appropriations, coupled with the Reagan administration's philosophy of returning as many of the Federal Government's responsibilities to lower levels of government as possible, that led to the passage of ARTA in early 1983. There was also a perception in Congress that the State of Alaska could well afford to take on this role.

**U.S. Railway Association*



ALASKA RAILROAD ROUTE MAP

FIGURE 1.

THE TRANSFER PROCESS

ARTA set out a series of conditions which had to be met for the State to acquire the railroad. In addition to accepting the purchase price, these included the State agreeing:

1) to operate the railroad as a rail carrier in intrastate and interstate commerce;
2) to assume all rights, liabilities and obligations of the Alaska Railroad on the date of transfer, with some limited exceptions regarding claims and causes of action;
3) to protect retirement benefits and to establish acceptable arrangements for continued employment during a two-year period following date of transfer;
4) to allow representatives of the Secretary of Transportation adequate access to railroad employees and records when needed in relation to the period of Federal ownership;[2]

The State was also obliged to operate the railroad for at least 10 years or face the risk of ownership reverting to the Federal Government. In return, the State would receive title to all properties of the

TABLE 1

THE ALASKA RAILROAD
Financial Results

Fiscal Year (1)	Revenue Millions	Expenses (Inc. Dep.) $ Millions	Surplus (Shortfall) $ Millions	Expense/ Revenue Ratio	Federal Appro- priations $ Millions
1973	17.7	20.7	(3.0)	117	-
1974	21.5	22.6	(1.1)	105	-
1975	42.3	36.5	5.8	86	6.0
1976*1	53.7	49.6	4.1	92	9.0
1977	35.0	36.0	(1.0)	103	6.0
1978	29.1	33.6	(4.5)	115	3.0
11979	25.2	31.8	(6.6)	126	9.3
1980	28.9	34.7	(5.8)	120	6.5
1981	43.9	40.6	3.3	92	12.6
1982	58.8	49.2	9.6	84	6.2
1983	55.9	53.3*2	2.6	94	7.6*3

*1 Year end changed from June to September in 1976. Transition quarter ignored.

*2 For comparison with previous years, includes $3.4 million of engineering expense previously treated as capital, as well as other expense adjustments, for a total $3.9 million.

*3 $7.6 million was appropriated in the continuing resolution, Public Law 97-377 in December 1982. The USDOT appropriations bill for fiscal year 1983 contained no funding for the Alaska Railroad.

Source: 1973-1982: USRA, Valuation of the Alaska Railroad, September 23, 1983, p. vii; 1983: Alaska Railroad Transfer Team, Office of the Commissioner, Department of Transportation and Public Facilities, Alaska Railroad Acquisition Assessment, December 15, 1983 Appendix E.

railroad except those subject to native claims[3] and to portions of the right-of-way within Denali National Park. Four different types of conveyance documents were specified, depending on the nature of the title.

The purpose of the initial report made in July by USDOT and the State was to begin to identify both the assets of the Railroad and the costs related to transfer. Unresolved issues between the two parties were noted, as well as the complexity of the transaction.

In addition to the one-time costs of transition, USDOT listed fourteen categories of continuing expense above what the railroad had incurred as a Federal entity with access to Federal resources:

- vehicle leasing,
- supplies and materials,
- legal fees,
- additional administrative expense,
- tort claims,
- working capital,
- lack of access to Federal surplus equipment,
- employee protection obligations,
- retirement obligations,
- severance obligations,
- non-availability of statutory exemptions if the railroad ceased to be a state instrumentality,
- loss of antitrust exemption,
- ICC regulation, and
- compliance with various state codes and regulations.[4]

It was USRA's task to determine these costs as well as others and to include them in the valuation, in addition to taking into account uncertainties of title and the need to project revenues and expenses into the future. USRA was directed by ARTA to apply generally accepted standards of valuation and it used the definition of fair market value as "what a willing buyer would pay...to a willing seller."[5] The underlying premise of the valuation is found in the following methodology statement:

> "...[F]air market value is based on economic value in the marketplace. It assumes that both buyers and sellers act rationally. It ignores the special desire of any particular buyer for the property and any unique value which the property may have to that particular buyer.
>
> This means that the fair market value of the Alaska Railroad properties is not the subjective or special value of those assets to the State of Alaska. The price which the State would have to pay to acquire the rail properties should be based upon how much it would have to pay to outbid any other potential purchaser, subject to ARTA's terms and conditions."[6]

TABLE 2

ALASKA RAILROAD VALUATION as of 10/1/83

(in thousands)

	Continued Rail Operations Scenario	Alternative Use Scenario
Real Estate	$ 47,800 *1	$ 54,800 *2
Rail Operations	(25,529)*3	(35,430)*4
	$ 22,271	$ 19,370

*1 Present value of the Railroad's non-operating real estate.

*2 Present value of the Railroad's real estate plus present value from alternate use of Railroad's operating real estate after 10 years.

*3 Includes all start-up costs.

*4 Includes all costs associated with rail operations during the first 10 years including start-up costs, plus labor protection costs associated with discontinuing rail operations. Also includes net proceeds from assumed liquidation of facilities and equipment.

Source: USRA, Valuation of the Alaska Railroad, p. 5.

Essentially, this involved performing two studies—a continued rail operations scenario and an alternative use scenario. The first scenario assumed that the railroad would be operated in perpetuity, and the second that after the required 10-year period of operations, the assets would be put to their highest and best uses. Both scenarios had a real estate component and a rail operations component.

A real estate appraisal firm assisted USRA in valuing the real estate owned by the Railroad. In the continued rail operations scenario the real estate value was derived by projecting future lease income from the non-operating rail property."[7] In the alternative use scenario, after the Railroad had ceased operations in the tenth year, the operating real estate was made available for leasing in the same manner. (As illustrated in Table 2, this increased the 1983 present value of the total real estate by $7 million to $54.8 million.)

For the rail operations analysis, USRA obtained revenue, expense and capital program forecasts from the Railroad and modified them where necessary. Both USRA staff and outside consultants inspected the physical plant and rolling stock.

The railroad's estimated future cash flows for 10 years were then discounted to present value. In both scenarios, the present value of the rail operations was negative. The larger loss in the alternative use scenario was due to the cost of labor protection after the railroad ceased operations. Table 2 provides the results of the valuation process. For rail operations, a constant dollar discount rate of 16% was used. This represented the weighted average cost of capital to a private purchaser including a consideration of the risks involved in the transaction.[8] The real estate analysis used an 18% discount rate on cash flows which took into account appreciation in value as well as other special considerations.[9] USRA concluded that a willing buyer would pay $22.271 million.

After the report was issued in September, 1983, there were some in the State of Alaska who thought the price too high, while a few in the U.S. Congress thought it too low. Governor Sheffield of Alaska appointed a committee to review USRA's work and it concluded in a December 1983 report that the price was reasonable.[10] Shortly afterward, the Governor announced that he supported the acquisition of the line and various bills were introduced into the State Legislature.

The transfer process then diverged into two separate but related paths. The State and USDOT are currently involved in delicate negotiations over many thorny issues. Prominent among them are labor compensation (including insurance and pension rights) and the method and timing of payment for the Railroad.

The second path led to the State Legislature. On May 19, 1984, Governor Sheffield signed into law a bill authorizing the purchase of the Railroad at USRA's price. A variety of institutional forms were suggested for the Railroad under State ownership. On June 8, 1984, the Alaska State Legislature passed House Bill 512 establishing the "Alaska Railroad Corporation." The next section will discuss the corporate structure chosen for the Railroad as well as some alternative approaches.

CORPORATE STRUCTURE

Given the Railroad's history of marginal operations as part of USDOT, will new ownership make a difference? In one of the many studies of the Alaska Railroad made in the last five years, the following, very appropriate comment was made:

> "Historically, the role of the Alaska Railroad has been subject to considerable confusion. At various times it has been a frontier development tool, a part of the national defense system, a vehicle for implementing federal policies, a resource recovery mechanism, a repository for surplus federal material, a means of social service delivery and a marketplace railroad."[11]

Commentators generally suggested three organizational models for the Alaska Railroad, reflecting this confusion in goals: (1) making the Railroad a line agency or part of the State USDOT or a related agency, (2) using an outside contract operator, (3) establishing a separate board or authority with top management appointed by the Governor.

As is often the case, the third approach was seen as a compromise, preserving both the state control of the first and the independence of the second alternative. One study done by a prominent group of Anchorage business leaders reflected this desire to have both control and independence:

> "The intent is to recommend a format that will isolate railroad management from unreasonable political pressure to provide services that are neither economic nor in the state's best interest, and at the same time protect the public interest. . . .
>
> "The committee concludes that a public corporation provides the best opportunity for success for the new Alaska Railroad. It provides for semi-autonomous management; allows for adequate control by the state; and clearly falls within the transfer legislation's offer of tax exempt status 'to a public corporation, authority or other agency of the state.' "[12]

This intent was found in Alaska Senate Bill No. 352 introduced by State Senate President Jalmar Kerttula, along with Senators Faiks and Halford, on January 13, 1984; the original Senate version of the final bill; and in the corresponding House Bill No. 512, the legislation which passed in early June. The Alaska Railroad Corporation Act established a public corporation or authority within the Department of Commerce and Economic Development to operate and manage the railroad in order to provide:

> ". . . the best possible combination of types and levels of safe, efficient and economical railroad transportation to meet the overall needs of 'the state, supported when necessary by state investment;' "[13]

One purpose of the act was "eventual transfer of the railroad to the private sector for its ownership or operation or both . . ."[14]

The Alaska Railroad Corporation Act was a product of much debate and compromise. The idea of a totally independent operator was dropped early in the legislative debate.

The public corporation established under the Act will have a Board appointed by the Governor and serving at his pleasure. It will be placed under the Department of Commerce and Economic Development rather than the Department of Transportation. This reflects primarily internal State politics and administrative concerns as well as the dual purpose of the railroad: to make money but also to meet the overall needs of the State for growth and economic development.

The tension between creating an independent profit-oriented organization and one which fulfills public goals is a traditional one when government enters areas formerly reserved for the private sector. For this reason, I believe that a public authority was probably the best alternative.

In general, how does this type of structure differ from making the railroad a part of a line agency? A study done for the Alaska Legislature on the State's existing public authorities listed some of the differences:

- Public corporations are separate legal entities.
- They are exempt from many administrative procedures and regulations.
- Their powers cannot be changed by executive order.
- They have different budget systems.
- They have independent borrowing capacities.[15]

Some reasons often cited for setting up a government corporation in lieu of a line agency include:

- greater managerial flexibility,
- separate financial identity,
- financial independence, and
- independence from "corrupt" political influences.[16]

Alaska already has seven public corporations in which the state has sought to use both public and private funds to achieve public goals.[17] They are primarily financial in nature and five of them receive direct State funding. As will be true for the Alaska Railroad, they are each tied to a specific State department for oversight purposes.

The main advantage of such an approach for the Alaska Railroad is that its management should be free to control daily operations, with long-term policy decisions being made by a Board of Directors appointed by the Governor. The top management of the Railroad may be hampered, however, by a provision which gives labor, but not management, a seat on the Board of Directors.

After transfer, the Railroad will exist in a more public environment than when it was Federally-owned and managed. For one thing, Alaskans are going to want to get something for their money and any decisions involving subsidy, abandonment, or expansion will be controversial. For another, the management will be local—they will not be able to blame Washington for their problems. Various attempts in the law to balance public and private concerns may end up creating a fishbowl atmosphere for railroad management.

There is often a tendency for public corporations to take on a life of their own. They have their own funding and their own constituency and they build a political base. Legislatures frequently do not have access to information necessary to oversee them effectively and the Governor's influence is limited to appointments.

While this may happen in Alaska, it is unlikely. The railroad is currently not capable of supporting and maintaining itself over the long term. State funding is needed for the transition and may be needed for capital improvements within the next few years. Passenger service is already being partially subsidized.

The structure set up by the Legislature ties the corporation more closely to the Executive Branch than is the case for many authorities in the "Lower 48." The initial appointments made to the Board of Directors will affect how much independence management will be actually allowed. The Governor's recall powers also give him an extra measure of control. In addition, any requests for appropriations have to be approved in advance by the Governor. The Railroad will not be able to go to the Legislature without his concurrence.

CONCLUSION

Critical decisions about what kind of railroad Alaska wants and needs have not yet been made. The structure and operating philosophy of the railroad must evolve over time, as decisions are made on route extensions, property rental levels and marketing strategy, to name a few upcoming issues. Removal from Federal ownership wil not automatically affect the Railroad's financial performance one way or another. While the intent of the transfer legislation appears to be to create a profit-oriented organization, too many uncertainties now exist to predict whether it will achieve the goal of eventual transfer to the private sector. Under State ownership, top management will still have to operate the Railroad as both a means of social service delivery and as a competitor in the marketplace.

REFERENCES

1. Mark S. Hickey, *State of Alaska 1984 Legislative Session Fiscal Notes: Alaska Rail Corporation Act of 1984.* March 15, 1984, Attachments D.
2. USDOT and the State of Alaska, *Alaska Railroad Transfer Report,* July 14, 1983, p. 8.
3. The real estate inventory of the Alaska Railroad contains certain parcels subject to claims under the Alaska Native Claims Settlement Act of 1971. Section 1906(b) (1) (a) of ARTA established a negotiation process to deal with these claims, the outcome of which is highly uncertain at this time.
4. *Ibid.,* Appendix L.
5. USRA, *Valuation of the Alaska Railroad,* p. 2.
6. *Ibid.,* p. 3.
7. *Ibid.,* p. 6.
8. *Ibid.,* p. 27.
9. Jackson-Cross Appraisal Company, *Appraisal: Alaska Railroad Railroad Real Estate to be Transferred Under the Alaska Railroad Railroad Transfer-Act of 1982, Volume I,* September 1983, p. 15.
10. See Alaska Railroad Transfer Team, Office of the Commissioner, Department of Transportation and Public Facilities, *Alaska Railroad Acquisition Assessment.* December 15, 1983.
11. Bivens, & Associates, Inc., *Assessment of the Alaska Railroad Ownership Operational Alternatives,* July 1981, p. 4.
12. Commonwealth North Railroad Committee, *The New Alaska Railroad,* January 1984, pp. 11-12.
13. Final House Bill No. 512: *An Act establishing the Alaska Railroad Corporation to manage and operate the Alaska Railroad: and providing for an effective date.,* Section 1 (3) (E), as amended June 8, 1984.
14. *Ibid.,* Section 1B (1).
15. Institute of Public Administration, *Alaska's Public Corporations, A Framework for Assessment,* January 1982, pp. 8-10.
16. *Ibid.,* pp. 13-19.
17. The Alaska Housing Finance Corporation, The Alaska Power Authority, The Alaska Industrial Development Authority, The Alaska Renewable Resources Corporation, The Alaska Municipal Bond Bank Authority, The Commercial Fishing and Agriculture Bank, and The Alaska State Housing Authority.

APPENDIX A

ALASKA RAILROAD OPERATIONS SUMMARY
(Dollar Amounts in Thousands)
Fiscal Years 1973-1982*

	FY 1973	FY 1974	FY 1975	FY 1976	FY 1977	FY 1978	FY 1979	FY 1980	FY 1981	FY 1982
Operating Revenue	$16,996	$20,783	$41,416	$52,517	$33,376	$27,440	$23,100	$26,737	$40,782	$55,445
Non-Operating Revenue	681	703	871	1,161	1,646	1,651	2,081	2,155	3,159	3,352
Total Revenues	17,677	21,486	42,287	53,678	35,022	29,091	25,181	28,892	43,941	58,797
Operating Expenses	$20,057	$22,389	$35,883	$49,387	$35,703	$33,301	$31,285	$34,380	$40,358	$48,978
Non-Operating Expenses	153	158	272	191	255	213	204	344	273	258
Total Expenses	20,210	22,547	36,155	49,578	35,958	33,514	31,489	34,724	40,631	49,236
Gain (Loss)										
Before depreciation - cash flow	($ 7)	$ 1,300	$ 8,513	$ 6,628	$ 2,186	($ 1,227)	($ 3,089)	($ 2,306)	$ 6,567	$13,274
After depreciation	($ 2,533)	($ 1,061)	$ 6,132	$ 4,100	($ 936)	($ 4,423)	($ 6,308)	($ 5,832)	$ 3,310	$ 9,561
Capital Expenditures	$ 1,260	$ 313	$ 2,772	$ 8,602	$ 8,316	$ 5,823	$ 8,181	$ 6,893	$11,409	$11,821
Revenue Tons of Major Commodities (in thousands of tons)										
Sand and Gravel	2	1	1	104	700	727	637	396	1,797	2,754
Bulk Petroleum	363	414	557	624	532	374	220	252	379	439
Coal	565	563	584	607	550	593	524	590	653	654
Iron & Steel Pipe & Fittings	11	15	107	174	16	28	33	37	83	165
Piggyback	48	57	95	114	100	100	89	92	113	122
Forest Products	49	56	120	124	82	68	55	109	101	77
Manufactured Iron & Steel	18	37	60	89	19	12	12	10	8	19
Cement	15	14	25	32	42	33	33	32	43	51
Machinery and Machines	12	21	60	31	47	47	24	16	28	24
Mfrs. & Misc. NOS	32	34	44	29	17	13	25	26	11	**
Other	216	165	209	260	200	183	156	181	146	198
TOTAL	1,331	1,337	1,862	2,188	2,305	2,178	1,808	1,741	3,362	4,503
Passengers	74,000	84,000	81,000	84,500	103,632	126,277	151,045	150,678	161,068	175,116

* The Federal Government changed its fiscal year from July 1-June 30 to October 1-September 30 beginning in FY 1977, resulting in a transition quarter in 1976. To avoid a 15-month fiscal year for comparisons, these statistics use July 1, 1975 through June 30, 1976 as FY 1976, and October 1, 1976 through September 30, 1977 as FY 1977, dropping the transition quarter.

**Mfrs. & Misc. NOS. (not otherwise specified) discontinued, now included in specific categories.

Source: Mark S. Hickey, State of Alaska 1984 Legislative Session Fiscal Note: Alaska Rail Corporation Act of 1984, March 15, 1984, Attachment E