


CHARLOTTE AREA TRANSIT SYSTEM

MEMORANDUM

September 4, 2008

TO: File

FROM: David J. Carol 

RE: Negotiation of the "O" Line License Fee

On July 25, 2006, CATS reached agreement with the Norfolk Southern Corporation regarding a 50-year license to use the Charlotte-Mooresville "O" line for future day-time operation of commuter trains. The agreement was summarized in a Term Sheet, which was shared with the MTC in Charlotte and with NS senior management at that time. The Term Sheet has not, to date, been reduced to a formal agreement. CATS and NS have discussed a number of minor changes to the agreement to reflect changes in the ensuing two years.

The following summarizes the negotiations between the parties, led by Ron Tober for CATS and Craig Lewis, Vice President Corporate Affairs, for the NS. Dave Carol and Carolyn Johnson assisted Ron. In addition, Kevin Sheys, an attorney with Kirkpatrick & Lockhart in Washington DC, provided legal input.

Four key issues impacted the analysis of the license fee.

- **NS Charter Rights:** Under North Carolina Supreme Court rulings, the width of the NS right-of-way on the "O" line is limited to the amount of property required for existing rail operations (including necessary slope and drainage). NS does not have a 100-foot right-of-way on the "O" line, as is presumed on other rail lines within the state. Generally, NS is using approximately a 35-50-feet of right-of-way for its tracks.
- **Continuing Freight Operations:** NS must continue to operate its one daily round-trip train on the "O" line. As a result, the parties agreed generally from the beginning of discussions that CATS would use the railroad during daytime hours (6 am – 8 pm) and NS would use the railroad at night.
- **Existing versus New Right-of-way:** Clearing, grading and constructing a new sub-grade and drainage for a rail line is very expensive; the rule of thumb on the cost is approximately \$1 million/mile. This cost for clearing and building up the right-of-way between Charlotte and Mount Mourne would total \$25 million, exclusive of the cost to acquire the right-of-way or to replace the ties and rail on the line. **This cost is avoided when one purchases the right to use an existing rail line.**
- **Corridor Valuation:** Appraisers add a premium to the across-the-fence fair market value of property when developing a cost for a rail (or utility) corridor. This is to account for the difficulty of creating a contiguous right-of-way. CATS' appraiser added a 1.5 multiplier to the property valuation to reflect the Corridor Assembly Valuation.

As detailed below, the estimated cost to CATS for assembling a rail corridor between Charlotte and Mount Mourne, and clearing and building the sub-grade right-of-way, would have come to at least \$37.7 million:

Appraised Valuation with Corridor Assemblage Factor:	\$12.7 million
Clearing and Constructing the Sub-Grade ROW:	<u>25.0</u>
Cost To Buy & Build the ROW:	\$ 37.7 million

Negotiations with the NS: CATS began discussions with NS about purchasing the "O" line in 2002 as part of its negotiations related to purchasing the South Corridor right-of-way. However, because of the complications relating to the NS charter rights on the "O" line, negotiations relating to the "O" line were deferred. These resumed in 2004 as CATS began its conceptual engineering for the North Corridor commuter rail project. Unlike the south corridor, where CATS purchased unused right-of-way for its new light rail system, NS proposed only an easement or license arrangement for the "O" line, with CATS sharing the existing NS tracks with freight trains.

Key meetings and actions are summarized below.

June 7, 2005: NS proposes that CATS license use of the "O" line for the price of \$66,235,000. NS did not explain how it derived this price, but it was implied that NS simply took the price for right-of-way sold to CATS for the South Corridor (\$2 million/mile) and multiplied by the 30 miles of track between Charlotte and Mooresville. A copy of the letter is attached.

October 13, 2005: Ron Tober responds by letter to NS countering with a price of \$8,375,000, based on a 2002 appraisal of the right-of-way, reduced to reflect the constraints on NS's charter rights for the right-of-way, and inflated to account for inflation. CATS noted that it also would be paying the full cost for upgrading the tracks, which would benefit NS, as well as for upgrading the crossings. A copy of the letter is attached.

July 2006: CATS completes a new appraisal for a 35-foot wide right-of-way extending 25 miles from Charlotte to Mount Mourne, based on fee-simple. The "across-the-fence" valuation for the property totaled \$8.5 million. The appraiser added a Corridor Assembly Valuation factor of 1.5, to reflect the difficulty and expense of creating a contiguous right-of-way. This resulted in an appraised value of \$12.7 million to purchase the 35-foot wide strip of right-of-way.

July 24, 2006: CATS and NS meet and agree on a set of terms for the use of the "O" line. The discussion focused almost exclusively on the price for the license fee:

- NS repeated its request for \$66 million
- CATS offered the appraised value of \$12.7 million.
- NS countered that CATS was avoiding some \$25 million in costs by using an existing rail corridor and that it would cost a minimum of \$37.7 million (using our appraisal value) to buy and build a new right-of-way equivalent to what NS was offering.
- CATS noted that NS would avoid recapitalization costs of at least \$5 million over the 50-year term and that CATS would only have day-time use of the rail line.

- NS noted that its ability to add new shippers on the line might be constrained by giving CATS such day-time use.
- After conferring with senior management in Norfolk, NS offered a final price of \$27 million.
- CATS insisted that the \$5 million in recapitalization costs were real and that the price should be reduced to \$22 million to reflect this real savings.
- NS agreed. The price equates to \$880,000/mile of track for a fifty-year term.

The price of \$22 million is some \$15.7 million less than our estimate for buying and constructing a separate right-of-way. While a license does not equate to fee simple control over the property, the reality is that it would be virtually impossible to create a new 25-mile right-of-way extending from Charlotte to Mount Mourne .

The parties agreed to a term sheet, a copy of which is attached. The term sheet did not address the timing for the payment of the license fee. NS informed CATS that it expected interest to begin to accrue starting July 2008. However, based on recent discussions with the NS, any interest accruals likely can be deferred until at least 2010. The value to NS of the \$22 million license fee decreases some \$660,000 annually, based on a three –percent inflation rate.

Attachments



Norfolk Southern Corporation
1717 Arch Street, 49th Floor
Philadelphia, PA 19103
Tel: 215-448-4228, Fax: 215-448-4232
Email: craig.lewis@nscorp.com

*H. Craig Lewis
Vice President
Corporate Affairs*

June 7, 2005

Mr. Ron Tober
Charlotte Area Transit System
600 East Fourth Street
Charlotte, NC 28202

Dear Ron:

I am advised that our respective legal and real estate personnel have discussed the north corridor issues and believe that a perpetual license is the preferred method by which Norfolk Southern Railway Company will provide to the Charlotte Area Transit System a long-term interest in the right of way and infrastructure from Charlotte to Mount Mourne, North Carolina.

NSR will license to CATS for a long-term (such as 50 years) renewable indefinitely, a restricted right to use the rail corridor and all of the adjacent right of way it may legally occupy. NSR will retain the exclusive, perpetual and transferable freight usage rights in the corridor. The use by NSR or CATS could not materially interfere with the provision by the other of freight or passenger service, respectively. CATS will take full responsibility for the cost of any capital improvements and maintenance necessary for its passenger service. Except as it may relate to NSR's rail operations, responsibility for all liability would belong to CATS and CATS will maintain liability insurance in amounts satisfactory to NSR. NSR will reimburse CATS for its use of the rail line by payment of a car mile fee. Additional details about operations, construction and the relationship of CATS and NSR will be negotiated with the exception of similarity between this project and the recently concluded south corridor project.

The full consideration of the perpetual license will be \$66,235,000.00.

I will be pleased to discuss this with you further and look forward to your reply.

Sincerely,



CHARLOTTESM

October 13, 2005

Mr. H. Craig Lewis
Vice President
Corporate Affairs
Norfolk Southern Corporation
1717 Arch Street
Philadelphia, PA 19103

Dear Craig:

This letter is in response to your June 7, 2005, proposal to provide the Charlotte Area Transit System (CATS) with access to operate North Corridor commuter rail service on the Norfolk Southern (NS) "O" line between Charlotte and Mount Mourne.

An agreement for use of the "O" line by CATS is in both CATS' and NS' interest. At its simplest, CATS operates a much-needed commuter rail service with minimal impact on NS freight operations; NS is relieved of future costs for recapitalization and maintenance of its "O" line. To this end, CATS envisions a transaction with the following key elements:

1. NS would provide to CATS:

- Any access rights NS may have to use the railroad right-of-way for commuter rail operations (i.e., all passenger train operating rights other than intercity passenger operations) on an effectively permanent basis.
- Operational control (dispatching and train operations with its own crews) during daytime hours (5:30 am – 9:00 pm) of the "O" line track (and any trackage added by CATS) between Charlotte and the North Corridor "Northern Terminus" (currently planned for Fairview Road, MP 25.0, in Mount Mourne).
 - CATS would operate using locomotive cab signals with no wayside signals
 - Rule 101(e) would not apply to commuter trains during daytime hours.
 - NS would resume operational control of the "O" line during night-time hours (9:00 pm to 5:30 am)
 - CATS could operate during night-time hours subject to dispatching by the NS.
- Any access rights NS may have to use the railroad right-of-way for new track (including sidings), driveway-consolidation roads, access required to provide access to facilities, stations and improve at-grade crossings, and other purposes related to commuter rail operations, on an effectively permanent basis.



www.ridetransit.org

600 East Fourth Street
Charlotte, NC 28202
PH: 704-336-6917
FAX: 704-353-0797

- Priority for commuter trains during the day (5:30 am – 9:00 pm) over all other trains on the “O” line or using the Atando “wye” track, and over CSX trains at the ADM diamond, if said diamond is re-installed at Graham Interlocking
- Right to extend service north of the “Northern Terminus” to Statesville in the future on substantially similar terms, subject to arbitration.

2. CATS would provide the following to the NS:

- Infrastructure Reconstruction
 - Tracks: CATS would fund the cost for a contractor to upgrade the portion of the NS line to be used by CATS (including ties, rail, ballast and drainage) from its current marginal FRA Class 2 to FRA Track Class 4.
 - Signal System: CATS would fund the cost of adding a new signal system on the portion of the NS line to be used by CATS, utilizing cab signals; to permit operations at fully authorized speeds in both directions.
- At-Grade Crossings: CATS would fund the closure or upgrade of all public and private at-grade crossings on the portion of the NS line to be used by CATS, including installation of quad gates and/or gates with median barriers at all public crossings. Current plans call for closure of at least 35 crossings. This would represent a fundamental improvement in grade crossing safety on the “O” line.
- Railroad Infrastructure Maintenance
 - Tracks & Signal System: CATS would fund maintenance by NS forces of the “O” line track on the portion of the NS line to be used by CATS to FRA Class 4 standards and of the signal system. (NS would provide a credit on a car-mile basis for maintenance associated with operation of its freight trains and would directly fund the cost of maintenance for freight sidings and other freight-related facilities).
 - At-Grade Crossings: CATS would fund maintenance of and repairs to all at-grade crossing protection equipment
- Railroad Infrastructure Recapitalization
 - During the term of its access agreement, CATS would fund any recapitalization of the line required to ensure continued safe, reliable CATS commuter rail service

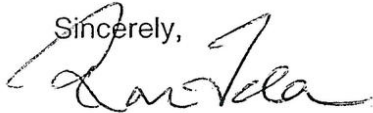
- Cash Consideration: In addition to the foregoing, CATS would pay NS the sum of \$8,375,000. This amount is based on a 2002 appraisal of the "O" line property, adjusted downwards to reflect right-of-way constraints and upward percent to reflect likely increases in local property values.

CATS believes that this package – cash payment, reconstruction of the line, and maintenance and recapitalization of track and crossing systems – would amply compensate NS for use of its line and would enable NS to avoid, for as long as CATS has access right, the cost of recapitalizing and maintaining the railroad.

I would note that the issue of a license versus an easement, and the associated legal and labor implications, remains an area that should be jointly analyzed and discussed.

I look forward to further discussing these issues when we meet on October 17.

Sincerely,



Ronald J. Tober
Chief Executive Officer, Charlotte Area Transit System
Director of Public Transit, City of Charlotte

Term Sheet
Norfolk Southern Railroad & Charlotte Area Transit System
License of the Norfolk Southern "O" Line

1. NS will provide to CATS:

- Use of the "O" Line: CATS shall have such access rights as NS may have to use the "O" line railroad right-of-way between Charlotte Gateway Station and North Corridor "Northern Terminus" (currently planned for Fairview Road, MP 25.0, in Mount Mourne) for commuter rail operations (i.e., all passenger train operating rights other than intercity passenger operations) for a term of at least 50 years, which access rights shall be assignable by CATS and shall not be terminable during the lease term without the express approval of CATS.
- Commuter Rail Operations: CATS shall have exclusive use of the "O" line tracks (including any trackage added by CATS) during daytime hours (5:30 am – 9:00 pm) between Charlotte Gateway Station and the North Corridor "Northern Terminus" for the duration of the license, which exclusive use shall not be reduced without the express approval of CATS.
 - NS retains the right to operate and dispatch CATS trains, subject to performance standards and provided that CATS can assume control of said functions in the event NS fails to meet those standards. In the event NS opts not to operate or dispatch trains, CATS would control such operations and dispatching during daytime hours. CATS shall have exclusive control over selection of a contractor to maintain its trains and to perform all non-train operation functions, including ticketing, station activities and security.
 - CATS can operate using locomotive cab signals with no wayside signals
 - Rule 101(e) will not apply to commuter trains during daytime hours.
 - CATS can operate during night-time hours (9:00 pm – 5:30 am) subject to priority for freight train operations.
 - Commuter trains will have priority during daytime hours (5:30 am – 9:00 pm) over all other trains using the "O" line-Atando "wye" track connection, and over CSX trains at the ADM/Graham diamond, if said diamond is re-installed at Graham Interlocking and to the extent NS effectively controls operations across said diamond.
 - CATS has the right to extend service north of the "Northern Terminus" towards Statesville in the future on substantially similar terms, subject to arbitration.
- Use of "O" line right-of-Way: CATS shall have such rights as NS may have to use the railroad right-of-way for new track (including sidings), driveway-consolidation roads, access to facilities and stations, parking, stations and platforms, to improve

at-grade crossings and for other purposes related to commuter rail operations and safety improvements, on an effectively permanent basis.

- NS Project Manager: NS agrees to provide, on an effectively full-time basis for the duration of NS' participation in the design and construction of the North Corridor commuter rail program, a Charlotte-based project manager to oversee and coordinate all design and construction activities and to serve as a central point of contact for CATS in working with the NS

2. CATS agrees to undertake the following:

- Infrastructure Reconstruction

- Tracks: CATS will fund the cost to upgrade the portion of the "O" line to be used by CATS (including ties, rail, ballast and drainage) to FRA Track Class 4 standards. The parties will determine whether NS or an outside contractor should perform said work.
- Signal System: If CATS opts to signalize the "O" line during the term of the lease, CATS will fund the cost of such signalization on the portion of the NS line to be used by CATS, utilizing cab signals. NS retains the right to design, approve and install said signal system on the "O" line.

- At-Grade Crossings: CATS will fund the closure or upgrade of public and private at-grade crossings on the portion of the "O" line to be used by CATS, including installation of additional crossings to consolidate crossing closures or provide access to stations, developments and/or facilities. NS agrees to cooperate fully in the implementation of the CATS at-grade crossing improvement program, including provision of such NS approvals as may be required to improve, close and/or add crossings.

- Railroad Infrastructure Maintenance

- Tracks & Signal System: CATS will fund maintenance by NS forces of the "O" line track to FRA Class 4 standards and of the signal system on the portion of the NS line to be used by CATS. (NS will provide a credit on a car-mile basis for maintenance associated with operation of freight trains in excess of an agreed-upon base operation, and will directly fund the cost of maintenance for freight sidings and other freight-related facilities).
- At-Grade Crossings: CATS would fund maintenance of and repairs to all at-grade crossing protection equipment required for commuter rail operations.

- Railroad Infrastructure Recapitalization

- During the term of its access agreement, CATS would fund any recapitalization of the line required to ensure continued safe and reliable CATS commuter rail service (but not including switches and sidings required for freight operations).

3. Cash Consideration: In consideration of the above for access and use of the "O" line, CATS will pay to the NS the net license payment of \$22 million for a 50-year license.
4. Charlotte Gateway Station Property Acquisition
 - In addition to the above payment, CATS agrees to pay to NS \$8,945,050 to acquire property owned by the NS along the west side of its main line tracks between 2d and Trade Streets in downtown Charlotte near the future Charlotte Gateway Station as part of that project, subject to any adjustment based on final determination of square footage to be acquired, as follows:
 1. Parcel 3 (073-15S-01) – 20,061 sq. ft. @ \$50/sq. ft totaling \$1,003,050.
 2. Parcel 1 (073-16S-01 & 073-17S-001) – 71,720 sq. ft. @ \$50/sq. ft. totaling \$3,586,000
 3. Out-parcel (078-16S-01) – 87,120 sq. ft. @ \$50/sq. ft. totaling \$4,356,000, subject to a credit of up to \$5/sq. ft for environmental remediation, as may be required.
 - NS agrees to work with CATS and North Carolina Department of Transportation (NCDOT) to timely advance the rail infrastructure work necessary for CATS to access Charlotte Gateway Station, including, if necessary, advancing CATS access to Charlotte gateway Station in advance of other improvements included in the joint NS-NCDOT-CATS program known as the Charlotte Rail Improvement & Safety (CRISP) program.