GOVERNMENT & REGULATIONS

What happens if the Cincinnati Southern Railway can't be sold?

Mayor Aftab Pureval announced Monday alongside other city leaders plans to sell the Cincinnati Southern Railway, the nation's only municipally owned interstate railroad, for more than $1.6 billion.

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The words "convoluted" and "complicated" came up last week when city officials described the existing lease between the city and the Norfolk Southern and what would happen if voters derailed the proposed $1.6 billion sale of the city-owned Cincinnati Southern Railway to the railroad.

A review of the lease and the provisions allowing for its extension show that those words were accurate.

If city voters, state lawmakers or federal regulators reject the sale, the city and Norfolk Southern could end up in arbitration if they can't agree on an annual rent payment, followed by more jockeying if one party does not like the arbitrator's decision. The lease gives the railroad a lot of power even if the city decides to try to sell the railway to another entity.

"We will have to get back to the table with Norfolk Southern and try to negotiate a new lease rate for the next 25 years," Paul Muething, the attorney who chairs the Cincinnati Southern Railway Board, said last week when asked what would happen if the deal dies. "It's frankly tortured. If we have to go through that, that's what we'll have to do."

The mayor-appointed board oversees the railroad on the city's behalf.

The subsidiary of Norfolk Southern that leases the railroad from the city has certain rights to use it all the way through Dec. 31, 2051 produced by an economy. It is an economic indicator developed by the U.S. Department of Commerce's Bureau of Economic Analysis.

Lease negotiations began 2021. Under the current lease, Norfolk Southern had the right to extend its lease for another 25 years starting on Jan. 1, 2022. If it gave notice by that date, lease negotiations commenced and could have concluded by June 30, although the current agreement gives the city and the railroad wide latitude to implement mutually agreeable deadline extensions.

A key provision in the lease calls for arbitrators to step in if the city and Norfolk Southern cannot agree on the annual lease payments. The arbitrators would determine the fair market rental terms, then both parties would file sealed statements about whether they accept the decision. If they both accept it, there's a deal and the lease continues for another 25 years.

If not, things get complicated and several scenarios and sub-scenarios arise:

The city rejects the arbitrators' lease proposal, but Norfolk Southern accepts it: The city can seek to sell the railway, but Norfolk Southern has "a right of first refusal to extend the lease or purchase the leased property on the same terms as any bona fide third party offer received" by the city. If there's no real offer within a year of the lease's expiration or the arbitrators' determination, Norfolk Southern can extend the lease on the terms decided by arbitrators.

Norfolk Southern rejects the arbitrators' lease proposal, but

- But if the offer is less favorable to the city than what the arbitrator proposed, Norfolk Southern has the right of first refusal to extend the lease or buy the property on the same terms as the third party offer.
- If the best third-party offer the city gets is equal to the arbitrators' proposal, Norfolk Southern has the right of first refusal on the same terms but only if the city also rejects the arbitrators' determination.
- If the city does not get any offers to lease or buy the railroad within one year of the lease expiration, Norfolk Southern has the right to continue using the property on the same terms as the current lease on a year to year basis. Meanwhile, the city can continue to try to sell or lease the railroad to another party. The city also can try to run the railroad itself, something it has never done.

How the current Cincinnati Southern Railway lease payments are calculated

Under the current agreement, at the beginning of each year, a new lease payment is determined. It is calculated by multiplying last year's rent by a number determined by dividing the implicit price deflator for the gross national product (IPD-GNP) for the prior calendar year by the same figure for the year before that.

For example, if the lease payment in 1988 had been \$11 million and the 1988 IPD was 117.5, with the 1987 IPD-GNP being 113.1, the 1989 lease payment would have been \$11,427,940. The calculation is arrived at this way: 117.5/113.1 = 1.03890 X \$11,000,000 = \$11,427,940.

maintaining existing infrastructure and the rest reinvested in reserve, with the aim of growing the fund over the long term. The city estimates the initial return in the first year will be $56 million, more than twice what it receives today. Below are the recent lease payments sent to the city by the railroad board:

- 2021 $23,359,043
- 2020 $23,085,708
- 2019 $22,684,866
- 2018 $22,190,245
- 2017 $21,804,737
- 2016 $21,480,172
- 2015 $21,194,471
- 2013 $20,553,019
- 2012 $20,189,606
- 2011 $19,709,868

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