

2007 RAILROADS FOR NON-RAILROADERS

PROTECTING THE FINANCIAL INSTITUTION

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November 13, 2007



Introduction

Railroads and Rail Related Credits

What is a Railroad?

- The lawyer's view



Clarence S. Darrow of Chicago



Lincoln

Real Estate

- Rights of Way
- Yards
- Warehouse, Office and Industrial parcels



Improvements

- Track
- Buildings
- Signaling and Communication



Equipment

- Rolling Stock
 - - Locomotives
 - - Cars
 - - Racks, covers, etc.
- Other
 - - tools, construction machinery, computers, office equipment
 - - vehicles



Accounts Receivable and Payment Intangibles

- Transportation charges from shippers
- Interline receivables
 - Running repairs
 - Car hire
 - Loss and damage accounts
 - Switching charges
 - Freight accounts / Divisions

Contract rights and intellectual property

- ❑ switching
- ❑ interchange
- ❑ operating agreements
- ❑ trackage rights agreements
- ❑ leases
- ❑ transportation contracts
- ❑ divisions
- marks

Operating Authority / Obligation

Government?



Special Aspects of Railroads and How to Deal with Them

Real Estate may not be owned

- Leases
- Easements
- Defeasible Fee

How do you know?

Title Insurance

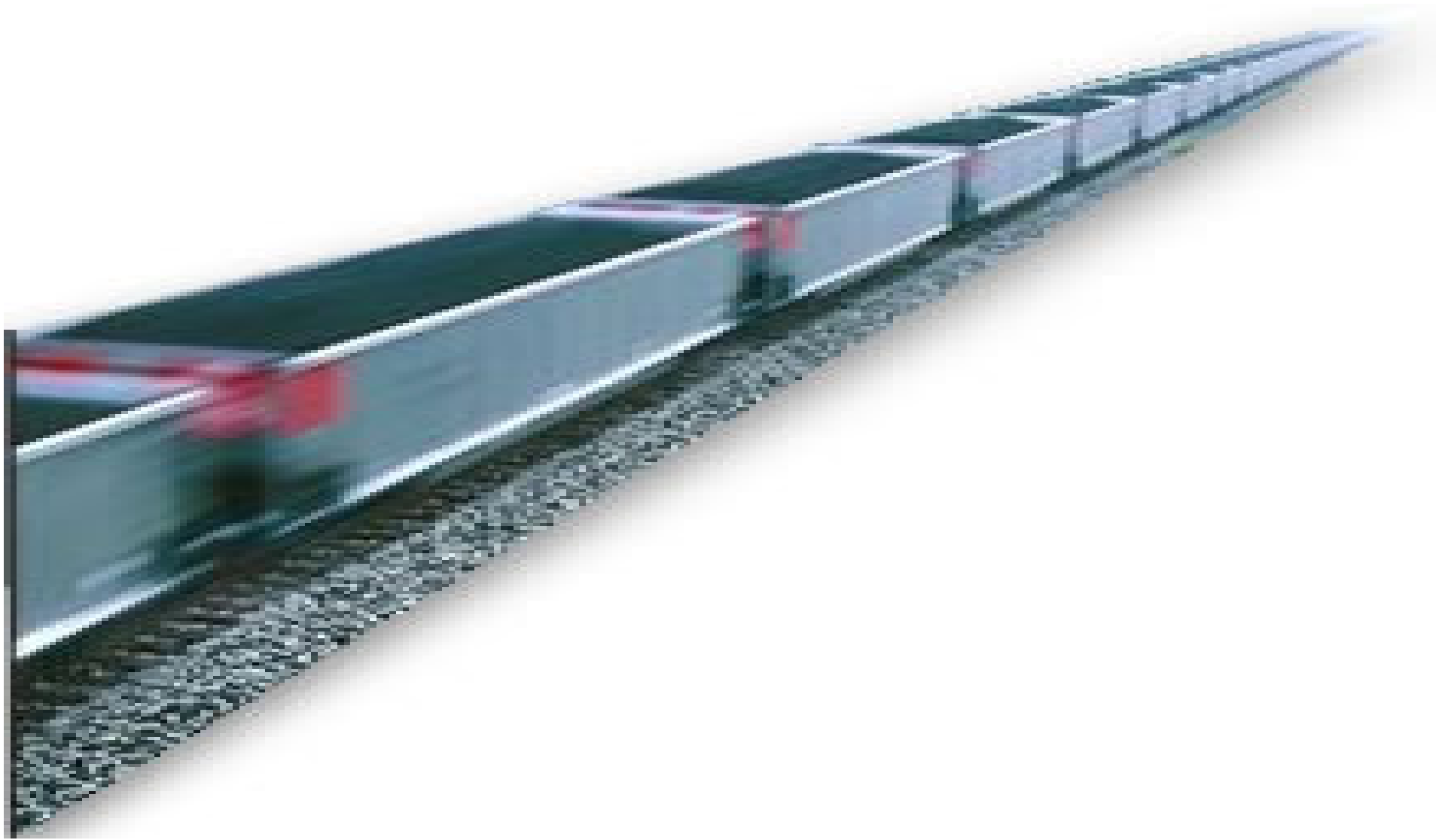
- Expensive, time consuming, sometimes limited value
- Consider full title insurance on high value parcels

Power of eminent domain

Adverse Possession

Prescriptive Easements

Rolling Stock



Forms of financing:

- Philadelphia Plan Equipment Trust (lease)
- New York Plan Conditional Sale
- Single Investor Lease
- Leveraged Lease
- Secured Equipment Notes
- Secured Loan
- Operating Lease

Perfection of Interests

- Surface Transportation Board (“STB”)

Type of Interest

- ❑ mortgage
- ❑ lease
- ❑ conditional sale
- ❑ bailment
- ❑ security interest
- No title registration

Type of Equipment

- vessels (limited)
- railroad cars
- locomotives
- other rolling stock
- accessories (including superstructures and racks)

"Intended for a use related to interstate commerce"

File a Memorandum

Where to file?

- - UCC preemption provisions
 - “filing of a financing statement is not necessary or effective to perfect a security interest in property subject to a statute, regulation, or treaty of the United States whose requirements for a security interest's obtaining priority over the rights of a lien creditor with respect to the property preempt (the UCC filing requirement).”
- - §11301 provides that filing under the law of the country of the person whose marks are on the equipment “shall be recognized with the same effect as having been filed under this section.”

State law issues

- Except with respect to the place and method of filing against rolling stock, state law generally governs interest

Other places to perfect

- Real Estate
 - generally county or township recording
- Fixtures
 - **transmitting utilities**: Secretary of State
- Vehicles
 - certificate of title

State UCC filing

- Central filing at “location” of the debtor
- A “registered organization” is located in the state of organization
- Get the name right

O Canada!

- Sections 104 and 105 of the Canada Transportation Act
 - Filing with the Registrar General Canada
 - Similar to U.S. STB filing
 - Expressly covers “accessories” (meant to include racks, etc.)
 - Expressly permits filing of summary or memorandum
 - If file under Sections 104 and 105 do not need to file elsewhere
 - But no express international choice of law provision

Personal Property Security Act (PPSA)

- **Provincial laws, similar to UCC Article 9**
 - *Long term leases may require filing*
 - *Where to file:*
 - Location of collateral
 - Mobile equipment, intangibles: Location of Debtor
 - Definition of "Location of Debtor"

Mexico - ?

- Mexican owner-trust
- Recording with local jurisdictions
- Issues remain to be resolved

Section 1168 of the U.S. Bankruptcy Code

General automatic stay in bankruptcy

- Creditors cannot exercise remedies against debtor in bankruptcy or its assets unless have leave of court

Benefit provided by §1168

- Lessor, secured party or conditional vendor may take possession of equipment unless
 - ❑ within 60 days after bankruptcy filing, trustee agrees to perform all post-petition obligations, and
 - ❑ all pre-petition defaults are cured within such 60 day post petition period, and
 - ❑ post petition defaults are cured within cure periods provided in the agreement (except within 30 days or end of initial 60 day period, if later, for defaults occurring within such 60 day period) .

Obligations of railroad secured by rolling stock are rated significantly higher than unsecured debt of same entity

Type of debtor:

- Railroad
 - cases arising under Subchapter IV of Bankruptcy Code

Type of equipment:

- rolling stock equipment and accessories, including superstructures and racks

For equipment *placed in service* **on or before**
October 22, 1994:

- Purchase-money equipment security interest
- Lease (true tax lease)
- Conditional sale

For equipment placed in service **after** **October 22, 1994:**

- Security interest
- Lease
- Conditional sale

1994 and 2000 amendments to 1168 /
1110 fixed most issues. The deal is
enforceable by its terms if no cure in first
60 days of bankruptcy regardless of
Bankruptcy

Section 106 of Canada Transportation Act

- Very similar to U.S. Section 1168

Receivables and Payables Issues

Handling money for others - prepay and collect

■ Trust Fund or Unsecured Debt

- ❑ 3rd Cir. (Pa, NJ, DE) Penn Central (1973)
 - Monies collected are held in trust for other carriers
- ❑ 6th Circuit (MI, OH, KY, TN) Ann Arbor RR (1980)
 - Followed Penn Central rule
- ❑ 7th Cir. (WI, IL, IN) in Iowa RR (1987)
 - No trust fund in bill and voucher system
- ❑ 1st Cir. (ME, MA, NH, RI, PR) (?) Bangor & Aroostook (2007)
 - No trust

Big trouble for misuse of trust funds

Other interlines:

- Running repairs
- Car hire
- Etc.

Reporting Marks Issues

- The reporting mark is the key to how railroads treat cars
 - movement directions
 - running repair bills
 - excess mileage charges
 - car hire
- Lose the railroad, lose the marks

Contract Rights

- acknowledgment and consent from key contracting parties:
 - Lessees
 - Lessors
 - Shippers
 - Connecting carriers

Public Utilities Regulations

- The laws of some states treat railroads as public utilities; there may be special approval required for incurring debt, granting mortgages, etc.

Government Contracts Issues

- Some railroads are government owned. Most states place restrictions on the ability of government entities to engage in certain types of transactions, such as incurring debt

Other Issues

- Operating Leasing
 - Net Lease
 - Full Service Lease
 - Per Diem Lease
- MACRS Depreciation
- Maintenance Standards / Return Condition
- Property Taxes
- Sales/Use Taxes

Liability Issues

- FELA
- Other Personal Injury / Property Damage Risks
- Environmental



Insurance

- AAR Interchange Rule 107 governs what a railroad pays for destruction of railroad cars
 - Casualty insurance of (non-railroad) car owner may be necessary to cover:
 - Private sidings
 - Deadbeat railroads

Liability insurance issues

- - Catastrophic events: (e.g. explosions)
- - Environmental hazards

Changing Insurance Concerns

- The insurance market can change. What makes sense from a cost/benefit point of view today may not make sense next year.
- Credits can change. Self insurance permitted today may not make sense tomorrow.

Labor and Employment Issues

- Railway Labor Act
- Railroad Retirement Act and Railroad Retirement Tax Act
 - More retirees than contributors
 - Railroad affiliates may not be subject to act if not performing railroad related responsibilities
- Labor Protection - New York Dock

Restrictions on Abandonment

- STB requirements
 - "Offer of Financial Assistance".
 - Sale at liquidation value
 - Rails to Trails
- Rights of Reversionary Interest Holders

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