Approved: March 26 1998
Date

MINUTES OF THE SENATE COMMITTEE ON JUDICIARY

The meeting was called to order by Chairperson Tim Emert at 10:15 a.m. on March 25, 1998 in Room 514S of the Capitol.

All members were present.

Committee staff present: Mike Heim, Legislative Research Department
Gordon Self, Revisor
Mary Blair, Committee Secretary

Conferees appearing before the committee: Mike Ogborn, OmniTRAX, Inc.

Others attending: see attached list

The minutes of the March 24 meeting were approved on a motion by Senator Bond and a second by Senator Goodwin. Carried.

HB 2715 - Enacting railroad leasing act (opponents)

Conferee Ogborn stated that he was speaking on behalf of 18 Kansas railroads, several of whom he identified using a Kansas State Railroad Map, (attachment 1) He detailed several reasons why the railroads oppose **HB 2715**. He digressed to review background information on OmniTRAX and then presented a rebuttal to statements made by proponents of the bill who claim there is a lack of "fairness" on the part of the railroads with regard to lease rates and contract provisions. He countered proponents claim that railroads refuse to meet with them regarding lease problems stating he met with the Kansas Grain & Feed Association (KGFA) a year ago to discuss lease rate concerns and offered to meet again with it's Board but received no reply. He took issue with certain portions of the bill, i.e., lease terms, and questioned the legislature's right to interfere with contractual negotiations between businesses. He stated that the bill "is an overly ambitious attempt to resolve legislatively, a real or perceived problem that should be addressed privately." (attachment 2) There was discussion between Committee and Conferee Ogborn regarding issues identified by both proponents and opponents especially with regard to the possibility of achieving equitable mediation between the two.

Written testimony in opposition to **HB 2715** was submitted by Bob Alderson, Kansas Legal Counsel for OmniTRAX, Inc. (attachment 3) and by Pat Hubbell, Kansas Railroads. (attachment 4)

Meeting adjourned at 11:04 a.m. The next scheduled meeting is this afternoon, March 25, upon adjournment of the Senate, in Room 254E.

SENATE JUDICIARY COMMITTEE GUEST LIST

DATE: March 25, 1998

NAME	REPRESENTING
Joe Lieber	KS Co-op Council
Marty Vanier	KS Ag Alliance
KEITH R LANDIS	CHRISTIAN SCIENCE COMM ON PUBLICATION FOR KS
KEVIN GRAHAM	KAN. SENT. COMM.
Thomas Schaefer	City of Lenexa
Tom Tunnell	Ks. Grain & Feed Assn. Ks. Fertilizer & Chemical Assn.
Doug Wareham	Kansas Grain & Feed Assn. Kansas Fertilizer & Chemical Assn.
BOB ACKERSON	CENTRAL KS. RAILWAY
Mike Osborn	OmniTRAX
Pat Hubbell	KS Railroads
Mary Jane Stattelman	KDA
Jim Allen	KGFA
[illegible]	KADA
Whitney Damron	KS Automobile Dealers Assn
Bill Fuller	Kansas Farm Bureau

HARD COPY

IN COMMITTEE BOOK

1998 OFFICIAL KANSAS STATE RAILROAD MAP

SENATE JUDICIARY COMMITTEE

3-25-98 (AM)

ATTACHMENT 1

SJ [illegible] att 2

STATEMENT OF MICHAEL J. OGBORN
MANAGING DIRECTOR
OMNITRAX, INC.

BEFORE THE
SENATE JUDICIARY COMMITTEE
SENATOR TIM EMERT, CHAIRMAN

HOUSE BILL NO. 2715

MARCH 25, 1998

TESTIMONY ON BEHALF OF THE KANSAS RAILROADS

Senate Judiciary
3-25-98
att 2

Chairman Emert and members of the Senate Judiciary Committee, my name is Mike Ogborn and I am the Managing Director of OmniTRAX, Inc. ("OmniTRAX"). In addition, I am a Manager of Central Kansas Railway, L.L.C. ("CKR") and of Kansas Southwestern Railway, L.L.C. ("KSW"). I appear here today in opposition to House Bill No. 2715, on behalf of the Kansas Railroads, an association of 18 railroads that operate in Kansas. I appreciate the opportunity to present my views to the Committee and will make myself available for any questions the Committee may have at the conclusion of my testimony.

Before testifying about the bill, I think a little background about OmniTRAX and its operations might assist the Committee in its consideration of the issues surrounding the bill.

OmniTRAX is a Denver-based holding company that owns and operates 12 short-line railroads in the United States and Canada. These railroads range in size from approximately five miles in length to over 1,500 miles. The railroads in the United States are located in six states, while the railroads in Canada are located in two provinces. These 12 railroads carry a variety of commodities, including wheat, barley, milo, chemicals, fertilizer, scrap metal, corn, petroleum and petroleum products, metals and metal products and general merchandise. In addition, one of its Canadian operations transports passengers.

OmniTRAX also operates an equipment leasing company, three industrial switching companies, an intermodal company, and a logistics company. The common factor in all these companies is that they are rail related.

Insofar as Kansas is concerned, the OmniTRAX railroads consist of the CKR and the KSW. The KSW operates over lines leased from Union Pacific Railroad Company ("UP"). Generally speaking, it operates from Wichita to Kiowa and from Wichita to Lyons, with lines extending basically in central and southern Kansas. KSW is in the process of purchasing the line from UP and expects to have that purchase completed in March, 1998.

CKR was formed in 1992 to purchase a series of lines in Kansas and Oklahoma from the Atchison, Topeka and Santa Fe Railroad Company ("ATSF"). That transaction was closed on December 31, 1992 and CKR commenced operations on January 3, 1993. Its lines extend generally from Wichita to Scott City, with various subdivisions serving such cities as Hutchinson, Salina, McPherson, Great Bend, and numerous others. In October, 1997, it leased the Hoisington line between Towner, Colorado and Salina from UP.

Both railroads are headquartered in Wichita in a building purchased from the City of Wichita. These two short-line railroads operate over trackage that is known in the industry as light density rail, much of which would have been abandoned

by the former Class I owners if the OmniTRAX railroads had not purchased or leased them. These companies are operated as freestanding profit centers, responsible for both the production of revenue and for expenses of operation.

Approximately a year ago, I met with the KGFA to discuss lease rate concerns. At that time, I offered to sit down and discuss that issue with the Board of KGFA but I did not hear from them again until HB 2715 was introduced. Pat Hubbell made the same offer in September, 1997 and was similarly rebuffed. At no time prior to the introduction of HB 2715 did KGFA discuss the contents of the bill with the railroads much less negotiate with us.

The railroads in Kansas appeared before the Chairman of the House Transportation Committee and certain of its members in a meeting held on February 6, 1998. The stated purpose of that meeting was to afford the proponents and opponents of the bill an opportunity to discuss their respective positions and to seek a non-legislative resolution of any problems. The railroads stated that they felt the legislative approach suggested in House Bill 2715 was inappropriate and constituted bad policy. Rather than having the government become involved in what amounted to a private dispute, the railroads suggested that Kansas Grain and Feed Association ("KGFA") appoint a representative group of its members to sit down with the railroads operating in Kansas and discuss the range of concerns (except lease rates). This open invitation was extended a number of times by the railroads during the meeting but KGFA either refused to acknowledge the invitation or to respond to it. Subsequent to the February 6 meeting, Kansas Railroads renewed the invitation five more times, including on the record at the hearing conducted by the House Transportation Committee on February 23, 1998. Each and every invitation was either ignored or rejected out of hand.

This invitation is renewed and extended one more time on the record today. The railroads submit a non-legislative approach will cause a better result as between the respective parties than legislation could ever accomplish. The issues can be better refined, the resolution can be better crafted to meet the specific situation identified, and unintended results can be avoided. This is in opposition to a legislative approach that is, in essence, a blunderbuss approach, i.e., one that overreaches and deals with non-existent issues to the detriment of all.

One further point also should be addressed before dealing with the provisions of the bill itself. It has been recognized by the Legislature, the members of KGFA, and the short-line railroads that one common goal exists among all the parties.

That goal is the preservation of as many rail lines in Kansas as is economically feasible. Achieving this goal could be enhanced by a future legislative's enactment of a transportation bill, not a highway bill. A transportation bill could address the provision of money to rehabilitate lines. Rehabilitation of certain lines could extend the useful life of those lines, thus preserving them. At the same time, the continued existence of those lines would help prevent deterioration of the State's highway system. This is a legislative fix that would directly benefit the members of KGFA and one to which it should be directing its legislative efforts instead of to House Bill 2715.

Kansas Railroads appear in opposition to House Bill 2715 for a number of reasons. The most important of these reasons is that we believe the proposed statute represents an unwarranted and unneeded intrusion by government in the affairs of business. In the opinion of the Kansas Railroads, the way to deal with the so-called leasing problems that have been testified to by certain members of the KGFA is for the railroads and a representative number of the members of the KGFA to sit down and discuss the best way to resolve any differences. Simply stated, bad law leads only to bad policy.

The genesis for this bill lies not with any general unfairness of lease provisions or unequal bargaining positions, but rather with some KGFA members being upset with the level and rapidity of rental rate increases. The leadership of the KGFA has decided to seek a legislative fix for those members who have opposed the rental increases, and in doing so, have either overstated the situation or have confused or misstated the facts.

For example, proponents have suggested that railroads have historically enjoyed the protection and benefit of governmental assistance, including grants of land. In fact, the railroads in Kansas by and large did not receive land grants, but rather obtained their rights-of-way through purchase of the land--often through fee simple purchases. In the case of CKR, every single foot of railroad right-of-way was purchased--for millions of dollars. As noted above, all of the track purchased by CKR was slated for abandonment by ATSF and exists today only because a short-line operator was willing to take a substantial financial risk and step up and purchase the lines.

CKR and KSW are small businesses which clearly provide essential services to the public. In fact, many of the members of KGFA are larger than either KSW or CKR in terms of assets and revenues. To single out public warehouses as needful of state interference in the business community

ignores this fact. It also ignores the fact that the short-line railroads in Kansas are significantly different than the Class I carriers such as UP or Burlington Northern Santa Fe ("BNSF"). Short-line railroads operate on much smaller margins and have significantly different cost structures than the Class I carriers. For example, the Class I carriers are self-insured while the short line railroads have to insure their operations through insurance policies with significant premium costs.

As noted previously, the lines over which the short-line carriers operate are light density branch lines. Many of the lines have only small amounts of traffic, making them marginal operations at best. Virtually every one of these branch lines faces incredible competition from trucks--subsidized by the federal and state governments--or from large, rapid load facilities built recently at strategic locations. Additionally, in many cases the Class I carriers allowed the lines to deteriorate through lack of maintenance, causing the new owners to stretch precious dollars over many miles in an attempt to rectify the benign neglect those lines suffered from over the years.

The so-called excessive lease rates that have been imposed in recent years reflect an attempt by all the railroads to bring the rates to competitive market levels. For years these rates were under any realistic market rates. From an historical perspective, the rates were put in place in exchange for freight. In the 1880's through the 1960's this was a workable situation. However, truck competition altered that situation and many of the elevators that previously used rail to transport their products switched to truck. This, in turn, forced the railroads to seek ways to supplement their income, and one way to do this was to seek increases in rental rates.

With the advent of the short-line industry in Kansas, this process was accelerated. This effort was driven in part because of the economic need of these small entrepreneurs to maximize revenues and, in part, because of the need to recover costs that the larger railroads either did not have or could cover from other sources. The rates that are now in place reflect market rates and are not exorbitant.

Regarding the other criticisms of leasing practices--many of those practices have been in existence for many years. For example, the hold harmless clauses have been in the various railroad leases for over seventy years. These clauses were included in the leases when the two parties were entering into leases with low rental rates in exchange for high levels of freight. If one accepts KGFA's premise that those leases were good, it follows that all the clauses in them were good. This

is not to say the two industries should not revisit these clauses, but rather that the proponents of the bill should be historically accurate.

Regarding the problems of the bill itself, CKR and KSW submit the following constitute some of them:

- Some sections are clearly preempted by federal law. An example of this is the section that requires a railroad that is abandoning a line to sell the land to the tenant. This ignores the requirements of the Rails to Trails Act.

- The bill appears to be a lawyer's dream. The definitions are overly broad and vague in places and in others are contradictory to either other definitions or to subsequent sections of the proposed Act. Again, this begs for litigation. Virtually every aspect of the sale or lease of rail property involves either an administrative or judicial proceeding or both--again a tool to enrich lawyers.

- The bill creates a protected class of tenants, namely, tenants on railroad land with special rights not available to other classes of commercial tenants.

- The bill is filled with internal inconsistencies. For example, the definitions purport to protect every type of rail property but the text of the Act protects only public warehouses.

- Section 2 of the bill contains definitions that are, in many cases, overly broad and vague. Many are internally inconsistent. For example, in Section 2(a), reference is made to a "well informed buyer." Nowhere is that phrase defined. That same section uses the term "is justified in accepting." What does that mean? The Section is silent.

  The definition of "railroad land" in Section 2(g) may be one of the most troublesome of all the definitions, because (1) it includes land that lies outside railroad rights-of-way; (2) the use of the phrase "any and all interests in" a parcel of land would include a parcel of land that is owned in fee simple and is not reversionary; and (3) the use of the word "any" when referring to parcels owned, held or used by railroads would mean that land totally unrelated to rail operations would be included within the ambit of the law. These are but a few of the problems with the definitions contained in the Act.

- Section 3 lists a series of clauses that the law would outright prohibit in leases. What business does the Legislature have in interfering with contractual negotiations between businesses? This is not a situation where an individual is attempting to negotiate a lease of an apartment, but rather a straightforward commercial transaction. Moreover, the types of clauses listed in this Section are ones which appear with regularity in commercial leases. Section 3(a) prohibits the following terms in a lease:

  (1) An agreement to waive or forego rights or remedies under the Act. In fact, there may well be good commercial reasons a tenant might desire to waive a right, including receiving something in return;

  (2) An agreement to confess judgment on a claim arising from a lease. Again, a party may want to have this in a lease in order to avoid litigation;

  (3) An agreement to pay another party's legal fees. Such an agreement is customary in commercial documents--it serves to discourage baseless litigation;

  (4) An agreement to exculpate or limit any liability of another party arising under law. Inclusion of such a clause is sometimes necessary in such instances as track leases when the elevator is responsible for maintenance;

  (5) An agreement for a lease term of less than one year. Often times tenants need a short term lease--why preclude such an opportunity; and

  (6) An agreement that the lease amount can be paid for a period longer than a year. A tenant may, for its own planning purposes, want to pre-pay the lease. Why preclude this option?

Finally, the prohibition of these clauses imposes unintended consequences. For example, a railroad would be unable to protect itself against the misdeeds of the tenant that cause environmental harm to the property.

- Sections 4 and 5 purport to deal with the lease and sale of the property on which the elevator is located. Both send <u>any</u> question raised by a tenant to arbitration, even trivial matters. Both tie up the property for up to 210 days. There are many more objectionable parts to these sections but, in short, they impose an unneeded,

cumbersome, time insensitive, and expensive process on the railroads and the tenants.

- Section 7 allows any person with an "interest" in the land to seek a declaratory judgment about any question. The term "interest" is not defined in the act. The Section could also subject a railroad to multiple court actions over the same parcel of land--once again a lawyer's fondest dream.

- A number of questions arise from the language in Section 9. First, what is meant by a "good faith improvement"? Second, the language used could mean that the mere payment of taxes would be "paying an obligation" that would trigger the Act.

These bullet points are merely a partial list of the problems with the bill and are not intended to be all inclusive. The examples show, however, that this bill is an overly ambitious attempt to resolve legislatively a real or perceived problem that should be addressed privately. The railroads have offered to do just that, but so far have been totally rebuffed by KGFA.

There are a myriad of issues and policies that should be addressed before this bill or anything like it should even be considered. For example, should the Legislature do away with over 100 years of precedent regarding reversionary rights by enacting House Bill 2715? Should the contractual rights of the railroads be trampled upon without due consideration? Should a costly scheme regarding arbitration be imposed and if so, would such an imposition cure the perceived problem or create new ones? The answers to these and other questions cannot be answered in the short time allowed this Committee. It is respectfully suggested that this entire issue should be deferred for more study before enactment is considered.

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MEMORANDUM

TO: Chairman Tim Emert
and Members of Senate Committee on Judiciary

FROM: Bob Alderson, Kansas Legal Counsel for OmniTRAX, Inc.

RE: House Bill No. 2715

DATE: March 25, 1998

Chairman Emert and Members of the Committee, I am Bob Alderson, a member of the Topeka law firm of Alderson, Alderson, Weiler, Conklin, Burghart & Crow, L.L.C. I serve as Kansas Legal Counsel for OmniTRAX, Inc., a Denver-based, Colorado corporation that owns twelve short-line railroads in the United States and Canada. Two of these short-line railroads (Central Kansas Railway and Kansas Southwestern Railway) together operate approximately 1,500 miles of rail line in Kansas and have their headquarters in Wichita. The testimony presented by this Memorandum is submitted on behalf of OmniTRAX and its Kansas short-line railroads.

The primary purpose of this Memorandum is to identify the various legal issues presented by HB 2715, and to discuss several of them in detail, relating those issues where appropriate to the public policy considerations which necessarily must provide the foundation for the various provisions of the bill. I will attempt to address the legal issues to the greatest extent possible without resort to "legalese."

In order to avoid unduly extending this Memorandum, I have included several attachments containing cases and other authorities pertaining to various issues presented by HB 2715. Attachment A presents cases and other authorities bearing upon requirements of the "Contract Clause" of the U.S. Constitution; Attachment B contains cases and other authorities relating to the reversionary nature of railroad right-of-way in Kansas; and Attachment C provides cases and . .

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statutes establishing the plenary, preemptive power of the federal government to regulate railroads. This format will avoid extensive case and statutory citations in this Memorandum, by merely referencing the particular attachment containing pertinent authorities; yet, it will enable you to review the various legal authorities which I have relied upon in presenting the issues.

I also want to mention that I have reviewed the Iowa Supreme Court case relied upon by the proponents of HB 2715 and referenced at the hearing on Tuesday. Several observations regarding this case are pertinent. First, while the decision might have "relevance" to litigation arising out of the passage of HB 2715, the decision will not be conclusive upon Kansas courts. Every case must turn upon the specific facts giving rise to the litigation. Even though I concur with many of the Iowa court's recitations of various constitutional principles which may be applicable to a consideration of the constitutionality of HB 2715, the decision rested upon the court's application of those principles to the facts giving rise to that case. It obviously cannot be known at this time the nature of the facts which might give rise to litigation challenging HB 2715, if it is passed. Moreover, I am unwilling to concede that, even if the facts were identical, a Kansas court would apply the legal principles in the same way that they were applied by the Iowa court.

Second, because the Appellant (CMC Real Estate Corporation) in the Iowa case was not an operating railroad, the issue of federal preemption was not addressed by the Iowa Supreme Court. If HB 2715 is passed, I can assure you that, in any litigation arising out of the application of its provisions to any of the operating railroads in Kansas, the issue of federal preemption will be raised.

In that regard, I believe a strong argument can be made that the entirety of HB 2715 is preempted by federal law. In Attachment C, I have included statutes and cases which establish the proposition that the federal government has plenary, preemptive power to regulate railroad transportation. Of significance here is the fact that railroad "transportation" is defined to include "a . . . warehouse . . . property, [or] facility . . . related to the movement of . . . property . . . by rail, *regardless of ownership or an agreement concerning use.*" (Emphasis added.) Although I am unable to cite a "bay horse" case at this time, I believe that any state legislation which impedes a railroad's right to use and dispose of its right-of-way, consistent with its obligations as a regulated carrier, is preempted by the provisions of the Interstate Commerce Act (as amended by the Interstate Commerce Commission Termination Act) referenced in Attachment C, as administered by the federal Surface Transportation Board.

Notwithstanding, I will address several of the other legal issues presented by HB 2715.

Contract Clause Issues

"Freedom of contract is a qualified and not an absolute right, but it is one of those freedoms protected by the Fifth and Fourteenth Amendments to the Constitution of the United States." Manhattan Bldgs., Inc. v. Hurley, 231 Kan. 20, 643 P.2d 87, 95 (1982). The Fifth Amendment imposes limitations upon the powers of Congress, while the Fourteenth Amendment serves as a limitation upon the powers of the various states. Wesley Medical Center v. McCain, 226 Kan. 263, 597 P.2d 1088, 1091 (1979). "Freedom or liberty of contract also involves the right to agree upon such mutual terms as are not against public policy or prohibited by law . . . ." 643 P.2d at 95.

Regardless of whether HB 2715 is viewed from the standpoint of impairing contract obligations existing by virtue of leases between railroads and lessees of railroads' property now in effect, or as a deprivation of the vested contract rights of a railroad regarding the use or disposition of its property, HB 2715 is constitutionally infirm.

As an initial consideration, it is to be noted that Section 2(d) defines "lease" as meaning "any lease, license, permit or other arrangement, under the terms of which a tenant occupies railroad land." Section 10 declares that the bill will not apply to or affect any valid lease entered into prior to the bill's effective date, and that it will apply only to "any renewal, extension, or modification of any such lease where such renewal, extension or modification is effected on or after" the effective date. However, this section's effort to make the bill's application prospective is illusory. As a rule, the renewal of a lease is addressed in the initial lease itself, and agreement is often reached that, in effect, absent notice to the contrary by one of the parties, the lease will be renewed upon the same terms and conditions. Thus, if the bill's requirements are to be imposed on any renewal, the bill has retrospective application to any lease which contains agreement as to its renewal.

It is clear, therefore, that the bill implicates the requirements of the Contract Clause, i.e., "[n]o State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . ." U.S. Const., Art. 1, §10. Attachment A contains pertinent cases and other authorities relevant to the application of the Contract Clause. Regardless of whether the constitutionability of HB 2715 would be considered under the Contract Clause or under the Due Process Clause of the Fourteenth Amendment, judicial scrutiny would begin by an inquiry as to whether there has been an impairment of contract

obligations or the abolition or curtailment of contract rights.

This inquiry would begin with Sections 3 and 4, which contain provisions that would specifically curtail the ability of a railroad to freely contract regarding a lessee's use and occupancy of the railroad's property. Section 3, for example, identifies in subsection (a) specific provisions which cannot be contained in a "lease." It should be clear from a review of the prohibited lease provisions in Section 3(a) that the bill would prohibit a lease from including many provisions which are commonly found in commercial leases. Thus, this section not only raises Contract Clause issues, but also is pertinent to the issue of whether the bill would deny to railroads Due Process and Equal Protection of the Law.

With respect to the Contract Clause issue, though, several of the prohibitions in Section 3(a) very substantially curtail the ability of a railroad to contract freely with tenants of its property. For example, subsection (a)(4) prohibits any agreement in a lease as to the exculpation or limitation of any liability of another party arising under law or an agreement as to indemnification of the other party. Elimination of an agreement by a lessee to indemnify the railroad has particular relevance to environmental concerns.

To illustrate, where a lessee of railroad land has caused pollution of soil and groundwater beneath railroad right-of-way, thereby creating liability under CERCLA, the railroad lessor is, by law, deemed a "potentially responsible party," even though its only involvement in the pollution is as lessor of the land to the polluter. If the polluting lessee does not voluntarily cause remediation of the contamination, the railroad is subject to potential liability. Thus, it can be seen that eliminating an agreement by a lessee to indemnify the railroad can have potentially severe economic consequences for the railroad.

Of course, environmental liabilities are not the only liabilities which may result to a railroad as lessor of its property due to actions of a lessee; yet, subsection (a)(4) would prevent the railroad from contracting for indemnification by the lessee.

This provision is apparently in response to the concerns of the bill's proponents regarding provisions typically found in railroad leases which make a lessee obligated to indemnify the railroad for liabilities arising out of the lessee's use and occupancy of the leased right-of-way, even where the railroad may have negligently contributed to such liabilities. The proponents have suggested to the Committee that such provisions are "unconscionable" and contrary to public policy. Yet, it is difficult to understand how such provisions

contravene public policy when the inclusion of such provisions in a railroad lease have been explicitly or implicitly upheld by the Kansas Supreme Court on several occasions. See Railroad Co. v. Blaker, 68 Kan. 244, 75 Pac. 71 (1904); Grain Co. v. Railway Co., 94 Kan. 590 (1915); Thirlwell v. Railway Co., 108 Kan. 700 (1921); Riddle Quarries, Inc. v. Thompson, 177 Kan. 308, 279 P.2d 266 (1955). These cases recognize that one of the principal considerations for a lessee's use and occupancy of railroad right-of-way is the exemption of the railroad from damages. As to public policy considerations, the Kansas Supreme Court stated in the Grain Co. case as follows:

> No case has been cited and we have found none where similar exemptions have been declared in contravention of public policy, and we are constrained to adopt the reasoning of the Supreme Court of the United States and the Iowa court, and to hold that the provision in this lease can not be said to be void on the ground of public policy.

94 Kan. at 593.

Subsection (a)(5) prohibits a lease term for less than one year; subsection (a)(7) prohibits a lease provision which would allow termination of the lease prior to the end of the lease term other than for "just cause"; and subsection (a)(9) prohibits an agreement by the tenant that it will remove any improvement placed upon the railroad's property upon termination of the lease. The latter is particularly egregious, as concerns the substantial financial burden that will be imposed on a railroad lessor.

If a lease of the railroad's property terminates, either by expiration of the lease term or otherwise, and the tenant can quit the premises without any obligation to remove the improvements, it places the burden on the railroad to remove them, if they are not useful to the railroad, to any subsequent tenant of the railroad property or (as will be discussed subsequently) to the "reversionary owner" of the property. The burden imposed on the railroad in this instance could rise to the level of a regulatory taking that would entitle the railroad to just compensation by the State.

Of course, these observations are equally applicable to the requirements of Section 9, which prohibits a tenant from being ejected from the leased premises until the tenant has been fully compensated for any improvements made to the leased premises. Presently, the removal of improvements from leased premises is a matter of contract for lessors and lessees in the lease agreement. See, e.g., Duvanel v. Sinclair Refining Co., 170 Kan. 483, 227 P.2d 88 (1951). In this regard, it must be recognized that most, if not all, existing railroad

leases in Kansas make it the responsibility of the lessee to remove improvements at the termination of the lease. To the extent that these leases also contain agreements as to the renewal or extension of the lease, the application of Section 3(a)(9) and Section 9 to the renewed or extended lease would constitute a substantial impairment of the existing contractual relationship, an impairment which potentially subjects the State of Kansas to liability for any damages sustained by railroads as a result.

Section 4 also represents a significant curtailment of a railroad's ability to freely contract regarding the use and occupancy of its property. Among other things, it compels a railroad to extend an offer to lease railroad property to any person who requests it, regardless of whether the railroad wants to lease the property. Further, as the bill was amended by the House Committee, it requires arbitration to establish the fair lease rental of the property and other terms and conditions of the lease which the <u>prospective</u> tenant disputes. This constitutes a significant impairment of the railroad's right to lease its property to whomever it determines and upon the terms and conditions it deems appropriate.

While the cases cited and quoted in Attachment A make it clear that the Contract Clause is not an absolute guarantee, and must be interpreted and applied in conjunction with the lawful exercise of a state's police power, these cases also make it clear that the Contract Clause has not been stricken from the Constitution and, if the state regulation constitutes a substantial impairment of a contractual relationship, the state's regulation must be justified by a significant and legitimate public purpose. It must remedy a broad and general social or economic problem, and cannot be confined to a singular, narrow purpose. The purpose of the state regulation must be to safeguard the vital interests of the state's people.

However, I submit that the bill addresses a very narrow, singular situation, one which affects a very limited number of persons.

Considered as a whole, it can be seen that the enactment of HB 2715 would effect a severe impairment of the contractual relationship between a railroad and a lessee of its property, thereby heightening the level of scrutiny which must be given to the proposed legislation. In light of the fact that the legislation does not address broad and generalized economic or social problems and is focused on a narrow, singular purpose, I believe that the heightened scrutiny compels the conclusion that the state's exercise of its police power through the enactment of HB 2715 is not reasonable and necessary to achieve a valid state interest.

Aside from the legal issues involving the restrictions that would be made on a railroad's ability to freely contract for the use of its property, there also is the underlying policy consideration. Is it good public policy to interject a layer of regulation in the contractual relationship between railroads and lessees of their property, a contractual relationship which has been in existence for more than 100 years? Proponents of the bill suggest that the Residential Landlord and Tenant Act (K.S.A. 58-2540 et seq.) provides a good model, not only for the public policy which will be evidenced by the passage of HB 2715, but also as to the validity of the various impairments of contractual obligations effected by the bill. The opponents of the bill strongly disagree with that proposition.

Although the proponents of HB 2715 contend that "small businesses" are the object of the remedial legislation, the bill is so broad in scope that companies such as Cargill, Koch and ADM are brought within the bill's purview. Thus, it can scarcely be argued that the bill is analogous to the Residential Landlord and Tenant Act which applies only to landlords and tenants of dwelling units which accommodate a single household or common household. Clearly, that act was promulgated to protect individuals who would otherwise be powerless to protect themselves from unscrupulous landlords. That clearly is not the case with HB 2715, which deals with commercial leases of property where some of the tenants are among the largest companies in the United States. Some of them are significantly larger than the short-line railroads operating in Kansas.

Railroads' Property Rights

The Fifth Amendment to the U.S. Constitution requires that persons receive just compensation when their property is taken for a public purpose. The requirements of the Fifth Amendment have been applied to the various states through the Fourteenth Amendment. 597 P.2d at 1091. Pertinent to HB 2715, the right to sell one's property at the seller's price has been held to constitute an attribute of property. See Schwegman Bros. Giant Supermarkets v. Eli Lilly & Co., 205 F.2d 788 (5th Cir.), cert. den., 346 U.S. 856 (1953) (holding that right to sell at a price fixed by owner is an inherent attribute of property itself, but upholding minimum price law).

Section 5 of HB 2715 severely restricts the railroad's right to sell to whomever it chooses and at whatever price it may obtain. It provides a tenant with a right of first refusal, not merely to purchase at a price offered the railroad by a third party, but at "fair market value," a term defined in the bill and which ultimately may be determined under Section 5 by arbitration.

The "fair market value" may be substantially less than the price which might be paid by a third party, since subsection (c) of Section 5 prohibits the consideration of the value of any interest or improvement that is not owned by the railroad. Yet, it requires little understanding of commercial real estate transactions to realize that the price a purchaser is willing to pay for property on which there is situated income-producing improvements, regardless of who owns the improvements, exceeds the price which the purchaser would pay for the same property without improvements. Thus, to the extent that a railroad is denied the ability to sell its property for a price reflecting the presence of income-producing improvements, even though such improvements may be owned by a lessee of the property, the railroad has been deprived of a property right. Such deprivation constitutes a regulatory taking of its property for which just compensation should be paid. Yet, HB 2715 makes no provision for compensating a railroad for such loss.

Property Rights of Servient Estate Owner

Attachment B sets forth cases and other authorities regarding the nature of railroad right-of-way. The definition of "railroad land" in Section 2(g) does not distinguish between property owned by a railroad in fee simple and property acquired by a railroad as right-of-way. To the extent that HB 2715 affects railroad right-of-way, the principles enunciated by the Kansas courts and reflected in Attachment B must be considered. For example, Section 5 vests a lessee of railroad land with what amounts to a right of first refusal whenever a railroad seeks to sell "railroad land under any other circumstance other than for continued use of railroad land for railroad purposes."

The Kansas case law set forth in Attachment B reveals that the interest held by a railroad in railroad right-of-way is an easement only. It makes no difference how the right-of-way was acquired by the railroad -- warranty deed, quitclaim deed, condemnation, right-of-way deed -- all that is acquired is an easement. And, upon abandonment of the right-of-way, the railroad's interest in that property ceases.

When that occurs, the popular understanding is that the property "reverts" to the adjacent landowner. Actually, as recited in many of the cases included in Attachment B, the owner of the servient estate which has been burdened by the railroad's easement for right-of-way purposes continues to own the property in fee simple, and such owner has the right to use the surface of the property included within the easement during the time the railroad is using it for railroad right-of-way purposes, so long as the landowner does not interfere with the railroad's operations. Thus, the abandonment of

railroad right-of-way effects an extinguishment of the railroad's easement which has burdened the servient estate, and the owner of the servient estate is no longer restricted in the use of the property.

Therefore, prior to abandonment of the railroad right-of-way, a railroad can sell right-of-way only under two circumstances: First, it might sell a portion of the right-of-way which is not needed for the railroad's operations to the servient estate owner, where the servient estate owner desires to extinguish the railroad's easement and have unrestricted use of the property prior to the time when the railroad might abandon the right-of-way in its entirety. Second, as contemplated by Section 5, the railroad might sell to another entity which will continue the property's use as railroad right-of-way.

Except for those two instances, a railroad cannot convey right-of-way prior to its abandonment. To convey the right-of-way to anyone who will not continue the property's use as railroad right-of-way will cause the extinguishment of the easement and the "reversion" to the servient estate owner. Thus, to provide a lessee of the right-of-way with the right to purchase right-of-way constitutes a taking of the servient estate owner's property, thereby making the state liable to pay just compensation.

Also, Section 5 implicates federal preemption issues which are addressed in Attachment C. In particular, during the process of abandoning the right-of-way, the railroad may convey all or a portion thereof to a party who will operate the right-of-way as a biking or hiking trail under the National Trails Systems Act, 16 U.S.C.A. §§ 1241 et. seq. The cases deciding these issues have held that the so-called "Rails to Trails Act" has preempted state-created property rights, even though such preemption may carry with it the constitutional obligation to pay just compensation for the state-created rights being destroyed. Accordingly, to the extent that the right of first refusal created by Section 5 would apply to the instance where the property is being conveyed under the Rails to Trails Act, the right is invalid, being preempted by federal law.

The final instance where the right of first refusal granted by Section 5 would apply is the instance where the railroad seeks to sell railroad land that is not used for right-of-way purposes. In that instance, for the reasons previously noted, the railroad is being deprived of a property right, the right to sell to whomever it wants and at the price it wants to sell. The railroad is being denied substantive due process, by a taking of its property without just compensation. To that extent, the right of first refusal is invalid and unconstitutional.

Conclusion

There are other constitutional issues generated by a consideration of HB 2715. However, I believe the issues identified in this letter are the ones which operate to render the entirety of HB 2715 invalid, either as being contrary to applicable provisions of the United States Constitution or as being preempted by federal law.

Although the proponents of HB 2715 have stated repeatedly that they do not want any "special treatment" and are merely asking for "fairness" by the enactment of HB 2715, even a cursory review of the bill's provisions suggests that these statements are made with tongue in cheek. HB 2715 contains unprecedented restrictions on railroads' abilities to freely contract with lessees regarding the use and occupancy of their property. No other class of commercial landlords have been so restricted. Correspondingly, it contains unprecedented advantages inuring to the benefit of tenants of railroad property. No other class of tenants will be so advantaged. Is this consistent with good public policy?

What will be the effect of HB 2715 on the system of rail transportation in the state of Kansas? Will it promote close cooperation among grain elevators and railroads in an effort to strengthen the system of rail transportation of grain and other agricultural commodities, so as to relieve the highway infrastructure of unnecessary truck trafficking of these commodities? We think not, particularly in light of the "all or nothing" attitude evidenced by the proponents' contention that the enactment of HB 2715 is their only answer, coupled with their corresponding refusal to come to the table with the railroads and openly discuss the issues which have prompted the introduction of this legislation.

Thank you for your willingness to review the legal issues I have discussed in this letter. If you have any questions or need additional information, I trust you will not hesitate to contact me.

ATTACHMENT A

Requirements of the "Contract Clause" of the U.S. Constitution

Section 10 of Article 1 of the U.S. Constitution enumerates limitations on the powers of the various States. Included in that section is the prohibition that "[n]o State shall . . . pass any . . . Law impairing the Obligation of Contracts . . . ." The judicial interpretation of this prohibition has involved the balancing of this constitutional guarantee against the exercise of a state's police power.

The factors which are considered in evaluating the impairment of contracts through police power legislation are succinctly reviewed in National College Athletic Association v. Miller, 795 F.Supp. 1476 (1992), which states:

> 'Analysis of a Contracts Clause claim proceeds in two steps. First, the court must determine whether the state law, 'substantially impairs the contractual relationship.' . . . This inquiry involves three components: whether there is a contractual relationship; whether a change in law impairs that contractual relationship; and whether the impairment is substantial. . . . If the impairment is minimal, the inquiry ends, and the state law is allowed to stand.
>
> Second, if the impairment is substantial, then the court must decide whether the degree of impairment is both 'reasonable and necessary to achieve a valid state interest.'

Id. at 1486. (Citations omitted.)

In that case a narrow statute was focused on investigations of Tarkanian at UNLV and the court found a violation of the contracts clause, stating: "While the statute does represent a legitimate exercise of police power, its singular narrow purpose does not elevate it to the level of state laws necessary to protect the health and safety of the people."

Id. at 1487.

Hence, as the court noted in H. Phillips Co. v. Brown Forman Distillers, 483 F. Supp. 1289, 1295 (D.C. for the W. D. Wisc. 1980):

> We know that 'the contracts clause' is not to be construed literally and that judicial balancing must be engaged in, but we also know that the contracts

> clause has not been dropped from the constitution, as it once might have seemed . . . The severity of the impairment measures the height of the hurdle the state legislature must clear."

Id. at 1295.

The court there found a serious constitutional question and denied the injunction that was sought.

The legislation must address a ". . . broad and generalized economic or social problem." Allied Structural Steel Co. v. Spannaus, 438 U.S. 234 (1978) at Syl. ¶C. There, the act relating to pension funds was struck down as a violation of the Contract Clause.

A line of landmark cases in this area culminated with Energy Reserves Group, Inc, v. Kansas Power and Light Company, 459 U.S. 400 (1983). The court therein reviews the history of the contracts clause stating:

> Although the language of the Contract Clause is facially absolute, its prohibition must be accommodated to the inherent police power of the State to safeguard the vital interests of its people.' Home Bldg. & Loan Assn. V. Blaisdell, 290 U.S. 398, 434 (1934).
>
> . . . The threshold inquiry is 'whether the state law has, in fact, operated as a substantial impairment of a contractual relationship.' Allied Structural Steel Co., 483 U.S., at 244. See United States Trust Co., 431 U.S., at 17. The severity of the impairment is said to increase the level of scrutiny to which the legislation will be subjected. Allied Structural Steel Co., 438 U.S., at 245. Total destruction of contractual expectations is not necessary for a finding of substantial impairment. United States Trust Co., 431 U.S. at 26-27.
>
> . . . If the state regulation constitutes a substantial impairment, the State, in justification, must have a significant and legitimate public purpose behind the regulation, United States Trust Co., 431 U.S., at 22, such as the remedying of a broad and general social or economic problem. Allied Structural Steel Co., 438 U.S., at 247, 249. Furthermore, since Blaisdell, the Court has indicated that the public purpose need not be addressed to an emergency or temporary situation. United States Trust Co., 431 U.S., at 22, n.19, Viex v. Sixth Ward Bldg. & Loan Assn., 310 U.S, at 39-40. One legitimate state interest is the elimination of

> unforeseen windfall profits. United States Trust Co., 431 U.S., at 81, n. 30.
>
> . . . Once a legitimate public purpose has been identified, the next inquiry is whether the adjustment of 'the rights and responsibilities of contracting parties [is based] upon reasonable conditions and [is] of a character appropriate to the public purpose justifying [the legislation's] adoption.' United States Trust Co., 431 U.S., at 22. Unless the State itself is a contracting party, see id., at 23, '[a]s is customary in reviewing economic and social regulation, . . . courts properly defer to legislative judgment as to the necessity and reasonableness of a particular measure.'

Id., at 22-23.

A U.S. Supreme Court case which would appear to have particular relevance to the analysis of the provisions of House Bill No. 2715 is Pennsylvania Coal Company v. Mahon, 260 U.S. 393 (1922). In that case the state had enacted legislation which forbid the servient estate owner from mining of minerals under homes or streets. In this case the servient estate owner had granted the city a street easement and retained the right to mine valuable coal beneath the street. The court found the law unconstitutional and allowed the servient estate owner to mine the coal with certain limitations to protect the road structure. The court specifically held "that the protection exceeded the police power, whether viewed as a protection to private surface owners or to cities having only surface rights, and contravened the rights of the coal-owner under the Contracts Clause and the Due Process Clause . . . ." Id. at Syl. ¶4.

ATTACHMENT B

Reversionary Nature of Railroad Right-of-Way

The general rule applicable to the grant of property for railroad right-of-way in Kansas has been stated in Abercrombie v. Simmons, 71 Kan. 538, 81 P. 208 (1905), as follows:

> An instrument which is in form a general warranty deed, conveying a strip of land to a railroad company for a right-of-way, will not vest an absolute title in the railroad company, but the interest conveyed is limited by the use for which the land is acquired, and when that use is abandoned the property will revert to the adjoining owner.

71 Kan. at Syl. ¶ 3.

Even if the deed does not specifically limit the ownership interest of the railroad to an easement, Abercrombie allows an "implied restriction" to exist.

> Where an absolute and unqualified fee-simple title is acquired by a railroad company it may of course, in the absence of express or implied restrictions, be conveyed to another. After stating this rule Judge Elliott remarks:
>
> 'But where there is an implied restriction, as is often the case in regard to the right of way, or the like, of a railroad company, the grant does not ordinarily vest a fee in the company, but vests such an estate, usually an easement, as is requisite to effect the purpose for which the property is required. . . .'
>
> The fact that the deed contains covenants of warranty, or that the right acquired is designated as a fee, is not necessarily controlling. . . .

71 Kan. at 542-543.

The rule announced in Abercrombie has been consistently followed (with a few exceptions not pertinent here) by Kansas courts. In Harvest Queen Mill & Elevator Co. v. Sanders, 189 Kan. 536, 370 P.2d 419 (1962), the deed purported to convey land "'for the purpose of building or constructing its roadbed and railroad and of completing and trimming its cuts and fills and for all other purposes for the building[,] constructing and maintaining its roadbed or of maintaining its railroad.'" (Emphasis in original.) 189 Kan. at 538. The Kansas Supreme

Court held that such deed did not convey fee simple in any of the land taken by the railroad. Id. at 543. In support of this conclusion, the Court stated:

> We have held that when land is devoted to railroad purposes it is immaterial whether the railway company acquired it by virtue of an easement, by condemnation, right-of-way deed, or other conveyance. If or when it ceases to be used for railway purposes, the land concerned returns to its prior status as an integral part of the freehold to which it belonged prior to its subjection to use for railway purposes. (Federal Farm Mortgage Corp. v. Smith, 149 Kan. 789, 792, 89 P.2d 838.). . .

189 Kan. at 541-542.

The principles enunciated in the Abercrombie and Harvest Queen Mill cases were most recently applied and affirmed in a reported decision of the Kansas Supreme Court in Gauger v. State, 249 Kan. 86, 815 P.2d 501 (1991). They also were affirmed in Board of County Commissioners of Riley County, Kansas v. Chicago Pacific Corporation (No. 66, 232), a case not designated for publication, by the Kansas Court of Appeals. While this case cannot be cited as precedent, since it was not designated for publication, it is important, nonetheless, because it demonstrates the judiciary's continuing adherence to these principles.

The Riley County case provides a good summary of Abercrombie and Harvest Queen Mill cases and the various cases which have followed the principles annunciated in these two cases, and the decision provides an appropriate summary of the case law emanating from these various decisions, as follows:

> It is apparent that, based on decisions of the Kansas Supreme Court, the law can be summarized as follows: (a) The form of the grant, i.e., whether it purports to be an absolute warranty deed of a fee simple title is largely irrelevant; (b) the width and shape of the tract involved is of considerable relevance; and (c) the purpose for which the tract was used, whether spelled out in the deed of conveyance or contract, is of ultimate importance.

Id. at p. 4. Subsequently, with respect to the Abercrombie decision, the Court of Appeals stated:

> As we read Abercrombie, it establishes the principle that the use to which the railroad put the tract is the preeminent feature. If the tract was used as a right-of-way, it will be called a right-of-way regardless of the language employed in the deed of

> conveyance. This is particularly true when the tract is a strip of land extending a great distance through the countryside.

Id. at p. 7. The Court in Riley County found that the Harvest Queen Mill case "further solidifies the position of the Kansas Supreme Court on narrow strips of ground and seems to flatly hold that a railroad cannot take fee title to such a narrow strip regardless of the purpose to which that strip is placed." Id. at p. 13. As noted above, the decision in Riley County was not published, which means that it cannot be cited as precedent. However, the case is important for two reasons: First, the fact that the decision was not published reflects the Court's beliefs that the principles enunciated above are well-settled law and that the Court's decision would not add anything to that law; and second, since it is a relatively recent case, the decision in Riley County probably reflects the current thinking of the Court of Appeals on this these issues.

It is clear from the long judicial history on this issue that, regardless of how a railroad acquires property in Kansas for railroad right-of-way purposes, the railroad acquires only an easement in the property. Kansas cases are equally clear and consistent in their determinations as to the property rights of the owner of the estate which is burdened by the easement. In The Kansas Central Railway Company v. Allen, 22 Kan. 285 (1879), the Kansas Supreme Court, after discussing the rights of a railroad under an easement acquired for right-of-way purposes, stated as follows:

> The former proprietor of the soil still retains the fee of the land and his right to the land for every purpose not incompatible with the rights of the railroad company. Upon the discontinuance or abandonment of the right of way, the entire and exclusive property and right of enjoyment revest in the proprietor of the soil. After the condemnation and payment of damages, the soil and freehold belong to the owner of the land, subject to the easement or incumbrance, and such land-owner has the right to the use of the condemned property, provided such use does not interfere with the use of the property for railroad purposes. . . .

Id. at 293. See, also, Midland Valley R. Co. v. Corn, 21 F.2d 96 (1927) (whether railroad's occupancy of the right-of-way, to the exclusion of the fee owner, is required is a question of fact, not of law).

The case of Federal Farm Mortgage Company v. Smith, 149 Kan. 789, 89 P.2d 838 (1939), held it to be "elementary that land condemned for a right of way for a railroad or other public

purpose continues to be the property of its fee-title owner." 149 Kan. at 791. In that case, the Kansas Supreme Court determined that, when a railroad right-of-way was abandoned, it reverted to the servient estate owner and became included in the mortgage on the servient estate owner's property adjoining the servient estate, even though the description of the right-of-way was not included in the mortgage instrument.

> The ultimate title to land subjected to railway purposes does not cease to be in the owner of the adjacent freehold from which it was derived, and the termination of its use for railway purposes has no effect upon the fee title. It merely relieves the underlying fee of the dominant estate which had been held by the railway company so long as it was used for railway purposes.

Id. at 793.

The more recent decision of Gauger v. State, 249 Kan. 86, 815 P.2d 501 (1991), recognized the right of the owner of the servient estate to convey the servient estate, concluding as follows:

> The rule is thus clear and of longstanding that when the owner of real estate conveys land abutting on a railroad right-of-way, and the owner (grantor) owns the servient estate of the railroad right-of-way and the railroad the dominant estate for right-of-way purposes, the grantor passes to the grantee the servient estate, unless the intention not to do so is clearly indicated.

249 Kan. at 92. See, also, Roxana Petroleum Corp. v. Jarvis, 127 Kan. 365, 273 Pac. 661 (1929); Roxana Petroleum Corp. v. Sutter, 28 F.2d 159.

In Energy Transportation Systems, Inc. v. Union Pacific Railroad Company, 606 F.2d 934 (10th Cir. 1979), the central issue was whether the plaintiff could build its coal-slurry pipeline under and across the railroad right-of-way. The plaintiff had obtained easements for this purpose from the servient estate owners involved, and the appellate court affirmed the trial court's finding that the servient estates had fee simple title and that the plaintiff could build the coal-slurry pipeline both under and across the railroad right-of-way, "so long as such did not interfere with Union Pacific's use of its railroad right-of-way for purposes of railroad operations." Id. at 935. The Court noted that "the grant of the right-of-way did not convey title to the servient estate underlying the right-of-way." Id. at 937.

The public policy enunciated by the courts in defining the respective property rights of a railroad acquiring land for right-of-way purposes and the owner of the fee burdened by the easement has been statutorily codified, to some extent, in K.S.A. 1997 Supp. 66-525. Among other things, this statute requires a railroad abandoning right of way to

> file a release of all right, title and interest in the right-of-way with the register of deeds of the counties in which the property is located, within 180 days after being requested by any owner of property servient to the right-of-way.

K.S.A. 1997 Supp. 66-525(b). Furthermore, subsection (f) of that statute states as follows:

> (f) Any conveyance by any railroad company of any actual or purported right, title or interest in property acquired in strips for right-of-way to any party other than the owner of the servient estate shall be null and void, unless such conveyance is made with a manifestation of intent that the railroad company's successor shall maintain railroad operations on such right-of-way, ...

This statute, which was enacted in 1986 (L. 1986, Ch. 247, §1) and subsequently amended in the 1987 and 1993 sessions (L. 1987, Ch. 258, §; L. 1993, Ch. 105, §1) clearly recognizes the vested property rights of servient estate owners consistent with the decisions of Kansas courts since the late 19th century.

A final issue concerns the point in time when railroad right-of-way is regarded as being abandoned. The case of Pratt v. Griese, 196 Kan. 182, 185, 409 P.2d 777 (1966), provides assistance in answering that question. In that case, the Kansas Supreme Court stated:

> Whether an easement for a right-of-way has been abandoned is largely a question of intent, and it is generally held that in order to constitute an abandonment there must be an intent to relinquish, together with external acts by which the intent is carried into effect.

Of similar import is Martell v. Stewart, 6 Kan. App. 2d 387, 387, 628 P.2d 1069 (1981), where the Kansas Court of Appeals held:

> To constitute abandonment of a railroad right-of-way, there must be a uniting of intent to renounce all interest in the right-of-way with a clear and unmistakable act to carry out that intent. . . .

> Neither failure to use right-of-way nor taking up the tracks necessarily constitutes an abandonment of a railroad right-of-way.

With regard to the time when abandonment occurs, it should be noted that K.S.A. 1997 Supp. 66-525(a) provides, in part, that

> a railroad right-of-way shall be considered abandoned when the tracks, ties, and other components necessary for operation of the rail line are removed from the right-of-way following the issuance of an abandonment order by the appropriate federal or state authority; or if, within two years after the exercise of such an order, removal of such components is not completed and railroad operating authority is not restored or reissued by an appropriate court or other federal or state authority;. . . .

As will be noted subsequently, the federal government has plenary, preemptive authority to regulate railroad abandonments, and to the extent that the foregoing Kansas statutory provision may conflict with federal requirements on railroad abandonment of right-of-way it is likely that the federal requirements would preempt and take precedence over the statutory provisions. However, there has been no case testing the validity of the Kansas statute.

ATTACHMENT C

Plenary, Preemptive Federal Power to Regulate Railroads

By numerous congressional acts and the decisional law which has interpreted those enactments, it is well established that the federal government has plenary, preemptive jurisdiction to regulate railroads. This jurisdiction was succinctly summarized in Preseault v. U.S., 100 F.3d 1525 (Fed. Cir. 1996), as follows:

> There can be no denying that the Federal Government, beginning as early as 1920, has occupied the field of regulation of interstate railroad operations, preempting any pattern of conflicting state regulation. See, e.g., Transportation Act of 1920, Ch. 91, 41 Stat. 456 (1920); Rail Revitalization and Regulatory Reform Act of 1976, Pub. L. No. 94-210, 90 Stat. 31 (1976)(4-R Act); 49 U.S.C. §§ 101 et seq. And there can be no question that if the Federal Government wishes to create a national network of public recreation biking and hiking trails, it is within its power to do so. See Preseault II, 494 U.S. 1, 110 S. Ct. 914, 108 L. Ed. 2nd 1. And that power includes the power to preempt state-created property rights, including the rights to possession of property when railroad easements terminate. Id. However, as Justice O'Connor succinctly pointed out in her concurring opinion, having and exercising the power of preemption is one thing; being free of the Constitutional obligation to pay just compensation for the state-created rights thus destroyed is another. Id. at 22, 110 S. Ct. at 927.

100 F.3d at 1537.

Until enactment of the Interstate Commerce Commission Termination Act (ICCTA), the federal government's preemptive power to regulate railroads was exercised by the Interstate Commerce Commission (ICC). Upon enactment of ICCTA, the Surface Transportation Board (STB) became the successor to the ICC's authority, and in fact such authority was expanded in that enactment. The general jurisdiction of the STB following enactment of the ICCTA is set forth in 49 U.S.C.A. § 10501. Subsection (b) is pertinent and provides as follows:

> (b) The jurisdiction of the Board over--
>
> (1) *transportation* by rail carriers, and the remedies provided in this part with respect to

> rates, classifications, rules (including car service, interchange, and other operating rules), practices, routes, services, and facilities of such carriers; and
>
> (2) the construction, acquisition, operation, abandonment, or discontinuance of spur, industrial, team, switching, or side tracks, or facilities, even if the tracks are located, or intended to be located, entirely in one State,
>
> is exclusive. Except as otherwise provided in this part, *the remedies provided under this part with respect to regulation of rail transportation are exclusive and preempt the remedies provided under Federal or State law.*

(Emphasis added.)

One of the keys to understanding the breadth of the STB's authority to regulate rail transportation is the definition of "transportation," which is set forth in 49 U.S.C.A. § 10102, as follows:

> (9) "transportation" includes--
>
> (A) a locomotive, car, vehicle, vessel, *warehouse,* wharf, pier, dock, yard, *property,* facility, instrumentality, or equipment of any kind related to the movement of passengers or property, or both, by rail, *regardless of ownership or an agreement concerning use;* and
>
> (B) services related to that movement, including receipt, delivery, elevation, transfer in transit, refrigeration, icing, ventilation, storage, handling, and interchanges of passengers and property. . . .
>
> (Emphasis added.)

Thus, the preemption language of § 10401(b), which utilizes the broad definition of "transportation" in § 10102(9), results in an expansive, comprehensive preemption of state economic regulation of railroad property and facilities, regardless of ownership or any agreement concerning use.

The exclusive, preemptive authority vested in the STB by the above-quoted provisions is even more expansive than that previously provided to the ICC. For example, contrary to the authority granted the STB by 49 U.S.C.A. § 10501(b)(2), the ICC did not have statutory jurisdiction over the construction, acquisition, operation, abandonment or discontinuance of spur, industrial, team, switching or side tracks located or intended

to be located in a single state. See, Illinois Commerce Com'n v. ICC, 879 F.2d 917 (D.C. Cir. 1989).

Of pertinence, is the federal government's authority regarding railroad abandonments. "Congress granted to the [Interstate Commerce] Commission plenary authority to regulate, in the interest of interstate commerce, rail carriers' cessation of service on their lines. And at least as to abandonments, this authority is exclusive." Chicago & N.W. Tr. Co. v. Kalo Brick & Tile Co., 450 U.S. 311, 323, 101 S.Ct. 1124, 67 L.Ed.2d 258 (1981).

In Kalo Brick, a railroad applied for abandonment with the ICC. One of the railroad's customers opposed the application for abandonment, but never filed its opposition with the ICC. Instead, the customer brought an action for damages in an Iowa state court, while the abandonment application was still pending. Id. at 1128-1129. A damages claim was not properly brought before the federal government. The court, therefore, held that the state lacked jurisdiction until the ICC has issued a certificate.

In considering the jurisdiction of the STB, as ICC's successor, over abandonments, it is important to understand the implications of the National Trails Systems Act, 16 U.S.C.A. §§ 1241 et seq. An excellent explanation of that act is provided by the U.S. Eighth Circuit Court of Appeals in Grantwood Village v. Missouri Pacific Railroad Company, 95 F.3d 654 (8th Cir. 1996).

> In 1968, Congress enacted the Trails Act in order to establish a national system of nature trails. See Glosemeyer, 879 F.2d at 318. By the early 1970s, Congress had become concerned about the abandonment of railroad rights-of-way. Id. (referring to the Railroad Revitalization and Regulatory Reform Act of 1976, § 809, Pub.L. No. 94-210, Title VIII, 90 Stat. 144 (codified as amended at 49 U.S.C. § 10906)). One of the major impediments to preserving these rights-of-way existed in state property laws which prescribed that once rail service is discontinued after the ICC's approval of abandonment, such easements would automatically expire and the rights-of-way would revert to adjacent property owners. Id. In response to this problem, Congress enacted the Trails Act Amendments of 1983. These amendments included a section that expressly dealt with the question of abandonment. Specifically, this section provides:
>
> > Consistent with the purposes of that Act, and in furtherance of the national policy to preserve established railroad rights-

> of-way for future reactivation of rail service, to protect rail transportation corridors, and to encourage energy efficient transportation use, in the case of interim use of any established railroad rights-of-way pursuant to donation, transfer, lease, sale, or otherwise in a manner consistent with this chapter, if such interim use is subject to restoration or reconstruction for railroad purposes, such interim use shall not be treated, for purposes of any law or rule of law, as an abandonment of the use of such rights-of-way for railroad purposes.
>
> 16 U.S.C.A. § 1247(d) (emphasis added).
>
> Congress determined that interim trail use was to be treated like discontinuance rather than as an abandonment. Preseault v. Interstate Commerce Comm'n, 4949 U.S. 1, 8, 110 S.Ct. 914, 920, 108 L.Ed.2d 1 (1990). Therefore, the ICC's authorization of interim trail use in its Decision precludes a finding of abandonment of the right-of-way under state law. See, e.g., Preseault v. Interstate Commerce Comm'n, 853 F.2d 145, 150 (2d Cir. 1988), aff'd, 494 U.S. 1, 110 S.Ct. 914, 108 L.Ed.2d 1 (1990).

95 F.3d at 658-659.

With respect to 16 U.S.C.A. § 1247(d) referenced in the foregoing quotation, the U.S. District Court for the Eastern District of Missouri concluded in Glosemeyer v. Missouri-Kansas-Texas Railroad Company, 685 F.Supp. 1108 (E.D. Mo. 1988), as follows:

> In this case, § 1247(d) by its express terms preempts state law insofar as that law would permit reversion of the M-K-T right-of-way to plaintiffs while the right-of-way is being used on an interim basis as a trail. Moreover, § 1247(d) is an adjunct to a federal regulatory scheme which the Supreme Court has viewed as plenary, exclusive and preemptive. See, e.g., Chicago & N.W. Transportation Co. v. Kalo Trick & Tile Co., 450 U.S. 311, 101 S.Ct. 1124, 67 L.Ed.2d 258 (1981).

685 F.Supp. at 1122. See, also, Nebraska Trails Council v. Surface Transportation Board, 120 F.3d 901 (1997) (interim use of established railroad rights-of-way shall not be treated, for purposes of any law or rule of law, as an abandonment of the use of such rights-of-way for railroad purposes).

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TO: Members of the Senate Judiciary Committee

FROM: Pat Hubbell

RE: HB 2715 (Railroad Leasing Act)

DATE: March 24, 1998

This memorandum addresses the legal issues presented by HB 2715, the proposed Railroad Leasing Act (the "Act"). HB 2715 poses numerous constitutional concerns as well as creating a state statutory framework that is preempted by federal law. The questions raised by each section of the bill are addressed separately.

Section Three

Section Three of the Act limits the provisions that may be contained within the leases of railroad lands. Such limits present due process and takings clause concerns.

Under federal law, due process requires that the means used in a law to remedy a problem be rationally related to a legitimate purpose. Unified School Dist. No. 259 v. Newton, 673 F. Supp. 418 (D. Kan. 1987). The promotion of general economic welfare is considered a legitimate purpose for purposes of the government's police power.

Kansas courts state the due process standard differently from the federal courts. The test is whether the law has a real and substantial relationship to the objective sought, or whether it is reasonable in relation to its subject and adopted in the interest of the community. Chilies v. State, 254 Kan. 888 (1994). A law cannot be unreasonable or oppressive under the guise of being an exercise of the police power. Delight Wholesale, Inc. V. Overland Park, 203 Kan. 99 (1969) (unconstitutional to prohibit vendors who sold ice cream from vehicles). Thus, while the police power can be used to promote public health, safety, morals and general welfare, it cannot be exercised in an unduly oppressive manner. State ex rel. Stephan v. Lane, 228 Kan. 379 (1980).

The due process clause protects the freedom to contract as a part of liberty. Manhattan Buildings, Inc. v. Hurley, 231 Kan. 20 (1982). See also Schwegman Bros. Giant Super Markets v. Eli Lilley & Co., 205 F.2d 788 (5th Cir.), cert. denied, 346 U.S. 856 (1953) (holding that right to sell at a price fixed by owner is an inherent attribute of property itself but upholding minimum price law). The freedom to contract is not absolute but the menace to be dealt with must be balanced against the rights curtailed.

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Manhattan Buildings, Inc. V. Hurley, 231 Kan. 20 (1982).

If enacted, HB 2715 would be unduly oppressive and would unreasonably interfere with the freedom of contract. Section Three of the Act contains severe restrictions on the ability of railroads to negotiate and enter into contract leases with whom and how they want. Such restrictions are unprecedented.

HB 2715 also runs contrary to the requirements of the takings clause and presents several serious legal problems. The Fifth Amendment to the Constitution requires that persons receive just compensation when their property is taken for a public purpose. This requirement has been applied to the states by incorporation into the Fourteenth Amendment. The government not only takes property when it exercises its eminent domain power; under certain circumstances, government regulations may constitute a taking--a regulatory taking. The Act raises several different takings problems.

In several cases, the Supreme Court has held that the government's violation of an owner's right of exclusive possession violates the takings clause--requiring that the owner be compensated for the violation. See, e.g., Loretto v. Teleprompter CATV Corp., 458 U.S. 419 (1982); Kaiser Aetna v. United States, 444 U.S. 164 (1979). Thus, when a state law authorized a cable television company to connect its cable equipment to a private apartment building, the Supreme Court held that the law constituted a taking of property. Loretto, 458 U.S. 419 (1982).

Section 3 of the Act violates a property owner's right of exclusive possession, thus constituting a taking, by authorizing tenants to occupy railroad land without compensation for a period of six months following the termination of a lease. Since the tenant's right to occupy railroad land terminates when a lease terminates, only the Act creates a right in the tenant to occupy the land after the lease's termination. This provision allows the tenant to occupy a portion of the railroad's land when the tenant otherwise has no legal right to occupy the land, thereby violating the railroad's right of exclusive possession.

Section Four

Section Four of HB 2715 describes the leasing procedure between the lessor railroad and the lessee. As presented, Section Four is in violation of the due process and takings clause.

Like Section Three, Section Four unreasonably interferes with railroads' ability to freely negotiate contracts in violation of due process. Whereas Section Three restricted the terms of the lease contracts, Section Four establishes an unduly burdensome procedure for contract negotiation and dispute resolution. In addition, Section Four requires the railroad to lease to a person who can invoke the protections of the Section

Four even if the railroad has decided not to lease to that person at some point in the lease negotiations.

Section Four also constitutes a takings problem by severely limiting the traditional right of a property owner, the railroad, to lease or sell its property. In Section Four, the railroad is required to lease to a prospective tenant once the railroad has made an offer to lease if the prospective tenant invokes its rights under the section.

Section Five

Section Five of HB 2715 addresses the sale of railroad land for use other than for railroad purposes. The bill establishes notification of the sale to the tenant and creates a right of first refusal in the tenant. Like Section Four, Section Five presents due process and takings clause problems.

Section Five unduly restricts the ability to contract by compelling a railroad to offer its interest in land to the tenant whenever the railroad seeks to sell land for nonrailroad purposes. Further, a railroad may not withdraw its offer to sell to the tenant buyer once the offer has been made. This is true even if the railroad has decided that it would rather not sell to the buyer, or sell at all. Indeed, if the railroad decides to sell its land for purposes other than railroad purposes, it must sell the land to a tenant if the tenant chooses to buy the land. The restrictions posed by Section Five are a violation of due process.

In addition, under Section Five the railroad must sell its land to a tenant who desires to purchase the land if the land is being sold for non-railroad purposes. If the parties cannot agree on the terms and conditions of the sale, the dispute may be submitted to an arbitration panel that will decide the terms and conditions of the sale. Even though the Act provides that the railroad is to receive fair market value for the land, the railroad is not entitled to any profit that it might have received if it had been able to find a buyer who would have paid more than the fair market value and the act restricts the railroad from finding such a buyer.

These are severe restrictions on the traditional right of an owner to sell its property to whom it wishes for a price it sets and under such other terms and conditions that it chooses. While the Supreme Court has upheld rent controls, Pennell v. City of San Jose, 485 U.S. 1 (1988), and restrictions upon the sale of personal property, Andrus v. Allard, 444 U.S. 51 (1979), the restrictions here appear to be excessive in light of the alleged harm sought to be remedied. Consequently, there is a good argument that the Act effects a taking by unreasonably restricting traditional rights of a property owner.

Section Eight

Section Eight prevents a tenant from being dispossessed by any party establishing a superior title until full compensation is made to the tenant for improvements made by the tenant. Such provisions would appear to violate the right of the party with superior title to exclusive possession by requiring the party to purchase all improvements: the party with superior title cannot request that the tenant remove the improvements. This would appear to impose an unconstitutional condition upon the right of the owner to have exclusive possession of the land.

General Comments

Commerce Clause

The federal constitution vests in Congress the authority to regulate interstate commerce. Thus, even when Congress has not enacted a law in a specific area of commerce, the legality of state regulations that affect commerce is determined by balancing the interference with interstate commerce against the extent of local benefit from regulations. If the state regulation is unreasonably burdensome, the regulation violates the so-called "dormant" commerce clause. See Healy v. Beer Institute, Inc., 109 S. Ct. 2491 (1989); Northwest Central Pipeline Corp. V. State Corporation Commission, 489 U.S. 493 (1989). One of the concerns with state regulations that affect commerce is that they will result in multiple, inconsistent burdens on business. The Kansas courts have held that state regulations that affect commerce violate the commerce clause when they have an excessive burden on interstate commerce in relation to the benefit of the regulations. R.B. Enterprises, Inc. V. State, 242 Kan. 241, (1987). If a state is viewed as directly regulating interstate commerce, the regulations may be struck down as violating the need for uniformity in an area of federal interest without resorting to any balancing test.

There is no doubt that the Act regulates commerce that is interstate in character. The Act is not designed to protect public health or safety; rather, it appears to be aimed directly at regulating commerce involving railroads and agriculture. The Act clearly is an effort to decrease the bargaining power of railroads and to drastically limit the freedom of railroads to contract. Sections Three through Eight of the Act all limit the freedom of railroads to contract and to dispose of their property as they deem appropriate.

The Act would appear to have a significant impact upon the potential profitability of railroads and the flexibility that railroads might desire to deal with their property as they choose. Since the Act does not directly promote public health and safety, the state's interest may be less compelling. However, the Act does not appear to create the possibility of multiple, inconsistent burdens. The fact that other states might legislate differently in this area should not create mutually inconsistent burdens on railroads operating in Kansas. Still, there can be no doubt that the Act has a substantial effect

upon interstate commerce in an area of substantial federal interest. There is a serious question whether the law is permissible under the commerce clause.

Preemption

"Preemption" occurs where State law (whether statutory, regulatory or common law) is made inapplicable because of Federal law. It appears that the ICC Termination Act of 1995, Pub. L. No. 108-88, 109 Stat. 803, would preempt the application of the Act.

First, it appears that the Act is an attempt to regulate the economic activities of railroads. As outlined above, the Act specifically targets the commercial activities of railroads in several ways, including the regulation of land leases and the attempt to control the profits railroads earn on the sale of land.

Second, the ICC Termination Act preempts state economic regulation of rail transportation by expressly giving the Surface Transportation Board jurisdiction over rail transportation between points in the same state, 49 U.S.C. Section 10501 (a)(2)(A) (1996); by providing that the Board's jurisdiction over transportation by rail carriers, and the remedies provided in the ICC Termination Act are exclusive, and preempt the remedies provided under Federal or State Law, 49 U.S.C. Section 10501 (b); and by providing that the Board's jurisdiction over spur, industrial, team switching or side tracks, or facilities is exclusive even if the tracks are located or intended to be located in one state, 49 U.S.C. Section 10501 (b).

The key to the application of the ICC Termination Act as preempting HB 2715 is in the ICC Termination Act's definition of "transportation". "Transportation" is defined as including a "locomotive, car, vehicle, vessel, *warehouse* [emphasis added], wharf, pier, dock, yard, *property* [emphasis added], facility, instrumentality, or equipment of any kind relating to the movement of passengers or property by rail". Thus the preemption language of Section 10501(b), coupled with the definition of "transportation" in Section 10102 results in a comprehensive preemption of state economic regulation over railroad facilities that specifically includes warehouses. The interaction of the federal statute would appear to specifically remove the railroad land leased to tenants from state regulation.

Takings Clause

Aside from the analysis of the above sections, in general the Act severely interferes with traditional attributes of property ownership. The Supreme Court has held that the character of a government regulation may result in a taking when the regulation abrogates a traditional incident of property ownership. See Hodel v. Irving, 481 U.S. 704 (1987) (law abrogating right of Indians to leave certain property by descent or devisee unconstitutional taking based upon character of regulation). See also Babbit v. Youpee, 117 S. Ct. 727 (1997) (same). As noted earlier, the right to sell one's property at the seller's price has been held to constitute an attribute of property. See Schwegman Bros. Giant Super Markets v. Eli Lilley & Co. 205 F.2d 788 (5th Cir.),

cert. denied, 346 U.S. 856 (1953) (holding that right to sell at a price fixed by owner is an inherent attribute of property itself but upholding minimum price law).

Conclusion

The HB 2715, the Railroad Leasing Act, raises a number of serious constitutional issues. The Act's extreme limitations upon the traditional rights of railroads appear disproportionate to the harm that the law seeks to remedy. In addition, the property of railroads is regulated exclusively by the Surface Transportation Board as provided by the ICC Termination Act of 1995 and thus HB 2715 is preempted by federal law. The Act is especially suspect under the due process clause, the commerce clause, the takings clause, and the doctrine of preemption.