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SERVICE DATE – DECEMBER 15, 2011

SURFACE TRANSPORTATION BOARD

DECISION

Docket No. FD 35491

SANTA CRUZ REGIONAL TRANSPORTATION COMMISSION—PETITION FOR
DECLARATORY ORDER

Digest:¹ Santa Cruz Regional Transportation Commission (Santa Cruz) does not need Board authorization to acquire the physical assets of the Santa Cruz Branch line in Santa Cruz County, Cal. Although Santa Cruz is acquiring the physical assets of the line, it will not acquire the right and legal obligation to provide freight rail service, which will be retained by the seller and then transferred to a third-party easement owner/operator. Nor will Santa Cruz be in a position to interfere unduly with freight operations.

Decided: December 13, 2011

On April 8, 2011, Santa Cruz Regional Transportation Commission (Santa Cruz), a noncarrier, filed a petition for declaratory order asking the Board to determine that it does not have regulatory authority over Santa Cruz's proposed acquisition of the physical assets of the Santa Cruz Branch line (the Line). On August 22, 2011, the Board issued an order indicating that two aspects of the transaction documents appeared to contravene the precedent set forth in Maine Department of Transportation—Acquisition and Operation Exemption—Maine Central Railroad, 8 I.C.C. 2d 835 (1991) (State of Maine), and thus could disqualify Santa Cruz from invoking that precedent. The Board also stated, however, that Santa Cruz could submit modified transaction documents to the Board. Santa Cruz subsequently revised its transaction documents and submitted a supplemental petition for declaratory order on September 7, 2011. In its supplemental petition, it argues that the acquisition does not require Board approval because the transaction documents have been adjusted to comport with the requirements of State of Maine.

Exercising our discretionary authority under 49 U.S.C. § 721 and 5 U.S.C. § 554(e), we will issue a declaratory order to remove uncertainty in this matter. As discussed below, we will grant Santa Cruz's request for a Board declaration that the transaction, as proposed, would not cause Santa Cruz to become a common carrier by rail and would not require our authorization under 49 U.S.C. § 10901. Based on our interpretation of the transaction documents, we find that this transaction would not be subject to the Board's authority and would come within the purview of our State of Maine line of precedent.

¹ The digest constitutes no part of the decision of the Board but has been prepared for the convenience of the reader. It may not be cited to or relied upon as precedent. Policy Statement on Plain Language Digests in Decisions, EP 696 (STB served Sept. 2, 2010).

BACKGROUND

Santa Cruz, a public agency created under the laws of the State of California, is not and does not wish to become a rail carrier. Nevertheless, Santa Cruz proposes to acquire the physical assets of the Line, which is owned by Union Pacific Railroad (UP). The Line is approximately 30.957 miles long and runs between milepost 0.433, near the east boundary of Salinas Road, and milepost 31.39, near the Highway 1 crossing at Davenport, Cal., in Santa Cruz County, Cal. Santa Cruz wants to preserve freight rail service on the Line and to allow the operation of tourist excursions and the development of other public uses. To that end, Santa Cruz claims that under the proposed two-part transaction: (1) it would acquire only the physical assets of the Line, while UP would retain the common carrier obligation, and (2) UP would then simultaneously transfer its retained easement for the purpose of conducting freight rail operations (Freight Easement)² to Sierra Northern Railway (Sierra),³ which currently leases the line from UP. Sierra N. Ry.—Lease & Operation Exemption—Union Pac. R.R., FD 35331 (STB served Dec. 17, 2009). A condition of closing under the proposed Purchase and Sale Agreement is a Board finding that the transaction does not conflict with State of Maine, and that Santa Cruz will not become a carrier as a consequence of the transaction.⁴

In its initial petition for declaratory order, Santa Cruz submitted copies of the transaction documents to the Board as an attachment to the petition.⁵ Santa Cruz would acquire the physical assets of the Line pursuant to a Purchase and Sale Agreement and Quitclaim Deed with UP. The Quitclaim Deed reserves for UP what Santa Cruz described in the initial petition as a “perpetual, exclusive freight easement” for the purpose of conducting freight rail operations on the Line.⁶ The Purchase and Sale Agreement provides that UP would transfer its Freight Easement to Sierra through an Assignment of Freight Easement. Santa Cruz and Sierra would enter into an Administration, Coordination, and License Agreement (ACL Agreement) that would govern their relationship.

On August 22, 2011, the Board issued an order identifying two areas of concern in the transaction documents that could potentially run afoul of the State of Maine precedent and thus could prevent Santa Cruz from invoking it. First, language describing the Freight Easement suggested that the property interest created would be neither permanent nor exclusive. Second,

² The parties describe the property reserved by UP more fully in the proposed Quitclaim Deed, and refer to it as “the Freight Easement.” Santa Cruz Supp. Pet., Attach. 1, Ex. D, pp.1-2.

³ Sierra filed a verified notice of exemption, which is now effective, to acquire the Freight Easement. Sierra N. Ry. —Acquis. & Operation Exemption—Union Pac. R.R., FD 35490 (STB served Apr. 21, 2011).

⁴ Santa Cruz Pet. at 3; Santa Cruz Pet., Attach. 2, § 6.8.2.

⁵ On April 8, 2011, UP submitted a statement indicating its support for Santa Cruz’s petition for declaratory order. On July 22, 2011, Congressman Sam Farr submitted a letter urging the Board to expeditiously review Santa Cruz’s petition.

⁶ Santa Cruz Pet. at 2.

language in the ACL Agreement indicated that Santa Cruz could have the ability to interfere unduly with Sierra's common carrier operations. Because these two aspects of the transaction appeared to be inconsistent with State of Maine, the Board gave Santa Cruz the opportunity to adjust its proposed transaction and submit modified transaction documents that would remove, revise, or clarify the language that called into question the permanence and exclusivity of the Freight Easement, and that appeared to give Santa Cruz the ability to interfere unduly with operation of the Line.

Subsequently, on September 7, 2011, Santa Cruz filed a supplemental petition for declaratory order with proposed revisions to the transaction documents. Santa Cruz represents that both UP and Sierra support the proposed revisions.⁷ Santa Cruz now asks the Board to declare that the proposed transaction, if consummated pursuant to the revised transaction documents, would not be subject to the Board's regulatory authority under the Board's State of Maine precedent.

DISCUSSION AND CONCLUSIONS

The acquisition of an active rail line and the common carrier obligation that goes with it ordinarily require Board approval. Where the acquiring entity is a noncarrier, the standard for approval is set out in 49 U.S.C. § 10901. State of Maine and its progeny, however, hold that the sale of the physical assets of a rail line by a carrier to a state or other public agency does not constitute the sale of a railroad line within the meaning of § 10901 when the selling carrier: (1) retains a permanent, exclusive freight rail operating easement giving it the right and common carrier obligation to provide freight rail service on the line, and (2) retains sufficient control over the line to carry out its common carrier operations. When the seller retains the common carrier obligation and control over freight rail service, our precedent holds that ownership of the railroad line remains with the selling carrier for purposes of § 10901(a)(4), even when the physical assets of the line have changed hands.

For a transaction to fall within that precedent, however, the terms of the sale must protect the seller from undue interference by the purchaser in the provision of common carrier freight rail service. Mass. Dept. of Transp.—Acquis. Exemption—Certain Assets of CSX Transp., Inc., FD 35312, slip op. at 5 (STB served May 3, 2010), aff'd sub nom. Bhd. of R.R. Signalmen v. STB, 638 F.3d 807 (D.C. Cir. 2011). The seller may transfer its freight rail operating easement and the related common carrier obligation to a third-party easement owner/operator, as long as the transaction transfers sufficient contractual rights to the new owner/operator to carry out the common carrier obligation it has acquired. Mass. Coastal R.R.—Acquis. —CSX Tansp., Inc., FD 35314, slip op. at 3-5 (STB served Mar. 29, 2010). Therefore, in determining whether Santa Cruz would become a rail carrier if the transaction were completed, the Board will look to whether, as part of the transaction, Sierra, as the third-party easement owner/operator, would obtain a permanent, exclusive freight rail operating easement and would have sufficient interest in and control over the Line to permit it to carry out its common carrier obligation.

⁷ Santa Cruz Supp. Pet. at 1.

As indicated above, the Board expressed concerns in its prior order that the transaction documents were inconsistent with State of Maine in two respects: (1) the language describing the Freight Easement suggested that the property interest created would be neither permanent nor exclusive, and (2) several sections of the ACL Agreement appeared to give Santa Cruz the ability to interfere unduly with freight rail operations.

The revised transaction documents address the Board's concerns. First, the parties' agreements now provide that the seller (i.e., UP) will retain a permanent, exclusive freight rail operating easement over the Line in order to carry out its common carrier obligation, which, in turn, will be transferred to Sierra in full. In response to the Board's concern that the Quitclaim Deed did not contain any language indicating that the Freight Easement was exclusive, the parties have now specified that the seller "reserves unto itself, its successors and assigns, forever, an exclusive easement."⁸ Additionally, the parties have removed language in various parts of the Quitclaim Deed stating or otherwise suggesting that the Freight Easement was made subject to the ACL Agreement.⁹ In response to the Board's concern that the transaction be set up so that the Freight Easement cannot be abandoned or freight rail service permanently discontinued without Board approval, the parties have also modified section 8.2 of the ACL Agreement to state that "[u]pon expiration or termination of this agreement by either party, Sierra shall proceed to abandon Freight Service in accordance with section 8.3; provided that no expiration or termination of this agreement shall be effective unless and until the STB has approved such abandonment."¹⁰ Similarly, in section 8.3 of the ACL Agreement, the parties have added language stating that no abandonment, transfer, or rail banking will be effective until the Board has issued its approval, and that the "agreement shall not terminate with respect to all or any portion of the Property unless and until the STB has issued such approval."¹¹

Second, the agreements, as revised, would not give Santa Cruz the ability to interfere unduly with Sierra's ability to carry out its common carrier obligation. To address the Board's concern that certain provisions of the ACL Agreement could be read to permit Santa Cruz to exercise undue control over Sierra's freight operations, the parties have added a new section 2.3 to the ACL Agreement. Section 2.3 states that "[n]otwithstanding the rights retained by [Santa Cruz] under this agreement, the exercise of such rights by [Santa Cruz] may not materially interfere with Sierra's Freight Service rights and obligations under federal law, unless first approved by the STB."¹²

⁸ Santa Cruz Supp. Pet., Attach. 1, Ex. D, p.1.

⁹ Santa Cruz Supp. Pet., Attach. 1, Ex. D, pp. 2-3

¹⁰ Santa Cruz Supp. Pet., Attach. 2, § 8.2.

¹¹ Santa Cruz Supp. Pet., Attach. 2, § 8.3.

¹² Santa Cruz Supp. Pet., Attach. 2, § 2.3. The parties have also modified several provisions of the ACL Agreement to clarify that Santa Cruz's consent to an act may not be granted or withheld in its sole and absolute discretion, but rather is subject to section 2.3. Section 16.3, however, still provides that Santa Cruz's consent to certain acts may be granted or withheld in its sole and absolute discretion. Although section 16.3 does not explicitly reference section 2.3, the latter section is nonetheless applicable, as the withholding of consent might

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In response to our concerns about specific sections of the ACL Agreement, the parties have modified sections 4.2 and 4.3, which address any future agreements by Sierra. These provisions previously appeared to vest significant control in Santa Cruz by, for example, providing that any agreement by Sierra “is subject to [Santa Cruz’s] prior written consent and is to be documented by Sierra using forms approved by [Santa Cruz].”¹³ Sections 4.2 and 4.3 now expressly recognize that Santa Cruz’s consent is subject to the provisions of section 2.3, which prohibits material interference with Sierra’s freight operations unless first approved by the Board.¹⁴

The parties have also revised section 6.2, which pertains to modifications and improvements necessary for freight service.¹⁵ Whereas section 6.2 previously stated that Santa Cruz’s written approval of such modifications or improvements could be granted or withheld in Santa Cruz’s sole and absolute discretion, it now provides that Santa Cruz’s consent is subject to the provisions of section 2.3. In addition, section 6.2 now states that Sierra’s modifications or improvements will be coordinated with other uses of the property authorized by Santa Cruz, as opposed to stating that modifications or improvements may not interfere with or impede any other uses.

The parties have included similar revisions in section 6.3, which addresses locations for storage and maintenance of equipment necessary for Sierra’s freight operations.¹⁶ Section 6.3 previously stated that Santa Cruz’s written consent to construction of additional maintenance and storage locations could be granted or withheld in Santa Cruz’s sole and absolute discretion. That section now provides that Santa Cruz’s consent is subject to the provisions of section 2.3.

Finally, the parties have modified section 7.1.2, which concerns laydown space.¹⁷ Previously, that section provided that, if Santa Cruz objected to a specific use of laydown space, then Sierra would have to discontinue such use. Section 7.1.2 now provides that, if Santa Cruz objects to a specific use of laydown space, Santa Cruz will make available an alternative laydown location reasonably acceptable to Sierra.

Collectively, these modifications to the proposed Quitclaim Deed and ACL Agreement comport with the State of Maine requirements, in that the seller would retain a permanent,

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materially interfere with Sierra’s rights and obligations under federal law and section 2.3 is applicable to the entire agreement. That the parties may have failed to explicitly incorporate section 2.3 in a particular provision does not diminish its applicability.

¹³ Santa Cruz Supp. Pet., Attach. 2, § 4.2.

¹⁴ Santa Cruz Supp. Pet., Attach. 2, §§ 2.3, 4.2, 4.3.

¹⁵ Santa Cruz Supp. Pet., Attach. 2, § 6.2.

¹⁶ Santa Cruz Supp. Pet., Attach. 2, § 6.3.

¹⁷ Santa Cruz Supp. Pet., Attach. 2, § 7.1.2.

exclusive freight rail operating easement and the subsequent third-party easement owner/operator would maintain sufficient control over the line to carry out its common carrier operations. Although the ACL Agreement contains provisions regarding the term of that agreement, as well as its termination and expiration,¹⁸ these provisions cannot be interpreted or enforced in a way that would affect Sierra's common carrier service. Moreover, as several of the parties' revisions suggest, the Freight Easement preserves Sierra's common carrier rights and obligations as to the Line unless and until the Board approves a transfer of the Freight Easement to another carrier or approves discontinuance of Sierra's service.

Based on this record, we find that nothing in the proposed transaction would affect the continuing validity of Sierra's permanent, exclusive Freight Easement, or would otherwise unduly interfere with Sierra's ability to fulfill its common carrier obligation. Therefore, the proposed transaction is consistent with State of Maine, and the proposed acquisition of the assets of the Line by Santa Cruz would not constitute the acquisition of a railroad line under 49 U.S.C. § 10901(a)(4) or cause Santa Cruz to become a rail carrier. Under these circumstances, we declare that the transaction, as proposed, does not require Board authorization under 49 U.S.C. § 10901.

This action will not significantly affect either the quality of the human environment or the conservation of energy resources.

It is ordered:

1. Santa Cruz's petition for declaratory order is granted as discussed above.
2. This decision is effective on its service date.

By the Board, Chairman Elliott, Vice Chairman Begeman, and Commissioner Mulvey.

¹⁸ Santa Cruz Supp. Pet., Attach. 2, § 8.