

SURFACE TRANSPORTATION BOARD

DECISION

Docket No. FD 35225

SAN BENITO RAILROAD LLC—ACQUISITION EXEMPTION—
CERTAIN ASSETS OF UNION PACIFIC RAILROAD COMPANY

Digest:¹ San Benito Railroad LLC (San Benito) seeks Board approval of an agreement to purchase a rail line in San Benito County, Cal., from Union Pacific Railroad Company. San Benito also filed a request that the Board determine that this notice was unnecessary because the terms of the transaction are structured in such a way that San Benito will not become a rail carrier. San Benito argues that, if it does not become a rail carrier, then the Board's approval is not needed to complete the sale. In this decision, the Board is denying San Benito's request, finding that San Benito would need Board authorization if it purchases the physical assets of the line.

Decided: June 20, 2011

In this decision, the Board is denying the motion to dismiss the notice of exemption filed by San Benito Railroad LLC (San Benito). The Board finds that San Benito has not met the requirements for the State of Maine exception to 49 U.S.C. § 10901(a)(4) because it has not offered a legitimate business justification for the proposed transaction that advances either the preservation of freight rail lines or the promotion of passenger rail operations.

BACKGROUND

San Benito, a noncarrier, filed a verified notice of exemption under 49 C.F.R. § 1150.31 to acquire from Union Pacific Railroad Company (UP) its right, title, and interest in the physical assets of approximately 12.43 miles of rail line in San Benito County, California, known as the Hollister Branch,² subject to UP's retention of a permanent freight rail operating easement. San Benito simultaneously filed a motion to dismiss the notice of exemption, asserting that the transaction does not require Board authority, because San Benito will not become a common

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).

² The Hollister Branch is located between approximately milepost 0.07 (near Hollister, Cal.) and approximately milepost 12.50 (near Carnadero, Cal.) in San Benito County, Cal.

carrier as a result of the acquisition. E.g., Me., Dep't of Transp.–Acquis. & Operation Exemption—Me. Cent. R.R., 8 I.C.C.2d 835, 836-37 (1991) (State of Maine). The Brotherhood of Maintenance of Way Employees Division/IBT and the Brotherhood of Railroad Signalmen (BRS) (collectively “Unions”) filed a joint response in opposition to San Benito’s motion to dismiss.³ The Board subsequently heard oral argument in this proceeding.

The Transaction. San Benito states that it has entered into an agreement with UP giving it the option to purchase UP’s current ownership interest in the physical assets of the Hollister Branch, subject to UP’s retention of a perpetual, exclusive easement and the obligation to provide common carrier freight rail service on the line.⁴ UP also would retain the right to expand or extend the Hollister Branch in order to provide freight rail service. Pursuant to the parties’ agreement, San Benito would have the right at its discretion to assume the management, operation, dispatching, and maintenance of the Hollister Branch. In the event that San Benito fails to maintain the Hollister Branch, UP could perform the required maintenance.

San Benito represents that it would use the Hollister Branch to provide intrastate passenger rail service, through a designated third-party operator, to a planned community, El Rancho San Benito, which would be developed by an affiliate. San Benito also states that it would obtain passenger rail operating rights on UP’s Coast Line from Carnadero north to Gilroy, Cal., where passengers would be able to connect with the Caltrain regional commuter rail line to San Jose and points north into San Francisco.

El Rancho San Benito. El Rancho San Benito was a planned community designed to include 6,800 homes for up to 20,000 residents, schools, a fire station, and shops on a 5,792-acre site in San Benito County. The developer was El Rancho San Benito LLC (ERSB), which was owned by Longwood San Benito LLC (Longwood) and by DMB ESRB LLC (DMB), an entity controlled by a large Arizona development company. In early May 2009, DMB, acting as the managing partner of ERSB, withdrew the application for approval of El Rancho San Benito from San Benito County and announced that it was suspending the project.⁵ At approximately the same time, DMB filed suit in the U.S. District Court for the Northern District of California

³ The Unions’ interest in this case arises from the possibility that work on the Hollister Branch now performed by UP maintenance of way employees, signalmen, and dispatchers, represented by the Unions, would be lost if San Benito acquires the right to operate and maintain the line.

⁴ San Benito submitted *pro forma* versions of a quitclaim deed, reflecting UP’s retention of a freight rail operating easement, and of a usage agreement, but it did not submit the executed options agreement.

⁵ San Benito County had not yet approved the application, and no physical development activities had occurred on the property.

against Longwood, seeking to dissolve ERSB. DMB alleged that it had reached its contractual funding limit for the project and was unwilling to provide additional capital. It claimed that it had lawfully adopted a business plan to dissolve the partnership, but that Longwood wrongfully insisted that DMB must make additional contributions.⁶

Longwood filed an amended answer and counterclaim, on July 8, 2009, for breach of contract and breach of fiduciary duty, in which it claimed that DMB wrongfully stopped funding the project in order to obtain control of Longwood's interest in the project fraudulently. Of particular relevance to San Benito's motion to dismiss the notice of exemption at the Board, Longwood's counterclaim recited that, without funding from DMB, San Benito was unable to make the closing payment for the Hollister Branch by June 27, 2009. UP, therefore, became entitled to cancel San Benito's right to purchase the line. Longwood stated later in the counterclaim that it had procured an extension from UP to October 1, 2009.⁷

A status report filed with the court by both litigants on August 13, 2010, stated that the parties had negotiated a complex agreement to transfer DMB's membership interest in the El Rancho San Benito venture to Longwood. On August 27, 2010, the parties filed a stipulation dismissing all claims with prejudice. The court accepted the stipulation and entered an order of dismissal on September 2, 2010. The terms of the settlement were not disclosed.

DISCUSSION AND CONCLUSIONS

In State of Maine, we held that that a state's acquisition of an ownership interest in track, right-of-way, and related physical assets would not constitute the acquisition of a railroad line under 49 U.S.C. § 10901(a)(4),⁸ and would not result in the state agency becoming a rail carrier

⁶ DMB ERSB, LLC v. Longwood San Benito LLC, No. C 09 02003 JW (N.D. Cal., San Jose Div.) (filed May 6, 2009). The facts concerning the status of the El Rancho San Benito project are drawn from the complaint and answer in the lawsuit and other publicly available information. San Benito did not inform the Board of the lawsuit, which was filed approximately 6 weeks after it filed its motion to dismiss here, or of the other relevant events that resulted in the cancellation of the planned community.

⁷ Neither the record before us nor other publicly available information discloses whether UP has granted an additional extension beyond October 1, 2009.

⁸ Section 10901(a)(4) provides: "A person may—in the case of a person other than a rail carrier, acquire a railroad line or acquire or operate an extended or additional railroad line, only if the Board issues a certificate authorizing such activity under [49 U.S.C. § 10901(c)]." See Common Carrier Status of States, State Agencies & Instrumentalities, & Political Subdivisions, 363 I.C.C. 132, 135 (1980), aff'd sub nom. Simmons v. ICC, 697 F.2d 326 (D.C. Cir. 1982).

under 49 U.S.C. § 10102(5),⁹ provided that the arrangement guaranteed that: (i) the selling freight rail carrier would retain a permanent, exclusive freight rail operating easement, together with the common carrier obligation on the line; and (ii) the terms of the sale would protect the carrier from undue interference with the provision of common carrier freight rail service. See, e.g., Mass. Dep’t of Transp.—Acquis. Exemption—Certain Assets of CSX Transp., Inc., FD 35312, slip op. at 5 (STB served May 3, 2010) (Mass DOT), aff’d sub nom. Bhd. of R.R. Signalmen v. STB, No. 10-1138, slip op. at 5-6 (D.C. Cir. Mar. 29, 2011) (“Signalmen”).¹⁰ This doctrine has been applied in over 60 subsequent decisions.

Our State of Maine doctrine serves 2 important public purposes. It helps states and local communities preserve freight rail service on lines where profitability is marginal. The doctrine also promotes the efficient use of existing freight rail corridors for rail mass transportation without harming common carrier freight rail operations. Mass DOT, slip op. at 7; Signalman, slip op. at 6. Yet we have recognized that the doctrine potentially could be misused. When the transaction entails the transfer of maintenance and dispatching responsibilities to the non-carrier, we have further observed that “we do not intend for the State of Maine transaction structure to be used for the primary purpose of circumventing the railway labor laws.” Fla. Dep’t of Transp.—Acquis. Exemption—Certain Assets of CSX Transp., Inc., FD 35110, slip op. at 10 (STB served Dec. 15, 2010) (Fla DOT). To address that concern in Fla DOT, the Board considered whether there was a legitimate business justification for the use of State of Maine and the impact of the transaction on railway labor.

We will apply the same criteria here. To prevent abuse of the State of Maine transaction structure, where a party seeks a Board determination under State of Maine that its acquisition of an ownership interest in railroad property will not be the acquisition of a railroad line under 49 U.S.C. § 10901(a)(4), and where, as here, the proposal entails shifting the maintenance or dispatching (or both) to the non-carrier purchaser, the moving party must demonstrate a legitimate business justification for the proposed transaction that advances 1 of the twin purposes underlying our State of Maine doctrine. See Fla DOT, slip op. at 10.

First, we note that the transaction proposed here could shift the maintenance and dispatching of the line from UP to San Benito, even if San Benito were never to provide any

⁹ A “rail carrier” is defined in 49 U.S.C. § 10102(5) as “a person providing common carrier railroad transportation for compensation.” See also Am. Orient Express Ry. v. STB, 484 F.3d 554, 556 (D.C. Cir. 2007).

¹⁰ The Unions argue that State of Maine was wrongly decided and must be overturned because it is contrary to the statute. Subsequently, however, the United States Court of Appeals for the District of Columbia rejected the same arguments in Signalman, finding the agency’s reading of the statute sensible and reasonable. Consequently, we will not address those aspects of the Unions’ arguments further.

passenger rail service. In contrast to the Mass DOT and the Fla DOT CSXT transactions where the transfer of maintenance and dispatching from the rail carrier to the public agency acquiring ownership of the rail line assets was tied to the commencement of commuter rail service,¹¹ the San Benito-UP usage agreement, submitted as an exhibit to the motion to dismiss, gives San Benito the option at its discretion to take over such operations at any time after giving notice, and to receive payment based on UP's movement of loaded freight cars over the line. This provision could be used to transfer work from UP's unionized labor force covered by the Railway Labor Act to a different workforce that would not necessarily be covered by the railway labor laws even though San Benito would not be providing passenger rail service itself or through a third-party operator.

Consequently, as stated in Fla DOT, there must be a legitimate business justification for placing the maintenance and dispatching of the line in the hands of the acquiring noncarrier.¹² In addition, we place a heightened burden on a private party like San Benito to demonstrate that its proposal is likely to satisfy the purposes of State of Maine. Unlike a public body, which acts on behalf of its citizens to preserve and promote services that benefit the public, a private entity has more parochial interests that are not necessarily aimed at protecting new or improved freight, commuter, or other passenger rail service. Indeed, while the Board has not categorically precluded private entities from using State of Maine, the doctrine is intended to assist states and other public entities in carrying out governmental functions that provide public benefits.¹³

We find that San Benito has not offered a legitimate business justification for the proposed transaction that advances at least 1 of the dual purposes behind our State of Maine doctrine. The stated purpose for the acquisition of the assets of the Hollister Branch – the development of an intrastate passenger rail service to serve a new planned community – is unlikely to occur because El Rancho San Benito is defunct. The development permits for the El Rancho San Benito planned community have been withdrawn. The website for El Rancho San Benito consisted solely of an open letter to the public letter dated May 7, 2009, which states that, due to the protracted economic downturn and an anticipated significant reduction in state and county funds available for transportation improvements due to California's budget woes, the project managers have decided to withdraw the existing project application from San Benito County.¹⁴ The domain name is now unregistered. The partners were in litigation for 17 months and reached a settlement that apparently places ERSB, the putative developer, in the hands of

¹¹ See Mass DOT, slip op. at 13-14; Fla DOT, slip op. at 11-12.

¹² See Fla DOT, slip op. at 10.

¹³ See Fla DOT, slip op. at 5 n.8 (characterizing as “unique” the circumstances in which the Board has found the State of Maine doctrine applicable to the sale of physical assets in a railroad line to a private party).

¹⁴ Available at: “<http://www.elranchosanbenito.com/>”.

Longwood, which, without DMB, could not fund the purchase of the Hollister Line assets. Thus, there is no indication that the planned community will be developed in the foreseeable future. Without the planned community, there could be no call for passenger rail service along this line.

Under these circumstances, we cannot find that this transaction meets the requirements of the State of Maine doctrine. Therefore, we will deny the motion to dismiss the notice of exemption without prejudice to San Benito. Because we are basing our denial in part on public material about the planned community (of which we take official notice), San Benito may renew its motion to dismiss if circumstances have changed materially, or if it can otherwise demonstrate a legitimate business justification for placing the maintenance and dispatching of the line in the hands of the acquiring noncarrier. Otherwise, if these parties wish to consummate this transaction as currently structured, they must first obtain our regulatory approval.

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

It is ordered:

1. San Benito's motion to dismiss the verified notice of exemption in this proceeding is denied.
2. This decision will be effective on the date of service.

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