37238 SERVICE DATE – LATE RELEASE AUGUST 25, 2006
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SURFACE TRANSPORTATION BOARD

DECISION

STB Docket No. AB-914X

McCLOUD RAILWAY COMPANY—ABANDONMENT AND DISCONTINUANCE OF SERVICE EXEMPTION—IN SISKIYOU, SHASTA, AND MODOC COUNTIES, CA

IN THE MATTER OF A REQUEST TO SET TERMS AND CONDITIONS

Decided: August 25, 2006

By decision served on October 14, 2005, the Board, under 49 U.S.C. 10502, exempted from the prior approval requirements of 49 U.S.C. 10903 the abandonment by McCloud Railway Company (MCR) of approximately 80 miles of rail line in Siskiyou and Shasta Counties, CA, and the discontinuance of service provided under a grant of trackage rights over a 31.4-mile line owned by BNSF Railway Company in Siskiyou and Modoc Counties, CA.[1] The Board granted the exemption subject to standard employee protective conditions and environmental conditions. The exemption was scheduled to become effective on November 13, 2005, unless stayed by the Board or unless a formal offer of financial assistance (OFA) under 49 U.S.C. 10904 and 49 CFR 1152.27(c)(1) was filed by October 24, 2005.

On October 6, 2005, Seaside Holdings, Inc. (Seaside) filed a pleading styled a "Notice of Intent to File an Offer of Financial Assistance" to purchase the 80 miles of rail line proposed for abandonment. In the filing, Seaside also requested that MCR provide it with information necessary to formulate its OFA.

On October 17, 2005, MCR filed a petition to toll the 10-day period for submitting an OFA. MCR explained that it could not promptly furnish certain data sought by Seaside, and requested that an OFA be made due 10 days after the carrier provided the data to Seaside. In a decision served on October 19, 2005, the Board granted the request and directed MCR to notify the agency when it had furnished the information so that the due date for filing OFAs could be determined. On June 15, 2006, MCR notified the Board that it would be providing the information concerning the estimated Net Liquidation Value (NLV) of the rail line to Seaside and others on June 16, 2006.

[1] The 80 miles of rail line include: (1) a rail line between milepost 3.3 east of McCloud and the end of the track at milepost B-61 at or near Burney; (2) a rail line between milepost B-19 at or near Bartle and milepost B-31.4 at or near Hambone; (3) a rail line between milepost B-58 at or near Berry and milepost S-7 at or near Sierra; and (4) a rail line between milepost B-31.6 at or near Bear Flat and milepost P-3.93 at or near Pondosa.

On June 26, 2006, Seaside timely filed an OFA under 49 U.S.C. 10904 and 49 CFR 1152.27(c) to purchase the 80 miles of line. In a decision served on June 28, 2006, the Board, by the Director of the Office of Proceedings, (1) found Seaside to be financially responsible, (2) postponed the effective date of the exemption to permit the OFA process to proceed, and (3) set July 26, 2006, as the due date for any request to establish the terms and conditions for the purchase of the line.

On July 26, 2006, Seaside requested that we set terms and conditions for the sale because the parties were unable to agree on the sale price. In its request, Seaside contends that the purchase price for the line should be set at $1,288,955. To derive this price, it started with a total track asset value of $3,339,836, a figure based on an appraisal conducted by Mr. Jim Okroy of A&K Railroad Materials, Inc. (A&K). From this total value, Seaside subtracted $1,143,068 for removal costs, $544,688 for the salvager's overhead, and $363,125 for the salvager's profit. Seaside asserts that MCR's evidence fails to demonstrate that the real estate has any value whatsoever, and Seaside therefore proposes to pay nothing for the underlying real estate.

In a reply filed on July 31, 2006, MCR asks that the Board reject Seaside's OFA. It claims that Seaside has not made a bona fide OFA because it does not have an interest in providing continued rail service on the line. As evidence, MCR points to the fact that Seaside has not contacted the major shipper on the line, Sierra Pacific Industries (SPI), regarding continuation of service, and that Seaside's principals have no experience in operating a rail line. MCR claims that Seaside is actually a "straw man" for A&K, a salvager, and that A&K is attempting to purchase the line via the OFA process rather than through private-sector negotiations to reap a greater profit when A&K sells the line for scrap at a later date. MCR points to what it claims is A&K's unreasonably low NLV as evidence of this scheme.

MCR asks that, if the Board does not dismiss the OFA, it set the line's value at $3,514,883, consisting of $291,419 for land and $3,223,464 for track materials. To support its land valuation, MCR has submitted a land appraisal, a title report prepared by Siskiyou County Title Co., and a verified statement from Mr. Jeff Forbis, President and sole owner of MCR and its parent company, 4 Rails Inc. The railroad supports its valuation of the track materials through an appraisal and verified statement from Mr. Mike Williams of Railroad Materials Salvage, Inc.

On August 4, 2006, Seaside filed a reply to MCR's request that we dismiss the OFA and a petition asking that the reply be accepted into the record. In its reply, Seaside states that it has no business affiliation with A&K, and that it has merely engaged the services of a well known appraiser. Seaside further states that it has every intention to continue rail operations on the line for at least 2 years, and longer if it is commercially reasonable, and specifically commits to serving SPI in accordance with the common carrier obligation. Seaside explains that it did not need to contact SPI regarding continuation of service because the shipper's traffic is described in MCR's petition for exemption.

PRELIMINARY MATTERS

Seaside's August 4, 2006 reply will be accepted into the record. Although a "reply to a reply" is ordinarily prohibited under our regulations, the instant submission will be allowed because it provides a more complete record, does not delay the proceeding, and does not prejudice MCR.

We will deny MCR's request that we dismiss Seaside's OFA. The railroad has failed to demonstrate that Seaside does not intend to provide continued rail service.

TERMS AND CONDITIONS

Valuation and Evidentiary Standards. Proceedings to set conditions and compensation are governed by the provisions of 49 U.S.C. 10904(d)-(f). Under section 10904(f)(1)(B), the Board may not set a price that is below the fair market value of the line. In the absence of a higher going-concern value for continued rail use, the proper valuation standard in proceedings for offers to purchase under section 10904 is the NLV of the rail properties for their highest and best nonrail use.[2] Chicago and North Western Transp. Co.—Abandonment, 363 I.C.C. 956, 958 (1981) (Lake Geneva Line), aff'd sub nom. Chicago and North Western Transp. Co. v. United States, 678 F.2d 665 (7th Cir. 1982). NLV includes the value of the underlying real estate plus the net salvage value of track and track materials.

The burden of proof is on the offeror, as the proponent of the requested relief. See Lake Geneva Line, 363 I.C.C. at 961. Placing the burden of proof on the offeror is particularly appropriate in forced sale proceedings under 49 U.S.C. 10904, because the offeror may withdraw its offer at any time prior to its acceptance of the terms and conditions that the Board establishes pursuant to a party's request. The rail carrier, on the other hand, is required to sell its line to the offeror at the price the Board sets, even if the railroad views the price as too low.

Because the burden of proof is on the offeror, absent probative evidence supporting the offeror's estimates, the rail carrier's evidence is accepted. In areas of disagreement, the offeror must present more specific evidence or analysis or provide more reliable and verifiable documentation than that which is submitted by the carrier. If the offeror does not present such evidence and/or documentation, then the Board accepts the carrier's estimates in these forced sale proceedings. See Burlington Northern Railroad Company — Abandonment Exemption — In Sedgwick, Harvey and Reno Counties, KS, Docket No. AB-6 (Sub-No. 358X) (ICC served June 30, 1994), and cases cited therein. To determine the NLV, we will address below the parties' evidence on the value of the land and the track and track materials.

[2] The parties do not argue that the line has a going-concern value. Although an OFA contemplates future rail service, in the absence of a higher going-concern value, we value the line as if it were to be dismantled and taken out of service.

Land.

MCR states that it owns eight parcels along the right-of-way in fee. In support of this assertion, the railroad submits a Preliminary Report from the Siskiyou County Title Co. that lists the parcels as owned in fee by 4 Rails Inc. MCR estimates that the real estate is currently worth $291,419. It derives this figure by taking a 2001 assessed value of the land and increasing it by 20% to account for appreciation.

In its request to set terms and conditions, Seaside takes issue with MCR's ownership. Seaside notes that the parcels are not held in the name of MCR, but by 4 Rails Inc. instead. The offeror also claims that the land is not owned in fee because the grantor retained ownership of the timber, minerals, and rights to enter and extract these materials.

Seaside has not provided its own real estate appraisal, but only criticizes the valuation presented by MCR. The offeror attacks MCR's valuation for failing to include any comparable sales for across-the-fence valuation, and points out that the 20% increase in the 2001 assessed value is arbitrary. Seaside also notes that MCR failed to account for the cost of selling the real estate. It claims that, based on these deficiencies, MCR has failed to substantiate that the realty has any value whatsoever. Accordingly, Seaside includes no value for the real estate in its NLV estimate.

We find that Seaside has failed to show that the real estate should be accorded no value in a forced sale. Although the land technically is not held in MCR's name, Mr. Forbis, president and sole owner of both 4 Rails Inc. and MCR, explains in his verified statement that he can, and would, transfer title to MCR should the line be ordered to be sold. Additionally, MCR's title report indicates that 4 Rails Inc. holds a fee interest in the subject real estate, notwithstanding the grantors' retention of mineral and/or timber rights. See Nevada Irrigation Dist. v. Keystone Copper Corp., 36 Cal. Rptr. 775, 778 (Cal. Ct. App. 1964) (separate conveyance of surface title and subsurface mineral rights "creates two separate fee simple estates in the land, each of which has the same status and rank"); Peterson v. Gibbs, 81 P. 121, 122 (Cal. 1905) (plaintiff was "owner in fee" of the land, subject only to defendants' interest in timber); see also Grand Trunk Western Ry.—Abandonment—In Montcalm and Gratiot Counties, MI, Docket No. AB-31 (Sub-No. 8) (ICC served May 16, 1984) (grantor's retention of mineral rights did not render parcel unmarketable). Thus, the circumstance of separating ownership of timber and mineral rights from the land does not destroy Mr. Forbis' fee interest in the land or render his title to it unmarketable. Moreover, Seaside, the party with the burden of proof here, has provided no evidence indicating that the 2001 assessed values put forth by MCR encompass property interests broader than those held by MCR or are otherwise incorrect.

Because Seaside has not submitted an appraisal of the real estate in its evidence and has not shown that MCR's valuation should be rejected, we accept MCR's estimate of the 2001 assessed value of the real estate as the best evidence of record. However, as noted by Seaside, MCR does not provide any evidentiary basis for the 20% escalation it applied to that assessed value. Accordingly, we do not include the 20% escalation included by MCR.

The offeror is also correct that MCR's valuation does not reflect any real estate sales cost. However, Seaside provides no evidence regarding the level of sales costs that should be applied. Although such costs are typically accounted for in our valuation cases, the accepted level of such costs is case-specific and can vary widely from case to case. Seaside, as the party bearing the burden of proof, has failed to meet its burden of showing the level of sales costs that should be applied, and without any evidence before us, we cannot arbitrarily quantify such costs.

Based on the best evidence of record, as adjusted, we set the value of the land at $242,849.

Track and Track Materials.

Seaside calculates, based on A&K's appraisal, that the line's net salvage value is $1,288,955. The offeror utilizes a factor of 15% for overhead and 10% for profit in reducing the track value from retail to wholesale value. It includes unit values for the price of relay, reroll, scrap rail, and other track materials (OTM) based on quotes Mr. Okroy obtained from Raw Materials Inc. and the June 2006 figures published in American Metal Market. Lastly, Seaside includes an estimate of $1,143,068 for the removal of the track system from the right-of-way.

MCR calculates a net value for the track materials at $3,223,464. As noted before, MCR supports its valuation through a verified statement from Mr. Mike Williams of Railroad Materials Salvage, Inc. Mr. Williams values the various track materials at higher dollar amounts than Seaside. These higher figures are based on written purchase offers from parties including CMC Rail, Azcon Corporation, United Railroad Materials Company, Inc., and Wheelabrator Shasta Energy Company, Inc. Furthermore, MCR claims that profit and overhead should only equal 5%, and Mr. Williams claims that that is all he will collect for salvaging the line. MCR adopts the costs quoted by A&K for removing the track from the right-of-way.

In his verified statement, Mr. Jeff Forbis of MCR estimates that 5 miles of the 20-mile segment of track the railroad will retain needs to be rehabilitated over the next 10 years. He claims that the railroad had planned to use materials from the abandoned line for this work, but that, if the line is purchased through the OFA process, the railroad will need to purchase $1,121,975 in track and track materials to perform the needed maintenance. However, MCR does not include the asserted $1,121,975 in its estimated net salvage value, so we will not consider it.

Both MCR and Seaside provide current price quotes from third parties for the purchase of the salvaged rail system. Because both parties have provided equally credible evidence and the offeror has the burden of proof, we will use MCR's unit values for relay, reroll, and scrap rail, and OTM and crossties.

Seaside and MCR both provide estimates for what a salvager would receive to cover profit and overhead. We note that Seaside's quote by Mr. Okroy of A&K incorrectly applies his profit and overhead percentages to MCR's real estate value in addition to his estimated track and track material asset value, although Seaside argues elsewhere that the real estate should be given

no value. Because Seaside has not met its burden of proof by providing more reliable evidence, we will use MCR's 5% figure.

Based on the best evidence of record, we set the net salvage value of track and track materials at $3,223,464.

Net Liquidation Value.

Accordingly, relying on MCR's values, as modified, for the land, track, and track materials, we set the purchase price at $3,466,313.

Terms of Sale.

In addition to the compensation for this line specified herein, we will impose our typical OFA terms: (1) payment is to be made by cash or certified check; (2) closing is to occur within 90 days of the service date of this decision; (3) MCR shall convey all property by quitclaim deed; and (4) MCR shall deliver all releases from any mortgage within 90 days of closing. The parties may alter any of these terms by mutual agreement.

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

It is ordered:

1. Seaside's petition for leave to file a reply is granted, and we accept the offeror's August 4, 2006 submission.

2. The purchase price for the line is set at $3,466,313, and the parties must comply with the other terms of sale discussed above.

3. To accept the terms and conditions established here, Seaside must notify the Board and MCR in writing, on or before September 5, 2006.

4. If Seaside accepts the terms and conditions established by this decision, Mr. Jeff Forbis shall promptly, but in any event prior to closing, cause 4 Rails Inc. to convey to MCR all of its title and interest in the subject real estate.

5. If Seaside accepts the terms and conditions established by this decision, Seaside and MCR will be bound by this decision.

6. If Seaside withdraws its offer or does not accept the terms and conditions with a timely written notification, we will serve a decision by September 14, 2006, vacating the prior decision that postponed the effective date of the decision authorizing the abandonment.

7. This decision is effective on its service date.

By the Board, Chairman Nottingham, Vice Chairman Mulvey, and Commissioner Buttrey.

Vernon A. Williams
Secretary