

Court Must Recalculate \$100M Kinder Morgan Rent Award

By **Michael Lipkin**

Law360, San Diego (November 06, 2014, 9:10 PM ET) -- A California appeals court on Wednesday threw out a \$100 million back-rent award to Union Pacific Railroad Co. for 1,850 miles of pipeline easements it gave to a Kinder Morgan Inc. subsidiary, finding a lower court failed to rule on whether the railroad could rent the property.

The appeals panel ruled that the trial court never made a proper factual determination of what property the railroad controlled and didn't consider case law generated by the 19th century federal acts granting the land. There were several opinions casting doubt on whether railroads had rights to subsurface areas under those lands, according to the panel.

"The land provided by Congress was neither purchased by the railroads nor was it given to them with no strings attached. Strings were attached," Los Angeles Superior Court Judge Russell S. Kussman, sitting by designation, wrote in a unanimous opinion.

Retired Judge Eli Chernow, who heard the case, ruled the railroad controlled virtually all the contested property, but based his findings on the fact that no one else had attempted to collect rent for the pipelines or interfered with their use, according to Wednesday's decision. The pipelines are owned by Santa Fe Pacific Pipelines LP, a Kinder Morgan subsidiary.

The appeals court ruled that acts from the 1800s gave railroads interest in surface property and anything below the surface needed to support the railroad itself. Other laws said the land needed to be used for "railroad purposes," which did not include leasing the land to generate revenue. The land grants were passed to encourage construction, not to allow railroads to rent subsurface lands to private third parties, according to the opinion.

"Congress did not include such a provision, and we will not insert, create, recognize or enforce such a provision here," Judge Kussman wrote.

The panel remanded the case back to trial court to recalculate the award based on the railroad's actual property interests, because none of the land received under the federal acts could be used to collect rent for the pipelines. Some of the land may still be rentable because it was received in grants from states and other sources, according to the opinion.

Union Pacific filed suit in September 2004, seeking a declaratory judgment to determine the fair annual rent of the roughly 1,850 miles in easements, located in six western states, through which SFPP runs

more than 3,000 miles of oil pipelines.

The suit was filed under the conditions of a 1994 settlement agreement between the parties, which requires that the fair rental value of the easements be determined at 10-year intervals and provides that if the parties can't agree on the value, they can seek adjudication from the courts.

During the trial, Union Pacific contended that the value of the property was \$20 million for 2004, but SFPP contended it was \$7 million.

In April 2012, Judge Chernow found that the fair rental value of the property as of 2004 was \$14 million a year and ruled that SFPP owed \$81 million in back rent and \$19 million in prejudgment interest.

The appeals panel ruled the rent calculation needed to be revised because it had assumed that all the contested land was properly rented. It also found that the railroad could not collect rent on properties it sold before the 1994 agreement if those lands were obtained from the federal acts.

The court dismissed the pipeline's arguments that Judge Chernow ignored hundreds of comparative sales, essentially excluding the evidence. But the trial court discussed the evidence at length in a 30-page analysis, according to the panel, finding Judge Chernow was allowed to find it unpersuasive.

"The pipeline fails to recognize or accept the fundamental distinction between the admissibility of evidence and its weight," Judge Kussman wrote.

The appeals panel sided with the pipeline, however, in its attack on the prejudgment interest. The interest award meant that the railroad suffered damages by an unlawful act, but the pipeline was merely following the terms of the agreement that allowed it to pay 2003-level rent with inflation adjustments until the case was resolved, according to the opinion.

The railroad may be able to recover prejudgment interest for some of the back rent because the pipeline completely withheld rent for some portions of the easement, claiming it was not liable for that rent. If the lower court decides on remand that the pipeline is liable, it would be considered damages and open up the pipeline to prejudgment interest, according to the opinion.

Attorneys for the parties did not immediately respond Thursday to requests for comment.

Justices Laurence D. Rubin and Madeleine Flier and Los Angeles Superior Court Judge Russell S. Kussman sat on the panel that reached Thursday's decision.

Union Pacific is represented by Michael H. Wallenstein and Thomas F. Winfield III of McKenna Long & Aldridge LLP.

Santa Fe Pacific Pipelines is represented by Steven M. Strauss, M. Ray Hartman and Summer J. Wynn of Cooley LLP.

The case is Union Pacific Railroad Co. v. Santa Fe Pacific Pipelines Inc. et al., case number B242864, in the Court of Appeal of the State of California, Second Appellate District.

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