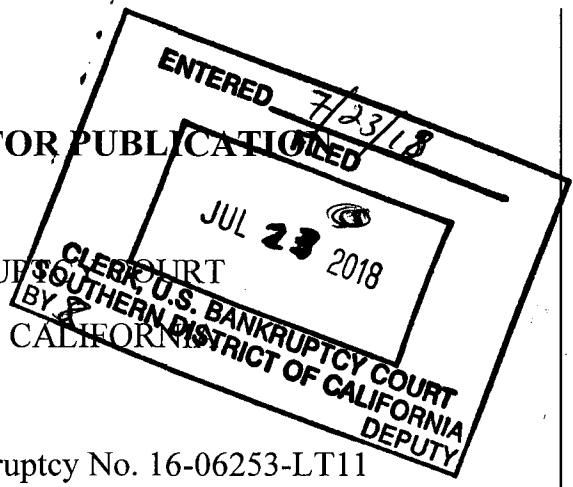


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WRITTEN DECISION - NOT FOR PUBLICATION



UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA

In re:) Bankruptcy No. 16-06253-LT11
PACIFIC IMPERIAL RAILROAD, INC.,) Adversary No. 17-90161-LT
Debtor.)
PACIFIC IMPERIAL RAILROAD, INC.,) MEMORANDUM DECISION¹
Plaintiff,)
v.)
CHARLES E. FLETCHER,)
Defendant.)

On May 16-18, 2018, the Court held an evidentiary hearing in the adversary proceeding filed by Reorganized Debtor Pacific Imperial Railroad, Inc. ("PIR")² seeking to set aside the lien held by Charles Fletcher. PIR asserts that Mr. Fletcher's lien is unperfected and, thus, is subject to avoidance under 11 U.S.C. § 544.³ PIR alleges that, as a result, Mr. Fletcher does not have a lien against the proceeds of the sale of substantially all non-cash assets of the bankruptcy estate.

¹ This opinion is intended only to resolve the dispute between these parties and is not intended for publication. On July 20, 2018, the Court orally announced this decision. To the extent of any discord between the transcript containing the oral ruling and this memorandum decision, the memorandum decision controls. But the oral ruling and this document should be considered together, and to the extent the oral ruling contains additional but not contradictory information, such content should not be disregarded.

² The Court will use PIR to refer to the entity in its pre-petition, debtor in possession, and reorganized debtor forms unless specificity is required or the context is unclear.

³ Unless otherwise indicated, all chapter, section, and rule references are to the Bankruptcy Code, 11 U.S.C. §§101-1532, and to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037. Citations to Bky. Dkt. refer to documents in the bankruptcy case docket. Citations to Dkt. refer to documents in this adversary proceeding docket.

1 After considering all relevant evidence and legal argument, the Court concludes that
2 Mr. Fletcher holds a claim secured by a properly perfected security interest in personal
3 property and that this lien extends to some, but not all, of the proceeds of the sale of assets
4 during the bankruptcy case. The bankruptcy estate sold interests in real property and
5 personal property, the locomotives, where Mr. Fletcher has no claim to proceeds. But the
6 Court concludes that the when the chapter 11 estate sold and assigned its rights and interests
7 under the Lease and Operating Agreement dated December 20, 2012 (the "Agreement") the
8 proceeds were generated in part from the transfer of contract rights that are properly
9 characterized as personal property. As a result, while the Court cannot find that
10 Mr. Fletcher holds a properly perfected lien that encumbers all sale proceeds currently
11 available for distribution, and the Court will take additional evidence on this point if
12 complete precision is required, Mr. Fletcher is not an unsecured creditor as his lien cannot
13 be set aside entirely.⁴

14 **Facts and Procedural Background⁵.**

15 **Early history, challenges, and potential of the Desert Line.** In 1906 John D.
16 Spreckels announced plans to construct the Desert Line Railroad (the "Desert Line");
17 construction was complete in 1919. It stretches over approximately 70 miles from
18 Milepost 59.6 at the U.S./Mexican Border in Division, California, to Milepost 130.0
19 at Plaster City, California.⁶

20 But the Desert Line was never particularly successful. Starting in the 1950s, it
21 was little used. And there are good reasons for its dormancy.

22 A railcar traveling over the Desert Line's 70 miles will traverse 17 tunnels and
23 57 bridges. It will wind its way through the Carrizo Gorge Canyon where a rail car
24

25 ⁴ The Court understands that PIR commenced bankruptcy with cash assets that it did not sell. To
26 the extent some or all of these assets are proceeds of an earlier transfer of rights under the
27 Agreement, the analysis in this memorandum decision is applicable. Any determination of whether
28 Mr. Fletcher is or was fully secured may need to consider these funds as well.

⁵ In addition to the facts specifically discussed here, the Court notes that it also reviewed and relied
on the parties' joint statement of undisputed facts.

⁶ The Court bases its discussion at pages 2 to 4 on numerous filings in the case and its general
knowledge based largely on handling this case. As the facts are not contested, the Court will not

1 passenger will look down a near vertical drop off a rocky precipice. The locomotive
2 will pull the train along a prolonged ruling grade of 1.4% through the Carrizo Gorge,
3 with approaches to the Gorge reaching grades up to 2.2%.

4 Climbing and falling could well describe travel over portions of the Desert
5 Line. And over 60% of its length features curvature – sometimes significant and
6 exceeding 10 degrees; so twisting and turning also factors into any narrative of a
7 Desert Line journey. As the Debtor's Disclosure Statement put it, the rail line is
8 among the most rugged in the country.

9 As the Court learned during course of the case, the Desert Line's challenging
10 topography is coupled with operational difficulties. Bridges, tunnels, and track that
11 climbs and plunges and then sinuously twists and turns are all expensive and difficult
12 to maintain and repair. Further, the railroad traverses areas of San Diego and
13 Imperial County, California, that are, to put it mildly, thinly populated and remote.
14 The railroad has been in operation for almost 100 years. But in recent times it has not
15 been economically viable.

16 Having said all this, one wonders why anybody would be interested in
17 investing in the Desert Line. But the Desert Line is also a railroad of intriguing
18 possibilities.

19 It commences on the border with Mexico and terminates near a major
20 transcontinental highway and rail lines that run throughout the rest of the
21 United States. Its terminus point is well outside the major population centers in
22 Los Angeles, Orange, and San Diego Counties. As a result, if one has the ability to
23 maintain and repair the line, one can take advantage of a business opportunity with
24 enormous potential.

25 Goods manufactured in the 100's of world-class manufacturing centers on the
26 Mexican side of the border can be loaded onto rail cars and transported to the
27 United States. At rail line terminus, there is land available for construction of an

28 _____
provide extensive citation.

1 intermodal facility that would allow prompt and efficient transfer from rail car to
2 tractor trailer and truck or intercontinental rail line. Thus, the manufactured goods
3 would be on their way to other parts of the United States. A flow of goods in the
4 opposite direction is also possible.

5 The benefits of avoiding the time and delay necessary to perform these same
6 operations using the crowded border crossings, ports, rail centers, and highways of
7 San Diego, Orange, and Los Angeles County could yield extraordinary economic
8 benefit. See Bky. Dkt. # 124-4, Court-approved marketing materials, for a discussion
9 of this point. In 2015, \$19 billion in trade value of goods crossed over from Mexico.
10 *Id.* The Desert Line is theoretically in an excellent position to capture some of this
11 trade. *Id.*

12 It is the allure of this cross-border intermodal operation that makes dreamers
13 look at the Desert Line with desire and causes investors to at least consider parting
14 with their money.

15 But at the time of the chapter 11 case, the Desert Line was not operational;
16 many of its bridges and much of its track was unsafe. Dkt. # 73 at 130:14-132:20;
17 Dkt. # 74 at 61:16-25. It was shut down, technically embargoed, around 2008. *Id.* at
18 91:20-25. And the money necessary to repair it is significant. During trial and
19 throughout the bankruptcy case, amounts approximating \$60-100 million were
20 bandied about. Dkt. # 73 at 96:18-24; Dkt. # 74 at 61:1-15. The amount could be
21 more, perhaps significantly so, but it is highly unlikely to be significantly less. As a
22 result, various groups attempted to capitalize on the opportunities of the Desert Line
23 but failed; they were not able to raise the necessary capital.

24 Interested parties, however, existed. During the course of the case, numerous
25 parties long on interest and litigiousness and allegedly low on net worth actively
26 participated in the bankruptcy. See e.g. Bky. Dkt. ## 141, 323-26 & 334. See also
27 Dkt. # 75 at 111:14-112:4. Apparently, this pattern of active interest and failure to
28 secure financing has been a long-term problem.

1 Others of more financial stability also considered attempted involvement in
2 good faith but were unwilling to take on the significant risk that is a counterpoint to
3 the Desert Line's opportunity or were daunted by litigation risk. At least one good
4 faith party was the defendant in this adversary proceeding, Charles Fletcher.
5 Mr. Fletcher was intrigued with the possibility of the Desert Line and made what he
6 understood to be a secured loan to allow continued short-term operations. Dkt. # 75
7 at 101:14-102:23. He considered taking a more active lending and equity position but
8 ultimately decided not to do so. This case involves the alleged security for his loan.

9 **Pre-PIR involvement: ownership and operations related to the Desert**
10 **Line.** Ownership of the Desert Line passed through several hands from the time of
11 its creation. San Diego and Arizona Eastern Railway Company ("SD&AE") now
12 owns the Desert Line. And in 1979 the San Diego Metropolitan Transit Development
13 Board ("MTS"), a California public agency, purchased all stock in SD&AE. Dkt.
14 # 73 at 65:14-17; Dkt. # 44 at 4 (Stipulated Fact ¶ 3). For purposes of this
15 Memorandum Decision, the differences between the interests of SD&AE and MTS
16 are largely irrelevant, and the Court, thus, will refer to them jointly as MTS unless the
17 context requires specificity.

18 MTS recognized the potential of the Desert Line in terms of freight services
19 and apparently was under other pressure to make the Desert Line operational. It,
20 thus, entered into various agreements for the operation of freight services. These
21 include an agreement with RailTex, Inc. in 1984 that included but was not limited to
22 operations on the Desert Line. See PIR Ex. 4; Dkt. # 44 at 4 (Stipulated Facts ¶ 4)
23 San Diego and Imperial Valley Railroad, Inc. is the assignee of these contract rights.
24 *Id.* (Stipulated Facts ¶ 5). The agreement was modified in 1988. See PIR Ex. 5; *Id.*
25 (Stipulated Facts ¶ 6).

26 Beginning in March of 2002, MTS and others entered into an agreement with
27 Carrizo Gorge Railway, Inc. ("Carrizo Gorge") in relation to operations on the
28 Desert Line. See PIR Ex. 6; Dkt. # 44 at 4 (Stipulated Facts ¶ 7). This agreement, an

1 extension or assignment of the rights and obligations of the 1984 agreements, was
2 also amended on various occasions. See PIR Exs. 7, 8, 10, and 11; Dkt. # 44 at 5
3 (Stipulated Facts ¶¶ 8, 9, 11-13). And while Carrizo Gorge was allowed to take on
4 the Desert Line-related obligations under the 1984 agreement, the original contracting
5 party also remained legally obligated on its contract. Dkt. # 73 at 76:3-15. But MTS
6 was dissatisfied with Carrizo Gorge's operations and efforts. It saw no progress
7 towards establishing regular (or any) freight services on the Desert Line. Dkt. # 74 at
8 64:1-23.

9 Eventually, MTS approved the assignment of Carrizo Gorge's rights under its
10 agreements to PIR. See PIR Exs. 11, 12, and 13; Dkt. # 44 at 5-6 (Stipulated Facts
11 ¶ 14). Execution of PIR Ex. 13 actually severed the Desert Line operational rights
12 out of the 1984 agreement. Dkt. # 73 at 71:3-15; 88:1-12; Dkt. # 44 at 6 (Stipulated
13 Facts ¶¶ 14-15).

14 Subsequent to this assignment of rights, the parties entered into the agreement
15 that is the focus of this Adversary Proceeding.

16 **The Museum Train.** Given the remote areas traversed by the Desert Line, it is
17 not currently a good candidate for most passenger or commuter rail services. But
18 riding the rails in an older train through rugged country has its appeal. Thus, MTS
19 and others contracted with the Pacific Southwest Railroad Museum Association, a
20 California nonprofit corporation (the "Museum") to allow railcar excursions on the
21 safely utilized portions of the Desert Line. Dkt. # 73 at 79:20-80:6; Dkt. # 44 at 5
22 (Stipulated Facts ¶ 10). The most recent operative contract was signed in 2007 and
23 allowed for the operation of passenger excursion services and for custody and control
24 of a portion of the Desert Line for five years. *Id.* at 80:3; PIR Ex. 9. While the
25 record reflects that this contract has terminated, the evidence is also clear that the
26 Museum has continued to the present day to operate excursion services on the
27 Desert Line and to utilize at least one building, the Campo Depot, on the Desert Line
28 right of way as a user in hold over status and with the full knowledge and consent of

1 MTS. *Id.* at 80:23-81:2; 82:21-83:7. MTS has taken no steps to terminate the
2 Museum's use of the Desert Line. *Id.* Indeed, Karen Landers, general counsel of
3 MTS, stated MTS' view: The Museum services are a great asset for the community,
4 MTS wants to support this use, and, if possible, MTS wants this use continued. Dkt.
5 # 74 at 152:2-155:2.

6 **The Lease and Operating Agreement dated December 20, 2012.** As MTS
7 considered a transfer of Desert Line freight operation rights from Carrizo Gorge to
8 PIR, and given the problems with the previous operators on the Desert Line, MTS
9 wanted to avoid problems in its contract with PIR. Ms. Landers stated the opinion
10 that the prior agreements were poorly drafted. Dkt. # 73 at 88:24-89:14; Dkt. # 74 at
11 69:23-70:1. She set out to correct the problems. Dkt. # 74 at 69:16-22. She wanted
12 more oversight, better insurance and indemnification, and certain controls. *Id.* at
13 55:12-25; 70:2-71:1. She also wanted to increase revenue. *Id.* at 65:3-11.

14 She also needed to deal with the entirety of the real property comprising the
15 Desert Line right of way and certain additional real property associated with Desert
16 Line operations. She described the Desert Line itself as a 100 foot right of way but
17 also discussed that there were other features of relevant real property involved in
18 Desert Line operations. Dkt. # 74 at 71:2-15. In particular, there were buildings in
19 Campo and Jacumba that served as a depot, living space, and repair areas for railroad
20 employees. *Id.* at 70:20-24; 71:4-15. She recognized that a lease in relation to at
21 least this real property might be essential. *Id.* at 70:22-24.⁷

22 So MTS initially contemplated two documents, a lease and an operating
23 agreement, to document the relationship with PIR. Dkt. # 73 at 91:10-22; Dkt. # 74
24 at 84:10-85:10. Ms. Landers was the principal drafter of the document. She
25 acknowledged that her initial operating agreement draft contained terms that could be
26 in both a lease and an operating agreement. *Id.* at 84:10-20. She initially envisioned
27

28 ⁷ The Court is not clear from this testimony whether these buildings are located on the right of way
or on land additional to the right of way.

1 an additional simple lease. Dkt. # 74 at 84:23-85:1. Eventually, however, she came
2 to doubt the utility of this form of documentation, and she combined the documents.
3 Dkt. # 73 at 91:10-92:5. She entitled the new version of the document "Lease and
4 Operating Agreement", but she testified that she considered it a lease, albeit for the
5 specified purpose of exclusive freight operations. *Id.* at 92:1-9; 94:5; 100:12-16.
6 Eventually, she was satisfied that the Agreement was sufficient to be a lease. *Id.* at
7 86:13-18. Consistent with this view, she signed a memorandum of lease. *Id.* at
8 100:21-101:11; PIR Ex. 21.

9 It is also clear that Ms. Landers' lease analysis focused on more than simply the
10 use of the track for freight services. She was aware that operational use of the
11 Desert Line entailed use of the right of way to store equipment, to use or build depots
12 and other buildings, and of more immediate moment to build and maintain facilities
13 for customs operations at the border crossing. *Id.* at 149 at 22-150:12.

14 What resulted, eventually, is the document at the center of this dispute, the
15 Agreement. PIR Ex. 17. PIR attempted through the testimony of Donald Stoecklein
16 to establish that the first draft of the document (PIR Ex. 15) was actually a lease from
17 inception. Dkt. # 74 at 24:6-34:18. Given Ms. Lander's testimony regarding her
18 thought process and the history of documentation in relation to freight services, the
19 Court found this testimony strained and of no worth. In this same testimony,
20 however, Mr. Stoecklein also emphasized that he always intended a lease. *Id.*

21 There are numerous features of the Agreement (PIR Ex. 17) that the Court
22 views as relevant to the resolution of the current matter. The Court focuses on the
23 following:

- 24 • The Agreement uses both the defined terms "Lease" and "Agreement" to
25 define itself. Having said this, the defined term "Lease" is used with more
26 frequency. The Agreement also uses other terms consistent with a lease
27 such as rent and leased premises.

- 1 • The Agreement recites that SD&AE owns the Desert Line right of way
2 and defines this as the "Desert Line."
- 3 • In the recitals, the Agreement states that SD&AE is willing to "extend
4 PIR's exclusive operating rights subject to the [terms of the Agreement]."
- 5 • At section 1.1, the Agreement provides PIR with a 50 year term to
6 provide freight rail services subject to SD&AE's right to do two things:
7 (1) to terminate this Lease; and (2) to require PIR to discontinue operations
8 on the Desert Line. The clause is written in the conjunctive and suggests
9 that the rights are distinct.
- 10 • If PIR fails to meet "performance guidelines as set forth in the
11 Agreement", it may be terminated by SD&AE consistent with section 8 of
12 the Agreement. The provisions of section 8 provide for a termination of all
13 operational rights except as required for common carrier obligations during
14 the pendency of any Surface Transportation Board ("STB") discontinuance
15 proceeding. See section 8.6. Section 8.6 requires cooperation both in
16 termination of the Lease and discontinuance of operations on the
17 Desert Line. If there is a delay due to a STB discontinuance proceeding,
18 PIR must coordinate to allow another rail carrier to use the Desert Line.
- 19 • Section 2.1 and its subparts describe payments to SD&AE as "rent."
- 20 • Section 2.2 allows SD&AE to sell the "leased premises" – including as
21 part of a larger parcel – subject to PIR's right of first refusal.
- 22 • Section 2.3 allows SD&AE to lease or grant a contract right of the leased
23 premises in relation to generation of "Collateral Revenue," which cannot
24 interfere with PIR's lease and which is subject to PIR's right of first refusal.
- 25 • Section 3.1 gives PIR the exclusive right to operate freight services on
26 the Desert Line. Thereafter in subpart 3, the Agreement discusses extensive
27 requirements in relation to this operation.
- 28

- 1 • Section 4.1 grants PIR the "exclusive rights to provide rail transportation
2 on the Desert Line to provide the common carrier obligation for rail freight
3 services on the Desert Line." To the extent of any ambiguity as to whether
4 this language gives possessory or operational rights extending beyond
5 freight, section 7.7 resolves the issue. In that section, SD&AE reserves to
6 itself the right to provide passenger or commuter rail services on the
7 Desert Line. Section 7.7 further provides that such services will have
8 priority over the freight services operated by PIR. Section 7.6.1 also speaks
9 to this issue as it provides that PIR takes its interests under the Agreement
10 subject to the rights of the Museum under its 2007 lease, which is
11 acknowledged to be in holdover status, and the Campo Depot lease and that
12 MTS wants this use to continue notwithstanding that the Museum is in a
13 holdover status.
- 14 • Sections 4.3-4.3.6 relate to Concession income (Collateral Revenue)
15 from use of the Desert Line right of way other than for freight services.
16 Collateral Revenue is defined to include things like wind power, billboards,
17 and solar power. PIR can seek to obtain such revenue except as to mineral
18 rights, but SD&AE has the final approval rights in connection with such
19 agreements and is entitled to a share of revenue.
- 20 • Section 4.5 gives PIR exclusive control and responsibility in connection
21 with rail freight services on the Desert Line. Consistent with this grant,
22 section 4.5.1 grants PIR the right to manage the Desert Line and to contract
23 with all shippers and connecting lines. Section 4.5.2, in fact, requires PIR
24 to "maintain and safely operate adequate freight service on the Desert Line."
25 But section 4.5.1.6 limits this right by an express prohibition; PIR cannot
26 allow use of the Desert Line by other railroads for freight services without
27 the consent of MTS.

- 1 • Section 4.5.2.3 reserves to SD&AE the right to approve encroachments
2 or crossings of the Desert Line right of way so long as they do not interfere
3 with PIR operations and PIR is insured and indemnified against risk.
- 4 • Section 7.6 provides for SD&AE's retention of the right to allow
5 installation of telecommunications or utility facilities on the "real property
6 portion of the Desert Line." It also reserves to SD&AE the right to allow
7 access to install or work on such projects.
- 8 • Section 7.8 provides that SD&AE, through San Diego Trolley, Inc., will
9 have exclusive dispatching control of any joint use facilities with SD&AE
10 subject to the obligation to establish a nighttime window for freight priority.
11 The agreement acknowledges that no joint use facilities exist at this time as
12 there are no passenger or commuter services at present.

13 Mr. Stoecklein negotiated the Agreement for PIR. Dkt. # 73 at 110:6-7. He
14 knew that PIR needed a long term agreement to attract the required financing. *Id.* at
15 110:16-111:6. And he wanted it to be a lease. *Id.* at 111:20-21. But he also
16 recognized that the use of the line was limited to freight services. *Id.* at 113:3-5;
17 115:5-9. He was involved in the preparation of the memorandum of lease as it was
18 requested in connection with some early financing, but it was never recorded. *Id.* at
19 115:15-116: 24. And he recognized that the Agreement was an "all-encompassing"
20 document that included an operating agreement. *Id.* at 133:8-14. He also recognized
21 that the rights PIR got from Corrizo Gorge did not constitute lease rights. *Id.* at
22 135:1-136:1.

23 Mr. Stoecklein also was involved in the negotiation and preparation of the
24 documents related to Mr. Fletcher's loan. *Id.* at 117:15-18. No one discussed a deed
25 of trust as a required portion of the collateral package. *Id.* at 123:3-6. But he
26 assumed that Mr. Fletcher could get whatever documents he wanted. *Id.* at 123:12-
27 25. Because of the language used in the representation and warranty as to perfection,
28 he did not believe he was necessarily warranting that perfection by the filing of a

1 UCC-1 financing statement was sufficient. Dkt. # 74 at 36:23-41:13. But he also
2 believed that Mr. Fletcher was "properly secured." *Id.* at 45:10-49:19. He also noted
3 that he believes he would have advised Mr. Fletcher to obtain a trust deed if he
4 thought it necessary. *Id.* at 49:9-17.

5 While Ms. Landers and Mr. Stoecklein both testified that they intended the
6 agreement to provide for a lease of the Desert Line, it is not clear what this meant to
7 MTS or PIR. When Ms. Landers began the documentation process she envisioned
8 two documents, and she began with one entitled "operating agreement." It contained
9 the majority of the key points that found their way into the final document, the
10 Agreement. See Dkt. # 73 at 138:25-140:13; 142:3-145:3; 148:24-154:16. See also
11 PIR Ex. 15 and Ex. 17. Mr. Stoecklein could not explain what document terms
12 necessarily converted the document entitled "operating agreement" (PIR Ex. 15) into
13 a lease. See *id.* at 157:17-158:4.

14 What was clear from the testimony, however, was that the label lease was
15 important. For Mr. Stoecklein, it was an aid to financing. *Id.* at 155:20-22. He
16 wanted the longest term possible, but acknowledged that he got this, at least as to the
17 initial 50 year term, through the document entitled operating agreement. *Id.* at 142:3-
18 16; 156:8-12; PIR Ex. 15. For Ms. Landers, the term lease appeared to be important
19 because, as discussed above, she wanted to wrap up all aspects of the Desert Line
20 operations into one package and she saw a lease as essential to this endeavor. As
21 MTS had previously leased the Campo Depot to the Museum in a standalone
22 document, this view was reasonable.

23 **Baja Agreements.** Immediately before the petition date, Baja California Rail
24 Road, Inc., a California corporation ("Baja") acquired the rights to operate over a
25 portion of the Desert Line pursuant to a May 16, 2016 agreement. Bky. Dkt. # 197 at
26 7:27-8:6; Dkt. # 73 at 101:20-102:20; PIR Ex. 22. Baja paid \$3,000,000 for these
27 partial rights. Dkt. # 75 at 84:11-18. Ultimately, through the bankruptcy case, the
28 Debtor sold all other non-cash assets to International Transportation Association

1 LLC, a Nevada limited liability company in which Baja is a 50% member ("ITA").
2 These assets included all rights under the Agreement that were not already transferred
3 and, in particular, the right to traverse the final 11 miles of the line. Bky. Dkt. # 187.
4 Because this buyer has strong contacts in Mexico and the ability to initiate trade
5 transfers from that side of the border, the Court hopes that the promise of the
6 Desert Line will be realized. But that is beyond both the bankruptcy case and this
7 adversary proceeding; the Court hopes to read about it in the news.

8 DISCUSSION

9 At its most basic, the issue which the Court must decide is: what did ITA
10 obtain when it paid \$3.8 million during the case for the Debtor's non-cash assets and,
11 if it obtained both real and personal property, was the consideration paid exclusively
12 for real property and the locomotives⁸. To the extent PIR exclusively sold real
13 property and the locomotives, Mr. Fletcher's claim is unsecured. Mr. Fletcher takes
14 the position that the assets sold consisted almost exclusively of personal property;
15 PIR alleges to the contrary.

16 To be clear, there is no question that PIR sold both real and personal property.
17 It owned vacant land. See Bky. Dkt. # 1 at 14. Mr. Fletcher does not claim an
18 interest in this real property, and, thus, it is not encumbered by any security interest in
19 his favor. PIR's scheduled value for this real estate, however, supports that even if
20 ITA sale proceeds are allocated to these assets, this allocation would not render
21 Mr. Fletcher undersecured. Mr. Fletcher also concedes that he did not properly
22 perfect his security interest in the locomotives owned by PIR; but again, the value of
23 the locomotives is not significant. So Mr. Fletcher must concede that he does not
24 have a lien, or has a lien subject to set aside, as to some sale proceeds. But he need
25 not concede that he has no collateral. PIR certainly sold some personal property,
26

27
28 ⁸ Mr. Fletcher concedes that he failed to perfect a security interest in the locomotives; his lien on
the locomotives, thus, is subject to set aside.

1 such as its tradename. But Mr. Fletcher's perfected security interest in such assets is
2 of negligible value.

3 So the focus of the debate is on the rights provided by the Agreement. PIR
4 focuses on the term Lease and argues that it exclusively conveyed rights in real estate
5 and that Mr. Fletcher needed a leasehold deed of trust to claim a properly perfected
6 security interest extending to these proceeds. Mr. Fletcher focuses on the Operating
7 Agreement portion of the document's title to make the contrary argument. He asserts
8 that the rights under the Agreement are pursuant to a license or other contract and are
9 personal property covered by his security agreement and perfected by his UCC-1
10 financing statement.

11 **Burden of Proof**

12 In an avoidance action under § 544, the bankruptcy trustee (or reorganized
13 debtor as in this case) bears the burden of proof by a preponderance of the evidence.
14 *See, e.g., Western Wire Works, Inc. v. Lawler (In re Lawler)*, 141 B.R. 425, 428
15 (9th Cir. BAP 1992). Section 544 bestows upon the trustee as of the petition date the
16 avoidance rights of a "hypothetical lienholder," and a "bona fide purchaser." Thus,
17 her hypothetical position is inferior to any existing properly perfected lien at the time
18 the petition is filed and superior to any improperly perfected lien. *In re Merrill*,
19 258 B.R. 750, 752 (Bankr. W.D. Mo. 2001).

20 Though the trustee's status as a hypothetical lien creditor or bona fide
21 purchaser is conferred by federal bankruptcy law, the trustee's rights vis-a-vis other
22 parties are determined by state law. *Taxel v. Chase Manhattan Bank, USA, N.A. (In*
23 *re Deuel)*, 594 F.3d 1073, 1078 (9th Cir. 2010).

24 There is no dispute that the ultimate legal determination here is whether Mr.
25 Fletcher properly perfected his security interest in the Agreement by filing a UCC-1
26 with the California Secretary of State. There is also no dispute that the resolution of
27 that legal issue turns in large measure on whether PIR's interest in the Agreement was
28 real or personal property. Thus, to prevail, PIR bears the burden to establish by a

1 preponderance of the evidence that the Agreement created an interest in real property
2 under California law.

3 **PIR fails to meet its burden of proof to establish that MTS holds fee title to**
4 **the entire Desert Line right of way.** One question that remains unanswered with
5 specific detail is: "what interest in the Desert Line does MTS hold"? MTS describes
6 its asset as a railroad right-of-way. But the term railroad right-of-way is ambiguous;
7 it does not necessarily require that MTS hold fee title to the real property through
8 which the rail line runs. PIR, nonetheless, asserts that MTS held fee title in the
9 entirety of the Desert Line or held an interest in real property capable of being leased.
10 PIR provided the Court with only limited evidence in this regard.

11 Timothy Bors Doolittle, a PIR research assistant, testified regarding Desert
12 Line title issues. Dkt. # 73 at 33:12 *et seq.* He was not qualified or offered as an
13 expert witness. *Id.* at 45:16-17.

14 Mr. Doolittle conducted research at the San Diego County Registrar's Office.
15 *Id.* at 34:24-35:2. In particular, he searched for conveyance documents related to the
16 real property that the Desert Line traverses in San Diego County. *Id.* at 35: 7-11; PIR
17 Ex. 1. He saw numerous notations in the grantor/grantee index that noted unspecified
18 documents that named the San Diego Railway Company as grantee, related to real
19 property through which the Desert Line runs, and date from the approximate time of
20 the construction of the line. *Id.* at 35:21-36:11; PIR Ex. 1. But he examined only a
21 few of the actual documents and could testify only as to one. *Id.* at 36:7-11. Only
22 this single document came into evidence at trial. PIR Ex. 2-A. It was a grant deed,
23 and it conveyed fee title to a narrow strip of property (100 feet on each side of the rail
24 line) consistent with a very short portion of the Desert Line. *Id.* From the testimony
25 it is clear to the Court that Mr. Doolittle did not examine most of the documents that
26 he identified as possibly relating to the Desert Line. Dkt. # 73 at 56:19-57:18.

27 So the most Mr. Doolittle can say is that documents relating to the San Diego
28 real property through which the Desert Line passes were recorded in favor of PIR's

1 predecessor in interest around the time the Desert Line was conceptualized and
2 constructed. With one exception, he did not and cannot say that any document
3 conveyed a fee interest in real property as opposed to an easement or other lesser
4 interest.

5 As to an easement, the Court notes that it is appropriate to record a document
6 granting an easement. See Cal. Civ. Code § 1169; *Moylan v. Dykes*, 181 Cal. App.
7 3d 561, 566 (1986). And if an easement is a grant absolute, it would be recorded in
8 the same book as a deed conveying a fee interest. Cal. Civ. Code § 1171. PIR's
9 Ex. 1, a grantor-grantee index, contains a heading titled: "[d]ate of Deeds Grants or
10 Transfers." This index makes clear that it covers more than transfer of title by deed
11 and, thus, that it does not unambiguously evidence transfers of fee title by deed.

12 Further, since 1872 California law has expressly recognized right of ways as
13 capable of creation through an easement. Cal. Civ. Code §§ 801 & 802. And much
14 more recently, the California Civil Code expressly recognized railroad right of ways,
15 at least as to passenger service, as a potential type of easement. See Cal. Civ. Code
16 § 801.7. And if PIR's right of way for the Desert Line consists of an easement or
17 lesser property interest, in whole or in part, its scope is defined by the terms of the
18 grant. *Union Pac. R. R. Co. v. Santa Fe Pipelines, Inc.*, 231 Cal. App. 4th 134, 164
19 (2014) (*citing Atchison T. & S.F. Ry. Co. v. Abar*, 275 Cal. App. 2d 456,464 (1969)).
20 With one exception, none of the documents allegedly creating a railroad right of way
21 were put into evidence.

22 In short, PIR's documentary evidence is ambiguous as to what MTS had as the
23 "owner" of the Desert Line and pursuant to the San Diego documents that
24 Mr. Doolittle identified. And Mr. Doolittle provided no testimony relating to the
25 Imperial County portion of the Desert Line; there was no evidence that he even
26 attempted to obtain any such information.

27 Ms. Landers, however, also testified that MTS "owns" a railroad right-of-way
28 running through the entirety of the Desert Line and also running through other parts

1 of San Diego County. Dkt. # 73 at 67:12-68:3; 69:15-7. But she also acknowledged
2 that MTS was unable to produce deeds or documents evidencing fee title to the
3 Desert Line right of way in response to discovery requests. Dkt. # 74 at 128:14-
4 129:21. So her testimony is not based on business records. Instead, this is her
5 understanding of generic MTS belief. Her testimony adds nothing supportive of the
6 assertion that MTS holds a fee interest in all the real property that underlies the
7 Desert Line. It stands for the proposition that MTS has the right to operate on the
8 Desert Line right of way – but it does not establish the exact legal basis for this right.

9 The Court is also aware that the Museum currently leases, or recently leased,
10 the Campo depot. This fact suggests that MTS owns the real property under the
11 depot or otherwise has the ability to create a leasehold interest. But, again, this fact
12 adds only a bit of additional definition to the portion of the Desert Line where the
13 Court can conclude that PIR met its burden of proof and established that a lease was
14 legally possible because MTS owned the underlying real property in fee.

15 Adding to the Court's view that the evidence of fee title is insufficient is the
16 fact that the term "rail road right of way" is not necessarily, or in the West perhaps
17 even usually, synonymous with fee title. *See e.g. Marvin M. Brandt Revocable*
18 *Trust v. United States*, 134 S. Ct. 1257 (2014) (discussing right of way easement
19 created by 1857 federal statute and the history of railroad construction in the West);
20 *N. Beach & Mission R.R. Co. (In re Widening Kearny St.)*, 32 Cal. 499 (1867)
21 (discussing easement for San Francisco street cars created by statute). PIR's reliance
22 on *Union Pacific* for the assertion that most Congressionally-created railroad right of
23 ways consist of a fee interest is perplexing. First, the case does not really so state.
24 But it makes clear that in and after the 1875 Act, Congress granted easements – not
25 fee title – as its priorities shifted. 231 Cal. App. 4th at 147-48. And if this was the
26 prevailing view of governmental entities, PIR's Ex. 1 raises more questions; it
27
28

1 evidences transfers to a predecessor of MTS from both the State of California and the
2 City of San Diego.⁹

3 Given the creation of the Desert Line in the early 1900s, *Union Pacific* is more
4 interesting for its point that these Congressionally granted easements were enhanced
5 given the view that railroads were perpetual highways of commerce. *Id.* at 162. In
6 the early 1900s, this view might have persisted; but the record here is silent in large
7 measure.

8 So the Court cannot and does not find that MTS owns in fee simple every
9 square foot of the real property underlying the Desert Line and constituting what
10 MTS refers to as the Desert Line railroad right of way. The Court, similarly, does not
11 find to the contrary.

12 And the Court does conclude that MTS had and has rights that allowed it to
13 operate the Desert Line and to allow PIR to use it. Put bluntly, MTS has operated or
14 claimed the right to operate the Desert Line for over 100 years. It owns a fee interest
15 in at least some of the real property comprising its right of way. To the extent it does
16 not have a fee interest in any portion of the Desert Line by virtue of deed, it may have
17 a formal grant of easement or license. And no one argues that its continuous exercise
18 of control over the Desert Line right of way does not sufficiently establish the right to
19 use the line as a matter of law. The parties appear agreed that if there is a title gap in
20 the Desert Line, the decades-long assertion of control through the rail line would be
21 sufficient under California law to defend against the claim of any owner of the real
22 property through which the line passes.

23 The problem for the Court as it confronts this evidentiary conundrum is that
24 without knowing what MTS owns, it is difficult to determine the exact form in which
25 MTS could convey the right to use the right of way. A lease is possible if the
26 property is owned in fee; and a lease conveys an interest in real property. And while

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28 ⁹ It seems unlikely that the City of San Diego transferred real property that became part of the
Desert Line. This likely relates to another project. But if not, this raises additional questions as to

1 it may be possible to convey an interest in an easement or lesser interest, it is far from
2 certain that this would involve transfer of an interest in real property or that a
3 recorded document would be necessary to perfect a security interest in such a right.
4 *See Darr v. Lone Star Ind., Inc.*, 94 Cal. App. 3d 895, 901 (1979) (easement cannot
5 be an estate in real property); *City of Hayward v. Mohr*, 160 Cal. App. 2d 427, 432-
6 33 (1958) (no easements on easements allowed). It is certainly unclear that one can
7 "lease" an easement. And, again, even if this is a theoretical possibility, it is not a
8 universal truth; the relevant documents transferring the interest must be examined as
9 it is not necessarily true that such an assignment would create an interest in real
10 property as opposed to personal property contract rights.

11 In the face of this uncertainty, PIR fails to meet its burden of proof. The Court
12 cannot conclude on this record that MTS owned the entirety of the Desert Line in fee
13 simple. The Court, thus, cannot determine that a lease was possible for the entire
14 length of the line. And contrary to PIR's suggestion at trial, proof that a few miles of
15 right of way is owned in fee simple is not dispositive of the issue. The Court, thus,
16 concludes that PIR has failed to meet its burden to establish that it obtained a lease
17 from MTS for the entirety of the Desert Line right of way.

18 **The Lease and Operating Agreement, in the main, creates personal**
19 **property contract rights.** Even if one assumes that MTS could lease the entirety of
20 the Desert Line, however, the Court concludes that PIR fails to meet its burden of
21 proof to establish that the Agreement creates exclusively rights in real property that
22 must be perfected through a deed of trust. While some leasehold interests may have
23 been created in the underlying real property, assuming the legal ability to do so, the
24 Court concludes that the Agreement separately created a license to operate over the
25 Desert Line. This license creates personal property rights, and Mr. Fletcher holds a
26 properly perfected security interest in them. Support for the Court's conclusion
27 comes from an examination of the historical practices of MTS, the negotiation and

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what the document really evidences.

1 terms of the Agreement itself, and California law. While the Court acknowledges
2 testimony regarding the intent to create a lease, the Court concludes that MTS
3 largely, but not entirely, intended a relationship with PIR that differs substantially
4 from a landlord-tenant relationship under California law and that PIR acquired the
5 label lease and a lengthy term of use but did not acquire tenant rights as defined under
6 California law.

7 **Historical Documentation of the right to provide freight services on**
8 **the Desert Line.** Historically, at least to the extent the parties provided evidence to
9 the Court, MTS did not utilize a lease or a document entitled lease when it authorized
10 parties to provide freight services on the Desert Line. The parties enjoying rights to
11 operate on the Desert Line before PIR did so pursuant to an operating agreement.
12 And PIR initially acquired rights pursuant to an assignment of such a document. So
13 there is substantial evidence that MTS understood that it could allow a freight
14 operator to use the Desert Line without conveying an interest in real property through
15 a lease.

16 **MTS originally contemplated a two document approach.** When PIR
17 entered the picture, MTS decided to improve the documents governing use of the
18 Desert Line in several respects. It determined that it needed better rights to terminate
19 use, better rights to compel payment notwithstanding that the railroad was non-
20 operational, and better rights to require performance milestones and the acquisition of
21 protection such as insurance. It is also clear from the testimony of Ms. Landers that
22 she recognized that there were buildings on the Desert Line right of way and that a
23 lease might be appropriate in connection with such structures. Apparently, the
24 Museum has or had a lease of the Campo depot, for example.

25 Ms. Landers originally envisioned two steps to documentation, first, an
26 operating agreement, and second, a real property lease. Eventually, she decided to
27 combine the two documents. But the fact that the transaction initiated in this two-
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1 step form again evidences a recognition that the formality of a lease is not required to
2 allow operations on the Desert Line.

3 **By its terms, the Agreement reserved extensive rights of possession,**
4 **control, and use to MTS.** While the Agreement grants PIR the right to conduct
5 freight services on the Desert Line, it conditions this right in significant respects.

6 First, MTS has very substantial oversight of PIR's operations. While this factor
7 is not dispositive, it goes beyond what would typically be seen in a lease. For
8 example, a shopping center owner may limit use of space to a particular type of retail
9 establishment, but it typically does not retain the right to approve the manager for the
10 establishment. See PIR Ex. 17 at 3.4.1. The control MTS obtains over PIR was
11 understandable given the nature of the operation, but it does not suggest a landlord-
12 tenant relationship.

13 More significantly, MTS retains a right to use the Desert Line during the term
14 established by the Agreement. *Id.* at 7.7. MTS can concurrently operate passenger
15 services on the line if it so chooses; and if it chooses to do so, it has paramount rights
16 in virtually all regards. *Id.*

17 MTS also obtained the agreement of PIR to respect the Museum's rights. *Id.* at
18 7.6.1. While this provision is far from dispositive given the state of the Museum
19 contract, it cannot be denied that such a provision is highly atypical in a lease
20 situation.

21 MTS also retained all rights to minerals and the approval rights (and a share of
22 profits) in relation to all collateral/concession revenue generated by use of the Desert
23 Line right of way for purposes other than freight services. *Id.* at 43-4.3.6. And MTS
24 reserved the right to approve workers on the Desert Line and the installation of
25 telecommunications equipment or utilities. *Id.* at 7.6.

26 And MTS also retained the right to approve encroachments or crossings of the
27 Desert Line subject only to the requirement that they not harm PIR. *Id.* at 4.5.2.3.
28

1 In summary, the Agreement by its terms is very focused on the operation of
2 freight services and varies significantly from what the Court would typically see in a
3 standalone lease. As the Court sees it, the Agreement's terms are appropriately read
4 as potentially creating both a lease as to buildings on the right of way and certainly
5 creating a set of operational rights. And section 1.1 of the Agreement is entirely
6 consistent with this view. It provides MTS with the right to do two things if there is a
7 default. First, it can terminate the Lease. This would allow MTS to oust PIR from
8 possession, but to do so it would need to initiate an unlawful detainer action. And in
9 addition, MTS expressly retained the right to require PIR to discontinue operations.
10 This suggests that the operational rights under the Agreement arise from something
11 separate and distinct from a landlord-tenant relationship and can be terminated even if
12 any leasehold interest has not been terminated or cannot be terminated under other
13 law.

14 **California law supports the conclusion that the Agreement does not**
15 **exclusively create a leasehold interest in favor of PIR.** As the Court noted above,
16 the parties take opposite views as to what the Agreement creates. Assuming that
17 MTS has a quality of interest in some or all of the Desert Line that is capable of
18 creating a leasehold, the Court determines nonetheless that California law supports
19 that it also, and indeed principally, created contract rights in favor of PIR.

20 California law has been clear for over 100 years as to the basic features of a
21 lease. First it must be an agreement regarding use of real estate. Second, it must give
22 exclusive possession of the premises against all the world including the owner in
23 order for it to be a lease and not some lesser right to use property. *Shaw v. Caldwell*,
24 16 Cal. App. 1 (1911). *See also San Jose Parking, Inc. v. Superior Court*, 110 Cal.
25 App. 4th 1321, 1328 (2003) (discussing that document that requires contracting party
26 to allow reasonable pedestrian access and restrains unfettered use and income from
27 parking is not consistent with the exclusive possession that constitutes a lease); *Von*
28

1 *Goerlitz v. Turner*, 65 Cal. App. 2d 425, 429 (1944). In order for the Debtor to
2 prevail, it needs to establish this quality of property interest.

3 Much of the Trustee's case is based on labels, defined terms, and frequent
4 references to the operative document as a "Lease." These arguments, however, are
5 not particularly helpful. First, the labels used by the parties are not controlling.
6 *Fox v. Fox*, 42 Cal. 2d 49, 53 (1954). Second, the fact that the defined term for a
7 document entitled Lease and Operating Agreement is "Lease" is not surprising.
8 Calling it the Agreement would have been more ambiguous; and calling it the
9 Operating Agreement might have left less room for argument that it was solely a
10 lease. But the fact that they used the first word in the Agreement as the defined term
11 is of no particular moment.

12 And the fact that having defined the Agreement as the "Lease" they continued
13 to use the term throughout the document and in discussion of the document is of no
14 help whatsoever. The defined term "Lease" refers to the Lease and Operating
15 Agreement in its entirety. Mr. Stoecklein encapsulated the Court's view in some
16 respects when he noted that documents related to another attempted investment were
17 generated in such haste that he is surprised there is not more boilerplate. Dkt. # 75 at
18 29:12-30:12. Mr. Fletcher was happy to have the term used as it was the definition.
19 Dkt. # 75 at 121:21-24. To the extent PIR relies on defined terms and transactional
20 shorthand to carry the day, its arguments and evidence are entitled to little weight.

21 To be fair to PIR, its arguments may be intended as evidence of the party's
22 intent. This is an important concept. Indeed the parties' intention to create a lease
23 can be important under the case law. *Spinks v. Equity Residential Briarwood Apts.*,
24 171 Cal. App. 4th 1004, 1023 (2009) (the primary goal of contract interpretation is to
25 give effect to the parties' intention). And here Ms. Landers and Mr. Stoecklein both
26 stated a desire for a lease.

27 But in examining intent, the Court is not free to simply rely on the parties'
28 desire to have the document bear a particular label. *Fox*, 42 Cal. 2d at 53. Instead,

1 the Court must conduct an objective analysis and look within the document and to
2 surrounding conduct to discern intent. *Watson Pac. Ventures v. Valley Fed. Sav. &*
3 *Loan (In re Safeguard Self-Storage Trust)*, 2 F.3d 967, 970 (1993). *See also Spinks,*
4 *171 Cal. App. 4th at 1023-24.* Where this analysis creates ambiguity, the stated
5 desire to have it be a lease may be of critical importance. But where the document
6 clearly evidences an intention to convey rights that are fundamentally different from
7 those creating a leasehold relationship, the mere reference to a label must fail. And
8 here is where the problem arises for PIR. For the most part, it is clear that MTS did
9 not intend to convey rights consistent with a leasehold interest as that term is
10 understood under California law.

11 Here MTS did not provide, in the most significant measure, for possession of
12 the real property paramount to the rights of MTS. The interests granted to PIR were
13 far from insignificant, particularly given the most likely initial use of the Desert Line.
14 PIR obtained the exclusive right to operate freight services on the Desert Line. But it
15 did not have the exclusive right to use the Desert Line. Most importantly MTS
16 reserved to itself the right to operate passenger services on the Desert Line. Indeed,
17 at the point in time where it decides that passenger services will be offered, its rights
18 supersede those of PIR except for a narrow night time window when freight services
19 will have a priority. Put another way, if MTS decides to offer passenger services,
20 PIR's use of the line will be subordinate to MTS's rights in virtually all regards and
21 for virtually all points in time.

22 MTS provided testimony in an attempt to minimize this significant retention of
23 rights. In particular, Ms. Landers testified that she does not believe that passenger
24 services will ever be offered. Dkt. # 74 at 102:4-7. But Ms. Landers is not a
25 clairvoyant and neither is the Court. The Agreement could extend for approximately
26 100 years. And San Diego County and Imperial County can be expected to continue
27 to develop during that time period. Put bluntly, San Diego County development has
28 nowhere to go but east toward Imperial County; and Imperial County is likely to be

1 drawn toward such development from its neighbor to the west. And if a thriving
2 business develops in connection with the Desert Line, the communities adjacent to
3 the line may see increased residence and business. So MTS has wisely kept its
4 options open. If passenger services are needed, MTS, not PIR or its successor in
5 interest, has the right to offer them and to control the Desert Line to make sure that
6 they have priority.

7 PIR also baldly asserts in its trial brief that the Desert Line is wholly unsuitable
8 for passenger services. But there is no evidentiary support for this conclusion.
9 Indeed, the only evidence is to the contrary as the Museum exclusively offers
10 passenger services, albeit over only a portion of the Desert Line. The Agreement
11 would give MTS priority if it takes over the Museum's excursion rail services or if it
12 operates other passenger services over only a portion of the line.

13 But this was not the only possessory interest that MTS retained. MTS also
14 maintained control over some access to the Desert Line. PIR is not free to allow third
15 parties on to the Desert Line to perform services no matter how essential they are to
16 its operations without the consent of MTS. And as discussed above, MTS has the
17 right to approve concession income, encroachments, utilities, and
18 telecommunications equipment as well.

19 Further, the Agreement contains a current prohibition on unfettered use of the
20 Desert Line as it requires that PIR adhere to MTS' "current contract" with the
21 Museum. The Court heard testimony that makes clear that the relevant contract is
22 currently in hold-over status and not operational. Indeed, that apparently was the
23 case when the parties entered into the agreement. The Court, thus, does not place
24 heavy emphasis on this factor but notes that, yet again, the evidence indicates that
25 MTS did not intend to provide PIR with the unfettered right to use the entirety of the
26 Desert Line. Instead, it maintained control on its own behalf and on behalf of a third
27 party. The Court concludes that for the most part the Agreement is not consistent
28 with a lease.

1 But there may be exceptions to this conclusion. The testimony indicated that
2 there are buildings physically located on the right-of-way or on adjacent real
3 property. The Agreement provides for use of these structures in concert with rail
4 operations. The Agreement also appears to create a lease of these structures to the
5 extent it is established that MTS has an interest in the underlying real property
6 capable of supporting a lease.

7 The Agreement does not limit or condition use of these structures in the same
8 way that it conditions use of the rail line itself. The exception to this conclusion may
9 arise from section 7.8 of the Agreement which relates to joint use facilities. But the
10 Court understands from the testimony that this provision relates to track and joint
11 operation of trains. Thus, if PIR uses a building for storage, for example, it appears
12 to have the unfettered use that is the *sine qua non* of a true lease. Indeed, at this very
13 time Baja occupies the Jacumba Depot; an employee lives there. Dkt. # 74 at 156:21-
14 157:15. Another exception would be the Campo Depo where the Museum may have
15 paramount and potentially exclusive rights for at least a period of time. Even if PIR
16 loses the right to operate freight services on the Desert Services and MTS obtains a
17 voluntary or coerced cessation of such use, it may not be able to evict PIR or its
18 successor in interest from these buildings in a manner inconsistent with California
19 unlawful detainer law.

20 To the extent MTS has ownership rights that support a grant of a leasehold
21 otherwise, the Agreement may provide a lease as to other portions of the right of way
22 which are not directly involved in the railroad. There may be little value in any
23 leasehold right to these portions of right of way; the value appears to arise from the
24 right to operate a train over the track that runs over the line. But the lease component
25 could afford comfort and security, and – if so – it may have additive value.

26 Having reached this conclusion, the Court notes that there was testimony at
27 trial and the introduction of deposition testimony intended to evidence that
28 transactional attorneys at or formerly affiliated with very large New York law firms

1 concluded that the Agreement only conveyed personal property rights, that perfection
2 through a UCC-1 was adequate, and that a trust deed was not required. See *id.* at
3 168:20-175:25; 179:2-10; 182:11-24; 187:1-7; Dkt. # 86. There was also extensive
4 examination of Mr. Stoecklein as to the representations that PIR gave to Mr. Fletcher
5 and others that arguably stated that the filing of a UCC-1 was all that was required to
6 perfect an interest in the Agreement. See e.g. Dkt. # 74 at 184:13-187:7. The Court
7 gives little, if any, weight to this testimony and reached its conclusions in this matter
8 before reviewing Dkt. # 86.

9 Put bluntly, the Court thinks that Mr. Fletcher's attorney was correct in the
10 main but, based on lack of information or analysis, failed to obtain a complete picture
11 of PIR's assets. Further, the Court agrees with Mr. Stoecklein that the representation
12 and warranty used in Mr. Fletcher's transaction was ambiguous. The representation
13 and warranty required for the Ambassador Zappala transaction lacked such
14 ambiguity, so it is more evident of PIR's belief. But Mr. Stoecklein was clear that the
15 need for a trust deed did not occur to him as legal advisor for PIR, so PIR's
16 representation and warranty appears to be, at worst, an exercise in oversight as
17 opposed to evidence of a firmly held belief.

18 And the alleged failure of Ambassador Zappala's Wachtell Lipton attorney to
19 identify any lease aspects of the transaction counts for little. The deal, which never
20 funded, was a small loan apparently also secured by stock. As the Court discussed
21 already, the Agreement provided personal property rights under an operating
22 agreement that were paramount and significant. The Court will not conclude that
23 counsel would not have required a deed or deeds of trust if they were finalizing a loan
24 in the \$60-100 million dollar range.

25 Similarly, Mr. Fletcher's emphasis on the absence of title insurance and the
26 difficulty of obtaining it was not a significant factor in the Court's conclusion. A title
27 report would have been helpful to identifying what MTS owned with precision. And
28 the Court accepts that the title work necessary to track the Desert Line might be

1 significant and expensive. But the Court is not prepared to say that a policy was
2 either required or impossible to obtain.

3 **The Operating Agreement portion of the Agreement creates contracts**
4 **rights; a license to use real property for a specific purpose.**

5 Mr. Fletcher, argues that the Agreement provides for a license to use real
6 property. Under California law, a license provides authority to perform an act or acts
7 on the property of another. *Richardson v. Franc*, 233 Cal. App. 4th 744, 751 (2015).
8 Generally, licenses are revocable, but it is possible to create an irrevocable license
9 either by specific contract terms or when it would be inequitable to allow revocation.
10 *Id.* at 751-53. In *Richardson*, there was no express grant of an irrevocable license to
11 maintain landscaping on an easement that provided only for utilities and access, but
12 the Court found that such a license existed where the licensee had expended years of
13 effort and much money maintaining the landscaping within an easement area
14 notwithstanding that the easement did not provide for this use. *Id. passim*.

15 So here, the Agreement, like all of the operating agreements related to MTS's
16 control of the Desert Line, allows for use of the right of way for the specific purpose
17 of freight services. And the irrevocable, or less than fully revocable, nature of this
18 grant is express in the Agreement but likely would be implied at law once PIR or its
19 successor fund and implement the repairs required to make the Desert Line
20 operational. In short, MTS cannot terminate the use of the Desert Line except as
21 provided for under the Agreement.

22 Mr. Fletcher correctly focuses on the lack of exclusive use of the Desert Line
23 right of way in arguing that it is not a lease. This is apt; the fact that MTS has
24 superior rights to the use of the Desert Line under certain circumstances and
25 otherwise exercises significant control over the Desert Line, while inconsistent with a
26 landlord-tenant relationship, is not inconsistent with a licensor-licensee relationship.

27 A license can involve a right to use real property but it does not convey any
28 interest in the real property itself. *See San Jose Parking, Inc.*, 110 Cal. App. 4th at

1 1329. See also 6 Miller & Starr, Cal. Real Estate (3d ed. 2000), § 15:2 ("[T]he
2 Licensee has a personal privilege but does not possess other interest or right in the
3 land or any estate in the property.") As a result, for example, the loss of rights under
4 a license to use real property is not compensable in a California eminent domain
5 action. *Hubbard v. Brown*, 50 Cal. 3d 189,196 (1990); *Belmont Cty. Water Dist. v.*
6 *California*, 65 Cal. App. 3d 13, 17 (1976).

7 So to the extent PIR's focus was on obtaining long term rights to use the Desert
8 Line, a license would adequately convey such rights. See *Richardson, passim*. And
9 to the extent long term control was desired by MTS, a license arguably better met the
10 needs of MTS. In any event, it would not be inconsistent with its needs.

11 And as has been already discussed above, the fact that the terms rent, lease, and
12 leasehold are found in the agreement is not dispositive or even particularly helpful.
13 See *Golden W. Baseball Co. v. City of Anaheim*, 25 Cal. App. 4th 11, 30-34 (1994)
14 (while court concluded that issue was not dispositive, such terminology was not
15 controlling and did not require that Court view the agreement as a lease where
16 Golden West did not have exclusive possession throughout the year).

17 The Court determines that the rights PIR obtained under the Agreement
18 included a contract or license allowing use of the Desert Line right of way for freight
19 operations. PIR did not have unfettered use of the line with rights paramount to all
20 others, including MTS. But it obtained what is currently the most valuable right in
21 connection with the Desert Line – the right to transport freight from Mexico into the
22 United States using the Desert Line. And a security interest in this license and the
23 rights thereunder was properly perfected through the filing of a UCC-1 financing
24 statement.¹⁰

25
26 ¹⁰ In opening argument, PIR argued that the situation here resembled one where a landlord rented a
27 house but reserved rights to store equipment in a garage closet; in such a case, PIR argued, this
28 limited use would not convert the lease to a license. PIR is correct so far as its example goes, but
the Court sees the Desert Line situation as entirely different. The correct analogy would be to say
that you can stay in the home unless the landlord wants to move in his guests for most of the day in
which case you have no right to use the home. Such a document would not create a lease and

1 **Mr. Stoecklein and Ms. Landers were both credible, but both had**
2 **incentives to call the agreement a lease.** One question that must be asked is: "why
3 would Mr. Stoecklein or MTS care about whether this was a lease as opposed to a
4 license?" In Mr. Stoecklein's case, there is a potentially significant financial benefit if
5 Mr. Fletcher's security interest is set aside as this will free up money to pay unsecured
6 creditors. Dkt. # 75 at 16:1-6. The Court does not see Mr. Stoecklein as untruthful,
7 however. The sense of his testimony is that he wanted the label lease, wanted the
8 longest term for use of the Desert Line possible, and did not think that a trust deed
9 was necessary when he negotiated the deal with Mr. Fletcher. There is also a strong
10 sense in his testimony that he saw the duality in the Agreement; it was both a lease
11 and operating agreement in his eyes. And he testified that everyone saw it as such.
12 *Id.* at 22:11-16. See also *id.* at 39:21-40:13.

13 Ms. Landers was also incentivized to stick to her guns on the lease point.
14 Carrizo Gorge did not let go of its rights in relation to the Desert Line with
15 magnanimity. Instead, it initiated litigation and sought to enjoin MTS from
16 transferring rights to PIR. Dkt. # 74 at 63:12-25. And MTS was also sued by
17 Mr. Sweetwood in relation to the Carrizo Gorge and PIR transactions. *Id.* at 125:23-
18 126:10. If the Agreement was a lease, it could be approved in private session – this
19 may also have been true with a license, but Ms. Landers put that label on the
20 document with intent; and it allowed private approval during a time when litigation
21 risk existed.

22 But Ms. Landers was clearly honest in her testimony. She was simply
23 inflexible in considering questions designed to identify the quality of interest
24 conveyed and minimized provisions of the Agreement that made it seem far less than
25 a typical lease.

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28 _____ neither does the Agreement: PIR did not obtain the paramount right to quiet enjoyment superior to
the rights of all others that is the key element of a leasehold as understood under California law.

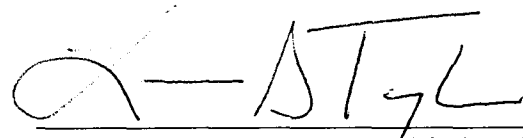
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CONCLUSION

PIR had the burden of proof here; it failed to meet it in the main. It almost entirely failed to prove that it possessed a real property interest in the Desert Line right of way sufficient to support a lease. And even if the Court is incorrect in this regard, except to a minor extent, it failed to establish that the Agreement conveyed rights sufficient to create a landlord-tenant relationship under California.

The Court acknowledges that this conclusion may not fully resolve all pending issues. Unless the parties stipulate that this memorandum decision sufficiently establishes that Mr. Fletcher is fully secured, an additional trial to value the assets not subject to his security interest may be required. The parties should meet and confer in this regard. Mr. Fletcher should promptly submit a final judgment if the parties think this appropriate.

DATED: July 23, 2018


LAURA S. TAYLOR, Chief Judge
United States Bankruptcy Court

PACIFIC IMPERIAL RAILROAD, INC. v. CHARLES E. FLETCHER, Adv. 17-90161-LT
(In re PACIFIC IMPERIAL RAILROAD, INC.; Bk. # 16-06253-LT11)

CERTIFICATE OF MAILING

The undersigned, a regularly appointed and qualified employee in the office of the United States Bankruptcy Court for the Southern District of California, at San Diego, hereby certifies that a true copy of the attached document, to wit:

MEMORANDUM DECISION

was enclosed in a sealed envelope bearing the lawful frank of the bankruptcy judges and mailed via first class mail to the party at their respective address listed below:

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Said envelope(s) containing such document was deposited by me in the City of San Diego, in said District on July 23, 2018.



Regina A. Fabre, Judicial Assistant

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