COMMONWEALTH OF PENNSYLVANIA

DELAWARE VALLEY RAILWAY COMPANY, INC.	:	BEFORE THE BOARD OF CLAIMS
VS.	:	
COMMONWEALTH OF PENNSYLVANIA, DEPARTMENT OF TRANSPORTATION	:	DOCKET NO. 2847

FINDINGS OF FACT

A. THE PARTIES

1. Plaintiff, Delaware Valley Railway Company, Inc. ("DVRC") is a wholly owned subsidiary of RailAmerica. RailAmerica is a publicly traded company and one of the largest short line regional operators in the world. (Complaint and Answer para. 1, Joint Exhibit ["JE"] 4, N.T. 40)

2. Defendant is the Commonwealth of Pennsylvania, Department of Transportation ("PennDOT"). (Complaint and Answer para.2)

B. THE LINES

3. United States Railway Administration ("USRA") Line 907, the Wilmington & Northern Branch, a short line railway extending from the Pennsylvania/Delaware state line in the south to Modena, Pennsylvania in the north, was owned at the time period relevant to this case by PennDOT. (JE-12; N.T. 188, 210)

4. During the same period, PennDOT held a freight easement from Southeastern Pennsylvania Transportation Authority ("SEPTA") on USRA Line 142, the Octotaro Branch, which is an east-west short line railway. (JE-4; JE-12, p.4)

5. Freight service on Line 142 required access through Line 907. (JE-1)

6. USRA Line 939, extending from the Delaware/Pennsylvania state line, where it connects

to Line 907, and Elsmere Junction, Delaware, where it connects to the CSX Line, was owned during the same period by the Wilmington and Northern Railroad Company, a subsidiary of the Reading Company. (JE-3, p.1)

7. Line 907 connects at the north with the Brandywine Valley Railway Company ("BVRC"), a short line railway that services the Lukens Steel plant in Coatsville. This railway was owned by Lukens Steel and had its northern terminus at the Conrail line. (N.T. 65, 217)

8. The CSX and Conrail lines are major national freight networks. The Conrail line is owned by the Norfolk Southern Corporation. In order for goods to travel to or from the major shippers (who were either Lukens or the companies on Line 142), Line 907 must connect with the CSX and Conrail lines. (N.T. 65-67)

9. In order to access the CSX lines to the south DVRC entered into a ten year lease with the Reading Corporation, the owner of Line 939, at the rate of $10,150.00 per month. (JE-3; N.T. 64)

10. Ninety percent of the funds used to purchase Line 907 were provided to PennDOT by the Federal Railroad Administration ("FRA"). (N.T. 91, 210).

C. THE REQUEST FOR PROPOSALS

11. On March 21, 1994 PennDOT issued an invitation for the submission of proposals for the acquisition under a lease-purchase agreement for USRA Line 907 (Wilimington & Northern) and for the operation of freight service on SEPTA owned Line 142. A copy of the invitation is Joint Exhibit 1. (Stipulation of Fact, Para. 1 ["SF-1"]; JE-1)

12. DVRC submitted a proposal in response to the invitation on May 9, 1994. (SF-2; JE-2)

13. The Request for Proposals from PennDOT stated that its purpose was to obtain a rail/freight operator to operate and purchase state-owned Line 907 and to operate on SEPTA-owned Line 142. (JE-1)

14. John Brown, PennDOT's Director of Rail Freight, Ports and Waterways, testified that PennDOT follows the Disposition Procedures with respect to the sale of state-owned lines and that, "We look at the shippers, that is our primary interest in all our state-owned railroads." (N.T. 139)

15. Mr. Brown testified that RailAmerica was selected by a board consisting of PennDOT representatives and shippers who heard presentations by several railroads in response to the Request for Proposals. (N.T. 145)

16. The document entitled, "Disposition Procedures for Pennsylvania State-owned Rail Lines" includes a policy statement that "the overall objective of the Department is to divest itself of ownership of the state-owned rail lines to the extent possible provided that transfer of ownership of these lines will not adversely impact the shippers need for effective and efficient rail transportation." (P-3, p.1)

17. In 1994, Gary Marino, Chairman, President and CEO of RailAmerica, participated in preparing his company's response to PennDOT's request for proposal. He testified that RailAmerica was looking for an opportunity "...to grow our business and nurture small railroads back to health and make them profitable." (N.T. 40-41)

18. Mr. Marino was aware that Line 907 had lost money under its former management, but he believed that with an investment in track improvements and a marketing plan, DVRC could make Line 907 a good investment. (N.T. 50-51)

D. THE OPERATING AGREEMENT

19. On or about July 1, 1994, DVRC entered into a lease with the Reading Company, owner of Line 939 in the State of Delaware, to operate trains on Line 939. The lease was for a term of ten (10) years, at the rate of $10,150.00 per month. (SF-3; JE-3)

20. On July 1, 1994, PennDOT and DVRC entered into the Agreement for the use of Rail Properties, Agreement Number 829412 ("Operating Agreement"). (SF-4; JE-4)

21. The Operating Agreement provided DVRC with exclusive use and control of rail freight service on Line 907, along with PennDOT's rights under its freight easement with SEPTA on Line 142. (JE-4, Art.II, Sec. 2)

22. Section 31 of the Operating Agreement provided DVRC with a purchase option. (JE-4)

23. Mr. Marino testified that to be eligible to be the new operator under the Operating Agreement, DVRC entered into a lease with the Reading Company for use of Line 939, which provides a connection between Line 907 and the interchange with CSX Transportation Company at Elsmere Junction. (N.T. 42)

24. Mr. Marino testified that, in reliance on the terms of the Operating Agreement, DVRC made expenditures for improvements and maintenance. (N.T. 44-45; JE 5-8)

25. On July 1, 1994, DVRC and PennDOT entered into an Accelerated Maintenance Agreement, Number 829411, providing for funding for Line 142. Under this agreement, PennDOT expended $341,675.00 and DVRC expended $85,419.00. (SF-5; JE-5)

26. On July 1, 1994, DVRC and PennDOT entered into a Maintenance Agreement, Number 829410, providing for funding for Line 907. Under this agreement, PennDOT expended $18,902.00 and DVRC expended $4,725.00. (SF-6; JE-6)

27. On July 1, 1995, DVRC and PennDOT entered into a Program Maintenance Agreement, Number 829530, providing funding for Line 907. Under this agreement, PennDOT expended $22,590.00 and DVRC expended $5,647.00. (SF-7; JE-7)

28. On July 1, 1995, DVRC and PennDOT entered into an Accelerated Maintenance Agreement, Number 829531, providing funding for Line 142. Under this agreement, PennDOT expended $232,298.00 and DVRC expended $58,074.00. (SF-8; JE-8)

29. On June 7, 1996, DVRC/RailAmerica terminated its lease for Line 939 with the Reading Company, effective June 30, 1996. (SF-9; JE-9)

30. By letter dated June 10, 1996, DVRC advised PennDOT that it would terminate the Operating Agreement in accordance with Section 30(a)(4) on June 30, 1996 and wished to exercise its option for a lease purchase agreement in accordance with Section 31 of the Agreement. (SF-10; JE-10)

E. THE AGREEMENT OF SALE

31. On July 18, 1996, PennDOT and DVRC entered into an Agreement of Sale, designated number 829601, for the sale of Line 907. (SF-12; JE-12)

32. Mr. Marino testified that DVRC incurred operating losses in reliance on PennDOT's commitment to sell Line 907 to DVRC. (N.T. 50-51)

33. The Agreement of Sale provides that PennDOT can sell Line 907 "through the competitive process to the extent practicable, less any reasonable selling and fixing up expenses" under CFR Part 18.3(2). (JE-12, p.2)

34. The Agreement of Sale defines "reasonable selling and fixing up expenses" as "rehabilitation or improvement costs, excluding routine maintenance, as approved by the FRA" and further defines "rehabilitation and improvement" as "replacing or upgrading the track, and other facilities needed to provide service on a line, to the extent necessary to permit adequate and efficient rail freight service on the line..."

(JE-12, p.2)

35. The Agreement of Sale further provides that DVRC, having been selected as operator of the Line through a Request for Proposal process and having entered a Use of Rail Properties Agreement, is entitled to purchase Line 907 for "fair market value, less the appraisal costs and any reasonable selling and fixing up expenses paid by" PennDOT. (JE-12, p.3) Mr. Marino testified that the appraisal costs and PennDOT expenditures to rehabilitate Line 907 would serve as a credit to DVRC against the purchase price. (N.T. 46-50)

36. The Agreement of Sale provides that "the Fair Market Value of the property will be determined by an independent appraisal selected through the DEPARTMENT's competitive bid process..." (JE-12, p.3)

37. The Agreement of Sale provides that "WHEREAS, the RAILROAD is desirous of purchasing the DEPARTMENT'S interest in the line and, pursuant to Section 31 of Operating Agreement No. 829412, will have sixty (60) days after completion of the appraisal process and submission of the appraisal report to accept the fair market value, less the appraisal costs and any reasonable selling and fixing up expenses paid by the DEPARTMENT through a rehabilitation program and as approved by the FRA from the track value." (JE-12, p.3)

38. In Section 3, the Agreement of Sale provides that PennDOT "agrees to accept the appraised fair market value less the appraisal costs and any reasonable selling and fixing up expense subject to FRA approval, as previously defined from the track material value to be paid at closing." (JE-12, p.7)

39. In Section 10 entitled "Approvals", the Agreement of Sale provides that "[t]he sale and conveyance hereunder shall be subject to and conditioned upon approval, if necessary, of the Public Utility Commission, the Federal Railroad Administration, the Surface Transportation Board, and/or any other governmental authority." (JE-12, p.10)

40. Approval by the Federal Railroad Administration was a condition of the Agreement of Sale. (JE-12, p.10)

41. In Section 13 entitled "Termination for Cause", the Agreement of Sale provides that "[t]he DEPARTMENT shall have the right to terminate this Agreement, upon thirty (30) days notice to the RAILROAD, for non-performance or breach by the RAILROAD of any of the provisions of this Agreement. RAILROAD shall have thirty days to cure said defaults." (JE-12, p.11)

42. The Agreement of Sale further provides that PennDOT intends to acquire Line 142 and, if it should decide to sell Line 142, will grant DVRC an option to purchase Line 142. (JE-12, p.4)

43. On July 23, 1996, the Surface Transportation Board denied DVRC's request for injunctive relief to relieve DVRC of its duty to continue payments to the Reading Company in accordance with its lease for the use of Line 939. (SF-14; JE-14)

44. The Agreement of Sale requires the selection of an appraiser of the value of Line 907. On or about October 25, 1996, PennDOT selected Main Line Management Services, Inc. to perform the appraisal. PennDOT and Main Line Management entered into a contract, Number 829641, to conduct the appraisal. (SF-13; JE-13)

45. By letter dated November 6, 1996, DVRC requested that PennDOT determine the net sales price of the property in accordance with Federal guidelines and standards, taking into consideration State and operator-funded improvements to the property made subsequent to the acquisition by the Commonwealth, as well as the net value of improvements funded by DVRC. (SF-15; JE-15)

46. On November 18, 1996, PennDOT stated that the sales agreement defines the terms of the sale, and specifically stated that only rehabilitation or improvement costs, and not routine maintenance costs, shall be deducted from the appraised value. (SF-16; JE-16)

47. On November 18, 1996, PennDOT and DVRC entered into a Capital Project Agreement, Number 829626, providing funds for Line 142. Under this agreement, PennDOT expended $874,132.00 and DVRC expended $46,007.00. (SF-17; JE-17)

48. On January 7, 1997, DVRC and PennDOT entered into an Accelerated Maintenance Agreement, Number 829656, providing funds for Line 907. Under this agreement, PennDOT expended $21,788.00 and DVRC expended $5,447.00. (SF-18; JE-18)

49. On July 1, 1997, DVRC and PennDOT entered into an Accelerated Maintenance Agreement, Number 829789, providing funds for Line 907. Under this agreement, PennDOT expended $18,000.00 and DVRC expended $4,500.00. (SF-19; JE-19)

F. NEGOTIATIONS AND AGREEMENT ON PRICE

50. On September 12, 1997, Main Line Management ("MLM") issued its appraisal. A copy of the appraisal was sent to DVRC on October 9, 1997. MLM's appraisal for the value of the land was $126,000.00, and the net liquidation value for the track assets was $596,000.00 for a total of $722,000.00. (SF-20; JE-20)

51. On September 17, 1997, PennDOT forwarded to FRA the final copy of the appraisal by Main Line Management and requested approval to begin the negotiation process to sell the line to DVRC.

(SF-21; JE-21)

52. On October 7, 1997, FRA authorized PennDOT to proceed with the sale. (SF-22; JE-22)

53. On October 15, 1997, the FRA stated to PennDOT that 49 CFR 18.31(c)(2) requires the use of sale procedures that result in the highest possible return for each line and that the current value of the track materials installed by Pennsylvania for rehabilitation may be deducted from the fair market value of the line for the purpose of determining the amount of compensation due. (SF-23; JE-23)

54. DVRC contacted a second appraiser, L.B. Foster Co., Inc., to appraise Line 907's rail assets. L.B. Foster issued its appraisal on October 31, 1997. L.B. Foster's net liquidation value for the rail assets was $392,221.70. (SF-24; JE-24)

55. By letter dated November 4, 1997, DVRC forwarded to PennDOT a copy of the L.B. Foster appraisal and requested that L.B. Foster's valuation of $392,221.70 together with the value of the real estate be accepted as the net liquidation value for the line. (SF-25; JE-25)

56. In a letter dated November 14, 1997, DVRC offered to purchase Line 907 for $126,000.00, equal to the MLM appraised value of the real estate. (SF-26; JE-26)

57. By letter dated December 5, 1997, PennDOT rejected DVRC's offer of $126,000.00, and stated it was willing to accept $518,221.00 as the purchase price of Line 907 ($392,221.00 for the track materials and $126,000.00 for the land). (SF-27; JE-27)

58. By letter dated December 15, 1997, DVRC rejected PennDOT's offer of $518,221.00, and reiterated its offer of $126,000.00. (SF-28; JE-28)

59. By letter dated January 5, 1998, PennDOT again rejected DVRC's offer of $126,000.00, and reiterated its offer of $518,221.00. (SF-29; JE-29)

60. By letter dated February 13, 1998, DVRC stated that it understood that it was entitled to credits toward the purchase price for expenditures made by the Commonwealth in rehabilitating Line 907, credits for operator paid improvements to the line, and a credit for the cost of the MLM appraisal. (SF-30; JE-30)

61. By letter dated February 25, 1998, PennDOT advised DVRC that state-paid expenses to rehabilitate Line 907 cannot be used as a credit toward the purchase price of Line 907. (SF-31; JE-31)

62. By letter dated April 8, 1998, DVRC renewed its offer to purchase Line 907 for $126,000.00. (SF-32; JE-32)

63. By letter dated April 15, 1998, PennDOT advised DVRC that it would forward DVRC's offer of $126,000.00 to the Federal Railroad Administration and by this action accepted DVRC's offer. PennDOT also told DVRC that the FRA had final approval authority over the purchase price. (SF-33; JE-33)

64. By letter dated April 28, 1998, PennDOT requested approval of the FRA to sell Line 907 to DVRC for "...the agreed-upon price of $126,000.00." (SF-34; JE-34)

65. In April 1998 when PennDOT requested approval of the $126,000.00 "agreed-upon" price, that amount represented the "highest possible return" under 49 C.F.R. sec. 183(c)(2) available for Line 907. (JE-32, JE-33, JE-34; N.T. 115-122)

66. PennDOT's April 28, 1998 letter acknowledges that the amount of credits which DVRC is entitled to deduct from the appraised value of $518,000.00 is in excess of $392,000.00 and that therefore DVRC's purchase offer of $126,000.00 is reasonable. (JE-34)

67. In her letter dated April 28, 1998, Ms. Elizabeth Sarge Voras, Deputy Secretary for Aviation and Rail Freight for PennDOT, recounts that DVRC had "severe operating losses due to factors outside their control." Ms. Voras further states that PennDOT is submitting the offer "in the interest of preserving rail freight service in the Commonwealth." Further, Ms. Voras states that "it is our conclusion that if the Department were to sell the line for the intended $518,000.00 and then apply the allowable rehabilitation credits, the result would be less than the $126,000.00 land value offer being made by Delaware Valley Railroad." (JE-34, p.1)

68. Finally, Ms. Voras states that, "for all these reasons" and because PennDOT will require DVRC to operate Line 907 for at least five years after consummation of the sale, "the current offer at $126,000.00 is reasonable." (JE-34, p.2)

G. OFFER FROM BETHLEHEM STEEL AND PENNDOT'S BREACH OF THE AGREEMENT OF SALE

69. On April 29, 1998, Secretary Bradley M. Mallory spoke at the Eighth Annual Rail Freight Seminar. Mr. Mallory's prepared text stated that PennDOT was "in the final stage of selling USRA Line 907 . . . to RailAmerica, Inc." (SF-35; JE-35)

70. A representative of Bethlehem Steel Corp. attended the Freight Seminar and learned of the pending sale of Line 907 to RailAmerica. (N.T. 153-154)

71. Bethlehem Steel did not participate in any request for proposal process, nor did Bethlehem

Steel have a contract with PennDOT relating to Line 907. Accordingly, Bethlehem Steel had not spent any money on Line 907, nor would it be entitled to any credits in connection with the purchase of the line. (N.T. 164)

72. By letter dated June 15, 1998, Bethlehem Steel's Subsidiary Railroad Companies offered $500,000.00 to purchase Line 907. (SF-36; JE-36)

73. By letter dated June 23, 1998, PennDOT forwarded Bethlehem Steel's offer of $500,000.00 to the FRA for "...whatever consideration [the FRA] deem[s] appropriate." (SF-37; JE-37)

74. On June 24, 1998, the Surface Transportation Board issued a decision denying DVRC's petition to set subsidy terms for the use of the Reading Company's Line 939. (SF-38; JE-38)

75. By letter dated August 10, 1998, the FRA authorized PennDOT to accept Bethlehem Steel's offer to purchase Line 907. (SF-39; JE-39)

76. By letter dated August 18, 1998, PennDOT advised DVRC that an offer higher than DVRC's offer had been received, that the higher offer had been forwarded to the FRA, and that the FRA had authorized PennDOT to accept the higher offer. PennDOT then notified DVRC that it intended to sell Line 907 for the higher amount, and, without disclosing the amount of Bethlehem Steel's offer, gave DVRC until September 8, 1998 to revise its previous offer. (SF-40; JE-40; N.T. 159-161)

77. In the letter dated August 18, 1998, PennDOT gave two reasons for forwarding the Bethlehem Steel offer to the FRA for approval: the Bethlehem Steel offer "...was considerably higher and the FRA guidelines require the Commonwealth to obtain the highest achievable return in line sales transactions." (SF-40; JE-40)

78. By letter dated September 4, 1998, DVRC requested from PennDOT the FRA's approved fair market value for Line 907, and further requested 60 days to review that value and apply credits for selling and fixing up expenses to it. (SF-41; JE-41)

79. By letter dated September 25, 1998, PennDOT advised that it intended to sell Line 907 to the other, unnamed, offeror (Bethlehem Steel). (SF-42; JE-42)

80. By letter dated October 13, 1998, DVRC requested the necessary closing papers needed to effectuate the transfer of ownership of Line 907. (SF-43; JE-43)

81. By letter dated October 21, 1998, counsel for DVRC advised PennDOT that DVRC was ready, willing and able to complete the purchase of Line 907 in accordance with the terms and conditions of the Agreement. (SF-44; JE-44)

82. By letter dated October 23, 1998, PennDOT confirmed its acceptance of Bethlehem Steel's offer to purchase Line 907 for $500,000.00. (SF-45; JE-45)

83. By letter dated December 17, 1998, PennDOT advised DVRC that the Agreement of Sale would terminate as of the close of business, March 19, 1999. (SF-46; JE-46)

84. PennDOT's purported notice of termination of the Agreement of Sale on December 17, 1998 provided the first notice to DVRC that the amount of Bethlehem Steel's offer was $500,000.00. (SF-46; JE-46, p.1)

85. By letter dated December 18, 1998, PennDOT advised DVRC that it intended to transfer its easement rights on Line 142 to the new prospective purchaser of Line 907, which, although unnamed in the letter, was Bethlehem Steel. (SF-47; JE-47)

86. By letter dated December 28, 1998, DVRC requested from PennDOT the specific provisions of the Agreement of Sale that PennDOT deemed DVRC had breached (SF-48; JE-48) DVRC also requested an opportunity to cure any defaults under Section 13. (JE-48)

87. By letter dated January 6, 1999, PennDOT advised DVRC that DVRC had failed to cure its "contractual pricing deficiency." (SF-49; JE-49) In this letter, like its prior letters, PennDOT failed to specify what amount would have to be offered by DVRC in order to cure its alleged default. (SF-49; JE-49)

88. By letter dated January 15, 1999, DVRC offered $500,001.00 to purchase Line 907. DVRC anticipated credits of an undefined amount toward this purchase price. The offer was made within the cure period specified in the contract. (JE-50; SF-50)

89. PennDOT refused to submit DVRC's offer of $500,001.00 to the FRA for approval. (N.T. 161)

90. By letter dated January 20, 1999, PennDOT advised DVRC that all negotiations toward the purchase price for Line 907 had concluded earlier and that the termination action taken December 17, 1998 was final and irrevocable. (SF-51; JE-51)

91. On March 18, 1999, PennDOT and Brandywine Valley Railway Company ("BVRC"), a subsidiary of Bethlehem Steel, entered an Interim Operating Agreement, Number 829876, for the use of Lines 907 and 142. (SF-52; JE-52)

92. On or about June 16, 1999, DVRC and the Reading Company settled its outstanding litigation regarding the lease of Line 939 whereby DVRC paid to the Reading Company the sum of $80,000.00. (SF-53; JE-53)

93. On October 13, 2000, Brandywine Valley Railroad Company filed a Notice of Partial Termination of Service with the Surface Transportation Board, giving notice that it intended to terminate service over Line 142 on December 31, 2000. (SF-54; JE-54)

H. DVRC'S DAMAGES

94. DVRC seeks damages based on two alternative theories: expectation damages (lost profits) and reliance damages (the amount it lost while relying on PennDOT to perform). (N.T. 298)

95. DVRC's damage analysis was presented by Debora Stewart, CPA, of PENTA Advisory Services and she was qualified as an expert to testify. (N.T. 273-365)

96. Ms. Stewart presented a damage analysis which calculated DVRC's loss of future profits as a result of PennDOT's refusal to sell Line 907 to DVRC. As an alternative theory, Ms. Stewart also testified to the losses incurred by DVRC as operator of Line 907 in reliance on PennDOT's written agreement to sell Line 907 to DVRC. (N.T. 273-365)

97. DVRC prepared periodic financial reports including income statements and balance sheets concerning its operations on Line 907, Line 142 and Line 939. (SF-55; JE-55)

98. DVRC never made a profit during the entire time it operated Line 907 and the two related shortline railways, Line 142 and Line 939 in Delaware. (Ex. P-23)

99. During the period from July, 1994 and ending June 30, 2000 which was the period of its operation on these lines, DVRC lost a total of $985,827.00. (Exs. P-23, P-26; JE-55; N.T. 294)

100. In determining DVRC's losses as a result of its operation of Line 907, Ms. Stewart relied primarily upon DVRC's financial statements. (SF-55; JE-55)

101. Since it never achieved any profits of its own, DVRC's expert used the business records of BVRC, an unrelated company and a subsidiary of Bethlehem Steel, to prove lost profit damages. (Ex. P-23; N.T. 278, 306)

102. Brandywine Valley Railway Company prepared a list of carloadings for its own operations on Line 907, Line 142 and Line 939. (SF-56; JE-56)

103. Ms. Stewart testified to her methodology for determining DVRC's lost profits. She

calculated the present value of the future cash flows had DVRC retained ownership of Line 907. (Ex. P-23; N.T. 274 et seq.)

104. Using DVRC's financial history and the shipments made by BVRC on Line 907 and Line 142 during 1999 and 2000, Ms. Stewart modeled the revenue and expenses produced from operating Line 907 and Line 142 from 1999 through 2008 and calculated the resulting profits. She then calculated the net present value of the profits as of December 31, 2000, using a rate of 6.02% and discount rates of 18.40% and 27.4%. Ms. Stewart's conclusion was the net present value of DVRC's lost profits is between $1,084,999.00 and $3,720,939.00. (Ex. P-23)

105. Ms. Stewart's higher lost profits number was based on the inclusion of (1) scrap shipments from Mars Industries to the Bethlehem Steel plant, (2) traffic moving from Bethlehem Steel's Sparrows Point Facility, and (3) diverted truck traffic. (Ex. P-23)

106. None of the Mars Industries shipments to the Bethlehem Steel plant in 1999 or 2000 were shipped on Line 907 making Ms. Stewart's inclusion of this in future revenue speculative and unreliable. (N.T. 193-200)

107. Inbound scrap metal shipments from Mars Industries to the Bethlehem Steel/Lukens plant in Coatsville have used both CSX and Norfolk Southern routes in the past. (N.T. 194-203)

108. Whether inbound scrap metal arrives at the Coatsville steel plant via CSX or Norfolk Southern depends on transport cost agreements reached between those two major carriers and Bethlehem Steel. (N.T. 267-268)

109. The figures used by Ms. Stewart for future increases in diverted truck traffic on Line 907 were not based on any actual traffic figures, but were based on projections Bethlehem Steel used to obtain a state grant. (Ex. P-4; N.T. 349-350, 355-356)

110. There is no potential for increased carloads on Line 907 of finished steel from the Bethlehem Steel Sparrows Point plant to the Bethlehem Steel/Lukens plant in Coatsville. (N.T. 201-205)

111. DVRC marketing initiatives often failed to increase the volume of carloads carried on Line 907. (N.T. 85-87, 223-228, 234-236)

112. Bethlehem Steel, parent of BVRC, is able to achieve cost efficiency in the transport of freight cars by virtue of its direct access to two major national rail networks, CSX and Norfolk Southern. (N.T. 267-269, 318, 413)

113. DVRC, in its lost profits calculations, also understates the costs involved in operating Lines 907, 142 and 939. (SF-23; JE-23)

114. DVRC's expert projects future costs for the operation of the lines using, in part, BVRC's income statements. However, the BVRC income statements understate the costs since they omit costs for home office overhead and depreciation, among others. (Ex. P-7, P-8; N.T. 332, 380-382)

115. DVRC's expert understates diesel fuel costs for 1999 and 2000 by over $43,000.00. (Ex. P-23; N.T. 320, 428)

116. DVRC's expert understates train and track salaries by $102,000.00. (Ex P-23; N.T. 428-429)

117. DVRC's expert understates freight car per diem costs by $14,000.00. (Ex. P-23; N.T. 321-322, 429)

118. DVRC's expert understates track costs by $44,000.00 annually. (Ex P-23; N.T. 321-322, 429)

119. DVRC understates track maintenance costs by assuming that monies previously paid by public entities, namely the Commonwealth of Pennsylvania, will continue after it buys Line 907. (Ex. P-23)

120. DVRC understates the cost of maintenance and capital improvement of Line 939 by failing to include any such costs in its lost profits calculations. (Ex. D-7; N.T. 431)

121. The cost of maintaining Line 939 - which is nine miles long - after it has been upgraded so that higher volumes of carloads can traverse it is conservatively estimated at $3,000.00 per mile annually. (N.T. 243, 254, 263)

122. PennDOT's damages expert, Louis Rubino, testified that he had no objection to Ms. Stewart's analysis and conclusion with respect to DVRC's losses, although he raised an issue with respect to a potential tax benefit which DVRC or RailAmerica could have received from deductions for its losses. There is no evidence in the record that DVRC or RailAmerica received any such tax benefit. (N.T. 434-435)

123. DVRC's losses while operating Line 907 in 1994, 1995, and one half of 1996 were $221,528.00. (SF-55; JE-55)

124. If $221,528.00 is subtracted from the total losses of $985,327.00, the amount remaining of $763,799.00 represents the amount which DVRC lost (from July, 1996 until its operations ceased) in reliance upon PennDOT's performance of the Agreement of Sale.

CONCLUSIONS OF LAW

1. The Board of Claims has jurisdiction over the subject matter of this action. 72 P.S. sec. 4651-4.

2. The Board of Claims has jurisdiction over the parties.

3. DVRC was the successful applicant in PennDOT's Request for Proposal for the operation of Lines 907 and 142. Because PennDOT initiated the public proposal process, it had an obligation to adhere to the procedures set forth in its request for proposal.

4. From July 1, 1994 through June 30, 2000, DVRC incurred losses in the amount of $985,327.00 as operator of Lines 907 and 142.

5. PennDOT and DVRC entered into an Agreement of Sale dated July 18, 1996 to purchase Line 907 and this was a validly executed, enforceable contract.

6. DVRC's losses were incurred when it was operating in reliance upon the Operating Agreement and the Agreement of Sale.

7. PennDOT and DVRC agreed-upon a purchase price of $126,000.00 for Line 907, which was the appraised value of the real estate.

8. PennDOT and DVRC agreed that the amount of credits which DVRC would receive under the Agreement of Sale was greater than the value assigned to the rail assets and that therefore the real estate value of $126,000.00 was a reasonable price for Line 907.

9. The $126,000.00 agreed-upon purchase price from DVRC was submitted by PennDOT to the FRA for approval.

10. A condition is an event, not certain to occur, that must occur before performance becomes due. A condition of the Agreement of Sale was the approval of the FRA.

11. When parties indicate in a contract that their agreement is conditional upon the approval of a third party, neither party has the privilege of revocation and no further assent is required.

12. Since DVRC and PennDOT had agreed to all the terms of the sale, the Agreement of Sale was a valid, enforceable contract which was subject to the approval of the FRA.

13. A duty of good faith is implied in every contract. The duty of good faith requires that if the contract is conditioned upon a third party's approval, the contracting parties must cooperate to achieve that

approval.

14. PennDOT had a duty of good faith to DVRC to cooperate in fulfilling the condition of the contract by getting FRA approval of the $126,000.00 price.

15. Where a party claiming the condition has not been satisfied is the cause of the non-occurrence, it may not claim the non-occurrence to its advantage.

16. While awaiting FRA approval, PennDOT improperly and in bad faith interfered with the approval process by submitting a bid of $500,000.00 from Bethlehem Steel.

17. The Bethlehem Steel bid was not made pursuant to any public competitive bidding process which was required under PennDOT's Disposition Procedures, Request for Proposal, the agreements with DVRC and the federal regulations.

18. Although Bethlehem Steel's bid may have resulted in a greater return to PennDOT, by accepting the bid, PennDOT violated its own Disposition Procedures, Request for Proposal, and agreements with DVRC.

19. PennDOT breached the Agreement of Sale by submitting the bid from Bethlehem Steel to the FRA for approval.

20. PennDOT breached the Agreement of Sale by accepting the bid from Bethlehem Steel.

21. PennDOT breached the Agreement of Sale by wrongfully terminating the Agreement of Sale with DVRC.

22. PennDOT breached the Agreement of Sale by refusing to transmit DVRC's bid of $500,001.00 made on January 15, 1999 to the FRA for approval.

23. PennDOT had no grounds to repudiate the Agreement of Sale.

24. PennDOT had no grounds to terminate the Agreement of Sale.

25. PennDOT's purported termination of the Agreement of Sale was invalid because DVRC had not breached any of its terms and was performing fully. Even if the termination was proper, PennDOT failed to give DVRC the right to cure.

26. DVRC did not breach the Agreement of Sale by any of its acts including selecting a second appraiser of Line 907, bidding less than the appraisal amount, or negotiating for the period that it took the

parties to reach the agreed-upon price of $126,000.00. If any of these acts were a breach of the Agreement of Sale, such breach was waived by the actions of PennDOT by continuing to negotiate and by accepting DVRC's $126,000.00 price.

27. PennDOT is equitably estopped from denying that it had a binding agreement on which DVRC justifiably relied and, by breaching the agreement, PennDOT is liable for the damages DVRC suffered.

28. The legal standard for proving lost profits is that they cannot be speculative and must be proven with a reasonable degree of certainty.

29. Courts look to the past record of a business which must provide a reasonably certain basis for the calculation of plaintiff's loss of future profits.

30. DVRC is not entitled to lost profits as its damages because it did not have any history of earning profits during the six years it operated Line 907.

31. The evidence does not establish with a reasonable certainty that if DVRC had become the owner of Line 907 that it would have earned increased profits by virtue of rail freight traffic from Mars Industries of Detroit, Michigan, from Bethlehem Steel's Sparrows Point plant in Baltimore, Maryland, or from diverted truck traffic.

32. The Board finds the testimony of Debora Stewart, CPA, DVRC's expert not credible regarding her estimates and projections of future DVRC revenues because they are based upon data from an unrelated company which was in a substantially different market position.

33. The Board finds the testimony of Louis Rubino, CPA, credible as it relates to the uncertainties he found in the revenue and cost data used by DVRC's expert in her lost profits projections.

34. The Board finds the testimony of Louis Rubino credible as it relates to the uncertainties in the cost figures used by DVRC's expert, particularly an understatement of diesel fuel costs, and understatement of train and track salaries, an understatement of freight cars per diem, and an understatement of track costs.

35. While the Board does not conclude that it was impossible for DVRC to make a profit in the future, the Board finds that DVRC has not proven with reasonable certainty that it would have had any lost profits for the years 1999 to 2008.

36. The financial history of DVRC's operations on Line 907 shows only losses and it has not been proven with a reasonable degree of certainty that DVRC would have made a profit in the years 1999 to 2008, or any of them.

37. The DVRC claim for future lost profits as the measure of damages for PennDOT's breach of the Agreement of Sale is denied.

38. Reliance damages are meant to restore a plaintiff to the same position it would have been in before the contract was entered.

39. Reliance damages are an appropriate measure of damages in this case.

40. The losses DVRC incurred after July 1996 were incurred in reliance on PennDOT performing the Agreement of Sale to sell Line 907 and are recoverable as reliance damages.

41. DVRC is entitled to $763,799.00 in reliance damages as a result of the breach of the Agreement of Sale by PennDOT.

OPINION

The complaint in this action was filed on March 15, 1999. The plaintiff, Delaware Valley Railroad Company ("DVRC"), demanded judgment against the Commonwealth of Pennsylvania, Department of Transportation ("PennDOT") for breach of contract. On April 16, 1999, the defendant filed an answer and new matter. On May 24, 1999, plaintiff replied to the new matter and a period of discovery followed. The hearing on the matter was held on several dates. The evidence on the liability issues was presented on December 7 and 8, 2000 and the evidence on the damage issues was presented on May 22 and 23, 2001. Thereafter the parties filed stipulations of fact as well as their own proposed findings of fact and conclusions of law. Post-hearing briefs were filed on May 23 and September 25, 2001 by DVRC, and on August 29 and October 24, 2001 by PennDOT.

BREACH OF CONTRACT

The plaintiff DVRC claims that it had a valid enforceable contract with the defendant PennDOT which PennDOT breached entitling DVRC to substantial damages. PennDOT contends that DVRC breached the contract first, thereby making it unenforceable. The Board finds that the parties had a valid

contract which was breached by PennDOT and we base that conclusion on the discussion which follows.

The relationship between the parties began on March 14, 1994 when PennDOT issued a request for proposals ("RFP") under a lease purchase agreement for the acquisition of USRA Line 907 and for the operation of freight service on SEPTA-owned Line 142. (JE-1) DVRC submitted a proposal and was selected to operate and provide services to customers on Lines 907 and 142. (JE-2)

Gary Marino, Chairman, President and CEO of RailAmerica, the parent company of DVRC, testified about his company's bid to acquire Line 907 under a lease purchase agreement and operate freight service on Line 142. (N.T. 39-40) He said that RailAmerica is the largest short line rail operator in the world, owns an interest in 47 railroads in four countries, and has annual revenues of four hundred million dollars. (N.T. 40) He testified about his company's decision in 1994 to respond to PennDOT's request for proposal and his participation in preparing the response. (N.T. 40-41; JE-1) He stated:

> "We were looking to grow the company...And this opportunity was consistent with what we were doing at the time to grow our business and to nurture small railroads back to health and make them profitable." (N.T. 41)

He was aware that Line 907 had lost money under its former management. (N.T.50) He believed that with an investment in track improvements and a marketing plan, DVRC could increase the volume of goods shipped on Line 907 which would make it a good investment. (N.T. 50-51)

On July 1, 1994, PennDOT and DVRC entered into the Agreement for Use of Real Properties ("Operating Agreement") which included an option to purchase Line 907. (JE-4) DVRC operated on Lines 907 and 142 until it was terminated by PennDOT in March, 1999.

The Operating Agreement executed by the parties contained the purchase option in Section 31:

> "Section 31. Purchase Option.
>
> The Department intends to sell Line 907 within the term of this Agreement under a lease purchase arrangement. The Department shall select an independent appraiser to determine fair market value in accordance with FRA requirements. The Department shall provide the Railroad Operator with the appraisal bid amount prior to executing an agreement with the appraiser. The Railroad Operator shall reimburse the Department for the actual costs of appraisal within 30 days of receipt of an invoice for completed work. Upon completion of the appraisal, the Department will give the Railroad Operator an option to purchase Line 907 prior to offering Line 907 to other prospective purchasers. The Department will notify the Railroad Operator of the appraised value of Line 907 in writing, and the Railroad Operator shall have 60 days from receipt of such written notice to notify the Department of its intent to exercise its option to purchase. Failure to exercise the option by providing written notice to the Department within such 60-day period shall be deemed a rejection of the option. In the event the Railroad Operator does not exercise its option to purchase Line 907 in accordance with the provisions of this Section, the Department will be free to dispose of Line 907 in accordance with the provisions of the Rail Freight Preservation and Improvement Act, 55 P.S. Sections 696.1-.11. The Railroad Operator agrees to continue as the operator of Line 907 under the terms of this Agreement until such time as the Department either sells Line 907 to another owner or selects an operator for Line 907 through the competitive request for proposal process. If the Railroad Operator exercises its option to purchase Line 907, the amount previously paid for the appraisal shall be deducted from the appraised value in order to determine the final purchase price. The Railroad Operator shall have ninety (90) days from the date of notice of intent to exercise its option to negotiate a lease purchase agreement with the Department. The parties agree to devote their best efforts to enter into a mutually satisfactory agreement that will benefit shippers using the line and the community."
> Operating Agreement, pp. 20-21.

DVRC operated on the line for almost two years and incurred substantial losses because its operating expenses and capital expenditures for equipment and track improvements exceeded the revenue generated. On June 10, 1996, DVRC advised PennDOT that it wished to terminate the Operating Agreement and exercise its option to purchase the line. PennDOT agreed and the parties executed the Agreement of Sale for Line 907 on July 18, 1996. (JE-12)

The Agreement of Sale set forth the terms and conditions of the sale. The purchase price for Line 907 was set forth in Section 3 which stated:

> "Section 3. Compensation.
>
> The DEPARTMENT agrees to accept the appraised fair market value less the appraisal costs and any reasonable selling and fixing up expenses subject to FRA approval, as previously defined from the track material value to be paid at closing." Agreement of Sale, p. 7 (JE-12)

In the Whereas paragraphs of the Agreement of Sale, the parties defined certain terms used in Section 3. The term "reasonable selling and fixing up expenses" is defined as "rehabilitation or improvement costs excluding routine maintenance, as approved by the FRA." (JE-12, p.2) The terms "rehabilitation and improvement" and "routine maintenance" are also explained. Id. For the remainder of this opinion, these expenses that were defined in the Agreement of Sale and allowed to be deducted from the appraised fair market value will be referred to by the Board as "deductible expenses." The actual amount of the deductible expenses was the subject of much debate and negotiation by the parties after the Agreement of Sale was signed. (JE-30, JE-31) Their disagreement about the amount was a major point of negotiation in reaching their agreement on the price DVRC would pay for Line 907. (JE-15, JE-16, JE-32, JE-33)

The Agreement of Sale provided that the method for determining the selling price was that PennDOT was to select the appraiser. (JE-12) PennDOT selected a firm called Main Line Management which valued the land at $126,000.00 and the net liquidation value for the track assets at $596,000.00, for a total of $722,000.00. (JE-13, JE-20, JE-21) DVRC did not agree with the appraisal of the rail assets and expressed the view that another appraiser with more experience specifically valuing rail assets would more accurately reflect the current fair market value. (N.T. 99) DVRC contacted a different appraiser, L.B. Foster Co., Inc. to appraise Line 907. (JE-24) On October 31, 1997, L.B. Foster issued its appraisal of the net liquidation value for the rail assets of $392,221.70. (JE-24) Over the next six

months, the parties exchanged letters of negotiation and finally agreed-upon the L.B. Foster appraisal of $392,221.70 for the rail assets and $126,000.00 for the value of the land. (JE-26, JE-27, JE-28, JE-29, JE-30, JE-31, JE-32) It was DVRC's position that the deductible expenses to which it was entitled under the contract were greater than the value of the rail assets, so it made an offer of $126,000.00 in November 1997. (Ex. P-4)

After initially rejecting this offer and further negotiations, PennDOT agreed to this price. (JE-34) By letter dated April 28, 1998, PennDOT requested the approval of the Federal Railroad Administration ("FRA") to sell Line 907 to DVRC. (JE-34) In that letter PennDOT stated that $126,000.00 was the "agreed-upon price" and justified it as "reasonable" by explaining that DVRC had operated on the line for four years and sustained "severe operating losses" and that as part of the deal DVRC would be required to continue to operate on the line for five more years after the sale.

Under Section 10 of the Agreement of Sale, a condition of the sale was approval by the FRA. That section provided:

> "Section 10. Approvals.
> The sale and conveyance hereunder shall be subject to and conditioned upon approval, if necessary, of the Public Utility Commission, the Federal Railroad Administration, the Surface Transportation Board, and/or any other governmental authority. The cost and expense of obtaining or attempting to obtain such approval will be borne solely by the RAILROAD." (JE-12, p.10)

While the parties waited for the FRA to approve the sale, another entity decided to make an offer to purchase Line 907. In the Spring of 1998, Bethlehem Steel acquired the Lukens Steel plant which was the main freight customer on Line 907. (N.T. 244, 372) At a PennDOT seminar in April 1998, PennDOT announced it was in "the final stage" of selling Line 907. (JE-35) A Bethlehem Steel representative was

in attendance at that seminar and on June 15, 1998 Bethlehem Steel's railroad subsidiary made an offer to PennDOT to purchase Line 907 for $500,000.00. (JE-36) The record is silent regarding any discussions or negotiations Bethlehem Steel had with PennDOT prior to submitting this offer. However, the record is clear that PennDOT made no attempt to terminate its sale contract with DVRC or tell DVRC that it was entertaining any other offers at this time. (N.T. 159-161) PennDOT certainly did not formally open any new competitive bidding process. PennDOT's witnesses state that the offer was "unsolicited." (N.T. 153-154) Because Bethlehem Steel had no prior operating contracts with PennDOT, it was not entitled to any deductible expenses from the sales price as DVRC was.

By letter dated June 23, 1998, PennDOT forwarded Bethlehem Steel's offer to FRA "for whatever consideration the FRA deemed appropriate." (JE-37) It is PennDOT's position that once it received the Bethlehem Steel offer it had no choice but to send it to the FRA for approval despite the facts that DVRC had an exclusive option to purchase Line 907, exercised that option, the parties had agreed to all terms of the sale, and the only condition remaining to complete the transaction was FRA approval. PennDOT did not tell DVRC either that it had received another offer or that it had submitted any other offer for FRA approval. (N.T. 159-161)

By letter dated August 10, 1998, the FRA replied to PennDOT and authorized it to accept Bethlehem Steel's offer to purchase Line 907. (JE-39) On August 18, 1998, PennDOT advised DVRC that it had received a higher offer but did not specify the amount. (JE-40) It told DVRC that the FRA had approved the other offer and that it intended to sell Line 907 for the higher amount, and gave DVRC until September 8, 1998 to raise its previous offer. (JE-40) DVRC expressed surprise at these developments and requested further information about the amount and terms of the other offer. At the same time DVRC

requested that PennDOT go forward and complete the purchase of Line 907 under the terms of the Agreement of Sale. (JE-41) PennDOT refused to proceed with the sale to DVRC. Instead, PennDOT notified Bethlehem Steel that its offer had received FRA approval and stated that PennDOT would proceed to prepare a new sales agreement. (JE-45) The FRA never specifically gave its approval or disapproval of the price submitted by DVRC.

On December 17, 1998, PennDOT sent DVRC a letter purporting to give DVRC notice of termination pursuant to Section 13 of the Agreement of Sale. (JE-46) The Agreement states the grounds PennDOT must have in order to terminate DVRC:

> "Section 13. Termination for Cause.
> The DEPARTMENT shall have the right to terminate this Agreement upon thirty (30) days notice to the RAILROAD, for non-performance or breach by the RAILROAD of any of the provisions of this AGREEMENT. RAILROAD shall have thirty days to cure said defaults." (Emphasis added.) Agreement of Sale, p.11

In the letter, PennDOT stated that its grounds for termination were "the inability of the Department and DVRC to agree on price and DVRC's failure to satisfy the 'highest possible return standard' as set forth in 49 C.F.R. Part 18.31." (Id.) On December 28, 1998, DVRC asked PennDOT to "identify the specific provision of the Agreement which you deem to have been breached by DVRC and set forth what you believe is necessary for DVRC to effect a cure under the Agreement." (JE-48) In response, PennDOT cited no specific provisions and stated that DVRC's breach was its "contractual pricing deficiency." (JE-49)

On January 15, 1999 (exactly thirty days after PennDOT's notice of termination and within the cure period), DVRC notified PennDOT that it did not agree that it had breached the contract, but offered $500,001.00 for the purchase of Line 907 "in accordance with the Agreement of Sale" meaning that

DVRC would insist on its contractual right to deductible expenses. (JE-50) PennDOT refused to submit DVRC's offer of $500,001.00 to the FRA for approval. (N.T. 161-162) On January 20, 1999, PennDOT wrote to DVRC, stating that "the 'cure' period granted under Section 13 of the Agreement of Sale had passed and, therefore, the termination actions taken by this Department and outlined in its letter of December 17 were 'final and non-negotiable'." (JE-51) On March 19, 1999, DVRC stopped operating on Line 907 and PennDOT entered into an Interim Operating Agreement with Brandywine Valley Railroad Company ("BVRC"), the rail subsidiary of Bethlehem Steel that planned to acquire Line 907. (JE-52)

Based upon the record in this matter, the Board finds that PennDOT breached the Agreement of Sale when it submitted the bid from Bethlehem Steel to the FRA for approval. This act interfered with the ability of DVRC to satisfy a condition of the contract, obtaining FRA approval. At that time, all terms including price had been agreed to and the parties had a valid enforceable contract that had not been terminated. The law is clear that PennDOT's act violated the contract's implied covenant of good faith and fair dealing because it prevented the satisfaction of a condition. PennDOT is therefore liable for damages. Had PennDOT terminated the Agreement of Sale pursuant to the terms of Section 13 before submitting Bethlehem Steel's bid to the FRA, it would not have breached the contract. We will discuss contract law regarding satisfaction of conditions to explain these conclusions.

A condition is an event, not certain to occur, that must occur before performance becomes due. Shovel Transfer and Storage, Inc. v. PLCB, 559 Pa. 56, 58, 739 A.2d 133, 139 (1999). Events that are part of the process of formation of the contract, such as offer and acceptance, are not included in the definition of a condition. Id. An act or event will not be designated as a condition unless clearly intended

by the parties. Id. An unfilled condition does not impede the formation of a valid contract, and one party cannot escape liability for non-performance on the ground that the other party failed to satisfy a condition where the first party caused the failure. Id.

In making a contract, parties may indicate that their agreement is conditional upon a collateral event such as the approval of a third person. In such a situation, neither party has the privilege of revocation and no further assent is required. See 8 Corbin on Contracts, § 31.11. The binding character of such a conditional contract has been judicially recognized. Id.

Under the second Restatement there is a duty of good faith implied in every contract. Restatement (Second) of Contracts sec. 205 (1981). What constitutes good faith depends upon the facts and surrounding circumstances of a given case. It generally requires that if the contract is conditioned on a third party's approval, that the contracting parties must cooperate to achieve that approval. The Board relies upon several cases involving situations in which one party to a contract interfered with the performance of a condition of the contract and the courts found such an act to be in bad faith and a breach of the contract.

As a general rule when one party to a contract unilaterally prevents the performance of a condition upon which his own liability depends, the culpable party may not then capitalize on that failure. Apalucci v. Agora Syndicate, Inc., 145 F.3d 630 (3d Cir. 1998). In Apalucci, the plaintiff brought a negligence action and obtained a default judgment against an insured because both the insured and the insurance company failed to defend the lawsuit. The plaintiff then sought payment of the judgment from the insurance company as a third party beneficiary under the insurance policy. When the insurance company refused to pay, plaintiff sued alleging bad faith and breach of contract for refusing to defend the insured and make

payment to plaintiff. The insurance contract contained a condition in the policy that suit could only be made against the insurance company if a final judgment was obtained after an "actual trial." No trial occurred here because a default judgment had been entered, so that condition of the contract had not been met. On appeal, the Court of Appeals for the Third Circuit applied Pennsylvania law and reversed the summary judgment granted by the trial court in favor of the insurance company. The Court of Appeals decided that although no actual trial was held, that plaintiff still had standing to sue. It reasoned that the insurance company breached its own insurance contract by unjustifiably refusing to defend its insured and thereby had itself caused the default judgment to be entered. Since the insurance company had prevented the occurrence of the "actual trial" condition of the contract, this breach made it liable to the plaintiff for damages.

In McDermott v. Party City Corp., 11 F.Supp. 2d 612 (E.D. Pa. 1998), another case decided under Pennsylvania law, the parties executed a stock purchase agreement which required a bank's approval. The approval was given but it was conditioned upon the wife of the buyer providing her personal guarantee for the transaction. Her guarantee was never given and the buyer refused to proceed with the sale. The buyer argued the contract was unenforceable because the agreement was not valid until all the conditions had been met. The court rejected the buyer's position because it found that his wife had routinely given her guarantee in prior transactions and the only reason it was not given here was because the buyer had prevented it. The court found that the buyer acted in bad faith and that his acts excused the condition. It stated:

> "If a party acts to hinder the satisfaction of a condition, the condition is excused. *Restatement (Second) of Contracts* § 224 cmt.b (1979). In other words, where a party claiming the condition has not been satisfied is the cause of the

> non-occurrence, he or she may not claim the non-occurrence to his or her advantage. *Commonwealth of Pennsylvania Dept. of Transp. v. W.P. Dickerson & Son, Inc.*, 42 Pa. Cmwlth. 359, 400 A.2d 437, 440 (1986) (A party 'may not, in fact, take advantage of an insurmountable obstacle placed by himself in the path of another party's adherence to the agreement.') *See, e.g. In re Stroud Ford, Inc.*, 190 B.R. 785, 787 (Bankr. M.D. Pa. 1995)." Id. at 621.

Shovel Transfer & Storage, Inc. v. Pennsylvania Liquor Control Board, supra., is a third case that is similar in many ways to the case at bar. In May 1986, Shovel Transfer entered into an agreement to provide warehousing services to the PLCB. After executing numerous extensions to the agreement, the parties eventually executed a storage and distribution contract on November 10, 1986. The PLCB Chairman and the Attorney General signed on behalf of PLCB, but the Secretary of the Budget and the Controller refused to sign the contract. PLCB took the position that no valid contract had been formed. In December 1987, PLCB refused to perform the contract and released a new request for proposal thereby subjecting the warehousing project to a second round of competitive bidding. The project was then awarded to another party. Shovel Transfer sued for breach of contract.

The Pennsylvania Supreme Court held that the two additional signatures were merely perfunctory and not required under the statute. It held that a valid contract for storage and distribution existed and was binding, subject only to certain conditions such as the issuance of contractors' licenses and permits. Id. at 63, 68. The failure of Shovel Transfer to fulfill those conditions did not invalidate the contract, but only postponed the PLCB's obligation to perform until these conditions were satisfied. Id. The court found the repudiation of the contract by PLCB and the award of the project to a third party prevented Shovel Transfer from fulfilling the conditions of the contract. Id. The PLCB was held liable for breach of contract.

Applying the decisions in Shovel Transfer, McDermott, and Apalucci, the Board finds that

PennDOT and DVRC entered into an enforceable Agreement of Sale and that the sale was conditioned upon PennDOT obtaining FRA approval. By submitting the Bethlehem Steel bid to FRA, PennDOT interfered with and prevented satisfaction of a condition necessary for the contract's performance. Accordingly, PennDOT breached the contract and is liable for damages. PennDOT had no grounds to repudiate the contract. It also had no right to entertain any other bids unless the Agreement of Sale had been previously terminated. As noted earlier in this opinion, PennDOT could only terminate the contract for cause under the terms stated in Section 13 of the Agreement of Sale. PennDOT could terminate for "non-performance or breach" by DVRC and if it did terminate it had to give DVRC thirty days to cure any default. (Agreement of Sale, p. 11.)

PennDOT asserts as its defense that certain acts by DVRC breached the Agreement of Sale first and gave PennDOT the right to accept Bethlehem Steel's higher bid. In December 1998, when PennDOT gave notice of termination to DVRC, it cited two of these acts. (JE-46) First, it said that there had been an inability of the parties to agree on price. This is clearly untrue since PennDOT told the FRA by letter in June, 1998 that $126,000.00 was the "agreed-upon price." (JE-34) PennDOT freely chose to accept that price and go forward to complete the final condition of the sale.

The second act PennDOT alleged to be a DVRC breach in its December 17, 1998 letter is that DVRC did not agree to a price which provided the "highest rate of return" as required by the FRA. (JE-46) The phrase "highest rate of return" comes from the federal regulations found at 49 C.F.R. sec. 1831, relating to the sale of real property including rail lines by states that had received federal grants to purchase the lines. 49 C.F.R. sec. 1831(c)(2) provides that a state's grantee (PennDOT) may sell property acquired under the grant (Line 907) under the following conditions:

> "(2) Sale of Property. Sell the property and compensate the awarding agency [FRA]. The amount due to the awarding agency will be calculated by applying the awarding agency's percentage of participation in the cost of the original purchase to the proceeds of the sale after deduction of any actual and reasonable selling and fixing-up expenses. If the grant is still active, the net proceeds from the sale may be offset against the original cost of the property. <u>When a grantee or subgrantee is directed to sell the property, sales procedures shall be followed that provide for competition to the extent practicable and result in the highest possible return.</u>" (Emphasis added.) 49 C.F.R. sec. 1831(c)(2).

The final sentence indicates that there should be competitive bidding "to the extent practicable." In the case at bar, PennDOT had competitive bidding when it put out its request for proposals in 1994. It chose DVRC as the best bidder, and entered into the Operating Agreement which contained the option to purchase. Once DVRC exercised the option to purchase and the parties executed the Agreement of Sale, <u>no further competitive bidding</u> was possible (or "practicable") unless and until the Agreement of Sale was terminated.

At the time that the price of $126,000.00 was agreed to by the parties and submitted to the FRA for approval, that price represented the "highest possible return" on the government's grant. PennDOT had worked very hard for two years to reach agreement with DVRC on that price. PennDOT's argument that it was "compelled" by the regulations to submit the later, higher offer from Bethlehem Steel to the FRA in order to meet the highest possible return standard is simply not true. PennDOT was already contractually bound to DVRC because it had accepted and submitted the $126,000.00 price. The words of the regulations do not compel PennDOT to breach its contract with DVRC. Rather, the regulations specifically allow for a situation in which competitive bidding takes place at an early point in the process, as here, and the parties proceed to negotiate the highest possible return under the market conditions then existing. Since DVRC was experiencing substantial losses on Line 907, it seems reasonable that PennDOT would

agree to the $126,000.00 sale price as the highest achievable rate of return at that time.

Also, PennDOT argues that DVRC breached the contract by failing to bid the price for Line 907 that was determined by PennDOT's appraiser, Main Line, and by seeking another appraisal from L.B. Foster. Under the contract it was PennDOT's right to select the appraiser. PennDOT further complains that DVRC breached by exceeding the time allowed for completing the transaction and by engaging in "prolonged negotiations". We find neither of these defenses are valid because even if either of these acts by DVRC were breaches of the terms of the Agreement of Sale, they were waived by the actions of PennDOT since it continued to negotiate over the "prolonged period" itself and since it actually agreed to the appraisal provided by L.B. Foster. Black Top Paving Co., Inc. v. Cmwlth., Dept. of Transportation, 77 Pa.Cmwlth. 612, 466 A.2d 774 (1983)(Contractual provisions can be waived expressly or impliedly.). PennDOT's acts were an implied waiver of any such alleged breaches by DVRC. PennDOT had no basis on which to terminate the contract in December 1998 when it claimed that the contract had been breached by DVRC's acts.

One further conclusion the Board makes is that in January 1999 PennDOT breached the Agreement of Sale a second time when it refused to submit DVRC's bid of $500,001.00 to the FRA for approval. In the middle of December, PennDOT purported to terminate the contract and, as stated earlier, this Board finds that such termination was not effective because PennDOT did not have proper grounds for termination under the contract's terms. However, even if the notice of termination under Section 13 of the Agreement of Sale was effective when given on December 17, 1998, DVRC still had thirty (30) days to cure any defaults. On January 15, 1999, within the cure period, DVRC bid $500,001.00 for Line 907. PennDOT's refusal to submit that bid to the FRA for approval was another act of bad faith and a

breach of the Agreement of Sale.

EQUITABLE ESTOPPEL

The liability of PennDOT has also been established by DVRC under the theory of equitable estoppel. Equitable estoppel is a doctrine of fundamental fairness. It precludes one party from depriving the other of the fruits of its reasonable expectations when the party inducing the reliance knew, or should have known, that the other would rely. See DeFrank v. Greene County, 50 Pa. Cmwlth. 30, 412 A.2d 663 (1980); Com. ex rel. Gonzalez v. Andreas, 245 Pa. Super. 307, 369 A.2d 416 (1976). Equitable estoppel can be applied to a government agency. See Com., Dept. of Environmental Resources v. Dixon Contracting Co., Inc., 80 Pa.Cmwlth. 438, 471 A.2d 934 (1984).

PennDOT is equitably estopped from denying any duty to perform under the terms of the Agreement of Sale. Pursuant to the established RFP procedures, PennDOT and DVRC executed two binding agreements, the Operating Agreement and the Agreement of Sale. The first agreement contained an option to purchase Line 907 and the second contained a promise to sell Line 907 to DVRC. In reliance on these promises, DVRC provided freight service and maintained Lines 907 and 142 and incurred losses of $985,327.00. Since PennDOT knew that DVRC was relying upon the promises contained in the two agreements, PennDOT is estopped from denying its duty to perform under the Agreement of Sale. DVRC reasonably expected that in exchange for its operation on the lines that PennDOT would act in good faith, that it would submit the agreed-upon price of $126,000.00 to the FRA for approval, and that it would do nothing to interfere with FRA approval being granted. DVRC was prejudiced by PennDOT's misconduct in entertaining another party's bid and conveying it to the FRA while DVRC was relying on PennDOT to procure approval and close the sale to DVRC. PennDOT is estopped from denying that it had a binding

agreement on which DVRC justifiably relied and PennDOT is liable for the damages DVRC suffered.

DAMAGES

DVRC claims two types of damages: lost profits and reliance damages. It is DVRC's burden to prove the damages it claims resulted from PennDOT's breach of the contract. See Spang and Co., v. U.S. Steel Corp., 519 Pa. 14, 545 A.2d 861 (1988). While DVRC does not have to prove damages with mathematical certainty, the witness testimony and exhibits it relies upon must support the damages claimed. As a general rule, damages are not recoverable if they are too speculative. See Restatement of Contracts (Second) sec. 352.

For breach of contract, a party can recover general compensatory damages measured by either expectancy or reliance. The expectancy measure quantifies the amount of money necessary to put the party in the position it would have been in had the contract been performed, usually by awarding lost profits. Reliance damages quantify the amount of money necessary to put the party back in the position it would have been in had the contract not been made. See Restatement of Contracts (Second) sec. 344 comment.

In the case before us, DVRC claims that it should recover its lost profits for PennDOT's breach. DVRC's accounting expert, Debora Stewart, CPA, opined that plaintiff's lost profits were from $1,084,999.00 to $3,720,939.00. (N.T. 95-96; P-23.) Within this range, the amount that she calculated should be awarded depends upon the discount rate which is used and the sources of rail traffic which are used in the projections.

DVRC's insurmountable problem in proving its damage theory based upon lost profits is that DVRC operated on these rail lines from July 1994 to March 1999 and never made any profit. (Ex. P-23; JE-55) This fact is not disputed. The legal standard for proving lost profits is that they must be demonstrated with a reasonable degree of certainty. Taylor v. Kaufhold, 84 A.2d 347 (1951). Courts

look to the past record of a business which must provide a reasonably certain basis for the calculation of plaintiff's probable loss of future profits. Palmer v. Connecticut Railroad & Lighting Co., 311 U.S. 544 (1941). Lost profits are not recoverable if they are overly speculative. Delahanty v. First Pennsylvania Bank, N.A., 318 Pa. Super. 90, 464 A.2d 1243 (1983). In Delahanty the court found that lost profits were not recoverable because the business had only been in operation for seven months. The business "might or might not have been profitable. Thus the element of reasonable certainty needed to collect damages for lost profits is lacking." Id. At 1261. The same is true for DVRC.

The Board finds that the reasonable degree of certainty test has not been met here. We cannot say that because DVRC incurred substantial losses that it was impossible for the railway to make a profit in the future. We only find that using all the facts found in this matter that it cannot be concluded with reasonable certainty that DVRC would have made any profit if the contract had not been breached and DVRC had owned Line 907 from 1998 to 2008.

In addition to this general reason for denying DVRC's claim for lost profits, the Board will also address some of the particular components of Ms. Stewart's expert report and opinion. She projected that DVRC's revenues would increase and its projected costs would decrease over the future ten year period. (Ex. P-23) PennDOT's expert, Louis Rubino, Jr., CPA, argued that Ms. Stewart's revenue projections were unreliable because they were not based upon DVRC's historical revenues, but on those of BVRC, the Bethlehem subsidiary. (Ex. P-23; N.T. 278, 306) He pointed out that the two rail companies were in substantially different market positions since BVRC's parent also owned the Bethlehem Steel/Lukens plant, the largest customer on Line 907. This meant that if BVRC owned Line 907, it would have retained more revenue per carload than DVRC from any freight shipped and also that its parent would have direct control

over the amount of product shipped and the route chosen to ship its steel products. The business decisions of Bethlehem Steel/Lukens would thus directly affect the future revenue generated on Line 907, so that DVRC future revenues could not be reliably based on those of BVRC.

A further reason why DVRC's revenues would not be the same as BVRC's is that DVRC would not be able to achieve the same cost efficiency in the transport of freight cars because BVRC had access to two major national rail networks, CSX and Norfolk Southern. (N.T. 267-269, 381, 413) This direct access allowed Bethlehem Steel and its rail subsidiary to promote competition between CSX and Norfolk Southern thereby realizing lower freight costs for Bethlehem Steel. Id. This ability to negotiate gave BVRC a competitive advantage over DVRC which had access to only one major carrier, CSX. Id.

Also, the Board finds that the testimony and opinion of Mr. Rubino, to be credible and reliable when he opined that the DVRC revenue projections which included the assumptions that added rail traffic from three sources would increase future revenue were highly speculative. For some of her profit projections, Ms. Stewart assumed that in the future there would be additional rail traffic on Line 907 from Mars Industries in Detroit, Bethlehem Steel's Sparrows Point facility, and diverted truck traffic. Mr. Rubino pointed out that 1)Mars Industries did not ship a single carload on Line 907 from September, 1999 to August, 2000, but used the Norfolk Southern Railway instead for that period. (N.T. 194-203); 2) the Sparrows Point rail traffic was actually not on Line 907. (N.T. 201-205); and 3) the source of the figures for future profits from an increase in diverted truck traffic that Ms. Stewart used was a Bethlehem Steel

application for state funding to upgrade Line 907 which was a totally speculative projection itself. (Ex. P-4) DVRC's expert's projection was not based on any actual figures for diverted truck traffic. (N.T. 201-201; Ex. P-18)

Mr. Rubino finds that Ms. Stewart's revenue projections are overstated because the number of carloads to be shipped on the railway lines is substantially overstated. Again, we agree. DVRC historically shipped an average of 1,500 carloads per year. As stated above, Ms. Stewart used BVRC figures which show shipments of 2,400 carloads per year in its two years of operation. Since BVRC's connection to Bethlehem Steel put it in a different market position, it does not seem accurate for DVRC to just forget its own financial history and step into BVRC's shoes for the purpose of projecting future revenues. This is also supported by the testimony of DVRC witnesses Mr. Marino and Alfred Sauer, Vice President of Business Development for RailAmerica. They both noted several marketing initiatives which DVRC undertook to increase the volume of carloads, but which failed. (N.T. 85-87, 223-228, 234-236) All these factors make Ms. Stewart's revenue estimates, and therefore her projections, very speculative.

The Board also agrees with Mr. Rubino's opinion that plaintiff's expert's cost projections were understated and unreliable. Rubino specifically pointed to an understatement of diesel fuel costs for 1999 and 2000 of $43,000.00 (Ex. P-23; N.T. 320, 428), an understatement of train and track salaries of $102,000.00 (N.T. 428-429), an understatement of freight cars per diem of $14,000.00 (N.T. 429), and an understatement of track costs of $44,000.00. (N.T. 321-322, 429) The Board finds this testimony credible and the cumulative effect of all these items casts significant doubt on the reliability of plaintiff's cost projections and therefore its claim of lost profits.

After examining all the evidence presented regarding damages in this case, the Board finds that lost

profits are not recoverable. The financial history of DVRC's operations on Line 907 shows only losses, and it has not been proven with a reasonable degree of certainty that DVRC would have made a profit in years 1999 to 2008, or any of them. The DVRC claim for lost profits is denied.

As an alternative to its lost profits theory of damages, DVRC is claiming reliance damages of $985,327.00. This is the total amount DVRC lost during its operation of Line 907 from July 1994 to March 1999. (Ex. P-23, Ex.L; JE-55) The amount of these losses is undisputed by PennDOT. (N.T. 432-435)

Reliance damages are awarded to place a party in the same position that it was in prior to the contract. Trosky v. Civil Service Com'n, City of Pittsburgh, 539 Pa. 356, 363-64, 652 A.2d 813, 817 (1995). See also, National Controls Corp. v. National Semiconductor Corp., 833 F.2d 491 (3d Cir. 1987). These damages are the amount of money a party spent in reliance upon the other party performing or it is the amount of the losses incurred in reliance upon the other party performing the contract. Shovel Transfer and Storage, Inc. v. PLCB, supra., at 140. In Shovel Transfer, the Pennsylvania Supreme Court found that reliance damages were the appropriate way to measure the harm suffered by the plaintiff. Such damages put the plaintiff back in the position it would have been in had the contract not been made. Id. The plaintiff recovered the money it spent on the purchase and renovation of a warehouse because it made these expenditures in reliance on the defendant performing the contract. Id.

In the case at bar, DVRC endured two years of losses while it operated on Lines 907 and 142 in 1994 and 1995. It clearly wanted to make a profit, and in July 1996 it executed the Agreement of Sale in reliance on PennDOT's promise to sell it Line 907 so it could make this a Class II system and develop more business. (Ex. D-1) The losses DVRC incurred after July 1996 were incurred in reliance on

PennDOT performing the contract to sell it the line.

While reliance damages appear to be the only appropriate remedy in this case, PennDOT makes several weak arguments opposing their award. First, it says such damages are not recoverable by DVRC because Line 907 had no future potential to be profitable. (PennDOT Brief, p. 22.) This is not a reason to deny reliance damages since PennDOT concedes that DVRC "incurred losses in hopes of realizing a profit in the future." Id. The hope and expectation of future profits is why DVRC wanted the opportunity to buy the line. This is substantiated by the testimony of Gary Marino, President of DVRC. (N.T. 41)

PennDOT next states that there is no causal connection between DVRC's losses and the breach since the losses occurred first. This is true for some losses but not for others. The Board finds that losses incurred by DVRC from the time that it executed the Operating Agreement in 1994 until it executed the Agreement of Sale in 1996 are not recoverable because during this period DVRC was deciding whether or not to exercise its option to purchase Line 907. Losses during this period were not sustained in reliance on the performance of the Agreement of Sale and thus are not related to the breach. However, in July 1996 DVRC exercised its option to purchase Line 907 and the parties signed the Agreement of Sale. The parties entered the Agreement of Sale and because all terms were agreed to, it was binding on the parties pending the satisfaction of the condition requiring FRA approval. From July 1996 forward, DVRC relied to its detriment upon PennDOT performing in good faith and as it had promised. The losses from this period forward are recoverable as reliance damages.

PennDOT makes two other arguments in its opposition to the award of reliance damages. Mr. Rubino opined that either DVRC or its parent RailAmerica would have received a tax benefit in the amount of $350,000.00 for the accumulated losses and therefore any damages should be reduced by that amount.

(N.T. 434-435) The problem with this opinion and argument is that it is totally unsupported by any facts, testimony, or exhibits in the record. Mr. Rubino admitted that he had never seen either company's tax returns and did not know if any tax deductions were actually taken. (N.T. 434, 445)

Mr. Rubino also claimed that any reliance damages should be reduced by the purchase price for Line 907 which he assumed to be $500,001.00. While DVRC did submit that bid to PennDOT in January 1999, we have already found that the bid was neither accepted by PennDOT nor transmitted to the FRA for approval, so it was clearly not an agreed-upon purchase price. Further, by the time that bid was made PennDOT had already breached the contract. The only price that was ever acceptable to both parties was $126,000.00. However, the Board does not find that $126,000.00. or any amount for the purchase price must be deducted from DVRC's reliance damages. DVRC never paid PennDOT for Line 907 and PennDOT never sold the line to DVRC. If DVRC had paid the purchase price to PennDOT, that amount would be refundable to DVRC as restitution because it never got title to Line 907 or it would be added to any amount of damages awarded.

Since reliance damages are meant to restore plaintiff to the same position it was in before the contract was entered, the Board finds that DVRC's reliance damages are those losses it suffered from July 1996 when the Agreement of Sale was executed until the time DVRC ceased operations on the system. During this entire period, DVRC continued to provide service to the freight customers and tried to expand the business on Line 907. In order to compute reliance damages, the Board starts with DVRC's losses for the period July 1994 through March 1999 which are $985,327.00. As stated earlier in this opinion, this amount was agreed to by the expert witnesses for both parties and the computation of these total losses is found in Ms. Stewart's report in Exhibit L to Plaintiff's Exhibit 23. (See also JE-55; N.T. 432-

435) The figures used in Exhibit L were all taken from DVRC's financial statements found in Joint Exhibit 55. The Board added the losses for the years 1994, 1995, and six months of 1996 from DVRC's income statements in Joint Exhibit 55. These losses totaled $221,528.00:

1994 loss	$82,316.00
1995 loss	$104,859.00
1996 loss (Jan. to June)	$34,353.00
Total	$221,528.00

In order to find the amount of reliance damages incurred from July, 1996 to 1999, the Board subtracted $221,528.00 from the total losses of $985,327.00 leaving a remainder of $763,799.00 which is the amount of the reliance damages the Board will award DVRC. .

For all the foregoing reasons, the Board finds that PennDOT breached the Agreement of Sale and acted in bad faith by doing acts which interfered with DVRC's ability to get FRA approval and meet the conditions of the contract. PennDOT committed to sell Line 907 to a third party and refused to fulfill its contractual obligations to DVRC. Further, the doctrine of equitable estoppel precludes PennDOT from denying the existence of a contractual duty under the Agreement of Sale and holds PennDOT liable for the damages DVRC suffered. PennDOT is therefore liable to DVRC for damages in the amount of $763,799.00 resulting from its conduct.

ORDER

AND NOW, this 13th day of March, 2002, after hearing, it is **ORDERED** and **DECREED** that judgment be entered in favor of Plaintiff, Delaware Valley Railway Company, and against Defendant, Commonwealth of Pennsylvania, Department of Transportation, in the sum of Seven Hundred Sixty-Three Thousand Seven Hundred Ninety-Nine Dollars ($763,799.00) with interest thereon at the legal rate of six percent (6%) per annum from March 15, 1999, the date on which the Complaint in this matter was filed.

Upon receipt of said award by Plaintiff, Plaintiff shall forthwith file a praecipe to mark the case settled and ended with prejudice with the Board.

Each party shall bear its own costs and attorneys' fees.

BOARD OF CLAIMS

____
David C. Clipper
Chief Administrative Judge

____
Louis G. O'Brien
Engineer Member

Opinion Signed

____
John R. McCarty
Citizen Member