Takings and the Public Interest in Railroad Reorganization

The decade of the 1960's brought an era of economic crisis to America's great eastern railroads. The crisis has precipitated a new breed of railroad reorganizations under Section 77 of the Bankruptcy Act, characterized by the carriers' basic inability to produce revenues large enough to cover even operating expenses. This economic fact has produced an acute conflict between the public's interest in continued rail service and the security interest of the railroads' creditors, for the continuation of services during reorganization proceedings perpetuates losses that must be financed by consuming railroad assets and devalu-

1. 11 U.S.C. § 205 (1970). Detailed studies of Section 77 reorganizations, their history, and their procedures can be found in H. GUTTMANN & H. DOUGALL, CORPORATE FINANCIAL POLICY 646-87 (3d ed. 1955); Swaine, A Decade of Reorganization under Section 77 of the Federal Bankruptcy Act, 56 HARV. L. REV. 1193 (1943); Will, Railroad Reorganization, 41 ILL. L. REV. 608 (1947).

2. For one excellent description of the overall ills of eastern railroads, see Shabecoff, Collapse of Penn Central Reflects Iills of Railroads, N.Y. Times, Feb. 11, 1973, § 1, at 1, col. 6. For a brief but helpful introduction to the interminable reorganization of the New Haven Railroad and to the ongoing reorganizations of the Penn-Central and the Boston & Maine, see Haskell, Railroad Reorganization for Beginners, 24 ALA. L. REV. 295 (1972). In addition to the Penn-Central and the Boston & Maine, the following northeastern railroads are presently in Section 77 reorganization: the Central of New Jersey, the Reading, the Erie-Lackawanna, the Lehigh Valley, the Lehigh & Hudson River, and the New Hope & Ivyland. See Shabecoff, supra.

In response to continuing rail losses exceeding $20 million per month, Judge Fullam, the Penn-Central's reorganization judge in the Eastern District of Pennsylvania, issued tough instructions to the road's reorganization trustees on March 6, 1973. He demanded that they submit by July 2 either a practicable reorganization plan or a proposal for liquidating the Penn-Central. See Bedingfield, A Deadline Given to Penn Central, N.Y. Times, Mar. 7, 1973, at 1, col. 7 (city ed.); Wall St. J., Mar. 7, 1973, at 3, col. 2. Judge Fullam's action in effect established a deadline for determining whether or not there was any reasonable likelihood of a viable reorganization of the Penn-Central and, therefore, any legal justification for continuing in Section 77.

The future of the Penn-Central and of the other bankrupt railroads is currently the subject of vigorous debate. The Department of Transportation is presently preparing a plan for restructuring the entire northeastern rail industry. This plan is expected to emphasize, as did Judge Fullam, the rights of creditors and to declare that forced deficit operations on bankrupt lines are not in the public interest as heretofore presumed. See Karr, Nixon's Plan to Realign Rail Freight Lines in Northeast Likely to Rule Out Federal Aid, Wall St. J., Mar. 22, 1973, at 4, col. 2; Robbins, U.S. Weighs Plan to Speed Close of Losing Rail Lines, N.Y. Times, Mar. 16, 1973, at 1, col. 2 (city ed.). A Senate Commerce Committee report issued on February 10 also offers wide-ranging proposals for salvaging the railroads. See Wall St. J., Feb. 12, 1973, at 2, col. 3; Shabecoff, supra. On March 24 the I.C.C. submitted a report to Congress outlining its views on the problem. See Robbins, I.C.C. Seeks Rail Aid Plan with 1% Levy on Freight, N.Y. Times, Mar. 25, 1973, § 1, at 1, col. 2.
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... creditors' interest in those assets. In the *New Haven Inclusion Cases* the Supreme Court faced this conflict for the first time and held that the creditors' interest was subordinate to that of the public. Not only were the trains properly kept running, the Court held, but also the burden of inevitable losses arising from their operation was properly left on the railroad's creditors.

As the *New Haven* case will show, the railroad crisis has produced in turn a potential crisis in constitutional doctrine that may eventually dwarf it in significance. The Fifth Amendment provides that "No person shall . . . be deprived of life, liberty or property, without due process of law; nor shall private property be taken for public use, without just compensation." In the past, courts have applied the latter clause, the Takings Clause, as a guarantee of owners' right to retrieve their property from unprofitable uses and to re-deploy it elsewhere. This right was apparently denied to railroad creditors in the *New Haven* case in deference to a supervening public right in rail properties. If the Takings Clause is to have any viability, it must be recognized that the "public rights" theory of *New Haven* was conceptually unsound, for the "right of retrieval" that it overrode is, in fact, the core of the Takings Clause. Courts faced with similar situations now and in the future must devise a theory on which to distinguish the *New Haven* case and acknowledge the right of retrieval as a measure of creditors' constitutional due.

I

The first major railroad reorganization of recent years began on July 7, 1961, when the New York, New Haven and Hartford Railroad (the New Haven) filed a petition under Section 77 of the Bankruptcy Act. When the New Haven entered reorganization, it was losing about $1.5 million per month. Despite the efforts of the reorganization trustees to economize, it was apparent by early 1963 that the line would never again be profitable. Rather than permit liquidation of the railroad,

4. U.S. Const. amend. V. The Fifth Amendment applies only to actions by the Federal Government. State governments are restrained instead by the Fourteenth Amendment, which contains a Due Process Clause but no Takings Clause. The relationship between the two Amendments, as they bear upon this Note, is considered at p. 1010 infra.
7. Id.
the ICC, which had responsibility for formulating and certifying a plan of reorganization, chose to attempt a sale of the New Haven to a large trunk-line rail carrier. Neither the ICC nor the New Haven's reorganization court (the district court) believed that it would be compatible with the public interest to allow a discontinuation of rail services and a liquidation of the New Haven. Eventually, the ICC extracted an agreement from the Pennsylvania and the New York Central Railroads—then seeking the Commission's permission to merge—to take over the New Haven line as a condition of the merger.

The plan ultimately devised by the ICC and approved by the district court required the Penn-Central to pay the December 31, 1966, "liquidation value" of New Haven assets. The valuation date

9. In 1969 the district court recalled that:
   By late 1963, it was clear to the Trustees of the New Haven and to [this] Court that
   only two courses were open: the Trustees must press to accomplish the inclusion in a
   Penn-Central merger or they must press for liquidation [of the New Haven]. The
   former was obviously in the public interest and the latter was not. The course of
   inclusion was followed . . . .

10. Prior to 1963 the reorganization trustees had sought governmental assistance in the
    form of subsidies and tax relief, which at the time seemed to offer a way of keeping
    the New Haven alive and independent. See In re New York, N.H. & H.R.R., Six
    Months Interim Report of the Trustees (Mar. 5, 1962), in 2 NEW HAVEN PROCEEDINGS
    793—(I), 799—(126-31). The hoped-for public assistance never materialized. See In
    287 (Feb. 15, 1965), in 5 NEW HAVEN PROCEEDINGS 3109, 3116-22.

11. See, e.g., New York, N.H. & H.R.R., Trustees, Discontinuance of All Interstate
    Passenger Trains, 327 I.C.C. 151, 201-18, 224-25 (1966); Passenger Fares, New York, N.H.
    & H.R.R., 314 I.C.C. 377, 378-79 (1961). From time to time, however, the ICC did authorize
    the abandonment of particularly unprofitable portions of the New Haven's pre-
    bankruptcy rail service, viewing these as undue burdens on interstate commerce. See, e.g.,
    New York, N.H. & H.R.R., Trustees, Discontinuance of Passenger Service between Boston

   In re New York, N.H. & H.R.R., Memorandum of Decision on Petition for Order No. 25
   (Oct. 20, 1961), in 1 NEW HAVEN PROCEEDINGS 290.

   The history and the terms of the Penn-Central merger are discussed in Penn-
   Central Merger Cases, 389 U.S. 486 (1968). This strategy for salvaging the New Haven line had
   been foreseen quite early in the reorganization, as an alternative to actual reorganization,
   if the federal and state governments did not provide adequate tax relief and subsidies.
   (Mar. 5, 1962), in 2 NEW HAVEN PROCEEDINGS 793—(I), 799—(30-31). The ICC had the
   power under Section 5 of the Interstate Commerce Act to require that merging railroads,
   as a condition precedent to approval of the merger, take over and operate smaller rail
   lines that might be adversely affected by the proposed merger. See 49 U.S.C. § 5 (1970).
   In its principal decision on the New Haven inclusion, the district court observed that:
   In consummating the merger Penn-Central agreed to pay whatever price and submit
   to whatever terms for the inclusion that the [ICC] and the Courts might find
   reasonable.
   and the New York Central Railroads agreed to the inclusion and to these terms in antici-
   pation of saving approximately $80 million per year through their merger. See New


15. Id. at 454.
supposedly accounted for the delay that would have accompanied actual abandonment of the railroad. The price thus generated, however, was less than that which would have arisen from the actual abandonment and liquidation of the New Haven. The discrepancy was rooted in the fact that the New Haven was required to continue its rail services during lengthy purchase price negotiations, absorbing operating losses at an annual rate of $10 to $20 million out of assets with a total initial worth of approximately $200 to $250 million. Assuming, as did the plan, that the liquidation process would have commenced on the date of the reorganization petition, at least some of the New Haven’s operating losses from July 1961 to 1967 (the period of hypothetical liquidation) would have been avoided. And, in actual liquidation, certainly the post-1966 operating deficits, fixed charges, and administrative expenses that were allocated in part to the New Haven would not have existed.

Ultimately, those who bore the brunt of those losses were the New Haven’s mortgage bondholders. The railroad’s losses were financed primarily through the issuance of trustees’ certificates, new debt instruments taking a higher claim on the road’s assets than any pre-bankruptcy securities. Additional sources of loss were deferred property taxes that continued to accumulate, also receiving priority over pre-bankruptcy debts, and the physical deterioration of railroad assets that resulted from postponement of maintenance.

From 1961 until 1968 the district court repeatedly cautioned that the Constitution might not tolerate perpetual forced deficit opera-

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16. Looking back on the case in 1969, the district court clarified this point: “[T]he term ‘fair liquidation value’ has been used in the present case to describe a method or theory of determining value. It envisioned sale of New Haven property over a period of six years and of economic factors related to the business process of turning the properties into cash.” In re New York, N.H. & H.R.R., 304 F. Supp. 793, 805 (D. Conn. 1969).

17. At the outset of the proceedings, the reorganization court directed that the New Haven continue operating. In re New York, N.H. & H.R.R., Order No. 1 (July 7, 1961), in 1 New Haven Proceedings 5. Moreover, under Sections 1(18) and 1(20) of the Interstate Commerce Act, 49 U.S.C. §§ 1(18), 1(20) (1970), the railroad would have had to secure a certificate of public convenience and necessity from the ICC prior to discontinuing services and abandoning the line. See Zim v. Hanover Bank, 215 F.2d 63, 69 (2d Cir. 1954).


19. The New Haven’s asset worth in 1961 was presumably at least the sum of $162.7 million, the 1966 year-end valuation, see In re New York, N.H. & H.R.R., 304 F. Supp. 793, 797 (D. Conn. 1969), and $88 million, the railroad’s deficits for the years 1951 through 1956, see In re New York, N.H. & H. R.R., 289 F. Supp. 451, 458 (D. Conn. 1969).


22. See Note, supra note 5, at 865-67.
At the same time that the court approved the ICC plan for a Penn-Central purchase of the New Haven, it ruled that "the continued erosion of the Debtor's estate from operational losses after the end of 1968 [would] clearly constitute a taking of the Debtor's property and consequently the interests of the bondholders, without just compensation."  

The Supreme Court, in the 1970 *New Haven Inclusion Cases*, also approved the basic plan. The Court added explicitly that the forced deficit operation of the railroad constituted no taking of the bondholders' property prior to 1969, when the Penn-Central in fact took over New Haven operations. Although acknowledging that the reorganization proceedings had "imposed a substantial loss upon the bondholders," the Court could "see no constitutional bar to that result."

Contrary to the Court, a sound interpretation of the Fifth Amendment cannot countenance the forced continuation of deficit rail operations without just compensation to rail creditors for their resulting losses.

II

The *New Haven* courts failed to consider two seminal cases that had defined a constitutional limit to railroad regulation. In *Brooks-Scanlon Co. v. R.R. Comm'n*, 251 U.S. 396 (1920), the district court first acknowledged that the inclusion decision of 1968 was already pending before the New Haven railroad bondholders appeal to the Second Circuit in advance of judgment. Appeal to the Second Circuit had been taken from a judgment of the New Haven's reorganization court—the District Court for Connecticut—which had reviewed the inclusion plan as a plan of reorganization under Section 77 of the Bankruptcy Act. See generally *Penn-Central Merger Cases*, 389 U.S. 486 (1968). The remaining actions were before the Court on certiorari to the United States Court of Appeals for the Second Circuit, which had August 20th, 1969, when its inclusion decision of 1968 was already pending before the new Penn-Central line. Some of these actions were on direct appeal from a decision of a three-judge court in the United States District Court for the Southern District of New York, which had reviewed the inclusion plan under Section 5 of the Interstate Commerce Act. See *New York, N.H. & H. R.R., Bondholders' Comm. v. United States*, 289 F. Supp. 418 (S.D.N.Y. 1968). Jurisdiction under the Interstate Commerce Act arose because inclusion of the New Haven had been an express condition of the Penn-Central merger. See generally *Penn-Central Merger Cases*, 389 U.S. 486 (1968). The remaining actions were before the Court on certiorari to the United States Court of Appeals for the Second Circuit, in which the Court had reviewed the inclusion plan as a plan of reorganization under Section 77 of the Bankruptcy Act. See *In re New York, N.H. & H. R.R.*, 289 F. Supp. 451 (D. Conn. 1968).
Ion Co. v. Railroad Comm'n, the Supreme Court unanimously invalidated an order of a state railroad commission that required an intrastate railroad to operate on specified schedules at a loss. So long as the railroad completely repudiated its state charter and its business as a common carrier, the Court held, the owners had a right to abandon and to liquidate: "If the [railroad] be taken to have granted to the public an interest in the use of the railroad it may withdraw its grant by discontinuing the use when that use can be kept up only at a loss." 

Four years later the Supreme Court reaffirmed Brooks-Scanlon in Railroad Comm'n v. Eastern Texas R.R. Once again a state regulatory commission had tried to prevent the shut-down and liquidation of an unprofitable rail line. The Court reminded the commission that the railroad, although devoting its property to the use of the public, does not do so irrevocably or absolutely. . . . And if at any time it develops with reasonable certainty that future operation must be at a loss, the company may discontinue operating and get what it can out of the property by dismantling the road. To compel it to go on at a loss or to give up the salvage value would be to take its property without . . . just compensation . . . .

These decisions have never been challenged. In fact, Brooks-Scanlon has been repeatedly acknowledged as a basic statement of rights under the constitutional law of takings.

Brooks-Scanlon articulated the principle that railroads may be compelled to operate at a loss only if compensated for that loss. There ap-
pears to be no reason why this principle should not have been applied in the New Haven case. The differences between New Haven and the earlier cases do not provide a basis for distinguishing their constitutional issues. First, there is no doctrinal significance to the fact that the state orders invalidated in Brooks-Scanlon and Eastern Texas were subject to the Fourteenth Amendment while the federal powers exercised in New Haven were governed by the Fifth Amendment. Fifth and Fourteenth Amendment takings law has been developed as a single theory, with courts often cross-citing freely between cases resting on the respective provisions. Moreover, it is the Fourteenth Amendment, not the Fifth, that lacks an explicit Takings Clause. Since constitutional strictures against state and local takings are thus purely inferential from due process of law, any arguable difference in the meanings of the two amendments would favor a stronger Fifth Amendment doctrine. Nor is it significant that the Brooks-Scanlon Company and the Eastern Texas Railroad were not in bankruptcy at the time of the litigation. Even the New Haven district court acknowledged the long-standing proposition that federal bankruptcy powers are exercised subject to the Fifth Amendment. The Interstate Commerce Act, which might be thought to have had some impact upon the constitutional rights of the New Haven's bondholders, is similarly subordinate to the Fifth Amendment.

III

The Supreme Court suggested a number of possible grounds for its refusal to recognize pre-1969 bondholder losses as a compensable taking of property. Although the Court alluded to possible procedural defects in the bondholders' presentation, the outcome seems to have turned

36. See p. 1005 supra.
42. The Court suggested, first, that the bondholders may have failed to make a requisite showing of "the depreciation and losses attributable to the prevaluation period," New Haven Inclusion Cases, 599 U.S. 392, 493 (1970). These, however, were statutory re-
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on two substantive propositions: first, that the bondholders had been deprived, at most, of remedial rights; and second, that the public interest in continued rail service superseded any property rights claimed by the bondholders.

The Court implied, to begin with, that the district court’s decision to continue New Haven rail operations did no more than suspend the bondholders’ “remedial” right to foreclose on mortgaged property. The district court’s unquestioned power to do this, the Court seemed to conclude, negated any claim that resulting losses were compensable under the Takings Clause. This perspective apparently derived from earlier railroad reorganizations that were, in fact, fundamentally different from New Haven.

The Court gave particular weight to Continental Illinois Nat’l Bank & Trust Co. v. Chicago, R.I. & P. Ry., the Supreme Court’s first con-

view proceedings to determine the fairness of the ICC’s inclusion plan; the bondholders were not making a direct claim against the Federal Government for compensation under the Fifth Amendment. See note 27 supra. At most the Court was asked to rule that the bondholders had been left with some uncompensated losses that constituted a taking, and the Court conceded that they had suffered “substantial loss.” See p. 1008 supra. No further proof was needed for the Court to have adjudicated the theoretical taking question.

Second, the Court suggested that the bondholders waived their rights to some degree by their long-term acquiescence in the reorganization proceedings: “[T]he failure of the bondholders to press for early liquidation of the New Haven meant that their initial application [in April 1967] for a dismissal of the reorganization proceedings came just as the objective of salvaging the New Haven appeared possible to achieve,” New Haven Inclusion Cases, 399 U.S. 392, 493 (1970). As an argument, this fails to be convincing. Not only had the Court already acknowledged the bondholders’ liquidation rights, id. at 489-90, but also, when the April 1967 dismissal petition was filed, the district court rejected it as premature. In re New York, N.H. & H. R. R., 281 F. Supp. 63 (D. Conn. 1968). It is not clear whether the Court was suggesting bad faith on the part of the bondholders, inasmuch as they cooperated as long as they did, or conditioning the constitutional right upon an early filing for dismissal, which would, as a procedural rule, result in creditors invariably requesting dismissal on the first day of reorganization. Neither interpretation is convincing. The district court seems to have reassured the bondholders for some time that their constitutional rights would be safeguarded in the court’s ultimate review of any takeover plan, see note 29 supra, thus minimizing whatever incentive the bondholders may have had to seek early dismissal. Moreover, each time the trustees petitioned for new financing that would precede the bondholders in priority in a distribution of rail assets, the court announced its intention to protect the interests of the New Haven bondholders. See, e.g., In re New York, N.H. & H. R.R., Memorandum of Decision on Petition for Order No. 81 (Mar. 5, 1962), in 1 NEW HAVEN PROCEEDINGS 673, 675-77; In re New York, N.H & H. R.R., Memorandum of Decision on Petition for Order No. 25 (Oct. 20, 1961), in 1 NEW HAVEN PROCEEDINGS 283, 289-93. In addition, the ICC was firmly opposed to any effort to abandon and liquidate the New Haven, and its approval of an abandonment of rail services would have been necessary even after dismissal of Section 77 proceedings, 49 U.S.C. §§ 1(18), 1(20) (1970). Pennsylvania R.R.—Merger—New York Cent. R.R., 354 I.C.C. 25, 54 (1968). The ICC and the district court, themselves, encouraged the acquiescence that the Supreme Court seems to have viewed as a bondholder strategy.

43. The Court said that a lien creditor’s claim that injury would result from suspension of his foreclosure rights, “‘presents a question addressed not to the power of the court but to its discretion—a matter not subject to the interference of an appellate court unless such discretion be improvidently exercised.’” New Haven Inclusion Cases, 399 U.S. 392, 490-91 (1970), quoting Continental Illinois Nat’l Bank & Trust Co. v. Chicago, R.I. & P. Ry., 294 U.S. 618, 677 (1935).

44. 294 U.S. 648 (1935).
institutional decision under Section 77 of the Bankruptcy Act. In *Continental Bank* the Court affirmed an injunction, pending reorganization, against the sale of bonds pledged by the railroad as security for certain collateral notes. The Court concluded that the injunction did not impair the pledgees' liens or otherwise deliberately cause a depreciation in their security interests. In view of the fact that the bonds had face amounts totalling three times the notes they secured, the pledgees' claims were not in jeopardy and the injunction did "no more than suspend the enforcement of the lien by a sale of collateral pending further action." Thus, on the facts, the pledgees lost no property cognizable under the Takings Clause.

The bankruptcy of the New Haven posed a problem dramatically different from *Continental Bank*: the New Haven could only run at a loss and its creditors were plainly disserved by continued operations. Each day the trains ran, as required by the district court's order, the creditors' losses mounted. In this vital characteristic, the *New Haven* case resembled *Louisville Joint Stock Land Bank v. Radford* rather than *Continental Bank*. In *Radford* the Supreme Court clearly interred any notion that bankruptcy proceedings may strip creditors of the right ultimately to receive the value of their collateral. The Frazier-Lemke Act of 1934, which amended the Bankruptcy Act, had declared a moratorium on farm mortgage foreclosures. *Radford* held the statute constitutionally defective in that it failed, among other things, to protect the mortgagee from accumulating deferred taxes and from a general wasting of the property. These terms of the Act, the Court held, directly took the mortgagees' property without just compensation.

Similarly, the New Haven bondholders' property interest in rail-

46. Id. at 676-77.
47. Id. at 680-81.
48. See p. 1007 supra.
50. Id. at 591-93.
51. Following the *Radford* decision, Congress amended the original Frazier-Lemke Act so as to require mortgagors to pay reasonable rental on the retained property, pay taxes in order to protect the title, and maintain the property to preserve its value. The Supreme Court then upheld the new Act under the Fifth Amendment. Wright v. Vinton Branch of the Mountain Trust Bank, 300 U.S. 440 (1937).
52. The province of the Court is limited to deciding whether the Frazier-Lemke Act as applied has taken from the Bank [the mortgagee] without just compensation, and given to Radford, rights in specific property which are of substantial value. As we must conclude that the Act as applied has done so, we must hold it void. If the public interest requires, and permits, the taking of property of individual mortgagees in order to relieve the necessities of individual mortgagors, resort must be had to proceedings by eminent domain; so that, through taxation, the burden of the relief afforded in the public interest may be borne by the public.

295 U.S. at 601-02.
road assets was deliberately and necessarily impaired by the requirement of continued rail services. But in *New Haven* the Supreme Court overlooked the character of resulting private injuries as a determinant of creditors' constitutional rights. That is, the Court ignored the distinction—illustrated in *Continental Bank* and *Radford*—between creditors' temporary loss of strategic control over their collateral and their loss of the collateral itself.53

The Supreme Court, however, did not base its decision only on the theory that "mere remedial rights" were affected by the continued deficit operation. The Court stated firmly that any losses imposed on the bondholders were warranted by the public's interest in uninterrupted rail service.54 This facet of the Court's opinion relies on the proposition that investors in railroads "assume the risk attached to their investments," including, it seems, the risk of collateral erosion in the event of bankruptcy reorganization. Such an idea had been previously expressed as dictum in *Reconstruction Finance Corp. v. Denver & R.G.W.R.R.*,56 quoted by the Court in *New Haven*: "[B]y their entry into a railroad enterprise, [security holders] assumed the risk that in any depression or any reorganization the interests of the public would be considered as well as theirs."57

Certainly railroad investors assume some duties in relation to the public. The scope of assumed risk imputed to the New Haven's bondholders, however, could not have derived from traditional contract theory. As the Supreme Court once observed:

> Apart from statute or express contract people who have put their money into a railroad are not bound to go on with it at a loss if there is not reasonable prospect of profitable operation in the

53. The district court, on the other hand, seems to have been aware of this distinction: [W]hile under these circumstances, an invasion or postponement of the creditors' remedies may justifiably be ordered, the court must remain keenly aware that § 77 limits the powers of the court to take action directly affecting the creditors' substantive rights. *In re New York, N.H. & H.R.R., Memorandum of Decision on Petition for Order No. 81* (Mar. 5, 1962), in *1 New Haven Proceedings* 673, 676. For this reason, citing *In re Third Ave. Transit Corp.*, 198 F.2d 703 (2d Cir. 1952), the court disapproved the Trustees' petition to create certain debt that would have taken priority over the bondholders' mortgage liens. At no subsequent point did it repudiate this decision that financing measures having such an effect would, like the terms of the first Frazier-Lemke Act in *Radford*, impair the bondholders' substantive rights.

54. We do not doubt that the time consumed in the course of the proceedings in the reorganization court has imposed a substantial loss upon the bondholders. But in the circumstances presented by this litigation we see no constitutional bar to that result. The rights of the bondholders are not absolute. *New Haven Inclusion Cases*, 399 U.S. 392, 491 (1970).

55. *Id.* at 492, quoting *Penn-Central Merger Cases*, 389 U.S. 486, 510 (1968).

56. 328 U.S. 495 (1946).

57. *Id.* at 536, quoted in *New Haven Inclusion Cases*, 399 U.S. 392, 492 (1970). The bondholders advanced no constitutional argument in *Denver & Rio Grande*. Thus, the quoted passage of Justice Reed's opinion has no clear constitutional significance.
future... No implied contract that they will do so can be elicited from the mere fact that they have accepted a charter from the State... 58

This passage states a basic doctrine of the rights of investors in public utilities. And nothing in the New Haven's charter can be construed as an express agreement to sustain deficit operations in bankruptcy. 59 Thus, under traditional notions, the bondholders' risk of being subordinated to the public interest was limited in scope to the type of loss permitted in Continental Bank: a suspension of the right to foreclose amounting to a temporary loss of control over collateral. 60

In this respect, Continental Bank typified pre-New Haven railroad reorganizations under Section 77, involving essentially profitable rail carriers. 61 In these cases, creditors had no compelling interest in abandoning and liquidating their debtor railroads in order to preserve the value of their collateral. In fact, "The uninterrupted continuation of the business and preservation of [the railroad's] operating and earning functions [were] inherently essential to the protection of the security of the mortgage..." 62 For this reason, private interests generally coincided with the public's interest in uninterrupted service. And in such cases, only the investor's discretion as to the timing of disinvestment was necessarily sacrificed to the public interest. 63

60. The Supreme Court spelled out its reason for enjoining the sale of collateral bonds in Continental Bank: It is evident that the effect here wrought by the menace of impending sales of the collateral would seriously embarrass and probably prevent the formulation and consummation of a plan of reorganization.
62. In re Chicago, R.I. & P. Ry., 90 F.2d 312, 315 (7th Cir. 1937). The Supreme Court made the same point in Continental Bank: [A railroad's] activities cannot be halted because its continuous, uninterrupted operation is necessary in the public interest; and for the preservation of that interest, as well as for the protection of the various private interests involved, reorganization was evidently regarded as the most feasible solution whenever the corporation had become [insolvent]... 294 U.S. at 671 (emphasis added).
63. The investor might not be injured, in terms of collateral erosion, by the continued operation of the debtor railroad and yet still prefer to disinvest. He may wish,
In *New Haven* the Supreme Court vastly enlarged the scope of investors' risk, raising the public interest to the level of a supervening public right in the assets of the railroad. The public plainly had an interest in the New Haven's continued operation. The Court did not explain, however, how the public's interest could be suddenly transmuted into a public right that constitutionally prevailed over the bondholders' claim on the assets.

In fact, the Court never acknowledged passing from the proposition that the bondholders' rights were "not absolute" to the conclusion that the railroad's deficit operation was reasonably necessary and that the bondholders' loss up to 1969 was permissible to promote a public interest in continued service. Indeed, when stated this way, the

for example, to exploit his debtor's bankruptcy as an event of default (as it always is under the bond indenture) in order to move from his old securities into currently more profitable ones. Thus, for him, a compulsory maintenance of the status quo typically entails some opportunity cost. However, it is the character of his loss, not the event of loss per se, that must be the criterion of taking. See generally note 73 infra.

64. *New Haven Inclusion Cases*, 399 U.S. 392, 490-91 (1970). This was the explicit theory behind the district court's decision: the New Haven's property would be "taken" only in the event of an "unreasonably long delay" in the Penn-Central takeover—defined under the circumstances as a delay beyond the end of 1968. In *In re New York, N.H. & H.R.R.*, 289 F. Supp. 451, 455, 459 (D. Conn. 1968). In a later decision, the court explained this approach: "The policy of imposing an interim burden of losses, through its deficit operation, on a railroad in reorganization is to afford a reasonable opportunity to the responsible agencies to arrange the continuation of the railroad's operation . . . ." In *In re New York, N.H. & H.R.R.*, 304 F. Supp. 793, 801 (D. Conn. 1969). The source of this perspective on the problem is identifiable: Section 77(g) of the Bankruptcy Act empowers the reorganization court to dismiss proceedings, as a preliminary to liquidation, if it foresees an "undue delay in a reasonably expeditious reorganization of the debtor." 11 U.S.C. § 205(g) (1970). Neither the district court nor the Supreme Court explained, however, how it transmuted this statutory standard for dismissal into a determinant of constitutional takings.

The "reasonable delay" theory in *New Haven* could not have been the same as that invoked in *Continental Bank*, see note 60 supra, since the latter case was as much concerned with protecting creditor interests as with aiding the public. Nor was the "reasonable delay" theory simply a standard of fairness formulated for the benefit of the Penn-Central. Although the holding of the *New Haven* cases, to be precise, concerned only the price the Penn-Central was required to pay for the New Haven, the reasoning that underlay that holding in fact defined the bondholders' constitutional due, and probably cut off legal recourse in the Court of Claims for supplemental compensation from the United States Government. If the Court had declined to rule on the bondholders' constitutional argument (thereby holding that the "fair and equitable" question under Section 77 was severable from the ultimate constitutional rights of one party to the proceedings), the bondholders would have had a plausible action against the Government on a claim arising out of lawful executive (ICC) action and "[t]ounded upon the Constitution." 28 U.S.C. § 1491(1) (1970). The *New Haven* decision precludes any such action. If the United States were held to be a party to the *New Haven* litigation, collateral estoppel certainly would bar any re-litigation of the takings question. See 1B J. Moore, *Federal Practice* ¶ 0.441[2] (1965). This seems a likely result, because the United States was a formal party in several of the cases consolidated at the Supreme Court. See note 25 supra. Indeed, in view of the drift of federal practice away from the requirements of mutuality and privity, see J. Moore, supra, ¶ 0.412[1] at 74 (Supp. 1972), the bondholders would probably be estopped even if the United States were not deemed a formal party to the inclusion litigation. In any event, the Court of Claims would almost surely treat the Supreme Court's decision as precedent, refusing to acknowledge an event of taking in the New Haven reorganization.
Court's conclusion may be seen to fit the fundamental contours of the substantive due process concept as described almost thirty years ago in *Nebbia v. New York.*65 "If the laws passed are seen to have a reasonable relation to a proper legislative purpose, and are neither arbitrary nor discriminatory, the requirements of due process are satisfied."66 In fact, the district court expressly relied on due process theory as the operative constitutional rubric in *New Haven.* The court had observed in 1965, for example, that “[N]o construction of due process will permit this court to require that the creditors of this estate witness the continuing erosion of their security without the slightest prospect of relief."67 The court continued, “[I]t has been stated on numerous occasions that the operation of unprofitable passenger service, however essential, at the expense of the creditors could only be temporary, as a matter of due process."68 But the bare assumption that the creditors possessed the relative rights in property guaranteed by due process left unasked the question whether, in the circumstances, they had some absolute right under takings theory.

IV

Since *New Haven* was by traditional analysis a takings situation, the case's "public rights" theory supplies a rationale—with very uncertain boundaries—for transferring private property into the public domain. Whenever a public interest is sufficiently compelling, it seems, the public may take a first claim on the use of private property. Certainly the public's interest in the New Haven Railroad was not qualitatively different from its interest in many other important industries. The per-

66. Id. at 537. The turbulent history of substantive due process doctrine is familiar to students of constitutional law. Generally speaking, before 1937 the Supreme Court seemed quite willing to strike down state or federal legislation that it deemed to be arbitrary, capricious, or unreasonable. The turning-point came in 1937 with *West Coast Hotel Co. v. Parrish,* 300 U.S. 379 (1937), when the Court began gradually restricting judicial upset power under substantive due process doctrine until that power virtually ceased to exist. See generally V. Woo, *Due Process of Law 1932-1949* (1951); McCloskey, *Economic Due Process and the Supreme Court: An Exhumation and Reburial,* 1962 *Sup. Ct. Rev. 34; Stern, The Problems of Yesteryear—Commerce and Due Process,* 4 *VAND. L. REV.* 446 (1951).

It is generally believed that the doctrine of substantive due process has become totally defunct under the Federal Constitution. For this reason, *New Haven* is peculiar even if viewed as a due process decision: while the courts held that bondholder losses after 1968 would have been constitutionally impermissible, the public interest in continued rail services (the "proper legislative purpose") would have been just as important after 1968—had the Penn-Central takeover been delayed—as it had been until that time.67


68. Id. at 3116 (emphasis added).
vasiveness of the public interest was acknowledged in 1877 when in *Munn v. Illinois*\(^9\) the Supreme Court approved state regulation of private grain elevators, stating that a business need not operate as a public utility or monopoly to be "affected with a public interest." Dissenting from the *Munn* decision, Justice Field opposed the approval of the regulation on a public interest rationale. With such a test, he argued, no boundaries to regulation could be set: "[T]here is hardly an enterprise or business engaging the attention and labor of any considerable portion of the community in which the public has not an interest in the sense in which that term is used by the court in its opinion . . . ."\(^70\) Justice Field’s prophecy was correct. Since *Munn*, the difference between private and quasi-public businesses has never been especially germane to the validity of business regulation under the Due Process Clause.\(^71\)

The same inability to draw convincing boundaries around "public interest" may be expected under the Takings Clause, should the *New Haven* rationale be accepted as a general proposition of takings law.

Admittedly, the *New Haven* decisions dealt only with one relatively small railroad. But what was good for the New Haven’s riders should be just as good for the patrons of others railroads. Moreover, the rail industry represents only one element of the nation’s vital transportation network, so that *New Haven’s* theory of supervening public rights would apply equally to any airline or bus line that may have the misfortune of providing a unique (or simply important) public service. Any public utility may bear a vital relationship to the public interest and would thus be susceptible to the *New Haven* doctrine.

To think that some distinction between public utilities and wholly private businesses would meaningfully limit *New Haven* is to nurture an illusion. The public interest could be equally damaged by Lockheed’s or Grumman’s ceasing to produce aircraft as by the New Haven’s ceasing to haul commuters. Nor is mere size a compelling criterion, except as it relates to the degree of public concern for an industry. A community might well be better off without its commuter trains than without its lone private hospital. In terms of the public interest, there is nothing unique about the New Haven, all railroads, public utilities, or big business generally; none of these categories provides a meaningful limit on the scope of *New Haven’s* "public rights" doctrine.

\(^69\) 94 U.S. 113 (1877).
\(^70\) Id. at 141.
If, as it appears, *New Haven* stood on a broad "public rights" theory, more than practical line-drawing problems are involved in the Supreme Court's failure to delineate the boundaries of its new theory. On closer examination, the *New Haven* theory seemingly repudiates the broader principle underlying the *Brooks-Scanlon* decision, namely the constitutional right to retrieve property from unprofitable uses, or to be compensated for the denial of that right.\(^7\)

If *New Haven* is read to renounce this principle, the decision has cut the Takings Clause to the quick; for, as demonstrated in a recent article by Professor Sax, this "retrieval rule" is the most basic guarantee of the Takings Clause.\(^7\)\(^3\) Sax approaches the takings problem from the perspective of maximizing the scope of non-compensable governmental regulation—that is, determining the minimum meaningful sweep of the Takings Clause. He explains that many property uses are inextricably related to one another, with each property owner enjoying, at any given point in time, a set of use rights disadvantageous to others. Activities that thus impose sacrifices on others have "spillover effects," and Sax argues that the legitimate scope of state police power (or the

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\(^7\) The retrieval rule has been vindicated repeatedly in case law. In addition to *Brooks-Scanlon* and *Eastern Texas*, discussed at pp. 1008-10 supra, see United States v. Pewee Coal Co., 341 U.S. 114 (1951); Bullock v. Florida ex rel. Railroad Comm'n, 254 U.S. 513 (1921) (dictum); Segarra-Serra v. Scott, 242 F.2d 315 (1st Cir. 1957); Rivera v. R. Cobian Chinca & Co., 181 F.2d 974 (1st Cir. 1950); Pewee Coal Co. v. United States, 161 F. Supp. 952 (Ct. Cl. 1958), cert. denied, 359 U.S. 912 (1959); Govt. of the Virgin Islands v. Massac, 161 F. Supp. 704 (D. Virgin Is. 1958); Wheelock Bros., Inc. v. United States, 88 F. Supp. 278 (Ct. Cl. 1950), vacated on juris. grounds, 341 U.S. 319 (1951).

\(^7\) Sax, *Takings, Private Property and Public Rights*, 81 YALE L.J. 149 (1971) [hereinafter cited as *Public Rights*]. Sax's analysis in this article marks a significant advance over his own earlier work, *Sax, Takings and the Police Power*, 74 YALE L.J. 36 (1964), and more especially over the previous work of other commentators on takings law. See, e.g., Cormack, *Legal Concepts in Cases of Eminent Domain*, 41 YALE L.J. 221, 226-27 (1951); Dunham, *Griggs v. Allegheny County in Perspective: Thirty Years of Supreme Court Expropriation Law*, 1962 Sup. Ct. Rev. 63; Note, *Governmental Seizure of a Business to Prevent Strike-Caused Work Stoppages—Regulation or Taking?*, 19 GEo. WASH. L. REV. 184 (1950). Writers, in attempting to differentiate "takings" from "mere regulation," have tested the logic of diverse criteria in search of a general theory of takings. The source of conceptual problems is not difficult to discern. In a sense, all governmental restrictions on property use deprive the owner of valuable opportunities to profit from property to which he has formal title. As restrictions grow, it quickly becomes difficult, if not impossible from a purely economic standpoint, to distinguish a formal condemnation and seizure of property from the regulatory destruction of valuable use rights; at best the distinction is a quantitative one. Not surprisingly, attempts to develop a degree of loss, or "diminution of value" test as a theory of takings have given commentators more exercise than enlightenment. The apparent economic paradox of selective loss compensation under the Takings Clause led one writer simply to conclude that the constitutional decision whether to compensate must rely upon ad hoc "social policy" judgments—a criterion of last resort with little to recommend it as a neutral principle. See Cormack, supra, at 259.

Professor Michelman's landmark work, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation*,” 80 HARV. L. REV. 1165 (1967), is somewhat unique in that his effort is concerned solely with rationalizing just compensation generally rather than with defining the scope of the Takings Clause.
federal regulatory powers) includes authority to alter the existing set of legal relations so as to eliminate or to reverse such effects.\textsuperscript{74}

The key to Sax's theory lies in the definition of "spillovers": a spillover is a use of or effect on another person's property or some common resource base that is not itself subject to private ownership. Sax argues that a reasonable construction of the Constitution allows governmental regulation of all such spillovers with immunity from the Takings Clause,\textsuperscript{75} on the theory that regulation of competing demands on a "common" or of conflicting uses of private property does not take away anything that was "owned." But he explicitly cautions that "Only in such situations may one use be curtailed by the government without triggering the takings clause."\textsuperscript{76}

Among the residual situations to which the Takings Clause is applicable, requiring compensation, would be the forced continuation of a property use to preserve the benefits it creates for other people. If curtailment of a non-spillover use must be a taking, as Sax contends, then the owner must have a right, absent compensation, to devote his property to any non-spillover use and to choose among such uses at his pleasure. This right is effectively impaired by the compulsory continuation of a particular use. Thus, the owner's right to retrieve and re-deploy his property is implicit in Sax's analysis as an affirmative statement of the right to pursue non-spillover property uses. Sax's derivation of this principle as the logical boundary of uninhibited government regulation lends new significance to the \textit{Brooks-Scanlon} retrieval rule. The rule emerges from Sax's theory as the core of the narrowest meaningful interpretation of the Takings Clause.

Sax thus outlines the permissible role of "public rights" vis-à-vis the Takings Clause.\textsuperscript{78} The public may be considered to have the same status in asserting its spillover interests (with respect to the common resource base) as does a traditional owner (with respect to private property). And when there is a spillover conflict between the public and a private owner, the state may, as a referee, choose between them without triggering a constitutional need for compensation. Sax illustrates

\begin{itemize}
  \item \textsuperscript{74} \textit{Public Rights, supra} note 73, at 151-62. The most obvious species of spillover is the "noxious use," or the nuisance prototype. \textit{Id.} at 161-62. But a spillover could also result from a non-tortious activity or land use that merely restricts another person's use of his own property, typified by the erection of a tall building in the glide path of landing or ascending aircraft. \textit{Id.} at 162, 164-69. Legislative restrictions upon these types of spillover suppress \textit{costs} that the one property owner had previously created and imposed upon others or upon the public at large.
  \item \textsuperscript{75} \textit{Public Rights, supra} note 73, at 161-62.
  \item \textsuperscript{76} \textit{Id.} at 161.
  \item \textsuperscript{77} 251 U.S. 396 (1920). See pp. 1008-10 \textit{supra}.
  \item \textsuperscript{78} \textit{See Public Rights, supra} note 73, at 155-61.
\end{itemize}
this type of case with two prototypes: the familiar airspace cases, in which aviation progress eroded the antiquated notion that land ownership extended vertically "from hell to heaven"; and certain "ecosystem" problems, as where a coastal landowner proposes to destroy wetlands that are believed to be essential to biological life-support systems. Sax's theory is inherently limited by the natural resource examples on which he relies. In those cases, the benefits enjoyed by persons other than the landowner were not created by the owner in the first place. Such cases are palpably different from ones similar to New Haven in which the private owner creates benefits through his own investment and effort. Sax nowhere suggests that these different sorts of cases merit similar constitutional treatment. Since owner-generated benefits do not fit Sax's definition of spillover, governmental action in such situations must be subject to the Takings Clause and trigger rights to compensation.

This reading of Sax identifies the retrieval rule as the primary operative principle of the Takings Clause, and indeed, the retrieval rule has been a constitutional theme in case law since the dawning of modern government regulation. In 1877, the Supreme Court upheld state regulation of grain elevators in Munn v. Illinois on the reasoning that public regulation of business could extend as far as any public interest created by the operator. The Court stipulated, however, that the operator "may withdraw his grant [of a public interest] by discontinuing the use." The Court accepted extensive economic regulation here, as in later cases, largely because the property owner always retained the right to retrieve his property and to escape regulation as an ultimate remedy against government interference.

The New Haven decision, by repudiating the retrieval rule, has
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carelessly upset settled and necessary constitutional doctrine. It has
broken down the last meaningful distinction between governmental
actions affecting property that require compensation under the Con-
stitution and those that do not.

VI

The New Haven decision has as yet made no lasting imprint on
general constitutional doctrine. The decision has been so thoroughly
enveloped in the factual and procedural complications of the New
Haven reorganization that its broader relevance to takings law has not
been widely recognized. This is fortunate. But, the New Haven deci-
sion does provide discernible precedent for further uncompensated tak-
ings in the context of major railroad insolvencies. Here, at least, it
poses a distinct threat to fundamental takings doctrine.

Already Congress has enacted one law, the Rail Passenger Service
Act of 1970,84 part of which would have been fatally defective under
the Takings Clause, were it not for the New Haven decision. This Act
bars any railroad that does not enlist its rail passenger services in the
Amtrak network—on contractual terms that could be extremely unfair
to the railroad85—from discontinuing those services for any reason be-
fore 1975.86 The Act was clearly designed to persuade passenger rail-
roads to join Amtrak despite contractual inequities.87 Although there is

for success are discussed in Thoms, Amtrak: Rail Renaissance or Requiem? 49 CHI.-KENT
L. REV. 29 (1972).
85. See note 87 infra.
86. Unless it has entered into a contract with the Corporation pursuant to section
561(a)(1) of this title, no railroad may discontinue any intercity passenger train
whatsoever prior to January 1, 1975, the provisions of any other Act, the laws or
constitution of any State, or the decision or order of, or the pendency of any pro-
ceeding before, a Federal or State court, agency, or authority to the contrary not-
withstanding. On and after January 1, 1975, passenger train service operated by such
railroad may be discontinued under the provisions of section 13a of Title 49.
87. This is illustrated in a recent decision in the Penn-Central reorganization. See In re
trak contract submitted by the Penn-Central's reorganization trustees. This contract
placed part of the Penn-Central's passenger line in Amtrak on terms that, in the final
analysis, perpetuated at least part of the private loss from continued rail service. Id. at
478-79. Indenture trustees for bondholders having a mortgage on the affected line chal-
enged the contract on constitutional grounds, pointing out that the property would be
worth more in liquidation than as a going concern within Amtrak. The court
eleded this issue:
The statute provides that any railroad which has not entered into a contract with
Amtrak by May 1, 1971 will be precluded from discontinuing any existing inter-city
passenger train until 1975; and there would be no possibility of again considering
entry into Amtrak until 1973. While the validity of these provisions may be open to
question, the Trustees are in no position to sustain the huge losses which would be
entailed in the continued operation of these trains while the validity of the statutory
provisions might be litigated.

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no evidence showing that the no-abandonments provision was inspired by the New Haven decision, that provision could be upheld on the authority of New Haven if and when it is challenged under the Takings Clause.

If the courts wish to preserve the Takings Clause as a viable and meaningful constraint on government action, they must find a way to interpret the New Haven decision as something less than a general repudiation of the retrieval rule. It may be possible for the courts to invoke New Haven's constitutional theory only in railroad bankruptcies. But while this strategy might work in practice, it would represent an arbitrary exception to general takings law. A better approach would be to limit the holding strictly to the facts of the case, perhaps by identifying some procedural nicety in the New Haven litigation as a pivot for the Supreme Court's decision. In this way, the decision would never crystallize as a doctrine in constitutional law. Whatever means may best serve, the integrity of the Takings Clause requires that the New Haven decision be strictly isolated.

Id. at 479.

Neither the “no-abandonments” provision of the statute nor the contract with Amtrak recognized the bondholders’ constitutional right of retrieval. Since the contract gave the railroad—and ultimately the bondholders—less than liquidation value for its property, the bondholders received less than just compensation for their property. Thus, in essence, the Amtrak legislation gave the railroad two alternatives: to hold out and be forced to keep operating as a loss, which would be like the New Haven result; or to have its line nationalized, in effect, at less than just compensation.

88. Several procedural theories were implicit in the Supreme Court's opinion, though they were not particularly compelling. See note 42 supra.