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Railroad Reorganization Under the U.S. Bankruptcy Code: Implications of a Filing by Amtrak

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Summary

In 1997, Congress enacted the Amtrak Reform and Accountability Act, the goal of which was to promote Amtrak's self-sufficiency with respect to operating funds within five years. The law has provisions directing Amtrak to make plans for its liquidation in the event that it does not reach the goals set forth. It directs the Amtrak Reform Council to present Congress a plan for restructuring intercity rail passenger service. It also directed the General Accounting Office to report on the implications of Amtrak's possible liquidation.

Many years have passed, and Amtrak has realized neither profit nor operational self-sufficiency. Although liquidation has *not* been proposed, the threat of shut-down has arisen.

This report examines the railroad reorganization provisions under the U. S. Bankruptcy Code, Subchapter IV, 11 U.S.C. §§ 1164 - 1174. These provisions, which exclusively govern railroad bankruptcy, reflect the general flexibility of chapter 11 to promote a wide variety of restructuring options, including liquidation. In railroad bankruptcies, a trustee is always appointed and the "public interest" is factored into the court's decisions.

This report also considers the constitutional authority of Congress to restructure railroad transportation under the Commerce Clause and to make laws concerning bankruptcy and liquidation under the Bankruptcy Clause. In the case of railroad insolvency, the two provisions are often related.

It is impossible to predict the precise financial impact an Amtrak bankruptcy – reorganization or liquidation – might have on its creditors and employees. But much of the concern expressed is focused on the future of rail service. It is unlikely that Amtrak's bankruptcy alone would determine the future of intercity passenger rail service. Shaping the future of rail service need not, and in all probability would not, occur solely through the vehicle of an Amtrak bankruptcy. Congressional action to address national transportation needs may occur independent of a court's supervision of an Amtrak bankruptcy.

This report will not be updated.

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Amtrak's chronic financial problems and the threat of shut-down have led many to question what procedures would be involved were Amtrak to file for bankruptcy under the U. S. Bankruptcy Code, 11 U.S.C. § 101 *et seq*. It is impossible to predict the outcome of any individual debtor's bankruptcy. Each bankruptcy is intensively fact-specific. The plan for and feasibility of reorganization – or liquidation – and the pay out to various creditors depends upon agreements between a debtor and its creditors that occur prior to and after the bankruptcy filing.[1] This report surveys those provisions in the Bankruptcy Code unique to railroad reorganization. And it considers laws governing Amtrak that could affect its filing under the Bankruptcy Code.

Railroad Reorganization Provisions in the U. S. Bankruptcy Code.

Background. The first bankruptcy provisions dedicated to railroad reorganization were enacted during the 1930s. A new § 77, entitled "Reorganization of Railroads Engaged in Interstate Commerce," was appended to the Bankruptcy Act of 1898,[2] the predecessor to the current Code. Despite the fact that § 77 was amended over the years, it was perceived as inadequate to resolve railroad industry problems arising during the 1970s. In 1973, in response to a national rail crisis precipitated by the bankruptcy filings of eight railroads in the Midwest and Northeast, Congress passed the Regional Rail Reorganization Act.[3] The act, intended to supplement to § 77, created a government corporation, the U.S. Railway Association, to formulate a plan to restructure the railroads into financially self-sustaining rail systems. It created Conrail as well. The act withstood many constitutional challenges,[4] including takings claims under the Fifth Amendment and

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[1]In a report to congressional committees, the General Accounting Office examines the implications of an Amtrak bankruptcy, including Amtrak's relationship with its creditors, as of the date of the report. *See, Intercity Passenger Rail: Potential Financial Issues in the Event That Amtrak Undergoes Liquidation* (GAO-02-871, September 2002).

[2]47 Stat. 1474 (March 3, 1933).

[3]P.L. 93-236.

[4]Regional Rail Reorganization Act Cases, 419 U.S. 102 (1974). Congress concluded that solution of the crisis required reorganization of the railroads, stripped of excess facilities, into a single, viable system operated by a private, for-profit corporation, which could not be created under § 77.

allegations that it violated the Bankruptcy Clause, which requires that Congress enact "uniform Laws on the subject of Bankruptcies throughout the United States."[5]

The Role of Chapter 11 Generally. Chapter 11 is designed to facilitate the rehabilitation of business debtors through financial reorganization. The chapter is premised on the assumption that creditors will be better served by preserving the debtor's business as an ongoing concern. If reorganization is not feasible, the debtor may be liquidated under chapter 11 as well. Although procedurally complex, the ultimate goal of the process is to permit a debtor, through negotiations with creditors, to reach a consensual plan for a feasible reorganization. While the Code has many provisions governing the *process* for reaching consensus, it is very flexible with respect to the business formats and options that a debtor may pursue. In short, the chapter is primarily concerned with two goals: preservation of the debtor's estate in a manner that optimizes its continuance as an on-going concern and marshaling the estate's assets for the benefit of creditors. However, a prime purpose of bankruptcy is to safeguard certain creditor rights, especially those of secured creditors, and to promote equality of distribution among similarly situated creditors. When reorganization is not a viable option, disbursements through liquidation must be made in accordance with the Bankruptcy Code requirements and applicable nonbankruptcy law.

Railroad Reorganization. Chapter 11 of the Code governs reorganization. Subchapter IV, 11 U.S.C. § § 1161 - 1174, deals exclusively with railroads. A railroad may not file for liquidation under chapter 7 of the Code,[6] but a railroad may be liquidated under chapter 11.[7]

Although all of subchapter IV deals with railroad-related issues, several areas may be noted:

- *Appointment of a trustee*. A trustee is ordinarily *not* appointed to oversee a general chapter 11 reorganization. Trustees are appointed "for cause" including fraud, dishonesty, incompetence, and mismanagement of the debtor's affairs by management. In the case of a railroad debtor, the appointment of a trustee is mandatory. The Secretary of Transportation is directed to submit a list of five disinterested, qualified persons to the U.S. Trustee for appointment.[8]

- *Representation of regulatory agencies; the right to be heard.* In a general business reorganization, the Securities and Exchange Commission (SEC) has a right to participate in the bankruptcy, but not to appeal court orders and judgments. A railroad bankruptcy confers a comparable right upon the Surface Transportation Board, the Dept. of Transportation (DOT), and any

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[5]Art. I, sec. 8, cl. 4.

[6]11 U.S.C. § 109(b)(1).

[7]11 U.S.C. § 1174.

[8]11 U.S.C. § 1163.

state or local commission having regulatory jurisdiction over the debtor.[9] If the provisions of a proposed reorganization plan would require Board approval, it must be sought. Conditions or modification imposed by the Board are subject to limited review by the court.[10]

- *Protection of the public interest.* The public interest as a discrete factor in reorganization appears only in subchapter IV.[11] The court and the trustee are directed to consider the public interest in the preservation of the debtor's rail service – in addition to the interests of creditors – when they make decisions regarding the debtor's reorganization.

In addition to the foregoing, subchapter IV addresses considerations relevant to a railroad debtor such as protecting creditors' interests in rolling stock, termination of railroad line leases, and abandonment of rail service.[12]

Interests of railroad employees. Several provisions of subchapter IV address matters concerning employee benefits. For example, collective bargaining agreements governing employee wages and working conditions are not subject to modification by the court, except in accordance with § 6 of the Railway Labor Act (RLA), 45 U.S.C. § 156.[13] The RLA requires that disputes concerning rates of pay, rules, or working conditions be submitted for arbitration to the National Mediation Board.

Another Code provision grants first priority for unsecured claims under 11 U.S.C. § 507 to claims against the debtor railroad for personal injury or wrongful death that may have occurred prior to the bankruptcy filing.[14]

Contents of a reorganization plan. Although the general requirements for confirmation of a reorganization plan under chapter 11 are applicable,[15] the Code expressly provides that the reorganization plan may allow for continuance, termination, transfer and/or abandonment of rail service and rail lines.[16]

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[9]11 U.S.C. § 1164.

[10]11 U.S.C. § 1172(b).

[11]11 U.S.C. § 1165. *See* S.Rept. 95-989, 95th Cong., 133 (1978) which comprises, in part, the legislative history of the 1978 Bankruptcy Reform Act. The Senate Report notes that the "public interest ... is an important factor in railroad reorganization, which distinguishes them from other business reorganizations."

[12]11 U.S.C. §§ 1168 - 1170.

[13]11 U.S.C. § 1167. *Cf.* 11 U.S.C. § 1113, adopted in 1984, governing modification or rejection of collective bargaining agreements for other chapter 11 debtors.

[14]11 U.S.C. § 1171. This priority applies to employee and non-employee claimants.

[15]11 U.S.C § 1123.

[16]The legislative history of this provision indicates that the plan may:

[c]ontemplate a liquidating plan for the debtor's rail lines, much as occurred in

(continued...)

If the proposed transfer to or operation of rail lines by another entity (other than the reorganized debtor or a successor to the debtor) would require the approval of the Surface Transportation Board, it must be sought by the debtor. Conditions or modifications imposed by the Board are subject to limited review by the court.[17]

The Board, however, is directed to require that the rail carrier "provide a fair arrangement at least as protective of the interest of employees as that established under section 11347 of title 49."[18] The successor to the cited reference requires that when affected railroads merge or are consolidated, the Board must require certain employee benefit protections.

Plan confirmation. The court shall confirm a plan when it meets general Bankruptcy Code requirements for confirmation. Creditors must receive or retain under the plan property equivalent in value to what the creditors would receive if the debtor were liquidated. The plan must be economically feasible and consistent with the public interest.[19]

Liquidation. The Code does not preclude the filing of a reorganization plan that is essentially a liquidating plan. If a plan has not been confirmed within five years of the bankruptcy filing, a party in interest other than the debtor may request, and the court may order, cessation of the debtor's service and liquidation of the estate as if it were under chapter 7.[20]

As the foregoing demonstrates, a railroad reorganization under the Bankruptcy Code retains the same flexibility to accommodate a wide range of reorganization or liquidation plans consistent with chapter 11 generally. With respect to railroads, the "public interest" is expressly accorded statutory prominence. This provision may be interpreted to allow greater regulatory input into the proposed reorganization and may allow creditors to wait longer than other chapter 11 creditors for resolution of the

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[16](...continued)

> the Penn Central case by transfer of operating lines to Con Rail. Such a liquidating plan is not per se contrary to the public interest, and the court will have to determine on a case-by-case basis, with the guidance of the Interstate Commerce Commission [Surface Transportation Board] and of other parties in interest, whether the particular plan proposed is in the public interest, as required under proposed 11 U.S.C. § 1172(3).
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> H.R. Rept. 95-595, 95th Cong., 1st Sess. 424-25 (1977).

[17]11 U.S.C. § 1172(b).

[18]49 U.S.C. § 11347 was repealed in 1995 and replaced by 49 U.S.C. § 11326.

[19]11 U.S.C. § 1173.

[20]11 U.S.C. § 1174.

plan.[21] With respect to a liquidation, the bankruptcy proceeding minimizes litigation to satisfy competing claims and provides finality to discharge of indebtedness.[22]

Amtrak as a Possible Debtor in Bankruptcy. Created by Congress in 1970,[23] Amtrak, arguably, may be unique among historic and prospective railroad debtors. Although originally created as a "for-profit" company to provide national, intercity passenger rail service, financial self-sufficiency has never been realized and Amtrak has been dependent upon federal subsidies to maintain operation.[24] Hence, Amtrak, unlike a wholly privately-owned company, was created to serve an identified national transportation need, and has been largely supported by federal funds.

Congress passed the Amtrak Reform and Accountability Act of 1997 to address Amtrak's dependence on federal subsidies.[25] The law created a goal of operational economic self-sufficiency by 2002.[26] Among other things, it created the Amtrak Reform Council. The Council was charged with the responsibility to assess the likelihood of Amtrak meeting the mandated goals. If the Council found that the goals were unlikely to be met by 2002, it was to "develop and submit to the Congress an action plan for a restructured and rationalized national intercity rail passenger system,"while Amtrak itself would "develop and submit to the Congress an action plan for the complete liquidation of Amtrak, after having the plan reviewed by the Inspector General of the Department of Transportation and the General Accounting Office for accuracy and reasonableness."[27]

The law sets out a proposed procedure for consideration by the Senate of a restructuring or liquidating plan proposed by Amtrak or the Reform Council.[28] To date, despite Amtrak's lack of operational self-sufficiency, the Congress has not pursued a course recommending or mandating Amtrak's liquidation, but has provided

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[21]*See* Regional Rail Reorganization Cases, *supra* note 4. Creditors of Penn Central Railroad argued that mandatory continued loss operation of the railroad constituted an "erosion taking" in violation of the Fifth Amendment. Acknowledging that such a taking could occur, the Court cited the qualifying proposition that "a railroad estate [may] suffer interim losses for a reasonable period pending good-faith efforts to develop a feasible reorganization plan if the public interest in continued rail service justifies the requirement." Id. at 122-23.

[22]Technically, only individuals receive bankruptcy "discharges," although confirmation of a chapter 11 plan has the same effect for corporate debtor. 11 U.S.C. §§ 727, 1141.

[23]P.L. 91-518, the Passenger Rail Service Act of 1970.

[24]CRS Report RL31473, *Amtrak Profitability: An Analysis of Congressional Expectations at Amtrak's Creation* by D. Randall Peterman.

[25]P.L. 105-134.

[26]Id. at § 201. "Commencing no later than the fiscal year following the fifth anniversary of the Amtrak Reform and Accountability Act of 1997, Amtrak shall operate without Federal operating grant funds appropriated for its benefit."

[27]Id. at § 204(c)(1)&(2).

[28]Id. at § 205.

temporary additional funding. Instead, Congress expressly forbade preparation of a liquidating plan.[29]

The Amtrak Reform and Accountability Act also made employee protection reforms by establishing special arbitration and mediation procedures under the Railway Labor Act and by extinguishing specified employee protective arrangements and severance benefits applicable to employees of Amtrak.[30] It expressly renders inapplicable 11 U.S.C. § 1172(c) to Amtrak employees.[31] Amtrak's labor costs, however, continue to represent a major segment of its operating cost.

National Transportation Policy Versus Debt Repudiation. Congress effects national transportation policy – including rail transportation policy – pursuant to its constitutional power to regulate interstate commerce.[32] Congressional authority to legislate on the subject of bankruptcies is derived from the Bankruptcy Clause. The provisions of Title 11 governing railroad reorganization generally permit all manner of sale, transfer, abandonment, and ultimately dissolution of a railroad carrier and its assets. The Bankruptcy Code has not historically operated as an obstacle to Congress' authority to effect the restructuring of railroads under its commerce clause power.[33]

The Bankruptcy Clause does, however, require that laws on the subject of bankruptcies be "uniform." The subject matter of bankruptcy is defined as "the subject of the relations between an insolvent or nonpaying or fraudulent debtor and his creditors, extending to his and their relief."[34] The U.S. Supreme Court has interpreted this to mean that enactment of a law to reassign priorities and distributions to creditors in a single, named debtor's bankruptcy violates the Bankruptcy Clause.[35] What implications do these principles have for Amtrak?

When people ask what will happen if Amtrak is liquidated, there are two components to the question: what will be the future of intercity passenger rail

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[29]The FY2002 Department of Defense Appropriations Act, P.L. 107-117, § 1102 provides that "[n]o appropriated funds or revenues generated by the National Railroad Passenger Corporation may be used to implement § 204(c)(2) of Public Law 105-134 until the Congress has enacted an Amtrak reauthorization Act."

[30]P.L. 105-134, §§ 141-142.

[31]Id. at § 142(d). Section 1172(c)(1) of the Bankruptcy Code provides that if the Surface Transportation Board approves a provision under the reorganization plan allowing for the transfer of, or operation of or over any of the debtor's rail lines by an entity other than the debtor, or a successor to the debtor, then the Board must require the rail carrier to provide a "fair arrangement at least as protective of the interests of employees as that established under section 11347 of title 49." Section 11347, however, was omitted in general amendments to Title 49 U.S.C. in 1996. Similar provisions were enacted at 49 U.S.C. § 11326.

[32]Art. I, § 8, cl. 3.

[33]*See* Regional Rail Reorganization Act Cases, *supra* note 4.

[34]Railway Labor Executives' Ass'n v. Gibbons, 455 U.S. 457, 458 (1982).

[35]Id.

service? And, what will happen to Amtrak's assets and creditors, including its employees? With regard to the former, Congress has many options to deal with the restructuring of intercity passenger rail service (although many may be premised upon continuing federal subsidies).[36] Few of these are foreclosed by the Bankruptcy Code requirements with respect to railroad liquidation. As to the latter, the General Accounting Office noted in its 2002 report that the liquidation of Amtrak would presumably result in losses by creditors, including the federal government. It could have a financial impact on participants in the railroad retirement and unemployment systems. Passenger rail service could be cut back or discontinued. However, many of these assumptions are premised on a hypothetical liquidation of Amtrak in a public policy vacuum, absent consideration of as yet unknown but probable supplementary law or action to salvage passenger rail service.

The only major constraint upon Congress with respect to a liquidation of Amtrak inheres in the requirement that bankruptcy laws be "uniform." Assuming that a congressional mandate to liquidate Amtrak is *not* premised on the desire to alter or otherwise impair creditors' rights, this constitutionally-based requirement arguably has greater impact on the legislative approach Congress may take with respect to Amtrak's insolvency than on Congress' prerogatives with respect to transportation policy and a restructuring of intercity passenger rail service. For example, though ambiguous, the Amtrak Reform and Accountability Act appears to contemplate congressional action to effect a liquidation through free-standing legislation. Congressional enactment of legislation to liquidate a single, named debtor, i.e., Amtrak, would be more likely to run afoul of the Bankruptcy Clause than liquidation under the U. S. Bankruptcy Code. Likewise, the provision in the Reform Act that makes 11 U.S.C. § 1172(c) inapplicable to Amtrak's employees is constitutionally suspect if it has the actual effect of reassigning creditor rights within a named debtor's bankruptcy. Amending the Bankruptcy Code for the sole purpose of reducing the rights of Amtrak employees could violate the uniformity requirement.[37]

Nevertheless, it is unlikely that the requirements of railroad reorganization or liquidation will be the vehicle for national transportation planning. Congressional collaboration in a transportation restructuring plan that has Amtrak's liquidation under the Bankruptcy Code as a mere component is a more likely scenario.

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[36]*See* CRS Report RL30659, *Amtrak: Overview and Options*, by (name redacted); *see also, Intercity Passenger Rail: Decisions on the Future of Amtrak and Intercity Passenger Rail Are Approaching* (GAO/T-RCED-00-277, Sept. 26, 2000). *See also,* CRS Issue Brief IB10032, *Transportation Issues in the 108th Congress.*

[37]The Amtrak Reform Act effected employee benefit reforms. The actual impact of 11 U.S.C. § 1172(c) in a bankruptcy filing is beyond the scope of this report. In many instances, statutory references are made to repealed statutes. Further, whether implementing the provision would have a material *de facto* impact on Amtrak employees is not considered.