

# Supreme Court of the United States

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APR 14 1970

OCTOBER TERM, 1969

In the Matter of:

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MANUFACTURERS HANOVER TRUST COMPANY, :  
 FIRST MORTGAGE 4% BONDHOLDERS COMMITTEE, :  
 RICHARD JOYCE SMITH, TRUSTEE OF THE :  
 PROPERTY OF THE N.Y., NEW HAVEN AND :  
 HARTFORD RR CO., et al. :  
 :  
 Petitioners; :  
 :  
 vs. :  
 :  
 THE UNITED STATES AND THE INTERSTATE :  
 COMMERCE COMMISSION, :  
 PENN CENTRAL TRANSPORTATION COMPANY, :  
 :  
 Respondents :  
 :  
 ----- x

Docket No.

914, 915, 916,  
917, 920, 921,  
1038, and 1057

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Place            Washington, D. C.  
Date            March 30, 1970

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IN THE SUPREME COURT OF THE UNITED STATES

October Term, 1969

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MANUFACTURERS HANOVER TRUST COMPANY,  
FIRST MORTGAGE 4% BONDHOLDERS COMMITTEE,  
RICHARD JOYCE SMITH, TRUSTEE OF THE  
PROPERTY OF THE N.Y, NEW HAVEN AND  
HARTFORD RR CO., et al.,

Petitioners;

vs.

THE UNITED STATES AND THE INTERSTATE  
COMMERCE COMMISSION,  
PENN CENTRAL TRANSPORTATION COMPANY,

Respondents.

----- x

Nos. 914,915,  
916,917,920,  
921,1038, and  
1057

Washington, D.C.  
March 30, 1970

The above-entitled matter came on for argument at

10:23 a.m.

BEFORE:

- WARREN E. BURGER, Chief Justice
- HUGO L. BLACK, Associate Justice
- WILLIAM O. DOUGLAS, Associate Justice
- JOHN M. HARLAN, Associate Justice
- WILLIAM J. BRENNAN, JR., Associate Justice
- POTTER STEWART, Associate Justice
- BYRON R. WHITE, Associate Justice
- THURGOOD MARSHALL, Associate Justice

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P R O C E E D I N G S

1  
2 MR. CHIEF JUSTICE BURGER: Numbers 914,915,916,917,  
3 920,921, 1038, 1057, the New Haven Railroad Inclusion Cases.

4 You may proceed now Mr. Seymour.

5 ARGUMENT OF WHITNEY NORTH SEYMOUR

6 ON BEHALF OF PETITIONER

7 MR. SEYMOUR: Mr. Chief Justice, may it please the  
8 Court:

9 I am going to open for the appellants on our side.  
10 I represent the Manufacturers Hanover Trust Company under the  
11 first mortgage bonds. I will be followed by Mr. Migdal who  
12 represents the Bondholders' Committee and he will be followed  
13 by Mr. Auerbach who represents the Trustee. A little later  
14 on I will explain the division of argument.

15 The bonds outstanding of this railroad consist of  
16 \$76 million of first mortgage bonds with about \$24 million  
17 of accrued interest and \$53 million of second mortgage bonds.  
18 The Harlem River Divisional bond will be paid off, so there  
19 is only the permanent two classes missing.

20 The Court already has some familiarity with these  
21 matters in the Penn Central Merger Case. The Inclusion Report  
22 of the Commission, which I will have occasion to refer to,  
23 was before the Court at the time it decided the Penn Central  
24 Merger Case.

25 The New Haven filed a petition for reorganization

1 in the Connecticut District Court in 1961, and that reorganiza-  
2 tion has continued since. Judge Robert Anderson was in charge  
3 of the reorganization from the beginning and continued to be  
4 after his appointment to the Court of Appeals.

5 It is a somewhat unusual type of reorganization in  
6 that from the very beginning, because the railroad had been  
7 running deficit since at least 1956, it was apparent that the  
8 only way to keep the railroad running was to have some kind of  
9 a merger or a sale to another railroad in existence.

10 During the time of reorganization, that is, from  
11 1961 through 1968 (at which time the Penn Central took over the  
12 New Haven and paid over the consideration, subject to review of  
13 the problem of price), the reorganization had accumulated some  
14 \$65 million of charges and claims ahead of the bonds as a  
15 result of reorganization expenses, borrowings and so on.

16 This process continued, I think there is no dispute,  
17 because of the determination on the part of the judge, the  
18 trustees, the trustees' counsel, and the Commission to keep  
19 the railroad running and a proper feeling on the part of Judge  
20 Anderson and the others that New England required the continu-  
21 ation of this railroad. I think Your Honors are familiar  
22 enough with its physical circumstances, so I do not need to go  
23 into those. It runs through Massachusetts, Rhode Island, Connect-  
24 icut, and New York, and is both a railroad which takes commuter  
25 traffic and interstate traffic of a more general character.

1           It is clear, I think, that from the very beginning  
2 the trustees were seeking to find a railroad with which there  
3 might be a merger of the New Haven or an acquisition of the  
4 New Haven and that, from the very beginning, while this search  
5 went on, there was no prospect that the road could have been  
6 abandoned or liquidated, because of the concern of everyone  
7 to keep it running.

8           In 1961 the trustees approached the Pennsylvania  
9 and the New York Central on behalf of New Haven to see if they  
10 were interested in some acquisition. In 1962 they reported that  
11 the only salvation for this railroad was some kind of a merger  
12 or acquisition. And in that same month, March 1962, the  
13 Pennsylvania and the Central asked approval of their merger  
14 under Section 5(2) of the Commission. In June, 1962 the trustees  
15 intervened in the merger case to seek inclusion.

16           There were negotiations in 1964 between Penn Central  
17 and the trustees which were unknown to the bondholders and which  
18 ultimately resulted in a agreement which was disclosed for the  
19 first time before the Commission examiner -- an agreement under  
20 which the merged corporation would acquire the New Haven assets  
21 for certain specified considerations.

22           The Commission approved the merger and required Penn  
23 Central to include both passenger and freight operations and said  
24 in its order: "all upon such fair and equitable terms as the  
25 parties may agree, subject to the approval of the Bankruptcy

1 Court and the Commission.

2 In October, 1966 the trustees and Penn Central filed  
3 their agreed Purchase Agreement as a first step in the plan of  
4 reorganization. Hearings before an examiner followed, report  
5 was dispensed with, and the matter was submitted directly to  
6 the Commission.

7 There were some intermediate proceedings in which  
8 arrangements were made for loans to the New Haven and other  
9 matters, but I do not see that they are relevant to what we are  
10 concerned with here. They are cited in the brief, and I will  
11 not take the time to talk about them.

12 There followed the Inclusion Report in November, 1967  
13 which is the report which was before this Court at the time of  
14 the Penn Central merger. At least this Court knew about it.

15 That report led to the first round of these appellants'  
16 successful application to the courts below. Those courts below  
17 remanded to the Commission. The essence of that Inclusion  
18 Report as far as the New Haven is concerned is that using  
19 evaluation as of the valuation date, December 31, 1966, the  
20 Commission found net liquidation value of the New Haven  
21 assets as a \$128.9 million which it rounded to \$125 million.

22 It found the fair value of the consideration to be paid  
23 by the Penn Central under the Purchase Agreement was a \$123.6  
24 million which it rounded to \$125 million, so that the considera-  
25 tion and the liquidation value were similar. And because of that



1 equality which it saw in the transaction upheld that the trans-  
2 action met statutory standards and approved it.

3           The present appellants petitioned for review and a  
4 Three-Judge Court was convened, consisting of Judge Friendly,  
5 Judge Levitt, and Judge Weinfeld from the Southern District.

6           By order of May 1968 the Court disapproved the Inclu-  
7 sion Report on the ground that it appeared that the Penn Central  
8 should pay an additional sum of \$45 to \$50 million. I do not  
9 think there is any use in going into the items there. They are  
10 set forth in our briefs on Page 15 from Judge Weinfeld's later  
11 dissenting opinion.

12           While the matter was pending before the Three-Judge  
13 Court, the Commission submitted the purchase agreement to the  
14 Reorganization Court as Step 1 in the plan of reorganization.

15           In April, 1968 the Court appointed a former judge of  
16 the Court of Appeals of New York, Judge John Van Voorhis, as a  
17 Special Master to consider the problems arising out of the Grand  
18 Central Terminal property.

19           Let me just say a word about that, although Mr. Migdal  
20 is going to carry the argument on the point on the matter that  
21 is still open. Just after the turn of the century, the railroads  
22 using Grand Central Terminal came down a great open ditch which  
23 is now Park Avenue, and that seemed a waste of valuable property.  
24 In the early part of the century, it was bridged over to create  
25 Park Avenue. As a result of that and the agreements between the

1 Central and the New Haven, a number of the principal hotels,  
2 of which we have all too few left in New York, were built: the  
3 Waldorf, the Biltmore, the Commodore, the Roosevelt. The Pan  
4 Am Building is on it and the Yale Club.

5 The New Haven and the Central set up a partnership  
6 interest in these properties, and there was dispute about the  
7 nature of that interest and its value. The Commission in its  
8 Inclusion Report struck a balance between various possibilities  
9 and arrived at a figure of \$13 million as the figure which  
10 should be allowed.

11 That was evidently too low, and Judge Van Voorhis was  
12 asked to report his views about the legal relationships. He  
13 upheld the view that there was a partnership interest in connec-  
14 tion with the Grand Central properties.

15 Ultimately, as I will show Your Honors, in the Remand  
16 Report the original allowance of \$13 million was advanced to  
17 \$28 million, so that under the present position of the Commission,  
18 New Haven is entitled to \$28 million for its interest. There is  
19 no dispute that the value of the property is \$227 million,  
20 So Penn Central has acquired a very valuable property for a  
21 very small amount.

22 Q Was Judge Van Voorhis appointed Special Master  
23 for the purpose only of considering this aspect of the problem?

24 A Yes, because of his background in the Court of  
25 Appeals, he was thought to be a great expert in the New York

1 property problems.

2 Q And his jurisdiction was confined only to that?

3 A That is correct.

4 Q Has he retired from the New York Court of  
5 Appeals?

6 A Yes. He is practicing law in New York.

7 The Reorganization Court like the Three-Judge Court  
8 concluded that the allowance by the Commission was inadequate,  
9 that they had undervalued the property. And it, too, remanded  
10 to the Commission.

11 The Three-Judge Court thought that the amount the  
12 Commission should increase its determination by was \$45 to \$50  
13 million. Judge Anderson's spread was a little wider. He  
14 thought it should be \$33 to \$55 million.

15 The Commission proceeded to hold expedited hearings,  
16 and it made its remand report on November 25, 1968. This is the  
17 one which these appellants attack here, so I will be talking  
18 about some phases of that a little later on.

19 The Commission was sustained on some matters by the  
20 courts later on. I don't think I need to take any time on that.  
21 What we are going to talk about on our side are those things  
22 where the Commission was sustained by division among the judges  
23 and those things where the Commission was sustained, but we  
24 think the court was wrong in sustaining it.

25 The effect of the decision on remand was -- starting

1 with the liquidation value of a \$128.9 million which the  
2 Commission had found on its original inclusion order and increas-  
3 ing that to \$162.7 million and then immediately retreating by a  
4 series of major deductions from that amount -- the most signifi-  
5 cant, and those to which I'm going to address myself, being two  
6 totaling \$22 million. One is a so-called "abandonment delay"  
7 and the other a so-called "bulk sale".

8           In both these cases our position is that Judge Ander-  
9 son and Judge Weinfeld who dissented below were correct in their  
10 view that these discounts were unjustified and that Judge  
11 Friendly and Judge Levitt were wrong in concluding that they  
12 could be justified. And so we shall ask Your Honors to follow  
13 the Reorganization Court in these matters.

14           A word or two about what they were: The first dis-  
15 count, the "abandonment delay" discount was in the substantial  
16 figure of \$15,386,00. And this was based upon the theory that  
17 beginning in 1967 the New Haven would have had to start an  
18 abandonment proceeding. That would have taken a year. In that  
19 year the New Haven would have been practically at a standstill.  
20 And although the loses for that year were already charged against  
21 the New Haven, the Commission could properly charge it again for  
22 up to an additional sum of \$15,386,000.

23           The "bulk sale" discount was a discount of about  
24 \$6 million. The Commission held that it could require that the  
25 New Haven's property be sold in bulk and at a discount, because

1 it had the power to condition the abandonment certificate on a  
2 sale in bulk -- this abandonment certificate which it thought would  
3 have to be sought but which was never sought and never could  
4 have been obtained could be conditioned on this "bulk sale"  
5 discount. And that was the theory on which the Commission went.

6           They made a few adjustments upward in their remand  
7 report, including an additional sum on the Grand Central Terminal  
8 which I have already referred to. But the net result of their  
9 whole operation of finding liquidation value of \$162 million and  
10 then making these large deductions was to arrive at a figure  
11 of \$140.6 to which it added \$5 million additional, arriving at  
12 a total figure of \$145.6 million. And then it proceeded to find  
13 that the consideration for that which was largely in stock was  
14 worth that amount and, therefore, it would approve the acquisi-  
15 tion at that price.

16           Now, taking the figure that the Commission arrived at  
17 that I have just mentioned -- just so you have a kind of guide  
18 to what it did -- taking the price of Penn Central stock involved  
19 in the consideration in December, 1968, which is the date of the  
20 Commission's remand report, the first mortgage bondholders  
21 would have received 24¢ on the capital on the dollar and 18¢  
22 on the dollar if interest is included.

23           You will see at once, of course, that the expectations  
24 of the reviewing courts, the Three-Judge Court that \$45 to \$50  
25 million would be added and of the Reorganization Court that \$33

1 to \$55 million would be added as a result of reconsideration,  
2 fell far short of achievement.

3 Judge Anderson, when the problem of the remand report  
4 came before him, approved the immediate transfer of the property  
5 of the New Haven to the Penn Central, so that the property would  
6 be acquired before the end of the year, having previously ruled  
7 that unless there was a transaction before the end of the year,  
8 the trains would stop running on January 1, 1969, because the  
9 erosion would then have gone beyond any possible constitutional  
10 limit.

11 So the transfer took place, and from that time on --  
12 This was before, Your Honors, there was an effort to stop the  
13 transfer. The courts below denied a stay, and so the transfer  
14 proceeded, leaving the question of price open.

15 Now, the state of the conflict between the courts  
16 below is that as to this "abandonment delay" discount, Judge  
17 Anderson and Judge Weinfeld thought it was entirely unjustified,  
18 that it was illegal and erroneous, that it was not sustained  
19 by substantial evidence. Judge Friendly and Judge Levitt in the  
20 Three-Judge Court affirmed (I submit, on the face of their  
21 opinion, somewhat reluctantly) that it was -- They could not  
22 say it wasn't sustained by substantial evidence, and they could  
23 not say it was irrational, but they did sustain it.

24 Q Did Judge Anderson's opinion precede the Three-  
25 Judge Court opinion?

1           A     Yes.

2           Q     By what kind of an interval?

3           A     A very, very short time, six weeks. So it was  
4 before the Three-Judge Court.

5           The division between the courts is the same on bulk  
6 sale, the same on the Harlem River and Oak Point yards which  
7 Mr. Migdal is going to talk about, and then on certain adjust-  
8 ments.

9           And then there were some matters on which the courts  
10 both disagreed with the position of the appellants here. We  
11 are going to present some of those points on argument and some  
12 on brief. Mr. Migdal will present, following my argument, the  
13 matter of the Harlem River Yard, and the matter of the questions  
14 on the Grand Central Terminal, and on the valuation of the stock.  
15 And then we will submit some of the points on the briefs,  
16 because there obviously is not time to cover all these points.

17           We submit that Judge Anderson and Judge Weinfeld  
18 were clearly right that the abandonment delay was, as Judge  
19 Anderson said, dragged in by the heels for the purpose of  
20 reducing the liquidation value with which both courts had former-  
21 ly held the bondholders were entitled. There is not any real  
22 dispute here, that liquidation value is the proper standard.

23           The deduction of \$16 million on liquidation value as  
24 found by the Commission was more than a departure in the interest  
25 of flexibility, or as the Commission said, a matter of

1 refinement or a matter of pricing out. It really subverted  
2 the whole concept of using liquidation value as the standard.  
3 And there was no justification for it. From the beginning it  
4 was perfectly clear that no application to abandon and liquidate  
5 would be granted. The Three-Judge Court thought that was clear.  
6 The Commission thought that was clear.

7           It is perfectly evident from the whole course of these  
8 proceedings that no such application would have been granted.  
9 And the requirement that that hypothetical application should  
10 be made, that these charges, in addition to the loses for 1967,  
11 should be piled on just to reduce the amount that Penn Central  
12 had to pay for these properties seems to us most unjust and  
13 inequitable, as Judge Anderson and Judge Weinfeld viewed it.  
14 And I submit that that decision should be reversed.

15           Now, there are details of that which are in the briefs.

16           Q     Excuse me, Mr. Seymour. Suppose the court, on  
17 that theory, pursuant to the order of the point, might have said  
18 since it can never be abandoned, we will just spread this  
19 abandonment delay indefinitely?

20           A     Well, if the Commission is permitted to say it  
21 would take one year, then they could say it would take two  
22 years, and they could make an allowance for that. And I submit  
23 that it opens an area of perfectly arbitrary conduct and decision  
24 which the Court should not permit. If I understood Your Honor  
25 correctly, the Commission could then spread it over a period of



1 time, so that no liquidation value would be paid. And I submit  
2 that erosion had reached the outer limits, and no further  
3 erosion was fairly and properly to be applied.

4 Q I am not sure I quite got your point on charging  
5 New Haven with the losses for the year and then, I think as you  
6 put it, superimposing the one-year abandonment delay on top  
7 of that hypothetical loss.

8 A Well, the New Haven was running in the year 1967,  
9 and the New Haven had to absorb the losses for 1967.

10 Q But this was a real loss, not a hypothetical one.

11 A That is right. It had to absorb those losses.  
12 Those eroded the values available for the bondholders to the  
13 extent of those losses, because they were paid off in some  
14 fashion --

15 Now, in addition to that loss, what the Commission has  
16 done is to put \$16 million on top of that to deduct from the  
17 value of the assets remaining, and, therefore, has piled it on  
18 top of the loss, I submit.

19 Now there are some details of that piling on which  
20 there is not time to talk about. But they have made up this  
21 \$16 million by taking first alleged delays in disposing of  
22 property. There was a fair amount of non-railroad property,  
23 1700 pieces in all. And it would have been perfectly possible  
24 during this year to dispose of some of that property.

25 They have added on preservation costs which are not

1 sustained, we think, by the record. Then they have added on  
2 taxes which, after all, would not have been added to if some  
3 of the property was disposed of in a reasonable time.

4 So that if you came to look at whether or not there  
5 was substantial evidence to sustain their conclusion as to the  
6 amount of this loss, you would find that it was not sustained.

7 But, I prefer to grapple with it on the basis that as  
8 a matter of law, it was improper for the Commission to apply this  
9 hypothetical loss to reduce the minimum value, the liquidation  
10 value, to which, we submit, the New Haven was entitled.

11 Now, to come to the "bulk sale" discount which is in  
12 a kind of curious position. The Commission held that they had  
13 power to condition an abandonment certificate on requiring that  
14 the property be sold in bulk. And thus they arrived at the  
15 "bulk sale" discount.

16 In the Three-Judge Court, Judge Friendly thought there  
17 was the gravest constitutional doubt about the ability of the  
18 Commission to condition an abandonment (to which they were  
19 constitutionally entitled as a losing railroad) upon a sale in  
20 bulk. And, therefore, he thought that went beyond their power.  
21 So, he sustained the decision of the Commission on a wholly  
22 different ground than the Commission had taken. He sustained  
23 it on the ground that he found evidence in the record by a  
24 witness named Simon that if the property was sold, a bulk buyer  
25 would have many risks on which he would want to get a discount.

1           But, that was not the basis on which the discount  
2 was allowed by the Commission. And, when Simon's testimony is  
3 examined, it is perfectly apparent that he was talking about  
4 acquiring this property or such property for development and  
5 breaking up in sale, not for bulk use as the Commission thought  
6 it should be, without breaking up the railroad, but breaking  
7 it up for development and other purposes.

8           And, I submit that this second ground on which the  
9 Commission was sustained was erroneous, that there is no founda-  
10 tion for the Commission's ruling in this regard.

11           Q     If it was not erroneous, you would perhaps have  
12 a tenere problem, wouldn't you?

13           A     Certainly. And I think that that really stares  
14 the Three-Judge Court decision right in the face.

15           Let me just add a word about scope of review, because  
16 my friends in the government say that it is a very simple case  
17 in which the only question is scope of review, that the Three-  
18 Judge Court applied Ecker, that Judge Anderson departed from  
19 Ecker. Therefore, you should sustain the Three-Judge Court and  
20 reverse Judge Anderson.

21           Mr. Auerbach will present the view that may well be  
22 that a court in reorganization, with its own independent  
23 judicial duty, is in a somewhat different position than the  
24 ordinary reviewing court.

25           But our position is basically that whatever the

1 standard of review, it is perfectly clear that there is no  
2 substantial evidence to sustain the Commission on these  
3 discounts, and that with regard to their conclusion, they reached  
4 a decision which is unjust and inequitable under the test both  
5 of the Commission statute and of 77 of the Bankruptcy Act.

6 I would submit to Your Honors that you should affirm  
7 Judge Anderson who has lived with this all these years and  
8 knows what the discounts were and not pile upon the losses  
9 which have taken place through erosion of \$65 million the  
10 additional losses which the Commission has imposed upon the New  
11 Haven.

12 MR. CHIEF JUSTICE BURGER: Thank you, Mr. Seymour.  
13 Mr. Migdal.

14 ARGUMENT OF LESTER C. MIGDAL

15 ON BEHALF OF PETITIONER

16 MR. MIGDAL: Mr. Chief Justice and may it please the  
17 Court:

18 While the Commission has acknowledged that liquidation  
19 value was the standard that should be applied with respect to  
20 the property of the New Haven, it has failed in several instances  
21 to give that liquidation value because it has not understood that  
22 when you go to find liquidation value, what you must find is  
23 what the liquidator of that property would receive if he sold  
24 it in the method that was best suited to his disposition. That  
25 was what was wrong with the "bulk sale" discount, and it is

1 what's wrong with the Harlem River valuation. And that was the  
2 question to which Judge Anderson and Judge Weinfeld addressed  
3 themselves to.

4 What you have in those two yards was simply the  
5 question of whether there would or would not be rail service  
6 available to the industrial users of those two yards in the  
7 event of liquidation.

8 Q That's the Harlem River and Oak Point yards?

9 A That's the Harlem River and Oak Point yards.

10 Q Then the question is whether or not there would  
11 be good rail service available to that market area.

12 A That is right, Your Honor. That is exactly  
13 the point.

14 Now, there isn't any question that the two values  
15 are the only two values we need to look at here. That is to  
16 say, that it is either the \$18 million or the \$22.5 million,  
17 because the testimony is the testimony of the same man, Mr.  
18 McCann.

19 One represents a discount he took on certain liquidation  
20 assumptions that were furnished to him. Those liquidations  
21 were that all of the electric power would be turned off  
22 (there would be no power to the property, although this was  
23 property just adjacent to the Consolidated Edison power plant)  
24 and that all the tracks would be torn up. Now, I submit that  
25 that was not the New Haven's best method of liquidation.

1           One of the things --

2           Q     Is there any disagreement between you and Mr.  
3 Seymour?

4           A     No, Your Honor, there is not.

5           The problem that you face here is what you mean when  
6 you say "scrap value", what you mean when you say "net salvage  
7 value". Now, I say that what you mean when you say "net salvage  
8 value" is the best use you can make of it. And, in this case,  
9 to have torn up the tracks, to have taken out the electric  
10 power would, first, have depreciated the value of the New Haven's  
11 assets and then would have sold a portion of it as junk and the  
12 balance of it for whatever you could get for it. And, no  
13 sensible liquidator would have liquidated in that way.

14           And, it was for that reason that Judge Weinfeld and  
15 Judge Anderson both said that it was simply impermissible to  
16 permit the assumption -- the basis here, liquidation -- to  
17 assume that there would be no service available.

18           They were aware that New York City had dealt with  
19 Hunt's Point market and that it had spent a \$100 million on  
20 that. It was a food lifeline to New York. It was being served  
21 then by a small piece of track which ran -- If you think of it  
22 as running north, it is three thousand feet between the Harlem  
23 River yard up to a point where it meets the Port Morris branch  
24 of the Pennsylvania Central which was not liquidated. The two  
25 yards, the Oak Point yard and the Port Morris yard, being cheek

1 by jowl, there is a switch point there. It comes onto the  
2 New Haven track, and it continues on up. In another mile there  
3 is a spur track, and that spur track goes another mile to the  
4 Hunt's Point yards.

5 And, therefore, there never seemed to Judge Anderson  
6 the possibility that a liquidator would tear up the track and,  
7 in that way, make it impossible to realize the best value he  
8 could on the sale of his 162 acres in the Harlem River yards and  
9 in the Oak Point yards and, at the same time, make it impossible  
10 for New York City to have the rail service that it required.  
11 Because most of this, for 99 per cent of its distances, came in  
12 on Pennsylvania cars and was then switched at the Port Morris  
13 yard and then went to Hunt's Point.

14 Q May I ask you an overall question?

15 A Yes, Your Honor.

16 Q Supposing you prevail, or substantially prevail  
17 here, what is the consequence? Is there a remand to the  
18 Commission?

19 A I think, Your Honor, on this point, there is no  
20 remand to the Commission, because I think that the record has  
21 been perfectly clear that if you found that these yards --

22 There is one question, however, that does raise a  
23 problem with respect to the remand.

24 In the valuation, when you consider the possibility  
25 that the mile and a half of track would be torn up, you then

1 have to consider that, on the liquidation hypothesis, that  
2 track would continue even if the New Haven, for example, had  
3 to give that track to New York, in order to make sure that the  
4 track would continue. Then the value of the right-of-way,  
5 which is about \$500,000, would have to be subtracted from the  
6 \$22.5 million, because then you would have valued it twice.

7           However, Judge Anderson clearly thought that there  
8 was no danger that New York City would pay a fair price for that  
9 right-of-way in order to preserve the service to the Hunt's  
10 Point yards. And, therefore, he did not make that deduction.  
11 And we submit that that is perfectly plain and correct. There  
12 does not need to be a remand again to value that small piece  
13 of right-of-way which, at worst, would have been donated to  
14 New York City or to the developers of the Oak Point and Harlem  
15 River yards.

16           Q     Is it about a mile or so or less?

17           A     It is three thousand feet from the Harlem River  
18 yards to the Oak Point yards with Penn Central's Port Morris  
19 branch. Then it runs on another mile until it meets the spur  
20 track to Hunt's Point.

21           In a certain sense, this unwillingness to permit the  
22 New Haven its real liquidation value, while always asserting  
23 that liquidation value is what is being granted -- The  
24 Commission's treatment of the Grand Central Terminal is another  
25 case in point. For there the New Haven enjoys the right, or



1 enjoyed the right until the closing, of bringing its trains  
2 into the station. It had this partly by charters which went  
3 back to the 1840's, and it had it partly by virtue of agreements  
4 which it made with the Central.

5 Now, that right permitted the New Haven to operate its  
6 trains into the station and out of all the Terminal properties.  
7 Here we are not talking simply about the station income itself.  
8 We are talking about all of the Park Avenue properties and all  
9 of their income.

10 By agreement these were being put into the Terminal  
11 account, and all of the expenses were coming out of the Terminal  
12 account to pay the expenses of both railroads, Central and the  
13 New Haven, in the station.

14 Now, obviously this income grew as the real estate  
15 developed, and it became more profitable. In 1907 this was a  
16 pretty remote part of New York City, but that changed in time.  
17 And the result of that was that, as the income increased, the  
18 difference between the actual expenses and the income from  
19 the properties began to disappear. Therefore, the parties  
20 each year had to contribute less and less out of their own pock-  
21 ets in order to meet the expenses of their operations in the  
22 Terminal and all of the expenses of the property.

23 There came a time in 1964 and thereafter, when, in  
24 fact, there was more income coming in than the total of the  
25 expenses, both for the fixed taxes and the charges on the

1 real estate and the operating cost. Now when that happened,  
2 there was excess income. So, the question then arose as to  
3 what the division of the excess income should be between the  
4 parties.

5 So, you get excess income and Terminal income as the  
6 way in which I have divided it for this discussion. And I  
7 hope that all that is clear.

8 Q Before you proceed, am I correct in my understand-  
9 ing that there is now no issue remaining as to the excess  
10 income?

11 A That is correct, Your Honor.

12 Q The issue goes to the \$5.6 million or the value  
13 of that income?

14 A That is correct, Your Honor. And yet it is  
15 extremely important to understand how the issue with respect  
16 to the excess income was settled.

17 In the first instance, Central had denied that the  
18 New Haven had any right in the income that those properties  
19 produced in the event that the New Haven stopped operation.  
20 As a result of that, in the negotiations between the Trustee  
21 and Penn Central, no value was allowed for that. And, we  
22 argue that that was all wrong. It was all wrong, because the  
23 nature of the New Haven's interest had been litigated in the  
24 New York Courts. It had gone all the way to the Court of Appeals,  
25 and the Court of Appeals had said that the New Haven was, in

1 effect, an equal partner with the Central in the management of  
2 those properties and treated them as joint venturers.

3           The Commission, however, on the first round, gave  
4 us this small value of \$13 million because it considered, in  
5 the first place, that there was a great question as to whether  
6 it would survive, in spite of the rule in the Biltmore case  
7 as to whether we had a real interest. In the second place, it  
8 considered that it ought to use as either end of the equation  
9 41 per cent on one side (because that was our traditional car  
10 use in the station) and \$5 million (which was a certain  
11 nuisance value attributable to the claim), and it split the  
12 difference and came out with \$13 million.

13           It was important that Judge Van Voorhis was named to  
14 look into the question, because the result of his decision was  
15 to declare that the New Haven Railroad was, in fact, an equal  
16 partner -- that it was an equal partner in an indefeasible way.  
17 And, therefore, the New Haven's interest in that excess income,  
18 the profits from the operations, had to be fully valued, and  
19 we had to be fully paid. And then to say that his declaration  
20 that we were an equal partner and that that interest was, in  
21 fact, indefeasible is very important for the purpose of under-  
22 standing what ought to have happened to the \$5.6 million.

23           What we had (as Penn Central's witnesses themselves  
24 testify) was the greatest bargain in history. We had a right  
25 to come into that terminal with our trains, and because the

1 Terminal income was so great, we didn't have to pay for it.

2 Therefore, the question is why now, when that valuable  
3 interest is turned over to Penn Central (so that Penn Central  
4 can perform the service that we formerly performed and perform  
5 it without cost, because it is utilizing the same income),  
6 Penn Central should not be required to pay for it.

7 I must say that if you read Judge Friendly's opinion  
8 on this point, you will see on the first round of review that  
9 essentially there was only one ground. In spite of all the  
10 grounds that are finally talked about, there is only one ground  
11 that really determined his decision. And that was his view that  
12 if the New Haven stopped operating, whether anybody would acquire  
13 our right -- whether anybody would be interested in doing that --  
14 or whether it was so speculative that somebody would acquire  
15 that right that we ought not to be paid for it.

16 Q It would appear -- At least your first answer  
17 is that the Penn Central did acquire your right.

18 A Yes, Your Honor. But it was inevitable that  
19 somebody would acquire it, because if nobody would acquire it,  
20 then precisely what the Chief Justice adverted to when he spoke  
21 to Mr. Seymour would have occurred. This would have gone on  
22 until we would have been drained of all equity.

23 On the one hand, we were not permitted to stop the  
24 operations, because we were bound to the public interest. And  
25 on the other hand, it was conceived by Judge Friendly that there

1 might not be somebody who would pick up that service and would  
2 perform it for its own people. Now, that, I submit, was simply  
3 unreasonable.

4 Q Now, I am not sure I understand that -- You  
5 are talking about the right to enter the Grand Central Station  
6 with your train?

7 A That is right, Your Honor.

8 Q Well, I had understood that the rationale was  
9 that even if the states of Connecticut and/or New York or any  
10 combination acquired it, their bargaining power would be such  
11 that they wouldn't pay anything for it.

12 A But, Your Honor, that, we submit, would have  
13 worked both an inequitable result and an unconstitutional one.

14 Q Am I mistaken in the rationale?

15 A I think in part you are, Your Honor, but I think--  
16 That was one of the statements made at one point in the case,  
17 and I think that I must clearly meet it. Though I don't think  
18 that it was the fundamental one. I think the fundamental point  
19 was that it was too speculative that the states would acquire it  
20 and, therefore, too speculative to value that right.

21 Now, I think that if you look at Judge Friendly's  
22 opinion, you will note that he says that it was possible to  
23 conceive of the possibility that the service would only be  
24 acquired as far as Woodlawn. And, in Woodlawn those 30,000  
25 daily passengers would be discharged each morning to walk four

1 blocks to the nearest Bronx subway station, and then they could  
2 find their way to work somehow and then go back in the evening  
3 the same way. And, I submit that that simply was an impractical  
4 solution.

5 Judge Friendly should have noticed from the very  
6 beginning, and the Commission should have recognized from the  
7 very beginning, that there was no possibility that that service  
8 would cease. New York and Connecticut had testified repeatedly,  
9 in the Train Discontinuance Case, for example, that that was  
10 essential to their citizens and that they were prepared to pay  
11 for it and produce it.

12 We are here today in a new posture of this case,  
13 because an authority was formed, in fact, by the states of New  
14 York and Connecticut. They had, in fact, entered into an agree-  
15 ment with Penn Central to operate that service.

16 Q Before you go on, could that have been operated  
17 by Penn Central without access to the Terminal? Could this  
18 operation be carried on without access to the Terminal which was  
19 the exclusive right of New Haven?

20 A It could not be operated into the Terminal,  
21 unless there was a lease from Penn Central to a new user. Now,  
22 it was for that reason that we felt --

23 I think that if you look at an earlier case decided by  
24 Judge Cardoza -- Judge Cardoza, in describing the New Haven's  
25 interest there, said that it was the value, under the agreement,

1 of the right to use the Terminal, that while we didn't have the  
2 fee, we had this valuable right.

3 Judge Friendly, himself, refers to it as a unique  
4 right when he questions what value should be put on it, if, in  
5 the end, we are trying to cease operations, and, as he says, no  
6 one will acquire it. Now, that we think is where the mistake was.  
7 New York and Connecticut --

8 Q It is a result, however, not unique to Judge  
9 Friendly. The Reorganization Court, Judge Van Voorhis, all  
10 the judges concerned agreed in ascribing and attributing no  
11 value to this income. Am I mistaken in that?

12 A Your Honor, I think that in the end result, you  
13 are correct, but I think --

14 Q You are not attacking Judge Friendly's reasoning,  
15 because the result was reached by all four of the judges con-  
16 cerned.

17 A I think that that is correct, Your Honor, but  
18 I would say this: Judge Anderson harbored and still harbors  
19 great doubts as to the correctness of that result. Judge Anderson  
20 always felt that some value should be placed on that, and he,  
21 therefore, remanded to the Commission the first time and asked  
22 them to find what value, if any, inhered in the New Haven's  
23 right to enter the Terminal and to enter the Terminal free of  
24 cost.

25 Now, what the Commission did was to refer to Judge

1 Friendly's language. And then said, on that review, that we  
2 answer our question by saying that we don't contemplate either  
3 that there is a buyer or that, if the states were to buy it,  
4 their bargaining power would not be so great that they couldn't  
5 get this benefit for nothing.

6 And, we say that where, for a public purpose, a  
7 valuable property right such as that is being obtained, any  
8 notion of just compensation requires payment therefor. And  
9 that to have said we will simply use our sovereign power to  
10 take this valuable right and pay you nothing for it was to  
11 say something which the Commission should not have said, and  
12 the courts should not have sustained.

13 Q In talking about liquidating value, there would  
14 be no need to -- If the property was going to be liquidated  
15 there wouldn't be any New Haven trains entering the station.  
16 I find a little bit of the same inconsistency in your argument  
17 that I find in the argument made in the brief, and I think so  
18 far not argued orally, that value should be attributed for  
19 "going concern" value in this case when, at the same time,  
20 you are arguing for liquidating value.

21 A Your Honor, in this case it seems to me --  
22 We do make that argument for "going concern" value, but I  
23 would say this. Under our best method of liquidation, we would  
24 not have, as Penn Central says on Page 98 of its brief --  
25 You must not assume that the tracks are assumed to have been



1 dismantled. And with the tracks along the New Haven's right-  
2 of-way torn up, free use of the Terminal can be of no value to  
3 the New Haven. Because that is not a proper method to liquidate.

4 And, I will also point to the PATH Case decided in  
5 New York where you have the same situation. You had something  
6 that was of use. You had a tunnel. But the Hudson-Manhattan  
7 Railroad Company was making no money with it, and it was prepared  
8 to stop. But the commuters needed the service. The State took  
9 the property. And when the State took the property, it did  
10 not attribute a zero value to it, because it had no value in the  
11 hands of the Hudson-Manhattan Railroad Company. It attributed  
12 a fair value to it, because that is what the State was using  
13 it for. It took it for a purpose; it got the value of that  
14 purpose. And it attributed (the New York City Court of Appeals  
15 said it was required to attribute) a very large value to that  
16 tunnel. And I say there is essentially no difference between  
17 our Grand Central situation and the PATH Case. I can't spend  
18 any more time on the PATH Case, but I think a careful reading  
19 of that case will show that the circumstances were identical.

20 I should say this. If I could add one more word  
21 on the Grand Central Terminal question. I pointed out that there  
22 was a question in Judge Friendly's mind as to what value would  
23 be put, in any event, upon the New Haven's right to enter the  
24 Terminal. How would you value that if New York State did take  
25 it over. And, I submit that if you look at the briefs filed

1 here by New York and Connecticut (which are filed in opposition  
2 to our being given any credit for that unique, valuable right)  
3 that you will see that all that has happened now is that the  
4 States and Penn Central are quarreling over the division of the  
5 spoils here. Otherwise New York State and Connecticut would  
6 have no interest in this proceeding.

7 And, I would suggest to you also that \$2.17 million  
8 can be derived by a reading of those briefs as the minimum  
9 value that needs to be capitalized, if the New Haven's right in  
10 the Grand Central Terminal's properties, as equal partner, is  
11 ever to be vindicated.

12 Q Somewhere the figure of \$70 million got in there.  
13 Is that capitalized value?

14 A That is the capitalized value of \$5.6 million and  
15 an 8 per cent rate which was the traditional basis that was  
16 used.

17 Q And that comes to \$70 million?

18 A That would come to \$70 million. Now, of course,  
19 on a minimum value basis it is \$2.17 million capitalized. We  
20 know that because that is what, in effect, Penn Central is  
21 paying to New York and Connecticut in order to give them  
22 free use of the Terminal in exchange for something of much  
23 greater benefit to them. They are being relieved of the  
24 deficits of those operations altogether. (New York and Connecti-  
25 cut are also providing a lot of new capital, improving the

1 stations and so on.) So that what Penn Central has realized  
2 out of that free use is something a good deal more than 2.17  
3 million. But that would at least represent a floor as to the  
4 valuation of the New Haven's rights.

5 Q Now, what is the capitalized value of that  
6 income?

7 A \$27 million.

8 Your Honor, the next part I would like to talk about  
9 is the artificial value which the Commission placed on the  
10 shares of stock of Penn Central.

11 It must be recalled that with respect to the valuation  
12 of the New Haven property, the property was all calculated on  
13 a piece by piece basis. It was estimated how long it would  
14 take for you to realize those values. They were then discounted  
15 back to present values, so that you had a current market value  
16 as of December 31, 1966 for each of the New Haven's pieces of  
17 property.

18 Now, with respect to some of the items, with respect  
19 to the bonds, for example, of Penn Central which were given as  
20 consideration for the New Haven, the same method was followed  
21 there. It recognized that a 5 per cent bond with a 25 year  
22 maturity would not sell at par, and, therefore, the 15 per cent  
23 discount was given in order to find the market value. So that  
24 what you had on one side of the equation, liquidation value,  
25 you have on the other side of the equation liquidation value

1 and those would meet.

2 But the \$83.1 million did not represent liquidation  
3 value at any point in this case; it does not represent it  
4 today. At no time, not since the liquidation value date until  
5 today could those 950,000 shares been liquidated for \$83 million.

6 We submit that the right day on which to value those  
7 shares is the same day that all the other property is valued,  
8 which was December 31, 1966. And the market value on that date  
9 was approximately \$50 million, and therefore there is a gap of  
10 some \$33 million.

11 There was some argument that it was reasonable to value  
12 the shares as of the closing date. Because after all that is  
13 when we gave our property up, and that is when we received the  
14 property back. But then the shares had a value of \$60 million.

15 Q That was in December of '68?

16 A That was in December of '68.

17 So what you have left is either a gap of \$33 million  
18 or a gap of \$23 million, but you have a very substantial gap.  
19 And both courts recognized that that wouldn't work. And so,  
20 Judge Anderson suggested, and the Three-Judge Court accepted,  
21 an underwriting. Judge Anderson had said by 1978 probably it  
22 will be worth that, and if it is not, then in 1978 Penn Central  
23 will pay in cash the difference between the market value and  
24 the value that you get by looking at averages for thirty days  
25 preceding February 1, 1978.

1           Now, we submit that that is entirely inequitable  
2 treatment here. We gave up property that had, as the Commission  
3 said, been conservatively valued. And it had a cash value on  
4 the day it was valued, and it had a cash value on the day it  
5 was given up.

6           Judge Weinfeld, in the course of argument on this  
7 very point (where Judge Weinfeld agrees with us that the courts  
8 have not gone far enough with us here) , asked the question was  
9 it within the Commission's power to order that this be paid for  
10 in cash. And the answer to that was yes.

11           Now, it did not order that it be paid in cash. But  
12 Judge Weinfeld's statement that it should have been paid in  
13 the cash equivalent we submit is exactly right. If it was  
14 thought too burdensome to require Penn Central either to add  
15 to its fixed charges by issuing bonds or by raising the cash, to  
16 have Penn Central pay for it in shares. That was easily arranged  
17 simply by the addition of more shares which would have had no  
18 effect on fixed charges and would have had the most minuscule  
19 effect on the earnings per share, because there are 24 million  
20 shares of Penn Central outstanding.

21           It, therefore, could not have been burdensome to  
22 Penn Central. And yet, it would have provided a certain fairness  
23 here.

24           Q Well, they are outstanding in the hands of the  
25 investing public. Are there a lot of treasury shares or

1 authorized but unissued shares in Penn Central?

2 A I am afraid I can not answer the question.

3 Q Then where are these shares going to come from?

4 A In any event--

5 Q You are going to have to use cash to buy them,  
6 unless they are authorized but unissued or treasury shares.

7 Q Your Honor, in the first place, there are  
8 shares there which could be issued. But, in the second place,  
9 there is a procedure by which Penn Central, as in this case in  
10 the finance docket, goes to the Commission and says we would  
11 like to issue shares in order to meet this obligation.

12 The Commission in this case did authorize Penn Central  
13 to issue the 950,000 shares and could have authorized the  
14 issuance of more than 950,000 shares in order to see that what the  
15 New Haven received was the equivalent of what it was giving  
16 away, which seems to us to have been an absolute minimum.

17 Q Has the price per share ever been as high as  
18 \$87.50 during this period?

19 A Never once, Your Honor. It did reach \$86, but  
20 it has actually varied. It is now, I believe, at something like  
21 \$25. If you look at the history from 1962 until now, you will  
22 see that it has had a history of being \$14 and climbing up and  
23 coming down again. Penn Central, itself, acknowledges that it  
24 is a very cyclical situation. It talks about the difficulties  
25 of starting up the merger and one thing and another.

1           But that, it seems to us, had nothing to do with this  
2 case. In this case we were entitled to be paid. For, in fact,  
3 it was nothing but a sale, the equivalent of what we gave up.

4           I have been handed, this morning, a chart which I am  
5 afraid I am unable to understand, but which I understand will  
6 be used in connection with an argument on this stock point.

7           Whereas, throughout, we have said that what the  
8 Commission should do is to give us the additional shares, so  
9 that it would make up the \$83 million. Because there was never  
10 any need to guess as to what the market price would be on the  
11 date of closing. There was a guess made by Kirk that the date  
12 of closing would be in 1970, that at that time the shares  
13 would pay between \$75 and \$100. And splitting that difference,  
14 \$87.50, you had a price which multiplied by 950,000 shares gave  
15 you \$83.1 million.

16           None of that guessing was necessary, and it was all  
17 wrong. We didn't close in 1970; we closed at the end of 1968.  
18 The price was not then \$87.50; it never reached \$87.50. The  
19 price then was \$63 and three-eighths. All these guesses were  
20 unnecessary, because history would have shown just what the  
21 price had to be. It was there that the Commission went wrong.

22           Judge Weinfeld has never yet accepted that and has  
23 said that it ought to be remanded to the Commission, so that  
24 the Commission can provide the cash equivalent.

25           We have tried not to interfere with the underwriting

1 formula farther than we had to in order to avoid that remand,  
2 because this proceeding has gone on now for some nine years.  
3 The underwriting, in a certain sense ( if some small correc-  
4 tions are made to it), does insure that eventually we will  
5 receive \$83 million.

6 We have had, however, in effect, just a part payment.  
7 That part payment is either \$60 million or \$50 million of the  
8 \$83.1, and the balance is still to come. We are general  
9 creditors, in effect, for the rest. We have not even a pur-  
10 chase money mortgage with respect to that balance. And nobody  
11 would have transferred all his real estate here for a part pay-  
12 ment without taking back, at least, a purchase money mortgage.

13 The underwriting provides us no security that that  
14 payment will ever be made, and that, we say, is one of its  
15 vices.

16 A second vice that we assign to the underwriting  
17 formula is this. We are now not receiving any income with  
18 respect either to the \$23 or \$33millions of consideration that  
19 we didn't receive, so we have said that we ought to be paid  
20 interest on that. When the New Haven was borrowing from Penn  
21 Central under the loan loss formula that interest was at the  
22 prime rate, and we submit that that is the very least that  
23 ought to be paid on the unpaid portion now.

24 There is one other deficiency in the underwriting.  
25 With that correction the bondholders could accept it and not



1 insist on the balance of the shares. Judge Anderson had  
2 provided as a part of that underwriting formula that if Penn  
3 Central shares traded at \$87.50 for a five-day period, then  
4 the underwriting would terminate. And, of course, we only  
5 looked for interest up to the point where we could liquidate  
6 and get \$83 million. We are not looking for interest right  
7 up to the end of 1978. It just depends on when, finally,  
8 the balance of the payment has been made, either because the  
9 market has reappraised Penn Central's shares or because Penn  
10 Central has paid them off. And that on that five-day termin-  
11 ation of the underwriting, we submit that it is unfair to use  
12 so limited a period. Because you could never sell, or the  
13 market could never absorb, 950,000 shares at that price simply  
14 because it could absorb a normal day's trading.

15 Q So that is self-correcting, if you are correct  
16 about that.

17 A If we put them on the market and offered them,  
18 Your Honor, then we would immediately collapse the price again.

19 Q Right, and so the condition wouldn't be met.

20 A That is correct, Your Honor.

21 Q Now, if you are right in your position that you  
22 ought to have security and all the rest, shouldn't the other  
23 side of the coin be that you should be obligated to return  
24 any excess so that you finally dispose of these shares at above  
25 \$87.50 a share? Or do you want the best of both worlds?

1           A     We don't want the best of both worlds, Your  
2 Honor. Our answer to that is that the underwriting formula  
3 contemplated that Penn Central to avoid that could offer to  
4 pick up in 50-share blocks and free itself of the underwriting  
5 at any time it cared to by paying the difference between the  
6 then market value and \$87.50. So that if there was a real  
7 likelihood that the best of the other side of the world was  
8 possible, Penn Central, itself, by exercising the option granted  
9 in the underwriting could take that benefit for itself. There  
10 really is no best of both possible worlds here.

11           Your Honor, this brings me to the last point that I  
12 would like to discuss and that is the terrible unfairness of  
13 the loan loss formula and the land which it has worked in this  
14 case.

15           The loan loss formula, we submit, was simply a formula  
16 by which the erosion was permitted to continue. By making  
17 available to the New Haven cash so that it could continue to  
18 operate at a deficit, not paying its taxes, not paying its per  
19 diem charges, the formula was not a formula for the relief of the  
20 New Haven; it was a formula which imposed further losses upon  
21 the New Haven. And, inevitably, for as long as we took the money,  
22 we had to run the railroad, and we had to lose money.

23           Now, when this matter was before the Court the last  
24 time, the notion was that we were only going to have a very  
25 small loss, because the formula would take care of all of the

1 New Haven's losses, and it was predicted that those losses  
2 would be small. You will recall that it was in a descending  
3 scale. Penn Central was to contribute a 100 per cent of the  
4 first year losses and then 50 per cent and 35 per cent that  
5 Mr. Justice Douglas wrote about in his dissent.

6 Now, what has happened is that we did close in the  
7 first year. And having closed in the first year, the losses  
8 that were contributed under the Commission formula was only  
9 \$5 million. But the Commission knew one month before it ordered  
10 the closing, in November of 1968 when it handed down the  
11 remand report, that its guess that those losses would be small  
12 and that the \$5 million would therefore cover just about all  
13 of the New Haven's losses -- they knew then that that was untrue,  
14 that the losses were much, much greater.

15 Nevertheless, in spite of our urging, they persisted  
16 in saying that that was as far as they would go. I submit that  
17 if the Commission was right in saying that it was fair for  
18 Penn Central to bear a 100 per cent of the first-year losses,  
19 it should not have withdrawn from that at the point when it  
20 found that the losses were larger than they had anticipated.  
21 Because it was certainly unfair in the circumstances of this  
22 case where the bondholders were required to absorb \$70 million  
23 of losses. And I submit to you that the \$70 million was \$10  
24 million more than the total value of the 950,000 shares we  
25 got. We were being eliminated; we were being obliterated here.

1           And then to say that the 100 per cent of the losses  
2 should be altered in the last year and limited to that \$5  
3 million, imposing \$6 million on the New Haven, that was  
4 improper.

5           MR. CHIEF JUSTICE BURGER: Thank you, Counsel.

6           Mr. Auerbach.

7                   ARGUMENT OF JOSEPH AUERBACH

8                           ON BEHALF OF PETITIONER

9           MR. AUERBACH: Mr. Chief Justice, may it please the  
10 Court:

11           The Trustee of the New Haven Railroad is here as an  
12 appellee-respondent, arguing on the side of the appellants,  
13 because he feels very strongly that in the four areas in which  
14 the Reorganization Court differed with the Commission the Court  
15 should be sustained.

16           Now I am going to address myself to the question which  
17 the Government and Penn Central says is probably the most  
18 important question, yet simple question, in its scope of review.

19           The Government says the Three-Judge Court was right  
20 and Judge Anderson was wrong on these four points because Judge  
21 Anderson did not review the Commission from the standpoint of  
22 the substantial evidence rule, whereas the Three-Judge Court did.

23           We don't agree with the Government because, while  
24 we are satisfied that the Three-Judge Court was bound by the  
25 substantial evidence rule, we do not think that Judge Anderson

1 as the Reorganization Court was.

2           The issue is simple in one respect. Both sides cite  
3 Ecker vs. Western Pacific as the basis for their position. Now  
4 there is no question that Ecker addressed itself squarely to  
5 the division of functions under Section 77 of the Commission  
6 and the Reorganization Court. There is no question that Ecker  
7 establishes the valuation of any property -- and we do not  
8 qualify that -- is the function of the Commission

9           The question is, however, what is the function of the  
10 Reorganization Court in reviewing that valuation. Is it true  
11 it is bound by the substantial evidence rule? Opposition  
12 here is that Ecker doesn't say that. Ecker says the contrary,  
13 we think.

14           Furthermore, it should be not bound by the substantial  
15 evidence rule because of the unique statute of legislative history  
16 and the reasons why the function of the Reorganization Court  
17 is spelled out in the detail it is in Section 77(e).

18           Let me address myself just very briefly to each of  
19 these points. In Ecker the Court said that while the judge is  
20 not to review valuation as such, the judge is to determine with  
21 such additional evidence as he deems appropriate (this is not a  
22 quote, but it is my reading of Ecker) whether the Commission, in  
23 fact, did obey the statutory standards.

24           Now, why would this be so? That this comes --- I  
25 think fairly, in fact, that the statute, Section 77, is wholly

1 unique. Under Section 77 you have an intertwining of administra-  
2 tive law and judicial review such as you can't find a parallel  
3 in any other statute to my knowledge.

4 In the first place, the background of 77 was to find  
5 a way of having some method of reorganizing railroads (and I  
6 will come back in a moment to the year; it was 1933) which  
7 got rid of equity receiverships as a function, which took away  
8 from the parties who controlled the railroads to control the  
9 reorganization.

10 At the same time you had (and this is one of the  
11 significant background pieces of reason in this statute)  
12 railroads going under, beginning in 1933. You did not have  
13 other modes of transportation that were fairly competitive as  
14 you may have today. You had the problem of a national interest  
15 so concerned with saving these railroads and a statute which  
16 forbids straight bankruptcy. You had to reorganize. Even  
17 today you can't go into bankruptcy with a railroad. Section  
18 77 is your only remedy.

19 On top of that you had an agency with a whole history  
20 of expertise in valuation. Since 1914 it had been valuing  
21 railroads under Section 19 of the Interstate Commerce Act.  
22 I think every railroad in the country eventually was valued  
23 as required under that statute.

24 With that background, the Congress fashioned a statute  
25 under which the Commission would determine the value of the

1 property because of the public interest, that it would determine  
2 the capitalization; it would determine what was the possibility  
3 of saving the railroad and making it solvent in the future.

4         The Court would determine (and this is the essential  
5 point in this interpretation), with independent hearings, whether  
6 this plan was fair and equitable. And in determining whether  
7 it was fair and equitable, the statute clearly contemplates it  
8 would receive additional evidence. I am not referring to the  
9 language in Ecker now. Section 77(e), itself, contemplates it  
10 and says so. That if the Court rejects the plan, it must send  
11 it back to the Commission with the evidence which it received.

12         Section 77 also points out that persons may come before  
13 the Reorganization Court (and this is without regard as to  
14 whether they were before the Commission) and introduce their  
15 claims for equitable treatment.

16         This brings us really to Mr. Justice Douglas' language  
17 in the St. Joe Case. He said there, "The Reorganization Court  
18 function is distinguished from the Commission function in that  
19 the Commission is the chief architect under Section 77(e)".  
20 And that I think is about a fair, shorthand expression as one  
21 could imagine, because that is precisely what happens. If nobody  
22 puts in a plan, the Commission devises its own plan.

23         But why the safeguards in Section 77(e) insofar as the  
24 Court is concerned? Certainly, we could not have the Commission  
25 both devising its plan and being the reviewing court of its own

1 plan.

2 And I think the legislative history ( and I have very  
3 little more time that I can devote to the subject), which is  
4 recited in full in Ecker, shows that at one point Congress --  
5 the House, as a matter of fact -- decided that the whole power  
6 should be invested in the Commission and not in the Court.  
7 But the Senate wouldn't accept that. And we find written into  
8 Section 77(e) the power of review, including independent hearings  
9 on the part of the Reorganization Court.

10 In closing on this point, I would like to bring to  
11 the attention of the Court that there is no dilemma here between  
12 Three-Judge Court and Reorganization Court under this interpre-  
13 tation of the law. There just isn't any.

14 The Three-Judge Court was clearly bound by the substan-  
15 tial evidence rule, and made its findings, however right or not,  
16 with that rule in mind. Judge Anderson recognized that he was  
17 subject to Ecker. He did not make his findings contrary to  
18 Ecker. He made his findings based on the section called  
19 "methods of valuation" which appear in Ecker.

20 The question whether these two principle discounts,  
21 for example, were proper deductions from the liquidation value.

22 I think, if the Court please, that it is fair to say  
23 here that there is every reason to recognize a different rule  
24 of review under Section 77. And I would point out to the Court --  
25 to harken back to 1933 for a moment -- that this is an extremely



1 important question. Because in the last eight and a half  
2 years, not only has the Commission petitioned in 77, but we have  
3 had two more eastern railroads, the Central of New Jersey and  
4 now the Boston and Maine. And the question of the impact and  
5 the relative impact of Sections 5 and 77 is not one which can  
6 be put on the shelf as being passed off just in this case.

7 Thank you.

8 MR. CHIEF JUSTICE BURGER: Thank you, Mr. Auerbach.

9 Mr. Goodman.

10 ARGUMENT OF LEONARD S. GOODMAN

11 ON BEHALF OF RESPONDENT

12 MR. GOODMAN: Mr. Chief Justice, may it please  
13 the Court:

14 These cases involve the fairness of a reorganization  
15 plan for the New Haven Railroad and at the same time the fairness  
16 of the terms for the inclusion of that railroad into the newly-  
17 merged Penn Central Railroad.

18 The reorganization plan was made possible, because of  
19 the happenstance that, during the course of the New Haven  
20 bankruptcy, Penn and New York Central applied for permission  
21 to merge.

22 In this merger the New Haven trustees saw both a  
23 threat and an opportunity as their counts were stated to the  
24 Court of Appeals in the Second Circuit in 1967. Inclusion in  
25 Penn Central in the view of the trustees afforded the only

1 practicable means for reorganization of the debtor that would  
2 be consistent with the best interest of the public and to all  
3 parties interested in the debtor's estate.

4 They quickly filed for inclusion in 1962, within 3  
5 months after Penn and Central asked for permission to merge.

6 Now under decisions of this Court, the Commission had  
7 no power to force the inclusion. At all stages the inclusion  
8 depended on the volition of the owners of the New Haven.

9 For 5 years, until 1967, no bondholder objected to the  
10 course being pursued by the trustees. And at that time the  
11 Reorganization Court rejected the sole objection presented by  
12 the committee since that objection failed to receive the support  
13 of either Manufacturers or Chase.

14 Now this has been a long and difficult assignment for  
15 the Commission. In no reorganization has the process of valuation  
16 been more meticulous or more carefully supervised by the courts.  
17 The oral hearings in 1967 extended over 37 days and over a  
18 period of 5 months. Further hearings were held before a Special  
19 Master of the Reorganization Court. And then more hearings  
20 before the Commission remanded the inclusion report.

21 The entire Commission considered and reconsidered  
22 this extensive record in three reports dealing with the  
23 valuation.

24 The bondholders' initial approach, before the  
25 Commission, was to value the New Haven as a freight-only

1 railroad. This was not merely in response to evidence presented  
2 by Penn central, but rather, they applied to the Reorganization  
3 Court for order No. 324 in July of 1965 for funds to complete  
4 such a study. And at the pre-hearing conference in 1966, they  
5 announced that "studies are being made with the view to  
6 evaluating the railroad as a freight-only operation".

7 Then the study was, in fact, presented in the hearings  
8 in 1967. It might have been possible to have reorganized a  
9 portion of the railroad to provide freight service. It was not  
10 explored in any depth by the Commission, since the study present-  
11 ed by the bondholders did not project freight-only earnings  
12 beyond the year 1965.

13 The valuation of the New Haven presented the Commission  
14 with a true dilemma. There was no reliable forecast of earnings  
15 for the railroad. As Judge Friendly stated in his first opinion,  
16 "a fair price for New Haven on the usual basis of capitalization  
17 of earnings would thus be negative or at least zero."

18 However, much evidence was presented by the trustees  
19 in Penn Central on the liquidation value of the railroad. The  
20 Commission turned to that evidence as indeed showing the  
21 maximum value of this railroad.

22 Well, we agree, of course, with Counsel for the  
23 bondholders, that there was no dispute before this Court as to  
24 the applicability of the liquidation value test. The essential  
25 question --

1 Q But as to the liquidation value what as of  
2 December 31, 1966 but discounted by reason of the fact that it  
3 would take at least six years to dispose of the assets, is that  
4 it? It was discounted, in your submission, by another year  
5 because of the year delay before the Commission would permit  
6 abandonment?

7 A Yes, those deductions are part of the --

8 Q Have I understood the date of the liquidation  
9 value?

10 A Yes. The valuation date is December 31, 1966.

11 Q And then 6 years estimated to dispose of it?  
12 And then you add another year for permission for abandonment,  
13 is that it? Or do I have this all wrong? Because of the  
14 bulk sale? It might be something else --

15 A Yes. These various deductions that you refer to,  
16 Your Honor, do enter into the valuation of the --

17 Q The liquidation value has a meaning or significance  
18 only if you tie it down to a date or dates.

19 A Well, this valuation was tied down to December  
20 31, 1966.

21 Q But not that it could all be liquidated within  
22 that 24 hour period?

23 A Oh no. Not at all.

24 Q Six years?

25 A The assumption was, the postulation was that it

1 would take six years to --

2 Q Six years and then you would take a deduction,  
3 because you say it will take another year to get permission to  
4 abandon?

5 A Yes.

6 Q Do you see any incompatibility at all between  
7 the time lag, with the bulk sale superimposed on that or vice  
8 versa? That is bulk sale price with a time-lag discount?  
9 Do you see inconsistency in that at all?

10 A I see no inconsistency. I will come to the theory  
11 of the bulk sale. Very briefly, the bulk sale involves a  
12 quantification of risks of the appraisals testified to by  
13 witnesses presented by the trustees that I did not take into  
14 account.

15 It is a quantification of the overall risk of the  
16 liquidation, that it would not occur strictly within a six year  
17 period.

18 The fact of the value of real estate in southern New  
19 England should also be taken into account.

20 Q What I am driving at is that, at least frequently  
21 if not ordinarily, bulk sale is thought of as a unitary, a  
22 single transaction. Whereas, liquidation is over a period of  
23 time, necessarily. Now you have both of them here, haven't  
24 you?

25 A We've got both of them here because --

1 Q Should the seller suffer a discount for both?

2 A There is no inconsistency. The phrase "bulk  
3 sale" is the name that the Commission assigned to the quantifi-  
4 cation of these risks that had unearlier been taken into  
5 account.

6 Q Well, are you suggesting that it has a different  
7 meaning within the context of Interstate Commerce Commission  
8 matters than in commerce generally?

9 A Frankly, Your Honor, I'm not familiar with the  
10 meaning of the term in commerce generally. I know what the  
11 meaning was that the Commission assigned the term here.

12 Q Generally speaking, I'd always thought it means  
13 a sale in bulk, all at once, for a price. I would think that  
14 is the ordinary commercial meaning of the term "bulk sale".

15 A Well, that, in fact, occurred. There was a sale  
16 in bulk and a removal of these additional risks from the  
17 New Haven when the sale actually, in fact, occurred. But that  
18 was not an essential ingredient to quantifying the risks that  
19 we are talking about.

20 The Commission assigned the name "bulk sale discount"  
21 to a quantification of risks that had not earlier been taken  
22 into account. And these risks, the Commission found, must  
23 realistically be taken into account in order to determine the  
24 liquidation value of the railroad.

25 But again, we come back to the liquidation value of

1 the railroad.

2 Q What were those risks again?

3 A Penn Central's witness, Simon, listed several  
4 different risks. His primary reference was to the inability  
5 to forecast that sales would be made strictly on schedule.

6 There was an additional very large risk on this record.  
7 The earlier appraisals had not taken into account the drastic  
8 effect that an abandonment of rail service in New England  
9 would have on the real estate market in New England. And the  
10 Trustee's appraiser, himself, testified that if this effect  
11 would actually be felt in the economy of southern New England,  
12 his appraisals had been overstated.

13 And the Commission did not address itself to quantify-  
14 ing any of these unpriced risks until the remand report. The  
15 reason for that I will come to.

16 The initial hearings for the terms of New Haven's  
17 inclusion were held in 1967 while the courts reviewed the legality  
18 of the Penn Central merger. While the focus of these 1967  
19 hearings was on an agreement entered into between the trustees  
20 and Penn Central under which the New Haven properties and freight  
21 operation would be transferred to Penn Central in return for  
22 stocks, bonds, and cash and Penn Central's assumption of certain  
23 liabilities.

24 The Commission tested these agreed terms, first,  
25 by considering the value of the properties. In the absence

1 of prospective earnings, the Commission's valuation proceeded,  
2 as I have stated, on the basis of the liquidation of the New  
3 Haven.

4 In a sense, as Judge Friendly noted, the liquidation  
5 hypothesis created a never, never land. But the need to postulate  
6 a liquidation of a huge railroad serving a large geographic  
7 area of heavy population also required the Commission to  
8 devote its skills and judgment to a great many complex problems.

9 Now, just one example: The witnesses for the trustees  
10 presented two widely-varying overall appraisals of the New  
11 Haven's properties on a liquidation basis. One appraisal  
12 assumed a 6 year period of liquidation. Another appraisal  
13 assumed a 10 year period of liquidation.

14 Under the 10 year hypothesis, it would cost the estate  
15 \$17 million more in liquidation expenses to realize the same  
16 proceeds as under a 6 year hypothesis. And, in addition, there  
17 would be a longer wait for those proceeds, and, hence, the pres-  
18 ent worth of the proceeds would be less.

19 Penn Central also presented a 10 year liquidation  
20 study. Its study reached a net liquidation value of \$50 million<sup>n</sup>  
21 less than the trustees' 10 year study.

22 Consequently, under either appraisal, under either  
23 the trustees' appraisal or Penn Central's, the 10 year liquida-  
24 tion period would be many millions of dollars more costly to the  
25 estate than the 6 year period.



1           The trustees' appraisers tended to support a 10 year  
2 period. They uniformly testified that the 6 year period was  
3 optimistic and on the low end of a reasonable range of years  
4 for such a major undertaking.

5           But on the basis of a finding that the bulk of the  
6 liquidation could be completed within a period of 6 years, the  
7 Commission, conservatively, adopted the 6 year liquidation  
8 period. And consequently, the much higher liquidation value  
9 than under any of the 10 year studies.

10           And another factor: All of the appraisals assumed  
11 that the estate could market the properties immediately and  
12 did not consider the need for an abandonment certificate on  
13 the valuation date.

14           The Commission recognized the need for a certificate  
15 but did not reach its value in the inclusion report.

16           Moreover, none of the appraisals priced out the over-  
17 all risks of making this schedule of sales exactly on time, for  
18 they simply assumed normal marketing conditions.

19           Thus, the Commission's first valuation in the  
20 inclusion report omitted major risk factors. But in the context  
21 of that report the omission made no difference.

22           The Commission reached the value of the consideration  
23 Penn Central had agreed to pay for the New Haven properties, and  
24 it found that that consideration would be at least equivalent  
25 to the liquidation value based on the appraisals without the

1 other risk factors taken into account.

2           When the inclusion report was remanded, however, by both  
3 courts, a new context was presented. For now the Commission was  
4 making a wholly new determination of price and not really  
5 finding a value that Penn Central had agreed to pay.

6           On the remand the Commission increased the consideration  
7 after revaluing the properties. The bondholders' essential  
8 argument before this Court is that the Commission did not  
9 increase that valuation and price enough.

10           But on remand, the Commission recognized it would not  
11 be realistic to assume a liquidation could occur without an  
12 abandonment certificate issued under Sections 1(18) and 1(19)  
13 of the Interstate Commerce Act.

14           If New Haven were to go into liquidation, the public  
15 would first have to be given the opportunity to be heard.  
16 Shippers that use New Haven would have to be heard from.  
17 Government agencies would certainly present plans for possible  
18 continuation of essential services.

19           What is more, the New Haven bondholders, themselves,  
20 urged, as late as 1968, that New Haven could be operated  
21 profitably as a freight-only railroad.

22           Given these positions of all the potential interests  
23 in a New Haven abandonment, the Commission could not have  
24 assumed, in the remand report, that an abandonment proceeding  
25 would be perfunctory or perform it. Shipper and Governmental

1 interests would have insured a bitterly-fought contest.

2 The Commission's finding that such a proceeding would  
3 take at least a year, including judicial stays, was clearly  
4 reasonable and, indeed, conservative, and, we submit, in the  
5 proper exercise of its judgment.

6 Q Well, on past history, wouldn't it really be  
7 thought more as being very conservative? Can you think of  
8 any matter of that magnitude that has been completed within  
9 one year?

10 A None.

11 Q Or even 2 or 3? That could take you quite a  
12 number of years and a consequent diminution of the price. And  
13 if someone really set out to keep the pot boiling, as it were,--

14 A If there had, in fact, been a liquidation, it  
15 is quite possible. As the Commission recognized that the  
16 abandonment proceeding would have lasted more than one year.  
17 The Commission said that if the Government parties requested time  
18 to prepare studies, the abandonment proceeding might last 2  
19 years. As Your Honor suggested, it might go on longer than that.

20 But, that is not essential here. Regardless of how  
21 long it would, in fact, occur, the Commission postulated but  
22 one year. And the Commission charged the state with that one  
23 year.

24 Q Do you agree with the appraisal made by your  
25 friends on the other side of the table that the Commission

1 could never permit the New Haven to stop running. And that,  
2 therefore, any hypothetical period of time for litigating the  
3 issue is really a fruitless exercise? That the time lapse  
4 would merely be a period within which some other solution to  
5 the transportation problem would be worked out? Is that  
6 not realistically correct?

7 A Some other solution, however, Your Honor, could  
8 have involved a liquidation of at least a portion of the New  
9 Haven. The bondholders, as I suggested, have in the past  
10 urged that the New Haven could have been reorganized as a  
11 freight-only railroad, that might have allowed for the abandon-  
12 ment of some unneeded facilities. But this all would have had  
13 to been explored in the context of an abandonment proceeding  
14 that was never held.

15 If it had been held, it could well have taken more  
16 than one year, which, we strongly urge, supports the conserva-  
17 tiveness of the Commission's estimate that it would take only  
18 one year.

19 In any event, the estate, under the liquidation  
20 hypothesis, could not have abandoned and liquidated without  
21 having given the public an opportunity to be heard.

22 Q Well, it may be helpful to you, Mr. Goodman, and  
23 perhaps to Mr. Cox, when he gives us his analysis, to indicate  
24 to you what gives me some problems, and maybe, you can clear  
25 them up. That the Commission seems to have worked with a series

1 of hypothetical situations and projections. And then it  
2 mingles with the hypothetical, the reality. It adjusts the  
3 hypothetical, which is unknown, with the reality, which comes  
4 to be known from time to time. And unless I missed something,  
5 almost invariably, the adjustment of the hypothetical by the  
6 real resulted in the reduction of the purchase price. Now,  
7 I may have missed some factors. Is that analysis correct?

8           A     I believe, Your Honor, that there is no mixture  
9 of the real and the hypothetical. The liquidation hypothesis  
10 is quite hypothetical. The Commission made no finding as to when  
11 the liquidation would actually begin. The valuation is as of  
12 December 31, 1966, and the fact of deducting from that a one  
13 year delay is, as Judge Friendly stated, to assume that the  
14 liquidation could occur January 1, 1968.

15           But that is only the fact of what the Commission has  
16 done. There is no finding here that the liquidation would,  
17 in fact, have occurred January 1, 1968. The Commission is  
18 merely saying that we cannot reach a liquidation value of this  
19 estate without considering the fact that it would have taken  
20 the estate one year to have obtained the certificate, the  
21 permission in hand, to liquidate.

22           Q     But I thought, therefore, your opponents'  
23 argument was that, taking everything into account, this was not  
24 a permissible judgment to speculate on something that, in  
25 reality, was never going to happen. I thought that was the

1 core of their argument. In other words, that it was not a  
2 question of the details as to how long it was going to take, but  
3 that, in truth and in fact, this question of speculating as to  
4 whether the New Haven -- given all the considerations that are  
5 involved -- would ever be liquidated was beyond the permissible  
6 judgment of the Commission to make. Maybe that is overstating  
7 their argument, but that is the way I understood it.

8           A     Well, Your Honor, I understand their argument  
9 a bit differently. I understand their argument to mean that  
10 the Commission is barred, as a matter of law, from considering  
11 the need of this estate for an abandonment certificate before  
12 it can liquidate.

13           Q     Well, all right. But it wouldn't take anything  
14 like a year, because the New Haven had been studied and restudied  
15 and canvased, and that they knew the situation. There is an  
16 absolute constitutional right to liquidate, your opponents  
17 say, under the decisions of this Court. And it was very clear,  
18 because of the deficit-ridden situation of the New Haven, there  
19 was no question about that right being exercisable in this case.  
20 That is what I had understood your opponents' argument to be.

21           A     That is also, Your Honor, a portion of their  
22 argument -- a necessary portion of their argument that New Haven  
23 had an absolute right on December 31, 1966 to shut down and  
24 liquidate the railroad. We say that this is not a permissible  
25 assumption, that the railroad could immediately shut down

1 without giving the public an opportunity to be heard. And  
2 that a necessary part of the liquidation value is this cost  
3 of the abandonment certificate that the State must have in hand,  
4 before it can begin the liquidation.

5 Q Do you know -- Well, I will put my question  
6 after lunch.

7 MR. CHIEF JUSTICE BURGER: Now, today Counsel, we are  
8 altering the schedule a little bit. We are going to allow  
9 Counsel one hour for lunch, and since you will be occupied for  
10 an hour, we will not return for an hour.

11 (Whereupon, at 12:00 Noon the argument in the above-  
12 entitled matter recessed, to reconvene at 1:00 p.m. the same  
13 day.)

1 (The argument in the above-entitled matter resumed  
2 at 1:00 p.m.)

3 MR. CHIEF JUSTICE BURGER: Mr. Goodman, you may  
4 continue.

5 FURTHER ARGUMENT OF LEONARD S. GOODMAN

6 MR. GOODMAN: Mr. Chief Justice, I believe the  
7 bondholder attack on the cost of the abandonment proceeding is,  
8 in fact, a demand that Penn Central pay a larger share of the  
9 pre-inclusion losses.

10 The Commission treated that claim as a matter separate  
11 from the valuation and did, in fact, cause Penn Central both  
12 to lend \$14 million to New Haven in the year 1968 and to pay  
13 \$5 million of New Haven's losses.

14 After December 31, 1968, all of the losses were  
15 Penn Central's from the New Haven operation. And, in fairness,  
16 we submit that Penn Central is not required to do more.

17 Q Mr. Goodman, for losses prior to when Penn Central  
18 actually, physically took the New Haven over and began to absorb  
19 all these losses you are talking about, how was the bondholders'  
20 first claim to their liquidation value lowered or eroded away  
21 by operating losses? I gather from the argument that it is  
22 said that some \$60 million value was eroded away as far as the  
23 bondholders were concerned by losses which occurred prior to  
24 the time of the transfer.

25 A In part the erosion occurred by the issuance of



1 trustee certificates, which took priority over their claims.

2 Q But, I gather there were not \$60 million worth  
3 of trustee certificates.

4 A No, there weren't.

5 Q Well, how else then? Just by equipment wearing out  
6 or something like that or depreciation?

7 A Insofar as this record goes, it is an inflated  
8 figure. There is no erosion in the liquidation value anywhere  
9 near comparable to \$60 million or \$70 million.

10 Q Well, to the extent some of these expenses were  
11 taken up with some kind of an arrestment which involved a prior  
12 lien, that would be true, wouldn't it? Were the trustees  
13 certificates prior with respect to the lien of the bondholders.

14 A The only reason that I raise the issue of  
15 trustees certificates, is that some of these were issued to  
16 Penn Central to cover the \$14 million and --

17 Q Those surely were subsequent to the bondholders  
18 lien?

19 A Yes.

20 Q And I suppose postponement of real estate taxes?

21 A Yes, this would also be prior to their lien.

22 But, the fact of the matter is the bondholders are attempting  
23 again to mix real world concepts with this hypothetical liqui-  
24 dation. And what they are being paid is on the basis of a  
25 hypothetical liquidation of the New Haven, and the accumulation

1 of these losses has not affected that value anywhere near to  
2 the extent of the \$60 million.

3 Q What is the exact amount involved in this  
4 particular lawsuit?

5 A Well, Mr. Justice Black, it would be in terms  
6 of the accumulation of the administration claims -- I'm sorry,  
7 Your Honor, I didn't understand your question then.

8 Q What is that?

9 A I'm sorry, I may not have understood your question.

10 Q Well, there is a litigation over here, and the  
11 argument is money. What is that amount?

12 A What is the --

13 Q What's the amount of money actually involved  
14 in this lawsuit? How many millions?

15 Q Well, it could be a \$100 million --

16 A It could easily be a \$100 million, yes.

17 Q -- counting \$70 million for the Grand Central  
18 properties and then another \$29 million, plus or minus, well  
19 over a \$100 million. It could be couldn't it, accumulating  
20 all the issues?

21 A Quite easily. The free-use argument, itself,  
22 amounts to \$70 million --

23 Q Who will lose that, if you lose?

24 A Well, of course, Penn Central will be required to  
25 pay these additional sums.

1 Q To whom?

2 A To the New Haven estate.

3 Q To the what?

4 A To the New Haven estate.

5 Q New Haven Estate?

6 A Yes.

7 Q A \$100 million.

8 A Yes. Of course --

9 Q How much is involved as a whole? In the  
10 property?

11 Q What was the purchase price?

12 A Fixed by the Commission? The purchase price  
13 fixed by the Commission was on the order of a \$150 million.

14 Q What?

15 A About \$150 million.

16 Q And one side claims that it is a \$100 million  
17 short?

18 A Yes.

19 Q Who is that?

20 A Those are the bondholders --

21 Q That's the bondholders?

22 A The bondholders of New Haven, yes.

23 Q And that's the whole litigation?

24 A Yes. Of course, our position there is that if the  
25 Commission has erred, it requires a remand to the Commission.

1 Q So, you are standing by what the Commission did  
2 on it?

3 A Oh yes.

4 I would like to say just a word about the bulk sale  
5 discount. Relying on the testimony presented by Penn Central  
6 in the remand hearings, the Commission found in its remand report  
7 that the unpriced risks of a liquidation should be valued at  
8 6.7 million. And it, therefore, deducted this amount in the  
9 computation of the liquidation value.

10 Now, the bondholders primarily argue here, before  
11 this Court, that the Commission had no rationale, whatsoever,  
12 for the bulk sale discount but merely sought to compel it.

13 It is true that the report refers to the Commission's  
14 power to compel the acceptance of some bulk discount to attract  
15 the purchaser for continued operation of the railroad. But  
16 this was not essential to its decision.

17 The essential basis of its opinion was that the bulk  
18 sale discount is a reflection of risks that have not already  
19 been accounted for in the earlier appraisals and were, for the  
20 first time, quantified in the remand hearings.

21 The Commission stated this quite plainly. The  
22 Commission said and I quote: "The Bondholders will receive the  
23 full economic equivalent of the liquidation value of the assets."  
24 The discount merely reflects a market appraisal of the risks that  
25 the estate avoids.

1           And then 2 pages later the Commission added that it  
2 would adopt the Penn Central deduction to "correspond to the  
3 risks of a 6 year liquidation of the New Haven".

4           Now Judge Anderson recognized that the essential  
5 basis of the Commission's findings was not compulsion. He  
6 addressed himself to whether the deduction reflected risks of  
7 marketing. But in so doing, he substituted his own judgment for  
8 that of the Commission as to whether the appraisals had accounted  
9 for all the risks.

10           Mr. Cox will describe the Simon testimony in greater  
11 detail. I simply want to submit that the Reorganization Court,  
12 in our view, went beyond bounds in substituting its own economic  
13 judgments for those of the Commission in this proceeding.

14           Q     Is that based on a difference in the tabulation  
15 of facts?

16           A     In a part it is, yes, Your Honor.

17           Q     How much of it?

18           A     Well, Judge Anderson seemed to believe that an  
19 earlier deduction made by one of the trustees' appraisers had  
20 accounted for all of the risks taken into account in this bulk  
21 sale deduction. That is a matter of interpretation as to what  
22 that witness is talking about, that was witness Mason presented  
23 by the trustees. We showed on brief, I believe, that that  
24 witness was not speaking of the risks that witness Simon was  
25 talking about.

1 Q How much is the difference between you and Judge  
2 Anderson a question of law?

3 A Well, Judge Anderson on this particular item  
4 would find --

5 Q I'm talking about the whole item, the difference  
6 in what you claim what the Commission found and what Judge  
7 Anderson found.

8 A The difference between Judge Anderson and the  
9 Commission was approximately \$30 million.

10 Q Is there a legal question there to decide?

11 A There are several legal questions, because Judge  
12 Anderson would have prohibited the Commission from taking into  
13 account either the cost of the abandonment certificate or the  
14 cost of the unpriced risks which the Commission called the  
15 bulk sale discount.

16 This is Judge Anderson's ruling as a matter of law  
17 that the Commission is precluded from taking into account these  
18 factors.

19 Q Is that a difference in judgment between him and  
20 the Commission as to what is the best and fairest way to do this?

21 A I think it is a substitution of judgment, yes.

22 Q Who is going to cover the Pennsylvania stock  
23 point?

24 A I am coming to that just now.

25 Over half of the consideration paid by Penn Central

1 for the New Haven properties was in the form of 956,576 shares  
2 of Penn Central common stock. And one of the major questions  
3 litigated before the Commission was the value of this stock.

4 The trustees bargained to obtain this stock so as  
5 to participate in future increases in stock value as the merger  
6 savings were realized. This, in turn, would permit the widest  
7 participation in the reorganization by the New Haven creditors.

8 Q With the creditors' permission on that basis too,  
9 or just the trustees'?

10 A Well, the agreement initially was negotiated by  
11 the trustees without the participation of the creditors. But  
12 now the creditors apparently agree that stock is acceptable to  
13 them, and they are, before this Court, asking either for more  
14 stock or for interest on top of stock.

15 Q Well, do you agree that the bondholders were  
16 entitled to the full liquidation value of the New Haven's assets?

17 A As of December 31, 1966, yes.

18 Q They are entitled to have \$145 million on that  
19 day?

20 A Yes, yes.

21 Q Well then, they certainly can't get it out of  
22 the stock they are getting.

23 A Yes they can; I'll come to that.

24 Q Well, they can't on that day. There isn't any  
25 possible way they could get it out of the stock on that day, or

1 even within a few days after that, is there? The formula that  
2 is provided doesn't let them get that amount out of it.

3 A They are not entitled to the \$145 million in cash  
4 in hand.

5 Q Why not?

6 A Because they are participating in the reorganiza-  
7 tion which provides for the creation of an investment company  
8 that is to stay in business for 7 years. And part of the assets  
9 of this investment company is the 950,000 shares, which the  
10 estate wants to keep in hand in order to participate in the  
11 expected increase in that stock. This is part and parcel with  
12 the reorganization plan.

13 Q So you say they are entitled to be paid the  
14 liquidation value over a period of 10 years?

15 A The present value of what they have in hand will  
16 be the \$145 million.

17 Q So the value on the critical date isn't a \$145  
18 million?

19 A The value on the critical date is \$140 million  
20 plus the \$5 million of participation in losses, and they will  
21 realize that \$145 million at the conclusion of the 10 year period.

22 Q The value on this will be \$145 million within the  
23 next 10 years sometime?

24 A The value of the consideration which they have  
25 received is the \$145 million. That is the present value.



1 Q But you couldn't get it out of it today.

2 A But they have in hand, also, an underwriting  
3 requirement, an obligation that Penn Central --

4 Q But the obligation doesn't mature up until  
5 1978.

6 A Well, this is why I have placed before the Court  
7 2 charts in which I attempt to show that the claim that the  
8 bondholders have before this Court for additional sums over and  
9 above the stock has been fully offset by Penn Central's under-  
10 writing obligation.

11 If the Court will bear with me --

12 Q May I ask you one question?

13 A Yes, sir.

14 Q What effect, if your adversaries win in connection  
15 with this increased valuation, would it have on the operation  
16 of the new railroad that has been created by these proceedings?

17 A That is a difficult question to answer, Your  
18 Honor, because --

19 Q Will it have any effect in increasing the value  
20 of the stock on which the public must pay rates?

21 A It might well increase the costs, for example,  
22 if Penn Central is required to issue bonds, it might increase  
23 its capital costs.

24 Q But how could it avoid it?

25 A It would depend on the form of the consideration

1 and it is quite likely --

2 Q The consideration is here the railroad is going  
3 to be running. These people are having a litigation here over  
4 the division of some money that is supposed to be a part of the  
5 value of the stock it has. The public has to pay rates on the  
6 value of the property. What effect will that have on the  
7 payment of rates, if any?

8 A It would have a very direct effect, if the  
9 capital costs of the business are increased.

10 Q How much?

11 A That is indeterminate. I don't know.

12 Q Well, would it be a \$100 million that you said  
13 the litigation is about?

14 A Potentially, that is true.

15 Q What?

16 A Potentially, that is true.

17 Q Potentially -- is it true? I'm just asking,  
18 because I haven't heard yet anyone making a direct, positive  
19 statement about what's involved in this lawsuit and what it  
20 means to the railroad and to the public.

21 A Well, it is very difficult to value some of  
22 these claims being made by the bondholders. We think that,  
23 potentially, it is upwards of \$100 million.

24 Q Will the results of this litigation, if you win  
25 or the other side wins it, show up in the operating cost of the

1 railroad because of the investment in it.

2 A Your Honor, all that I can say is that this is  
3 possible.

4 Q How is it possible? If you say it is possible,  
5 how is it possible and not probable?

6 A If the form of the consideration that Penn Central  
7 is required to issue increases its capital costs, then it could  
8 possibly have some effect on the rates.

9 A Well, somebody is going to have to pay something  
10 for this. If it is not out of the railroad, who is it coming  
11 from? You don't handle with millions this way without it  
12 affecting something that's involved. I'm simply asking if I  
13 know what happens. Maybe it's not material. I had an idea  
14 that I would like to know something about what's going to happen.  
15 If we decide in your favor or we decide in favor of the other  
16 side, are we merely adjusting an amount of money between the  
17 bondholders and somebody else, or are we adjusting it on a basis  
18 that will affect the future operation of this railroad with  
19 regard to its investment?

20 A Your Honor, I believe that it could possibly  
21 have an effect on the public and on the rates to be charged,  
22 if the price that is increased increases in turn the capital  
23 costs of Penn Central.

24 Q Well, it would increase it wouldn't it, a \$100  
25 million?

1           A     Quite likely.

2           Q     You say quite likely. It increases somebody over  
3 a \$100 million if your adversaries win, I understand. Whose  
4 pocket does that go into?

5           A     Presumably, it comes out of Penn Central's pocket  
6 and into the bondholders'.

7           Q     And to that extent, it has a tendency to enlarge  
8 the rate-making base, doesn't it? It can have that as you  
9 suggested?

10          A     It doesn't --

11          Q     It can, I didn't say that it would --

12          A     Yes, it can.

13          Q     --in the full amount of the differential, but it  
14 can have it, in fact, on the rate-making base.

15          Q     Well, why wouldn't it? Why do you say it could?  
16 How can you avoid it? I hadn't understood it fully, but no one  
17 has mentioned that part of the case, at least in a way that I  
18 could understand it.

19          A     It does not occur to me how it could be avoided.

20          Q     Is what?

21          A     I say, I do not see how it could be avoided.

22          Q     In other words then, you think it is going to  
23 happen?

24          A     I think it is quite possible.

25          Q     All right.

1           A     I should like to refer the Court, just one moment  
2 to the chart that I have placed before it concerning the price  
3 of the Penn Central stock.

4           The bondholders concede that the underwriting obliga-  
5 tion protects them on the up side. In other words, with this  
6 first chart labeled "Bondholder Assumption A" where they claim  
7 that the stock should be assigned the market value on the closing  
8 date of December 31, 1968, they concede that the underwriting  
9 protects them between 63 3/8 and 87 1/2. They then discount  
10 that at the present worth, and on a per share basis, they claim  
11 that this protection is only worth \$14. They then would say  
12 that we are entitled to \$10 as the difference.

13           In this process, however, they ignore the down side  
14 protection which is also accorded by the underwriting obligation.  
15 In this instance, the down side protection protects them from  
16 a drop in the price from 63 down to the current market value of  
17 25 and below and has a value of at least \$22.

18           Your Honors, at the time of the closing date on  
19 December 31, 1968, when these bondholders accepted the 950,000  
20 shares at 63 3/8 --

21           Q     Well, they accepted the shares, and the market  
22 value at that date happened to be that amount?

23           A     Yes, and they accepted a status as an equity  
24 holder in Penn Central.

25           Q     Holding 950,000 shares of Penn Central?

1           A     That is true. Penn Central, therefore, discharged  
2 its obligation to the estate to the extent of the \$63. What  
3 they were entitled to was something in addition to the \$63  
4 in order to bring it up to \$87.50.

5           However, the underwriting obligation doesn't work  
6 entirely that way. It not only protects them on the up side,  
7 but it also protects them on the down side. If the stock goes  
8 below \$63, they are still protected by this underwriting  
9 obligation.

10          Q     Well, they are protected, yes, up to \$87.50 a  
11 share.

12          A     Not only up to \$87.50 but down below \$63. If  
13 the stock drops below \$63, even if that amount has been discharged  
14 under the underwriting obligation Penn Central must make this up  
15 in 1978. Therefore, this down side protection, below \$63, has  
16 a substantial present value.

17          There is one further comment about scope of judicial  
18 review that should apply in this proceeding. The closing  
19 remarks of Mr. Seymour suggest to me that he is asking the Court  
20 to rely on the long experience of Judge Anderson with the New  
21 Haven estate. Their position on scope of review also seems to  
22 bear, apparently, on their position that no remand would be  
23 needed, even if the Commission has erred in its valuation of the  
24 Harlem River and Oak Point yards.

25          However, Section 77(e) states on its face that the

1 Commission shall determine the values. And valuation is not  
2 listed among the determinations to be made by the courts.  
3 The valuation is placed by the statute within the primary  
4 jurisdiction of the Commission.

5 The Court of Appeals in the Ecker Case adopted the  
6 present argument of the trustees. And it held that the District  
7 Court was required to exercise its own independent judgment on  
8 questions of value.

9 This Court reversed. This Court held that the District  
10 Court's degree of participation in the reorganization did not  
11 include valuation in that Section 77(e) left the determination  
12 of value to the Commission without the necessity of a reexamina-  
13 tion by the Court. When that determination is reached with  
14 material evidence to support the conclusion, then the Court is  
15 with legal standards.

16 But, to be sure, the Reorganization Court may receive  
17 new evidence. But, as Mr. Justice Douglas stated in the Group  
18 of Investors Case (decided the same day as Ecker), the power  
19 of the District Court to receive additional evidence may aid  
20 it in determining whether changed circumstances require that the  
21 plan be referred back to the Commission for reconsideration.

22 The third item which I distributed to the Court is an  
23 extract from hearings on a bill that was introduced just after  
24 the Ecker and Group of Investors Cases. That bill was introduced  
25 into Congress which would have overturned the decision of this

1 Court in Ecker. The text of the bill is set forth in that  
2 extract as well as a statement approved by the entire Commission  
3 in opposition to the bill. The bill was never reported and died  
4 in committee.

5 Thank you.

6 MR. CHIEF JUSTICE BURGER: Thank you, Mr. Goodman.

7 Mr. Cox.

8 ARGUMENT OF HUGH B. COX

9 ON BEHALF OF RESPONDENT

10 MR. COX: Mr. Chief Justice, may it please the Court:

11 Perhaps, it would be useful to the Court if, at the  
12 very beginning, I stated my view of exactly the liquidation  
13 valuation process that the Commission adopted here, because I  
14 think it is possible that there may be some confusion as a  
15 result of the discussion of specific points.

16 The Court by now understands, of course, that the New  
17 Haven was a hopeless railroad. It had been ridden with deficits  
18 for years, and it was a railroad not only with a passenger  
19 deficit but with a freight deficit. So that if you valued this  
20 railroad on any conventional basis of earnings or good will or  
21 anything of that kind there would be no value in it at all.

22 But it was clear to the reviewing courts -- and I  
23 think that my client would have to concede -- that the estate  
24 and the bondholders were entitled to something. They were  
25 entitled to a fair value. So that the only standard that the



1 Commission could apply was liquidation value.

2 Now there is an obvious problem there, because this  
3 railroad is never going to be liquidated. The Penn Central has  
4 been required to take it over and to continue the rail operations  
5 and to absorb indefinitely the deficits that those operations  
6 create.

7 Q Mr. Cox, when you say that is the only standard  
8 the Commission could apply, do you mean that is the only  
9 constitutional standard or statutory standard or practical  
10 standard or what do you mean?

11 A Well, I would say this: That it is the only  
12 standard I know of that would give the estate and the bondholders  
13 anything.

14 Q Do you think it is required as a minimal  
15 standard by the Fifth Amendment of the Constitution?

16 A I would suppose that if it is not, certainly,  
17 they are entitled to something under the statute before you  
18 ever get to the Constitution, and, certainly, perhaps by the  
19 Constitution. If there is a liquidation value which they could  
20 actually obtain by selling off the railroad piece by piece,  
21 I should suppose a statute, before you would get to the  
22 Constitution, would say that the Commission should give them  
23 something like that.

24 Q What do you mean something like that?

25 A Well, Judge Friendly said in his opinion that

1 this gets into an abstract problem, which I would rather not  
2 get involved in. Judge Friendly suggested that since, in this  
3 case, there was no taking in a real sense -- and there wasn't--,  
4 my client is in the position it is in, because it chose to do  
5 something and so is the New Haven.

6 Now Judge Friendly suggested, in those circumstances,  
7 that perhaps the constitutional rule did not apply, but that the  
8 standards in the fairness standard would require that something  
9 like liquidation or approaching liquidation value --

10 But, the reason I would prefer not to take time to  
11 get into this -- if I may be permitted to say so, Mr. Justice  
12 Stewart -- is because, in our view in this case, the Commission  
13 gave these people, we believe, the value that they would get,  
14 in this hypothetical liquidation that I am talking about, if the  
15 conditions are realistically appraised. So that whatever the  
16 standard is, we think that the Commission met it, and we think  
17 that is what the Commission meant to do.

18 Q Now these misfortunes which you spoke of that  
19 were encountered by the New Haven over a long period of time  
20 that were well-known -- Penn Central had encountered, to some  
21 degree, some of these same misfortunes, had they not?

22 A Oh yes, indeed. But, of course, while they were  
23 not in a thriving or flourishing condition, they were not in  
24 the condition of the New Haven. They had net deficits in their  
25 railway operating income, but, particularly, the old

1 Pennsylvania Railroad and, to some degree, the New York Central  
2 had other sources of income which enabled them to pay their  
3 fixed charges.

4 Q Would it be fair to say that this combination of  
5 Penn and Central first and now the inclusion of New Haven, which  
6 was made one of the conditions, is something compelled by the  
7 public interest in the furtherance of the national transportation  
8 system policy?

9 A So the Commission has determined, yes. That was  
10 the basis in which the merger of the two lines was approved  
11 and also the basis on which they required, as a condition, that  
12 the New Haven be included.

13 Q So that we have here something of unwilling  
14 buyers, and perhaps unwilling sellers --

15 A Well, I should not wish to speak for anyone  
16 except my client, but my client did not embrace this opportunity  
17 with any enthusiasm. They would have preferred not to take  
18 the New Haven. They were required to, if they wanted to merge.  
19 But, they made that choice. I'm not appealing for sympathy  
20 for the Penn Central as such here. They did this, and they  
21 committed themselves to pay for whatever the Commission and the  
22 courts approved as their term. And that is where we are.

23 Now, going back to this hypothetical liquidation,  
24 because I think that it is important to understand what it  
25 involves. It meant really -- You understand that the Commission

1 had to try to decide what prices would be paid by people who  
2 were never going to buy property that would never be sold. They  
3 didn't necessarily assume that it would be broken up; some of  
4 it might be sold in place. But, this whole thing, the valuation,  
5 was based on the hypothetical assumption that the New Haven would  
6 stop; it would abandon service. It wouldn't necessarily try  
7 to break up everything. It might try to sell some things in  
8 place. But it would stop service, and its property would be  
9 sold off piecemeal.

10 Now what, in our view, the Commission did in this  
11 case -- And to really understand what it did, you have to go  
12 back and look at the way it valued all the different kinds of  
13 property that were involved. But what it did in this hypothetical  
14 liquidation was to try, sofar as it could, to bring that  
15 hypothetical liquidation close to what, in fact, would have  
16 happened, if the New Haven had liquidated, had abandoned service  
17 and liquidated.

18 Now, that is the basis for the Commission's determin-  
19 ation that there should be an allowance for abandonment delay.  
20 It makes that very clear in a passage that occurs in its report  
21 about Page 146 of that printed volume of the first Appendix.

22 Because the Commission's view was that if you assume  
23 that there was going to be a liquidation of the New Haven --  
24 and you have to assume that, if you are going to fix a liquida-  
25 tion value -- it is reasonable to say, assuming that we will

1 give them a certificate so that they can abandon, nevertheless,  
2 under the law (and this is true), they have to ask us for the  
3 certificate. We can not issue it immediately. We are required  
4 to give notice to the governors of states; we are required to  
5 give them time to come in. If they make arguments about how the  
6 abandonment should be conditioned or whether the sale should  
7 be in place or as junk or any other problems which they present  
8 to us; we have to listen to those arguments and hear their  
9 evidence and then decide.

10           And we think it would be reasonable, assuming we'll  
11 grant a certificate, and assuming that the New Haven stops  
12 operating trains (which the Commission also assumes), we think  
13 it would be reasonable to say that that would take a year and  
14 that during that year the New Haven would incur some expenses  
15 which would affect the liquidation value of the estate.

16           Now that is what the abandonment allowance is about,  
17 and that is all that it is about. The suggestion that the  
18 Commission could prolong it indefinitely, it seems to me, need  
19 not detain us very long.

20           Q   Well, part of what it is all about is the year  
21 from when. The claim is -- as I understand it -- part of the  
22 claim of your brothers in opposition is that had they not been  
23 led down the primrose path --that is perhaps the wrong metaphor --  
24 but had they not been induced into this inclusion business, they  
25 would have filed for abandonment years ago, in the middle 60's.

1           A     Sir, perhaps they would. I wouldn't know, but  
2 they didn't.

3           Q     Well, they didn't, but we are talking about  
4 Alice in Wonderland anyway. You are talking about --

5           A     You are talking about Alice in Wonderland --  
6 Now, I think what the Commission really said, Mr. Justice Stewart,  
7 is this: That we have decided that it would take 6 years  
8 actually to sell the property no matter when you start. My  
9 client believes they made a very serious mistake there, because  
10 the evidence really required a longer period. But passing that,  
11 they said it would take 6 years to sell the property. But before  
12 you can start selling it, you have to get the certificate. So  
13 that, in a real sense, in this hypothetical frame the date  
14 doesn't make too much difference. They didn't, the first time,  
15 say 6 years from so and so will be the liquidation period, they  
16 just said 6 years whenever you start.

17                     And what the Commission -- it seems to me -- to be  
18 finding in the abandonment delay is that, in addition to  
19 taking 6 years to sell it, you are going to need another year  
20 to get in the position to start selling it.

21                     And if you look at it completely in the hypothetical  
22 frame, there is no doubt that they would have had to have had  
23 the certificate, and there is no doubt they didn't have one.

24                     Now it is true, they say, it is unfair to do it this  
25 way. You should pretend that we had a certificate, because

1 we have been waiting all this time to get in and we have been  
2 suffering all these losses.

3 Now, Mr. Goodman has dealt with that. As he said,  
4 I think it is simply an argument about how these pre-inclusion  
5 losses should be dealt with. And the Commission dealt with  
6 that as to the '68 losses, and both courts below sustained him.

7 I will just say this about it, and then I should  
8 like to pass on: They were in an unfortunate position. They  
9 had securities in a deficit-ridden railroad. And the trustees,  
10 without any objection from the debtors, decided to try to be  
11 included in the Penn Central, and it took a long time and they  
12 incurred some losses.

13 Q All those losses, Mr. Cox, are prior to the  
14 bondholders' interest, aren't they? Would all those operating  
15 losses be administrative expenses entitled to prior payment  
16 over the bondholders?

17 A Mr. Justice White, I have to answer that question  
18 by saying that sofar as they issued trustee certificates I  
19 think that you have to assume that they are.

20 Now, there have been some figures tossed around here,  
21 and I can't analyze those figures; I don't know what they are.  
22 But it is quite true that any amounts represented by trustees'  
23 certificates would be ahead of the bondholders'. And of course,  
24 they have been incurring deficits since 1956 right along, ever  
25 since they have been in receivership.

1           If you are applying a liquidation standard which  
2 requires a hypothetical liquidation -- and that is what is  
3 giving them, under the Commission's decision, a \$146 or \$150  
4 million (when any other way they would get nothing) -- my  
5 suggestion is that it ought to be applied consistently. They  
6 embraced it, and they really shouldn't complain when it hurts  
7 them.

8           Q     When did the bondholders first voice any objection  
9 to inclusion, or did they ever?

10          A     I think that the first time that they did so was  
11 in the spring of 1967. It was not so much in the form of  
12 objection to inclusion as it was a suggestion that the reorgan-  
13 ization proceedings should be terminated.

14          Q     And you should liquidate?

15          A     Yes, liquidate.

16          Q     Did they participate in the inclusion proceedings?

17          A     Oh, yes. I think that it was only one group of  
18 them that made the suggestion about -- I'm not too clear about  
19 that-- about terminating proceedings. But they participated in  
20 the inclusion proceedings but largely in the interests of  
21 increasing price. That is what they were trying to do.

22                If you begin to look at this problem in terms of  
23 who suffered most and you try to decide how this liquidation  
24 hypothesis should be applied by appealing to sympathy instead  
25 of looking at the merits of the particular methods the courts



1 used, some other considerations then come into play which I  
2 would be obliged to mention to the Court.

3           Whatever losses these people have suffered, Penn  
4 Central is required to suffer these losses in the indefinite  
5 future. And what is more, that is not something --

6           Q     Could they abandon some --

7           A     There is no indication that the Commission is  
8 going to allow them to abandon freight service, and nobody  
9 knows what will happen on the passenger service. As a matter  
10 of fact, since the inclusion they have lost -- or at least they  
11 have not received -- about \$4.5 million that the State used to  
12 give the New Haven.

13          Q     I thought that Penn Central agreed to underwrite  
14 losses, a certain percentage of losses, a 100 percent the first  
15 year on a declining scale?

16          A     That was the Commission, yes --

17          Q     They agreed to that, didn't they? Now the  
18 Commission lets them out from under that --

19          A     No, Mr. Justice --

20          Q     -- or part of that?

21          A     They simply applied the same formula but to one  
22 year. You see, that formula was assumed that it would be 3  
23 years before they would be included, and there was a maximum  
24 under the formula of \$5 million.

25          Q     I suppose you can get into a big argument about

1 that?

2 A It's just a matter of judgment. I think the  
3 suggestion was left this morning that the Commission modified  
4 its formula. It didn't really. There was always a maximum of  
5 \$5 million a year, and that is what the Pennsylvania paid for  
6 '68.

7 Q That was \$5,500,000. That was pro-rated for 1968?

8 A Yes, pro-rated over 11 months.

9 I think this -- The next think I should like to say  
10 something about is the so-called "bulk sale discount", which  
11 I think there has been some confusion about too.

12 That determination of the Commission does not assume  
13 a bulk sale. It doesn't assume a bulk purchaser. It is simply  
14 a method that the Commission used based on the testimony of an  
15 expert witness -- a method that the Commission used to value  
16 the real property of the New Haven as of the valuation date,  
17 on the assumption that that real property was going to be sold  
18 piecemeal over 6 years. That is all that determination of the  
19 Commission amounted to.

20 This witness, who was an experienced real estate  
21 investor, testified that if he were going to value these 3,000  
22 pieces of property that the New Haven had as of the valuation  
23 date, he would go about it in a particular way. And the way  
24 he went about it was making some computations about the amount  
25 of capital that would be involved in the venture.

1 He said 75% of mortgage capital at 9%, 25% equity  
2 capital at 15%. And by applying those rates of return to the  
3 cash flow on the proceeds, using the same appraisals that the  
4 New Haven people had made, and assuming a 6 year liquidation --  
5 the same way the New Haven people did -- he arrived at a figure  
6 which he thought represented the value of that mass of real  
7 property as of the valuation date, the end of 1966.

8 Now the Commission took his testimony and did it a  
9 little differently. They took a weighted average and got 10.5%  
10 which they applied, really, instead of the 6%. So what this  
11 issue about the bulk sale discount really comes down to is  
12 simply a question of whether the Commission would have discounted  
13 the real properties of the New Haven for the purpose of determin-  
14 ing its valuation of the valuation date by 6%, as it did the  
15 first time, or by 10.5 %, as it did the second time, on the  
16 basis of this testimony.

17 Q Mr. Cox, is it true that the 6% that was originally  
18 set as a discount -- was that intended to reflect just a value,  
19 the translation of future value to present value?

20 A That was what was called, I believe, Mr. Justice  
21 White, a money discount. It was based on the prime rate of  
22 interest and represented merely the difference between having  
23 the money now and --

24 Q So it didn't reflect any uncertainties in the  
25 economy or in real estate value or in not being able to sell

1 as soon as you thought or anything?

2 A That is right.

3 Q That's clear?

4 A That I think is clear on the record, and we have  
5 developed that in our brief. That was simply 6% to represent the  
6 difference between having the money now and having it 6 years  
7 from now.

8 Q That was its present value?

9 A That's right.

10 Q But now there have been introduced two other  
11 things: 1) either risk of real estate values going down,  
12 particularly in connection with abandonment and 2) the power  
13 of the Commission to require a sale in bulk.

14 A No, not in my view, Mr. Justice Stewart. That  
15 is the Chenery point, and I'd better say something about that.

16 Q I think you perhaps had.

17 A This judgment, as I think Mr. Goodman said,  
18 about how to value the properties was essentially a business or  
19 an economic judgment. And what the Commission was saying was  
20 that we think the best method of determining liquidation value  
21 of the real estate -- or a reasonable method -- is to do it  
22 in the way that Mr. Simon's testimony has demonstrated it  
23 could be done.

24 Now, the bondholders argued that, as a matter of law, --  
25 constitutional law they said -- they were entitled to have

1 liquidation value determined by a particular method. In other  
2 words, they said the only way you could do it under the  
3 Constitution is to take these individual appraisals, put them  
4 all together and maybe you can apply the 6% discount, but if  
5 you do anything besides that, you have departed from a  
6 Constitutional standard.

7 Now the Commission responded to that argument (and that  
8 is what all this discussion about what they could do in an  
9 abandonment proceeding) -- The Commission responded to that  
10 argument by saying there is nothing in this broad-Constitutional  
11 argument, because in some circumstances we could require you  
12 to sell to a bulk purchaser who is going to continue the rail-  
13 road operation.

14 Judge Friendly, who expressed some doubts about the --

15 Q The language could be called somewhat less than  
16 pellucid --

17 A Somewhat less than pellucid. Pellucid or not,  
18 I think when you read the whole thing with the view of determin-  
19 ing whether there is any internal consistency -- But my position  
20 is --

21 Q But he attributed to it a different meaning,  
22 didn't he?

23 A He attributed to it the same meaning I am  
24 attributing to it, which is that it was essentially an economic  
25 judgment, and it didn't depend on legal reasoning.

1 I think the Commission may have given a dubious or  
2 a more involved answer to this argument than it needed to have  
3 given. I would have thought that it could have answered  
4 simply by saying that you may be entitled to liquidation value,  
5 but we are entitled to determine liquidation value by any  
6 reasonable method that has support in the evidence. And this  
7 method does. But, instead of that, the Commission got into  
8 this argument about whether it could or could not do an abandon-  
9 ment proceeding.

10 Look at that report and consider that the Commission  
11 was dealing with an economic and a business problem about how  
12 to value property. And there is no reason to believe that its  
13 judgment on that economic issue would be at all affected if it  
14 were told that there may be some doubt, or even that it was  
15 wrong, about the legal answer it gave to the bondholders'  
16 argument. I think that economic determination can stand on its  
17 own foot.

18 This is really a stronger case than the Massachusetts  
19 Investors Co. Case was, because there they chose the wrong  
20 authority out of the two statutes. Here I think they simply,  
21 possibly, gave the wrong answer to an argument that could have  
22 been disposed of on separate grounds.

23 Q I take it that it is implicit in your argument  
24 that it is quite clear that the appraisals they are relying on,  
25 the expert testimony, was the value of the real estate as of

1 when?

2 A The valuation date, the end of December, 1966.

3 Q And none of the appraisals purported to be made  
4 in the light of the liquidation plan, that is, we predict this  
5 value would be worth so much in 6 years?

6 A Let me tell you how that was done, Mr. Justice  
7 White. New Haven first broke the land up into 3,000 parcels.  
8 They then had, as I understand it, 3,000 separate appraisals  
9 made. And those appraisals did not take into account the  
10 problem of market absorption or how long it would take to sell.

11 Q They didn't purport to include the factors that  
12 the Commission had included.

13 A That's right.

14 Q They purported to set a value if they were sold  
15 December, 1966?

16 A Or sold separately at or about that time. I  
17 suppose they sought some reasonable exposure to market. But,  
18 after the appraisals were made, then a witness for the New Haven  
19 came along -- he did not make the appraisals--, but he examined  
20 them. And he said, "Well, you obviously can not sell all these  
21 properties at once. I think it would take at least 6 years."  
22 I think even that witness admitted that that was an optimistic  
23 estimate. And, of course, my client said -- and one of the  
24 New Haven's witnesses said -- that you couldn't do it in 6 years,  
25 10 years --

1           Q     I take it that if you had experts that actually  
2 testified what the property would be worth if sold pursuant to  
3 this liquidation plan over a period of 6 years, you might have  
4 some problems with the ICC determination?

5           A     Yes, but you didn't have that, because these  
6 appraisals did not take that into account. This is all, and  
7 I think you can read our brief on it. I don't believe it can  
8 really be disputed when you look at the testimony.

9           The only thing they had done as to certain specific  
10 pieces of property -- They had applied what was called a "cats  
11 and dogs discount" of \$8 million as to certain particular  
12 parcels.

13           Now the witness, Simon, took that into account. He  
14 said, even with that, he would use this method of valuing the  
15 property -- which produced the 10.5% discount the Commission  
16 used.

17           But the "cats and dogs discount" was confined to  
18 certain particular pieces of property which had known infirmities  
19 at the time the appraisals were made. It really didn't look  
20 to the future risks.

21           At the risk, perhaps, of appearing to be rather  
22 disjointed in this presentation, I should now like to touch  
23 briefly on some points that have come up in respect to other  
24 aspects of the case, one of them being the situation of the  
25 2 yards in the Bronx.



1 I hope the Court is clear that the question there  
2 really comes down to an appraisal of the evidence over whether  
3 some railroad, in the event of liquidation of the New Haven,  
4 would serve these 2 New Haven yards in the Bronx. It is those  
5 2 yards that are in issue.

6 Now the Commission took an appraisal which was made  
7 on the assumption that the New Haven would abandon the service.  
8 The bondholders say that the Commission was bound to take a  
9 higher appraisal which the appraisers said would only apply if  
10 you assumed that some railroad, other than the New Haven,  
11 supplied the same service to New Haven.

12 So that, on the hearing it became an argument over  
13 whether the Penn Central could voluntarily or could be compelled  
14 to serve these 2 yards.

15 Q I'm looking at a map on Page ---

16 A Yes, I know the map. I think that is the map  
17 that shows the lines running -- shows 2 lines over on the left  
18 that run down the Harlem River and a yellow line going across.

19 Q Yes, and then it's got blue lines going down  
20 to the Hell's Gate Bridge.

21 A Yes, yes.

22 Q And it's got one going out the Bronx River in  
23 kind of a -- well, I wouldn't know what color to call that.

24 A What's that?

25 Q The one starting out the Bronx River, a short

1 line?

2 A These 2 lines over on the left are old New York  
3 Central lines.

4 Q One's a Harlem division and one's a Hudson  
5 division?

6 A Yes. And the yellow line was a New York Central  
7 branch which ran down to the former Port Morris Yard of the  
8 New York Central and then into an interchange point with the  
9 New Haven. Any traffic which the New York Central moved to this  
10 area was a part of these yards or to the Hunt's Point Market  
11 was interchanged at that point.

12 Now the Commission heard this evidence and having  
13 heard it found, on all the facts, that if the New Haven were  
14 liquidated (which is the hypothesis we're considering), Penn  
15 Central would not serve these yards and could not be compelled  
16 to. And the reasons that are set forth in our brief in length --  
17 we think that planning was fully supported by substantial  
18 evidence.

19 I just want to say one word about that, however, to  
20 make one point clear. The Reorganization Court took the view  
21 that the Penn Central could be compelled -- if the New Haven  
22 were liquidated -- to serve that market operated by the city  
23 of New York. The Commission found to the contrary, because that  
24 traffic is highly unprofitable.

25 But even if it is assumed -- and this is the point I

1 would like to make -- that Penn Central might serve that Hunt's  
2 Point vegetable market, or might be compelled to, it doesn't  
3 follow that it would serve either of these other 2 yards. The  
4 evidence showed that an average of only about 13 cars a day  
5 went to those yards to serve them. The Penn Central would  
6 either have to buy from the New Haven in liquidation or from  
7 somebody else tracks and facilities which would be extremely  
8 expensive, in view of the fact that the traffic would not be  
9 profitable anyway. Furthermore, the evidence shows that it  
10 would incur very substantial operating costs for the purpose of  
11 this small volume of traffic.

12 Now, as far as the suggestion that they could be  
13 compelled to serve them, the Commission disposed of that by  
14 examining the facts and saying that there was no evidence of any  
15 need for service to these 2 yards, or to the Hunt's Point Market  
16 for that matter, which would justify requiring service in the  
17 public interest. And, of course, the Commission would have to  
18 make a contrary finding to require service.

19 So I think that looking at that whole situation, it is  
20 quite clear that the Commission's determination there, which  
21 depended upon evidence as to what the operating conditions were  
22 and also involved the Commission's own judgment about what the  
23 transportation needs were, should clearly be sustained.

24 I may add that we point out in our brief that evidence  
25 before the Commission -- that New Haven, itself, sold large

1 chunks of one of these yards at exactly the square foot price  
2 that was in the appraisal that the Commission adopted, which was  
3 50¢ a square foot lower than the price in the appraisal that  
4 the bondholders now say the Commission is required, as a matter  
5 of law, to adopt. I think that if we're going to have a remand  
6 on this question, the Commission might have to have another look  
7 at the whole question of valuation.

8 I find that my time is nearing the end. I should  
9 like to say something about this issue of stock, because I  
10 think questions from the bench indicate that there is something  
11 that should be, perhaps, said about it.

12 The Commission, in treating the stock issue, fixed an  
13 inherent value for this stock that was going to be delivered on  
14 the closing date.

15 Q What's that?

16 A That was a determination that the stock would  
17 have that value in itself, even though it might not command a  
18 price on the stock market, as of a particular day, that was equal  
19 to that value.

20 Q Well, how does a moneylender get that inherent  
21 value out of a piece of paper?

22 A Well, he has to keep it until he can get it.

23 Q He has to keep it? He has to keep it?

24 A But that was part and parcel in this plan. Now  
25 the reason, and I think if you think about it ---

1 Q Well, that was part and parcel of the plan, but  
2 that is what they object to --

3 A Well, --

4 Q They want their money, and they wanted their  
5 money then and not 10 years from now.

6 A Mr. Justice White, they were not going to use this  
7 money. That wasn't --

8 Q Who wasn't going to use the money?

9 A The New Haven. They were going to put this  
10 stock in an investment company and keep it for 7 years. And the  
11 reason they were going to do that is because everyone knew that,  
12 at the beginning of this merger, the market prices stop was not  
13 going to reflect what it was really worth over any period of  
14 time.

15 Q Are you saying then a stop from making this  
16 claim? Is that basically what you are saying?

17 A I'm not arguing a stop --

18 Q Well, or whatever it is.

19 A I'm simply saying that the Commission -- I'm  
20 saying two things -- I think the Commission, in a transaction  
21 of this kind involving a reorganization of railroads, is entitled,  
22 as long as it has substantial evidence to support it, to  
23 determine a value of the stock that is inherent rather than a  
24 value that is evidenced by current market quotations. And that  
25 that is so, even if it may be some time -- depending upon --

1 Q So you're saying that although you agreed at the  
2 outset that, either under the Constitution or a statute, they  
3 are entitled to liquidation value, that you can satisfy that  
4 standard by giving it to them anytime within 10 years?

5 A I say you can give it to them in stock that has  
6 an inherent value on that date.

7 Q So you're saying, yes, the answer is yes, that  
8 you can satisfy that standard anytime within 10 years.

9 A That, I think, is an essential part of the power  
10 the Commission has to have in dealing with a reorganization of  
11 this kind. Because, frequently, they don't know what the stock  
12 will be worth in terms judged by stock market quotations. They  
13 can determine what its inherent value is.

14 Now, of course, the courts below took care of this  
15 problem --

16 Q Well, do you think they could satisfy liquidation  
17 the liquidating value standard, by giving them money today which  
18 will be worth a \$145 million 10 years from now?

19 A No, Mr. Justice White, money's different.

20 Q Well, that is what you're saying with the stock --  
21 we're going to give you some pieces of paper that within 10  
22 years will be worth \$83 million.

23 A In a reorganization -- and I think you could  
24 find this concept developed -- in a reorganization you give  
25 stock. You are giving that amount to an equity in a --

1 Q I agree with you, but that is what they say they  
2 don't want.

3 A Mind you, they are not rejecting stock; they  
4 want stock.

5 Q Well, they aren't rejecting payment. If you gave  
6 them \$83 million in cash, do you think they would take that  
7 rather than the stock?

8 A I can't answer that. All I can say is --

9 Q Well, you seem to though, by saying they wanted  
10 the stock.

11 A All I can say is that they have indicated they  
12 want stock. And some of the bondholders have said that they  
13 want more stock as opposed to bonds.

14 Q Well, that isn't --

15 A Because the junior bondholders' only hope in  
16 this thing is to have that stock go up in value, so that they  
17 can get something out of it.

18 Q So, you are suggesting that what their claim  
19 ought to be here, really, is that not that they want more stock,  
20 but they really ought to say that they want bonds which bears  
21 a rate of interest.

22 A If that's what they really want, yes. They have  
23 never taken that position. Payment of this large amount of the  
24 consideration in stock is something that has been in this plan  
25 from the very beginning. And so far as I know, the bondholders

1 have never insisted that more of it should be paid in bonds.

2 Now, they have asked for cash, at times, to make up  
3 differences between the market value. But the notion of getting  
4 a large equity position in this new company has been in this  
5 thing from the very beginning, and as far as I know, has not  
6 been objected to by anybody.

7 Q They suggest that this is the only way it would  
8 have been feasible; nobody could have raised the money to pay  
9 them cash?

10 A Penn Central wouldn't have had that money.

11 Q So you really can't blame that on them very much,  
12 then?

13 A You can't blame that on anybody, except, possibly,  
14 Penn Central but --

15 The distinction between a market quotation and inherent  
16 value is not a novel distinction in the law. You look at the  
17 valuation cases and the appraisal cases --

18 Q It's another matter when you're talking about  
19 giving somebody liquidation value than giving inherent value.

20 A Well, they get something that, I submit, is  
21 worth that. Now, they are going to have to wait a little while  
22 to get it; they are going to have to wait 7 years. Meantime,  
23 they've got an underwriting.

24 Q Whose idea was the underwriting?

25 A Judge Anderson's.



1 Q It originated with him, did it?

2 A Yes, and accepted by the Commission.

3 Q And accepted by the Three-Judge Court?

4 A And accepted by the Three-Judge Court. And, of  
5 course, any modifications in that underwriting would have to  
6 go back to the Commission, because it involved this question  
7 under Section 28.

8 Q One more question --you have a little time left --  
9 is that I get the feeling (perhaps this isn't a question)  
10 throughout here that the Commission, faced with trying to imple-  
11 ment the national transportation policy with two somewhat  
12 distressed railroads already merged and another more distressed  
13 railroad tacked on to the program, really was confronted with  
14 the problem of trying to allocate the deficits, if you can call  
15 them that. Here is a transportation system that really calls  
16 for large subsidies from the State or Federal Government, and  
17 they are not available. And so they are allocating this burden  
18 on the bondholders. Can you point out in a minute what's the  
19 policy of that?

20 A I don't think they are allocating any burden on  
21 the bondholders. I think they have given the bondholders,  
22 in my judgment, more than the bondholders would get if they  
23 really broke up this railroad and sold it.

24 I think the real problem is that Penn Central has been  
25 required to absorb these deficits and pay a price that my

1 client believes is too high for real liquidation value. And in  
2 the end the effect is not going to stop the equity of the Penn  
3 Central company. This is going to affect the rate-base, the  
4 costs, the rate-making power of the Commission, and the  
5 viability and vitality of Penn Central as a transportation  
6 company, and the transportation service that is available to  
7 shippers all over the northeastern part of the United States.

8 That is why the Commission has authority over securi-  
9 ties, so that the capital structure can't be inflated. Now at  
10 the end of our brief --

11 Q Well, the best thing then would be to just give  
12 this road to Penn Central for nothing.

13 A Well, you can't do that under the law of the  
14 Constitution. You have to give them at least -- We're operating  
15 on the assumption that they have to get the liquidation value,  
16 and we think they got it and a little bit more. They got \$8  
17 million for a building that is never going to be built over the  
18 Grand Central Terminal, and we think that --

19 Q For their rights?

20 A For their rights, yes.

21 Q That's never going to be built?

22 A Well, it is very doubtful. I think never is too  
23 strong a word --

24 Q It usually is.

25 A I was carried away by the advocate's enthusiasm.

1 It is very doubtful it is going to be built. They got \$6  
2 million, because the Commission overlooked, or forgot, or  
3 disregarded the evidence about how the costs of the Terminal  
4 were going to be increased.

5 Q Could I ask you one question? It may not be  
6 relevant and you may refuse. As I understand it, there is a  
7 difference what the bondholders will get by some \$100 million,  
8 a \$125 million more than the Commission allotted them. That's  
9 right, isn't it? For their bonds?

10 A Yes. That's right.

11 Q Now, from whose pocket does that come?

12 A It comes, in the first instance, from the Penn  
13 Central and, ultimately, it is going to come from the pockets of  
14 the people who pay rates. There isn't any doubt about that.

15 I just would want to say one thing at the end --

16 Q That's where the litigation is, isn't it?

17 A I'm sorry, Mr. Justice.

18 Q The real issue is between the bondholders who  
19 claim a certain amount and the Penn Central who claims they are  
20 not entitled to that amount. And that's the litigation?

21 A That's the litigation.

22 I just wish to say to the Court that on this question,  
23 the free use of the Grand Central Terminal, that as we read the  
24 briefs of states, they make it perfectly clear that they haven't  
25 paid Penn Central anything for the use that they're making of

1 that terminal.

2 Q Before you sit down, there have been references  
3 to this throughout the briefs and, to an extent, in oral  
4 argument that this involves Step 1 of the plan. And I think I  
5 understand that this involves how much is the New Haven entity  
6 going to be paid for its assets. Do I understand that Step 2  
7 is how those assets are going to be distributed among the  
8 various owners of the --

9 A That's right. That's the step that provides for  
10 the investment company for 7 years and how --

11 Q Right. And none of that is recorded?

12 A None of that is recorded, that's right.

13 MR. CHIEF JUSTICE BURGER: Thank you Mr. Cox.

14 You have 16 minutes left, Counsel.

15 REBUTTAL ARGUMENT OF LESTER C. MIGDAL

16 ON BEHALF OF PETITIONER

17 MR. MIGDAL: Mr. Chief Justice and may it please the  
18 Court:

19 In that short period I should try to answer some of  
20 the questions that I feel either I or my adversaries have not  
21 done entire justice to.

22 Q The Reorganization Court modified the under-  
23 writing, is that right?

24 A The Reorganization Court created the underwriting  
25 agreement.

1           Q     I know, but, in its opinion that's here for  
2 review, they added some supplementary provisions, did they not?  
3 The Reorganization Court?

4           A     No, Your Honor. The Three-Judge Court made some  
5 slight modifications in the underwriting formula provided for  
6 by Judge Anderson of the Reorganization Court.

7           Q     In this opinion that we're reviewing of the  
8 Reorganization Court, it did some embroidery-work upon the  
9 original underwriting agreement, is that right?

10          A     There never was an underwriting agreement until  
11 Judge Anderson created it. He did that because the \$83.1 million  
12 was so inadequate to -- because the 950,000 shares were so  
13 inadequate to discharge an obligation of \$83.1 million, and  
14 this was sort of a reform movement on his part.

15          Q     Well, if we should approve the Reorganization  
16 Court's ruling on that phase of the case, it would not have to  
17 go back to the Commission again, would it?

18          A     It would have to go back to the Commission, Your  
19 Honor, if you found it -- It would not have to go back if you  
20 found that the 950,000 shares with the underwriting was the  
21 equivalent of \$83.1 million. But if you find that it is not,  
22 then there are several things that are wrong with it, and those  
23 are: its failure to provide for interest, its failure to provide  
24 for security, and so on. Then it must go back.

25                I should like --

1 Q The Reorganization Court invented the underwriting  
2 agreement?

3 A That is correct.

4 Q That was accepted by the Commission, in principle,  
5 and it was accepted by the Three-Judge Statutory Court with  
6 a couple of minor variations?

7 A Yes, only Judge Weinfeld dissented and said that  
8 it still did not provide --

9 Q That it was insufficient. He said that it ought  
10 to be remanded to the Commission, but he was in dissent for either  
11 more shares or some other provision to provide the full \$83  
12 million. Am I wrong about that?

13 A No. That is exactly the posture.

14 Q That's what, on the whole, you wanted, something  
15 that is equivalent to \$83 million now, isn't it?

16 A Exactly, Your Honor, nothing more or less, as of  
17 the closing date, and we would take it in any form which we  
18 could get it.

19 I would like to say a word in connection to a question  
20 that Mr. Justice Black asked. And that related to the question  
21 of who bore the burden here. Suppose that, in fact, the Court  
22 decided that we were supposed to get another \$100 million. Is  
23 that going to come out of the public's pocket, or is that going  
24 to come out of Penn Central's pocket? And the answer to that  
25 is quite simple.

1           The Commission has the power to make up that \$100  
2 million simply in shares of Penn Central. Now as that happens --

3           Q     Simply in what?

4           A     Simply by providing that Penn Central pay the  
5 difference in shares of Penn Central. And if that happens --

6           Q     If Penn Central pays that much?

7           A     That's right. That Penn Central pay that. Now,  
8 if that happens, that will have no effect on the rate-making  
9 function or any other function, it would just have an effect  
10 on the earnings per share of Penn Central which would be  
11 diluted.

12           As far as the equity holders of Penn Central were  
13 concerned, it would have some modest effect on the equity that  
14 they would have, because there would be more shares outstanding.  
15 And the earnings per share would therefore decline slightly.

16           It would have an immaterial effect, therefore, on  
17 Penn Central stockholders and no effect on the public, if the  
18 Commission elected to provide that difference in shares.

19           Q     But the new railroad to start out with a burden  
20 of a \$100 million, or whatever that difference is, that it's  
21 had to pay out in some way, that would be a part of its assets,  
22 wouldn't it?

23           A     It would be a part of its assets, because there  
24 is, after all, --

25           Q     -- it's entitled to earn rates, isn't it?

1           A     Your Honor, if on the assumption that it was  
2 receiving, not a \$162 million worth of assets, but \$262 million  
3 worth of assets -- which is why it is required to pay another  
4 \$100 million --, there is no injury to Penn Central. It is  
5 simply paying exactly for what it is getting.

6           Q     You don't injure it by making it pay out a \$100  
7 million?

8           A     No, sir, because all you have done is found that  
9 it was underpaying by a \$100 million and taking advantage of  
10 a \$100 million of the New Haven's assets.

11          Q     I understand the other argument that the bond-  
12 holders are entitled to it. But when the bondholders are entitled  
13 to it, they have to get it from somebody, unless it's manu-  
14 factured.

15          A     That is true, Your Honor.

16          Q     But it wouldn't be manufactured, and on account  
17 of this, they would have to put the burden on Penn Central.

18          A     In the form, Your Honor, of shares it would not  
19 be a serious burden. It would be more of a burden, obviously,  
20 if it were in bonds, because then there would be an addition to  
21 fix charge. Suppose they had to issue another \$100 million  
22 worth of bonds. Now, had they issued another \$100 million worth  
23 of bonds, then those bonds, at a 5% rate, Penn Central would have  
24 to pay out \$5 million a year.

25                Now, that \$5 million a year would have the effect



1 on Penn Central's earnings per share of 21¢. It would reduce  
2 their earnings per share by 21¢, if you gave the whole \$100  
3 million in bonds. If, on the other hand, you gave it in shares,  
4 you would not affect their fixed charges at all, because there  
5 wouldn't be a requirement that they pay fixed dividends unless  
6 they were earned. So the only difference would be as to the  
7 extent to which there might be some slight dividend impairment  
8 to the extent that you provided the additional consideration.

9 Q But there wouldn't be any impairment on the --  
10 I mean the same rate base would exist --

11 A If you issued shares the same rate they --

12 Q -- the same asset value would go on the balance  
13 sheet for which you issued the shares, in any event?

14 A Exactly, Your Honor.

15 Q How do you know the same rate base will exist?

16 A Because it wouldn't affect the fixed debt, Your  
17 Honor. All you are doing is altering the equity structure here,  
18 not the debt structure.

19 Q Then, I suppose, the public may be getting the  
20 fleece in another way by having stock sold to them that isn't  
21 worth anything.

22 A That might be, Your Honor.

23 I would like to say to Mr. Justice White about the  
24 question as to whether these were, in fact, claims that came  
25 ahead -- the \$60 million were actually claims that came ahead

1 of those of the bondholders'. That they were, all of them,  
2 claims that came ahead of the bondholders' claims, not just the  
3 trustees certificates. That the way in which all of this  
4 erosion occurred was because the Reorganization Court enjoined  
5 the collection of a lot of obligations that we were running up  
6 in the course of that period.

7           So that the States were not being paid their taxes,  
8 though their claims came ahead of us. And, indeed, the tort  
9 claims, people injured on the road during the administration,  
10 they are still outstanding. And the per diem claims, all the  
11 railroads who put cars on our line, we had to pay. And we  
12 weren't paying them, but their claims are ahead of ours.

13           They are administration claims, and you can find all  
14 of that at Page 181(a), because the Commission, itself, set  
15 it out, put a value on it, and made a chart. And it appears  
16 in the remand report, and it's on Page 181(a) of the Appendix  
17 of Decisions and Constitutional and Statutory Provisions that  
18 were handed up with our briefs.

19           Q     How about the rolling stock of your railroad?  
20 Those were probably under Philadelphia Equipment Trust or the  
21 equivalent, weren't they?

22           A     Some were and had been repossessed, and some  
23 had some excess value --

24           Q     Your assets are primarily real estate?

25           A     That is correct.

1 Q Because those would be prior claims, wouldn't  
2 they? Though all the cars and locomotives that were subject to  
3 that sort of conditional sales are --

4 A We had been paying those throughout the adminis-  
5 tration. Otherwise, they would have been repossessed. Therefore,  
6 although there were debts with respect to those railroad cars,  
7 those were taken over when the cars were taken over by Penn  
8 Central at the closing.

9 Q I see. Also, the rolling stock is repossessed?

10 A Exactly, Your Honor.

11 Q Suppose the delay in consummating the merger and  
12 the transfer -- in terms of liquidation value, that probably  
13 is not all negative as far as the bondholders are concerned.  
14 Do you suppose the real estate would sell more in 1970 than in  
15 1960?

16 A That is exactly right, Your Honor. And in one  
17 of the earlier opinions of Judge Friendly, he had noted that,  
18 of course, if you are going to predicate some kind of delay, then  
19 you couldn't simply predicate the delay without revaluing the  
20 assets. And, therefore, his remand, in the first instance,  
21 was on a very limited ground. He had asked that the remand be  
22 on a limited ground.

23 It is absolutely unfair, however we may intend, for  
24 the Commission to stand here in the posture of saying that  
25 there was a quantifying of risks with respect to that bulk sale.

1           If you read the Commission's report, you will see  
2 that everything that the Commission has to say about this it  
3 says under a single title, "Limitations of the Right to Break  
4 Up the Railroad". There was no question of quantifying any  
5 risks. Mr. Simon did not know, for example, whether the  
6 appraisals that he was addressing himself to had been made on  
7 a very conservative basis or whether they had been made on a  
8 generous basis.

9           Now, obviously, if you make it on a generous basis,  
10 then you have got to worry about the possibility of whether it  
11 would be completed in 6 years or what other impacts there are.  
12 Mr. Simon knew nothing about that.

13           What Mr. Simon said -- and he's quoted on Page 29 of  
14 our reply brief -- was, "We are not talking today about users but  
15 we have been assuming a bulk sale and we have been discussing  
16 about the decision which is in the railroad's hands as to whether  
17 or not to go through the retail processes themselves ...".  
18 He says also -- And he said in other places that he, himself,  
19 did not study the appraisals, he simply assumed that they were  
20 carefully made.

21           If he didn't know what the Commission, in fact, said  
22 about them -- and that was that they were conservative. They  
23 understood the possibility that there was a 10 year liquidation  
24 study before them with a 7% discount as against a 6 year  
25 liquidation with a 6% discount, and they elected that.

1           But you would have to imagine the most remarkable  
2 coincidence -- that precisely the profits that a bulk buyer  
3 would require (which was computed on the basis of 25% of his  
4 own invested capital, giving him a profit of 15% and 75%  
5 borrowed at a 9% rate) would exactly equal the risks which  
6 the Commission somehow overlooked.

7           Obviously, he wasn't quantifying any of those risks,  
8 because he didn't know what they were. That kind of coincidence  
9 would have been an absolute miracle.

10           Q     Going back to this real estate evaluation again  
11 to pursue Justice White's point. If the generality of opinion  
12 about real estate values is correct, it does not involve much  
13 risk for a buyer. To buy real estate in 1970 at 1970 prices for  
14 payment in 1978 --

15           A     I would think not, Your Honor.

16           Q     -- is the essence of your point on that valuation  
17 of these properties, isn't it?

18           A     Exactly, Your Honor. The inflationary factor  
19 alone is going to deprive him of a good deal of the risks.

20           Q     So what you are saying is that the Commission  
21 forced on the seller all, or a very large part, of the risks if  
22 not all the risks on that score.

23           A     I believe that that is correct, Your Honor.

24           I believe that my answer, however, to a question of  
25 Mr. Justice Stewart, in the first part, was subject to some

1 misinterpretation. My colleagues inform me that it was possible  
2 to interpret my answer as meaning that Penn Central had the  
3 right to buy in 50,000 share blocks from us, and, in that way,  
4 we lost one of the advantages of underwriting.

5           What I meant was this: That at any time, they could  
6 pay us the difference between what the value of the shares then  
7 was and \$87.50 and be free of the underwriting.

8           At that point we stood in precisely the same position  
9 as anybody else who bought shares of stock. We were stock-  
10 holders. If we kept them, we kept them at our own risk. If we  
11 sold them, we sold them at our own risk. There was, therefore,  
12 this way out to avoid our having the best of both possible  
13 worlds.

14           In any event what I would say is this. The under-  
15 writing so delays us; it puts us off so far ahead, 1978. It  
16 gives us that in such an insecure way, that might be an  
17 enormous bill for Penn Central to pay.

18           Q     Why are you willing to accept the stock at all?

19           A     Your Honor, I believe that we went into -- I  
20 would say that the Commission has the power, in such a force  
21 sale as this, and I would say --

22           Q     -- Commission require you to take stock?

23           A     I think that it could require us to take stock,  
24 in all likelihood, as long as it represented the cash equivalent  
25 of what we gave up.

1 Q On that day?

2 A On that day. I think that that far it had a right  
3 to protect the public interest. By seeing that it did not so  
4 burden Penn Central in the form they were paying, I don't think  
5 that it could take anything away from the bondholders sofar as  
6 their constitutional rights were concerned.

7 But sofar as protecting Penn Central and the public  
8 in the form of the payment -- as long as it gives us the  
9 equivalent of what we were passing -- I think, to that extent,  
10 it could decide what the form of the securites should be. We  
11 never complained about that.

12 Q But you could never sell that stock for that  
13 much on that day, could you?

14 A No, Your Honor. In our briefs we have pointed  
15 out that that was another error. That while, with respect  
16 to our real estate, for example, every selling expense was  
17 deducted -- brokerage fees, lawyers fees, the expense of  
18 advertising, and everything else -- in order to get down to our  
19 net salvage value.

20 With respect to the shares at \$83.1 million, even there  
21 they failed to take into account our selling expenses in order  
22 to keep both sides of the equation equitable. But they did not  
23 do that.

24 On the Harlem River yards point, I would like to say  
25 this. Mr. Cox, it seems to me, is still suggesting that we

1 are entitled to liquidation value on something less than our  
2 best method of liquidation. There were two witnesses for Penn  
3 Central on the Harlem River yards, and both testified that  
4 someone would provide service to those yards. This was not  
5 something that we had made up.

6 The only question is, where it is clear that someone  
7 would provide rail service to those yards, is there any basis  
8 in law for finding net liquidation value on something less than  
9 the fair market value on our best method of liquidation.

10 MR. CHIEF JUSTICE BURGER: Your time is up, Counsel.

11 We will not commence the second case for today. That  
12 would involve splitting the argument, and Counsel could not  
13 possibly finish today. So we will rise at this time.

14 (Whereupon, at 2:30 p.m. the argument in the above-  
15 entitled matter was concluded.)