

Policy Analysis

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A Plan to Liquidate Amtrak

by Joseph Vranich, Cornelius Chapman, and Edward L. Hudgins

Executive Summary

Having found that the government-owned passenger rail company, Amtrak, will not be able to break even by the end of 2002, the Amtrak Reform Council is required by the Amtrak Reform and Accountability Act of 1997 to submit a reorganization plan by February 7. Amtrak itself had been required by the same law to develop a plan for its own liquidation, but a handful of senators blocked Amtrak from doing so. That congressional action shortchanges the public of a much-needed discussion of liquidation, considering that Amtrak's financial losses continue to mount and perpetuation of the status quo cannot be justified. The plan presented here is designed to contribute to the public's understanding of Amtrak liquidation issues despite the failure of Amtrak to put such a document on the public record.

Liquidation would force Amtrak to lay before the public and policymakers all the information about its poor financial condition and operating record. Liquidation would be the best way to stop the waste of taxpayers' dollars and to give parts of Amtrak's passenger operations the best chance of survival.

Railroad liquidations through insolvency proceedings were common in the 19th century when railroads were the principal means of transportation in America. Amtrak's passenger rail operations constitute a very small part of transportation today; thus bankruptcy would produce very little disruption of travel.

If unpaid creditors forced Amtrak into bankruptcy, a trustee would be appointed to manage the sale of Amtrak's assets. In the liquidation process the value of assets would be determined through a market process. A number of parties have already expressed interest in purchasing Amtrak's Northeast Corridor operations, which include the rolling stock, tracks, and stations. This part of the system likely could be run efficiently and at a profit by private owners. Other parts of the system might be purchased by freight companies of other operators. Money-losing routes no doubt would be abandoned.

The reforms currently being discussed by the Amtrak Reform Council are too little, too late. It is in the public interest to use existing bankruptcy laws to liquidate Amtrak.

Joseph Vranich served on the Amtrak Reform Council from February 1998 to July 2000. He has also served as president and CEO of the High Speed Rail Association and as executive director of the National Association of Railroad Passengers. Cornelius Chapman is a member of the Boston law firm of Hutchins Wheeler and Dittmar. Edward L. Hudgins is former director of regulatory studies at the Cato Institute.

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Amtrak's Fiscal Failures

Amtrak's persistent financial debacles, repeated federal bailouts, and loss of \$1.1 billion in 2001, the most in its history, lead to the inescapable conclusion that liquidation of the railroad is in the public interest.

When Congress established the National Railroad Passenger Corporation, commonly known as Amtrak, in 1970, it anticipated providing subsidies for only a limited time, until Amtrak could become self-supporting.¹ In fact, Amtrak has an unbroken record of fiscal failure resulting in federal subsidies exceeding \$25.3 billion.² Adjusting for inflation, and to put this figure in perspective, Amtrak's federal subsidies in current-year dollars exceed \$44 billion.³

Subsidies to Amtrak are at record highs. Infusions of \$4.43 billion in federal subsidies from 1998 through 2001 provided Amtrak with more taxpayer funding than in any other four-year period in its history. The figure would be higher if it included Amtrak subsidies that are attributed to the budgets of other public agencies such as the Federal Transit Administration and the Federal Railroad Administration. Moreover, Amtrak mortgaged New York's Penn Station for a \$300 million loan to stave off insolvency in fiscal year 2001⁴ and has received an FY02 federal appropriation of more than a half billion dollars. Still, its financial condition is worsening, which leads to the inevitable conclusion that Amtrak's financial hemorrhaging is irreversible.

The Amtrak Reform and Accountability Act of 1997 established the Amtrak Reform Council, which is authorized to evaluate Amtrak's financial performance. The ARC made a finding on November 9, 2001, that Amtrak would not achieve operational self-sufficiency by the statutory deadline of December 2, 2002, or by any reasonable later date.⁵

The ARC found that Amtrak is in a weaker financial position today than it was before passage of the Reform Act, that the railroad will likely report an operating performance \$185 million worse than projected in its busi-

ness plan for FY01, that it has used Taxpayer Relief Act capital funds for operating purposes, and that it has tripled its debt in the past five years to about \$3 billion.⁶ In a report dated January 24, 2002, the Transportation Department's inspector general announced that "Amtrak has not succeeded in implementing enduring financial improvements of the magnitude necessary to attain and sustain self-sufficiency in and beyond 2003. . . . For every \$1 Amtrak realized in additional revenue [since December 1997], cash expenses increased by \$1.05. . . . Amtrak's operating loss in 2001 of \$1.1 billion was \$129 million higher than the 2000 loss and the largest in Amtrak's history."⁷

In 1998 the U.S. General Accounting Office reported, "Amtrak officials told us that using a portion of the federal capital appropriation for maintenance will provide stability for Amtrak over the next several years, thus averting a possible bankruptcy."⁸ That has not turned out to be the case. If Amtrak had followed generally accepted accounting principles and had been subject to the traditional tests and oversight found in the investment community, the railroad would have been declared insolvent several years ago.

The ARC's Flawed Plan

The ARC has notified the president and Congress that Amtrak will fail to become operationally self-sufficient.⁹ Under the Reform Act, within 90 days of that finding, the ARC is required to submit to Congress a plan for a restructured and rationalized intercity rail passenger system. The ARC's February 7, 2002, plan includes reorganizing Amtrak by putting its train operations into one subsidiary and its real estate, tracks, and facilities into another and permitting Amtrak to control a future rail-franchising system.¹⁰

Unfortunately, the ARC's recommendations ignore fundamental problems and represent a too-little, too-late departure from Amtrak's present structure. For example,

before 1997 Amtrak was required by federal law to operate a specific route system—basically the same network it had been running since it was created in 1971. The Reform Act repealed that mandate, as well as other impediments to Amtrak’s redeploying its resources on current-day routes to fit actual market conditions. Yet, in the last five years, Amtrak has not discontinued service in any of its long-distance markets so as to reassign equipment to serve more promising short-distance markets. In fact, Amtrak has worked in Washington to preserve the status quo. It is unclear how the ARC’s recommendations will change that failed paradigm.

Worse, the ARC’s recommendations have the potential to inhibit innovation and private-sector participation by granting Amtrak authority over rail-franchising arrangements while at the same time granting an Amtrak subsidiary authority to operate trains under franchises. Amtrak could exercise authority to approve operation of its subsidiary’s trains and obstruct proposals from newcomers. It exhibited such behavior when the Guilford Rail System, a private freight carrier, offered to purchase or lease Amtrak’s Northeast Corridor line and to operate private passenger service as a “responsible approach to the inevitable failure of Amtrak”¹¹ and when the Railway Service Corporation, also a private company, offered to take over Amtrak service between Harrisburg and Philadelphia.¹²

States have begun to consider a private-sector role in converting Amtrak routes into locally controlled operations. A Washington State Transportation Department official commented in January: “What we’d really like to do is take the best from Amtrak, and turn it into a program that really allows us a great deal of flexibility and a whole new set of opportunities. . . . We think there’s a future for rail, and we would like to determine our own future.”¹³ According to the GAO, Illinois had been subsidizing regional Amtrak service for years. In 1996, when Amtrak requested more money for the service, state officials indicated that they would be interested in arrangements with other parties to continue

services should Amtrak go out of business.¹⁴

Hence, the ARC’s proposal appears to be anti-competitive; it sets up a bidding system in which Amtrak is guaranteed to win despite the quality of other proposals.

The Dangers of Limited Reforms

Recent lawsuits filed against Amtrak underscore the conclusion that Amtrak has conducted itself in ways that jeopardize the future of rail passenger service and injure the public interest.

Egregious Amtrak actions include manipulating the public competitive bidding process, disrupting the efficient construction of the high-speed Acela express trains, and attempting to sway public opinion by withholding critical information about its accounting system and operating losses.¹⁵ Those actions have in the last six months sparked significant litigation from a variety of sources.

Bay State Transit Services filed suit against Amtrak and rail labor organizations in November 2001 for restraint of trade in violation of antitrust laws. Amtrak had been operating and maintaining trains under a franchise from the Massachusetts Bay Transportation Authority. Noting that Amtrak was inefficient in maintaining commuter train equipment, MBTA put the contract out for bid in a fair, open, and rigorous competitive procurement pursuant to Federal Transportation Administration requirements. Four companies bid, three of which came in between \$175 million and \$195 million for the five-year contract; Amtrak’s bid was a staggering \$291 million.¹⁶ Bay State’s complaint outlines the coordinated action of Amtrak and the rail unions to undermine the award process and force MBTA “to terminate its agreement with Bay State despite Bay State’s vastly superior bid and enter into another contract with Amtrak.”¹⁷ That occurred even though Bay State’s bid was \$116 million less than

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Amtrak's and also was judged to be of higher quality. Noted one newspaper columnist, "What the experience of the bidding process showed without a doubt is that Amtrak and its unions have been gouging the MBTA, its paying riders and the taxpayers for years."¹⁸

Bombardier Corporation, a train manufacturer, filed suit against Amtrak in November 2001 seeking to recover \$200 million in damages. The complaint states that Amtrak disrupted the company's ability to produce and deliver Acela express trains on time and caused cost overruns. One passage highlights Amtrak's lack of competence in design and program administration for high-speed trains: "As a result of Amtrak's continuing interference, designs have been modified literally thousands of times, large numbers of already completed components have had to be discarded or retrofitted, the Equipment has been subjected to thousands of hours of unreasonable and unnecessary testing and Management Services have been rendered significantly more difficult and costly to perform. The magnitude of the extra work caused by Amtrak is reflected in the vast Contract record—over 19,900 letters, 9,000 engineering change notices, 4,700 retrofit notices and 800 formally recorded meetings."¹⁹ Meanwhile, over the manufacturer's objections, Amtrak scheduled multiple public relations visits to a test track; those visits disrupted operations in a quest to hype Amtrak's bright future and minimize public recognition of deficiencies in train design and program administration. Manufacturing delays apparently are inconsequential to those in Amtrak who believe image is more important than genuine success. The relevance here is that Amtrak is proposing to build high-speed trains elsewhere in the nation provided it receives \$12 billion more in subsidies. But that amount would cover only a fraction of the cost of proposed routes, warned the GAO, with the total closer to \$100 billion.²⁰ No wonder *The Economist* recently editorialized that giving Amtrak control over capital spending for high-speed rail "is insane."²¹

Anthony Haswell is a retired attorney who is often referred to as the "father" of Amtrak for helping to write the 1970 law that created Amtrak. He sued Amtrak in July 2001 under the Freedom of Information Act to force the railroad to disclose financial information on its individual train routes and services. The lawsuit is an attempt to provide transparency to Amtrak's accounting system to allow the public to determine how much money individual Amtrak routes lose each year—information that Amtrak refuses to publicly reveal.²² Among the items requested were documents underlying the creation of the Market Based Network Analysis, a much-hyped but eventually discredited attempt by Amtrak to justify adding additional money-losing trains to its system. "In order for the government and the public to make informed decisions on the future of Amtrak and intercity rail passenger service, the information I have asked for is essential," Haswell said.²³

Amtrak and other allies of the status quo rely on sheer political influence to perpetuate the organization. Yet when consideration is given to the perspectives found in the lawsuits along with damaging findings reported for many years by the GAO and the Transportation Department's inspector general, the unavoidable conclusion is that Amtrak does not represent a credible going concern and liquidation is an appropriate option.

Congress Undermines Reform by Blocking Liquidation Plan

The 1997 statute also requires that, within 90 days of the ARC's finding, "Amtrak shall develop and submit to the Congress an action plan for the complete liquidation of Amtrak, after having the plan reviewed by the Inspector General of the Department of Transportation and the General Accounting Office for accuracy and reasonableness."²⁴ The liquidation plan would assist the public in understanding Amtrak's financial condition. A major problem that members of the

ARC have faced is obtaining information from Amtrak, which often obfuscates its true financial and performance situation. The liquidation process would shine the public policy light into Amtrak's dark corners.

However, Congress short-circuited the Reform Act by lifting the mandate that Amtrak submit a liquidation plan. Sens. Joe Biden (D-Del.) and Ernest Hollings (D-S.C.) attached an amendment to the Defense Appropriations Bill that precludes Amtrak from spending funds to prepare a liquidation plan.²⁵ The amendment—which neglected to halt a single wasteful Amtrak spending practice—deprives the public of its right to understand Amtrak's financial condition and Amtrak's future requests for additional multi-billion-dollar bailouts. The resulting lack of transparency in Amtrak's financial affairs is more appropriate for the budget of an agency involved in national security, such as the Central Intelligence Agency, than for a deficit-ridden railroad. Moreover, advocates of the status quo are no friends to travelers. After all, liquidation is a *positive* development when an organization is dysfunctional. Reallocating assets could bring about better trains where America needs them whereas the status quo will perpetuate poor train service and diminish prospects for modern train service.

Finally, exempting Amtrak from the liquidation plan requirement undermined work by the Senate Commerce Committee, which said in its report on the Reform Act:

The Committee expects the Congress would consider legislation to address the fact that Amtrak is unable to operate in a financially viable manner and the bill provides a 90-day period for Congress to provide for a restructured passenger rail system. If the Congress does not take such action, Amtrak is required to begin implementing Amtrak's liquidation plan. Should this occur, the Committee believes that the liquidation plan must be carried out in a manner to protect the taxpayer's investment to

the greatest extent possible and fully expects the comments of the DOT-Inspector General and the GAO to be followed closely during the liquidation process.²⁶

It is unclear what the cost of liquidating Amtrak will be to the public treasury. The GAO examined costs in a 1988 report titled, "Issues Associated with a Possible Amtrak Liquidation" and stated that costs are difficult to predict because they will depend on such uncertainties as Amtrak's debt and financial obligations at the time of liquidation, the market value of its assets, and the proceeds from the sale of its assets.²⁷ Another GAO document examines "full faith and credit" questions and concludes that the United States would not be liable for Amtrak's labor protection obligations and other debts.²⁸

Railroads' History of Liquidations

The notion of using a judicial process such as a bankruptcy proceeding to deal with the failure of a railroad is not new. In fact, the system of debt restructuring currently contained in Chapter 11²⁹ of the Bankruptcy Code³⁰ has its roots in 19th-century railroad reorganizations. The private railroad companies that were formed in the 1800s used loans from East Coast and European financiers to finance their expansion westward, and by 1860 such borrowings exceeded \$1 billion. The product of that influx of capital was a dramatic increase in rolling stock and miles of track laid, and in the number of railroad companies competing with each other.³¹ The supply of railroad assets and services soon exceeded demand, causing the industry as a whole to become insolvent by the mid-1890s.³²

Thus, in the 1890s when railroads were the *primary* mode of intercity passenger transportation in America—not an incidental alternative to travel by car, bus, or plane—

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more than 27,000 miles of rail were taken over by courts, and another 40,503 miles of track were sold at foreclosure sales of railroad assets between 1894 and 1898.³³ No grave national crisis resulted; in fact, the creative destruction of failed railroad firms produced a fresh start for the lines affected, with new capital, no disruption in service, and enhanced prospects for the future.³⁴

Today, Amtrak presents an economic and legal profile similar in some respects to that of a typical 19th-century railroad. It operates unprofitable lines for which there is insufficient demand,³⁵ and its financiers—U.S. taxpayers, not robber barons—hold long-term obligations, such as Amtrak’s non-interest-bearing \$3.8 billion note to the U.S. Treasury that does not mature until 2975, that would undoubtedly yield less than their face value if sold currently.³⁶ Given these circumstances, it is time for the U.S. government to do as the capitalists of the 19th century did—recognize the problem, cut its losses, and liquidate Amtrak in a single proceeding in which diverse and competing claims can be resolved.

Today’s Context

There is one critical difference between the railroads that were reorganized by equity receiverships in the 19th century and Amtrak in the 21st, however. The railroad corporations whose assets and liabilities were liquidated in the equity receiverships of the 1800s had very little trade debt, that is, money owed to suppliers of goods and services. Suppliers of goods such as coal were paid in the ordinary course of business, and any debts of this type incurred in the six months before a receivership began were typically paid in full at the commencement of such a proceeding, since the products and labor provided by suppliers and contractors were critical to the continued operation of the railroad.³⁷ The creditors whose debts were restructured in the equity receiverships of the 1800s were institutional lenders who agreed to accept less favorable terms in order to salvage some part of their

investment.³⁸ In short, the creditors who “took a haircut” in the 19th century were wealthy, sophisticated, and represented by the most accomplished legal and financial professionals of their day,³⁹ and they could thus make informed business judgments.

By contrast, the creditors who stand to lose the most in a bankruptcy of Amtrak, planned or precipitated by others, are, first, the sort of unsecured creditors—vendors, independent contractors, and employees—who were paid in full in the 19th century in order to keep the railroads running through the course of an equity receivership, and, second, American taxpayers who over the years have funded Amtrak’s operations. For example, as of September 30, 1997, Amtrak had total debt to “vendors, employees and others” of \$279,000,000, an amount that exceeded its debt to banks and insurance company lenders for borrowed money and rent obligations to landlords.⁴⁰ While some of this amount would be entitled to a priority in a bankruptcy case due to a provision of the Bankruptcy Code that mirrors the “six month rule,” an informal equity doctrine used in the 19th century railroad liquidations,⁴¹ the vast majority of these creditors will receive only pennies on the dollar if Amtrak is allowed to continue its profligate fiscal ways, since Amtrak’s ability to service this sort of current liability has worsened dramatically over the past 15 years.⁴² In short, unlike the 19th-century railroad reorganizations, it is the “little guy”—not the institutional investor—who is sitting squarely in the middle of the tracks as Amtrak hurtles toward insolvency.

Amtrak’s massive debt to suppliers and contractors has two important consequences under American bankruptcy law: First, it makes Amtrak an appropriate subject for a bankruptcy proceeding, since the resolution of disputes solely between an insolvent debtor and its secured creditors—that is, those who hold contractual property interests in its assets, such as mortgages on land—are deemed inappropriate for resolution by bankruptcy courts.⁴³ Second, a large amount

of unsecured trade debt dramatically increases the likelihood that Amtrak will be forced into a bankruptcy court proceeding against its wishes, since involuntary bankruptcy cases can be commenced by creditors (and only those creditors) holding claims for which there is no, or only a minimal amount of, collateral.⁴⁴

Chapter 11 in fact contemplates that insolvent railroads will pass through it (rather than Chapter 7) on their way to liquidation, since a railroad may not file for protection under Chapter 7.⁴⁵ Subchapter IV of Chapter 11 provides express rules for railroad reorganizations, including the prompt appointment of a qualified trustee nominated by the secretary of transportation, special treatment for collective bargaining agreements subject to the Railway Labor Act, an industry-specific set of rules governing the circumstances under which lessors or secured creditors with interests in rolling stock may take possession of the same, and provisions governing the abandonment of railroad lines.⁴⁶ As a result, there is no more appropriate forum under American law for the liquidation of Amtrak than Chapter 11, with its centralized administration of claims and high level of public disclosure.

Amtrak in Chapter 11

What would a Chapter 11 resolution of Amtrak look like, and how would it unfold? In many respects, Amtrak's Chapter 11 proceeding would resemble that of any other operating business. The case would be commenced either by the filing by the National Railroad Passenger Corporation (Amtrak itself), a District of Columbia corporation, of a voluntary petition under Chapter 11 or by an involuntary filing against Amtrak by three or more of its creditors. In the case of a voluntary petition by Amtrak, the filing would consist of a skeletal petition listing the value of Amtrak's assets, the extent of its liabilities, and its 20 largest unsecured (or undersecured) creditors—that is, creditors holding no collateral

for their claims or creditors whose claims exceed the value of their security.

Amtrak could oppose an involuntary petition filed by its creditors, but it would be forced into a bankruptcy proceeding if the petitioning creditors proved that Amtrak was not paying its bona fide, undisputed debts as they became due or if Amtrak's property had become subject to a state law insolvency proceeding within 120 days before the filing of the involuntary petition.⁴⁷

Once Amtrak had become subject to bankruptcy court jurisdiction, a number of immediate changes would take place in the operation of its business. First, all creditor actions against it would be stopped by virtue of the "automatic stay" of such proceedings that goes into effect once a case under the Bankruptcy Code begins.⁴⁸ This provision of the Bankruptcy Code prevents both secured creditors (such as equipment lessors and real estate mortgagees) and unsecured creditors from taking any further action to enforce their claims by lawsuits or asset foreclosures without notice to other creditors and permission of the bankruptcy court.

The automatic stay would not prevent regulatory agencies with authority over Amtrak from enforcing laws and regulations that govern its operations, however, and Amtrak's business would thus remain subject to rail safety requirements.⁴⁹ While this is true generally of business bankruptcies, the provisions of the Bankruptcy Code that deal specifically with railroad reorganizations recognize certain exceptions from railroad regulatory requirements in areas that could impede an effective liquidation under bankruptcy court jurisdiction. Sec. 1166 of the Bankruptcy Code provides that the laws that ordinarily govern railroad mergers, abandonment of rail lines, and modification of railroads' financial structure⁵⁰ do not apply in Chapter 11, thereby permitting a bankruptcy court to order railroad abandonments or, more dramatically, to approve a merger of Amtrak into another, privately operated railroad company as part of a bankruptcy proceeding.

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The automatic stay serves to place all creditors on an equal footing once a bankruptcy proceeding has begun by making their right to collect debts subject to notice and court approval based on explicit standards that take into account the potential impact of a creditor's action on the debtor's ability to reorganize.⁵¹ The Bankruptcy Code similarly presumes that debtors in bankruptcy proceedings were insolvent during the 90 days immediately preceding the filing of a bankruptcy petition by or against them⁵² and, in an effort to achieve an equal distribution of a company's assets, provides that certain payments of money or transfers of property by a debtor to particular creditors (in the shorthand of the bankruptcy bar, "preferences") that occur during this period may be recovered and used to increase the amount that will be paid to all creditors. By this rule the Bankruptcy Code seeks to discourage precipitous action by creditors as a company's fiscal health declines and to undo such acts where they redound to the benefit of one creditor over others that are similarly situated.

In addition to the power to recover preferences, companies in Chapter 11 (and in the case of railroads in Chapter 11, their trustees in bankruptcy) may recover certain payments or transfers that represent either intentional fraud on creditors⁵³ or are made in exchange for inadequate compensation during the one-year period prior to the commencement of the bankruptcy proceeding, and which (i) are made while the debtor is insolvent or which render the debtor insolvent, (ii) leave the debtor with insufficient capital to conduct its business, or (iii) are made at a time the company intends to incur debts that it will be unable to pay as they mature.⁵⁴ Those transactions, known as fraudulent transfers or (under some state laws) fraudulent conveyances, are—like preferences—unwound so that all creditors share in the benefit that one creditor obtained to the detriment of others at a time when the debtor was insolvent.⁵⁵ The assets of the debtor's estate will thus represent those listed on its balance sheet at the time it becomes subject to bankruptcy court

protection plus those that can be recovered as preferences and fraudulent conveyances.

On the liability side of the balance sheet, a filing under Chapter 11 would bring before a single court all claims against Amtrak, including claims for unpaid wages and benefits owed to employees; trade debts owed to suppliers and contractors; claims of lenders (including the federal government), lessors, and vendors of railroad rolling stock; and claims for personal injury or death or property damage resulting from train accidents. A Chapter 11 proceeding would also permit Amtrak to escape from burdensome future payment obligations by terminating unexpired "executory" contracts—such as above-market real estate leases—and converting those liabilities into ordinary unsecured claims.⁵⁶

At the end of the bankruptcy process, Amtrak as a government corporation would cease to exist. Because it is highly unlikely that unsecured creditors would be paid in full, the federal government's preferred stock and the common stock of Amtrak held by private railroads and individuals would become worthless.⁵⁷ Currently, the only preferred shareholder is the federal government; four common shareholders hold proportionate interests as follows:

- American Premier Underwriters (a subsidiary of American Financial Group, 53 percent)
- Burlington Northern Santa Fe Railroad, 35 percent
- Canadian Pacific Railroad, 7 percent
- Canadian National Railroad, 5 percent

Current federal law requires redemption of all pre-reform-law common stock by October 1, 2002,⁵⁸ and thus far Amtrak and the common shareholders have been unable to agree on a redemption price for the stock.⁵⁹ Under principles of corporate law applicable to Amtrak as a District of Columbia corporation, Amtrak may not honor its redemption obligation if it is insolvent or if by paying the redemption price it would become insolvent.⁶⁰ While this statu-

tory provision prohibiting redemption may be trumped by federal law requiring redemption under Article VI of the U.S. Constitution, the so-called supremacy clause under which federal laws take precedence over conflicting state laws, the redemption of Amtrak's common stock would nonetheless give rise to creditors' remedies against Amtrak and its officers and directors for authorizing the redemption. Any payment made to common stockholders at a time when Amtrak was insolvent, or which caused it to become insolvent, would also attract scrutiny in a bankruptcy proceeding as a preference or a fraudulent transfer.⁶¹

Through the bankruptcy process, most of Amtrak's assets probably would end up in private hands, having been sold by the trustee to the highest bidder after notice, a hearing, and any required auction process.⁶² Many of its operations—for example, the Northeast Corridor routes—would probably continue under new owners. No doubt many money-losing routes would be discontinued with some assets transferred by new owners to more promising routes and other assets scrapped.

The status of labor contracts also will be an important issue to be resolved by the bankruptcy process. Let us say a private company purchases the rolling stock, the tracks, and other assets on the Northeast Corridor. The provisions of the Bankruptcy Code that govern railroad liquidations do not require purchasers of assets to assume labor contracts; instead, they merely prohibit bankruptcy courts and trustees from modifying wages or working conditions of employees that are governed by collective bargaining subject to the Railway Labor Act.⁶³ Bankruptcy courts can thus authorize the sale of railroad rolling stock and the sale or abandonment of rail lines and other property, "free and clear" of the interests of third parties that would frustrate the purposes of Chapter 11. This would facilitate the reorganization of viable businesses and provide a forum for the liquidation of those that are not viable. Thus Amtrak's onerous labor contracts, which have hindered its

ability to achieve flexibility in the workplace and profitability, would not stand in the way of a liquidation of Amtrak's assets through bankruptcy.

There would no doubt be considerable political pressure to retain workers with all of their current Amtrak benefits. The virtue of a Chapter 11 proceeding is that it is insulated from such political pressures, since a bankruptcy judge has both express statutory authority and broad equitable powers to deal with Amtrak simply in terms of its debts and its creditors. A bankruptcy case by its nature destroys, rather than preserves, the status quo, as it liquidates assets and claims (both present and future) and distributes the proceeds of the debtor's assets in accordance with prescribed statutory priorities.

The Public Loss Issue

Some members of Congress will object to liquidation by alleging that "public investment will be thrown away," considering the more than \$25 billion in federal funding Amtrak has received over the years.

Such arguments sidestep the issue of "sunk costs," generally defined as costs already incurred that cannot be recovered regardless of future events. Defining assets as "sunk costs" is *beneficial* to companies and the nation's economy. Private enterprises routinely account for costs that simply will never be recovered. They "bite the bullet," dispose of underperforming assets, identify such sunk costs to shareholders, and move on to more profitable ventures. This is the best strategy in the case of outdated or low-value Amtrak assets. Further, while Amtrak's structure has the appearance of a private company as opposed to a government agency, the taxpayers, through the federal government, are the principal owners of Amtrak. The taxpayers deserve to be free of constant losses associated with Amtrak's bad investments.

Indeed, it would be a harmful economic practice to keep using Amtrak assets in future money-losing operations simply because the decision was made in the past to

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purchase such assets. Amtrak bleeds money. In essence, the public investment is already lost. Giving more money to the railroad is truly throwing good money after bad. Three decades of handouts show that too many assets have been too unproductive for too many years.

The government's goal in liquidation should be to secure the maximum return for U.S. Treasury coffers. Amtrak's creditors certainly should seek the best possible settlement of debts and the government the best price for assets. But the government that is responsible for Amtrak's poor performance should not be expected to benefit from liquidation beyond stemming Amtrak's heavy financial losses that burden taxpayers.

Amtrak can be compared with a money-losing enterprise in the collapsing socialist countries of Eastern Europe or the Soviet Union. The most successful privatization efforts in those countries did not aim at generating maximum revenue for governments from asset sales. Rather, they aimed at placing assets in the hands of productive individuals so that the assets would stop draining government funds and actually might produce profits for the private owners and goods and services for consumers. Such enterprises might produce profits by downsizing labor forces and thereby distributing wages and workers more rationally, reorganizing the production process, or shutting down or contracting out money-losing parts of the operations. Amtrak liquidation should be thought of as a similar process but an easier one since it takes place in an industrialized, free-market country with many potential buyers.

In light of this understanding of the goals of liquidation, it is important to focus not only on the price that might be secured from the sale of some particular material asset but also on the value of the assets if they continue to be used to provide passenger rail service. Consider the potential disposition of a vital Amtrak asset—long-term leases on the high-speed Acela express trains used between Boston and Washington. It's unlikely that a

foreign bidder would seek to own the equipment because the trains' electrical systems would need reconfiguration to operate overseas. But for the sake of argument, and to acknowledge that events may occur that are unforeseen by us today, let us assume that a high bid is made by an overseas railroad. This is an example of a situation in which the high bid should be ignored in favor of a bid—even if lower—by a domestic franchise operator who intends to continue to use the trains between Boston and Washington. This is an example of maximizing future use of railroad assets as opposed to gaining every penny possible for the U.S. Treasury, which could leave future franchise operators without proper resources to provide rail passenger service and earn a profit.

Regarding fixed assets, there might be a purchaser that was willing to buy the Northeast Corridor tracks, stations, and parking garages as a package. The price paid for some given asset, for example, the Philadelphia 30th Street Station, might be less than the price of the asset sold separately. But in certain circumstances a package sale could bring in as much or more than the assets sold separately. And even if that were not the case, as long as the sale brought in a reasonable price, there would still be in place an operating passenger rail system in the Northeast, one that could generate profits for the new private owners and, incidentally, tax revenue for governments. The price for which assets are sold must be understood in this context. On the other hand, should the Northeast Corridor tracks and signal system be transferred to a new regional authority, a market still exists for private interests to purchase stations, parking garages, maintenance facilities, and surplus real estate.

Further, policymakers should concede that a good price will not be received for some assets no matter who the bidder. For example, some old locomotives may find no buyer other than a scrap dealer. But this situation is no different from private companies' losing money on products that do not sell or nonperforming divisions. Washington policymakers must

acknowledge the role sunk costs will play in the disposition of Amtrak assets.

Inventory of Assets

In every line of business the fair market value of assets is represented by the price at which an asset would change hands between a willing and able buyer and a willing and able seller, acting at arm's length in an open and unrestricted market. The extent of the market for Amtrak assets will become more fully understood when a franchise system is established and potential franchisees determine which Amtrak assets are needed for future train operations. Until then, any attempt to assign values to Amtrak assets is hypothetical.

In any event, assets do not just disappear in liquidation; market forces cause a reallocation of resources and assets to their most remunerative possible use. For example, when Pan American Airlines, at one time one of the country's premiere carriers, declared bankruptcy, its aircraft were not dumped into the ocean, its terminal gates dynamited, and its routes abandoned. Rather, other airlines, chiefly Delta, purchased most assets and hired many former Pan Am workers to fly and maintain the planes and assets it had purchased.

A byproduct of liquidating Amtrak is that by selling assets the government can get a "refund" (although of admittedly undetermined proportions) for assets purchased with federal capital subsidies, but clearly that is not the main intent of liquidating Amtrak. The following is a representative sample of Amtrak assets and transfer or disposition opportunities.

Rolling Stock

It is conceivable that private-sector interests planning to become franchise operators and others who use rail passenger equipment will place Amtrak rolling-stock assets (locomotives, passenger cars, freight cars) in three categories:

- High-value assets: Those most likely to

be used to provide future service;

- Variable-value assets: Equipment that will be put to different uses; and
- Low-value assets: Equipment appropriate to only a narrow market niche.

Table 1 illustrates possible transfer or disposition of Amtrak rolling stock.⁶⁴ For much of Amtrak's rolling stock, it is likely that creditors with liens on such assets would seek to foreclose on them outside bankruptcy after obtaining relief from the automatic stay on creditor actions that goes into effect when a bankruptcy case is filed.⁶⁵ In the case of low-value assets, Amtrak may have paid off the debt incurred to finance their purchase, in which case liquidation under the auspices of a bankruptcy court may be both necessary and desirable as the most efficient means of disposing of such assets.

Real Estate and Facilities

Rail Lines. As of September 1997, the value of one of Amtrak's largest assets, real property on the Northeast Corridor, was about \$4.3 billion.⁶⁶ However, the market value of this property is untested and may be affected by the easements commuter and freight railroads possess to provide service on the Northeast Corridor. Updating the assessed value is a relevant exercise if this infrastructure is to be offered for sale to private companies. On the other hand, valuation attempts may be an academic exercise if the line is to be transferred at no cost to a newly created regional public authority. The only other significant piece of right-of-way owned by Amtrak is a stretch of track on the Detroit-Chicago line. Everywhere else in the nation Amtrak pays fees to operate over the tracks of the private freight railroads.

Railroad Passenger Stations. Ownership of train stations and parking garages is quite varied. In the Northeast Corridor, Amtrak owns the larger stations. Many others all along the line from Massachusetts to Maryland are owned by commuter authorities or other public agencies. Elsewhere in the nation, Amtrak owns stations whose values range from significant (with Chicago Union

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Table 1
Possible Transfer or Disposition of Amtrak Rolling Stock

Rolling Stock	Possible Purchaser	Comments
High-value assets		
Acela express train Electric locomotives Metroliner cars (version of Amfleet)	Franchise operators	High potential utility in the Northeast, the most substantial single rail, travel market in the U.S. Franchisees will need the equipment. Inconceivable that it would be sold for foreign operations or scrapped.
Variable-value assets		
Diesel locomotives (main line & switching)	Franchise operators States Commuter railroads Local commuter rail authorities Major freight railroads	Values will vary depending on age, condition, and potential use. Placing some locomotives on commuter rail lines may save Federal Transit Administration funds from being used to buy new units, a benefit to federal, state, and local taxpayers.
Single-level Passenger cars (Amfleet, Horizon, Heritage)	Franchise operators for short-distance corridor services States Commuter railroads Local commuter rail authorities	Values will vary depending on age, condition, and potential use. Placing some cars on commuter lines may save Federal Transit Administration funds from being used to purchase new cars, a benefit to federal, state, and local taxpayers.
Freight and Express cars, RoadRailers (truck trailers able to roll over railroads)	Freight railroads Trucking companies Parcel carriers Freight forwarders Re-creation of Railway Express Agency	Unpredictable category. Some railroads may want to use the RoadRailers. If railroads or freight forwarders re-create a Railway Express Agency-type of service to carry freight now moved by Amtrak, the entire fleet of more than 1,100 boxcars and trailers may be required.
Low-value assets		
Double-decker Superliner coaches, dining cars, sleeping cars	Franchise operators Tour-train operators Excursion companies ^a	This is equipment Amtrak should never have purchased in the first place. Even with lavish subsidies, Amtrak's long-distance market is infinitesimal. A portion of the fleet could see use in specialized "land-cruise" operations, aimed at tourists, some may be used on medium-distance intercity routes, and some may be scrapped.

^aCommuter rail interest in coaches will be limited because of the configuration of the cars.

Station a notable holding) to nil (a shelter and platform in some small towns). Asset disposition is not an issue with many stations used by Amtrak because the structures are owned by others such as regional commuter rail agencies (for example, Los Angeles Union Passenger Terminal) and local communities (for example, Irvine, California). In many places the freight railroads continue to own passenger stations in which Amtrak's interest is that of a tenant.

Freight Terminals. Highly uncertain is the fate of Amtrak freight terminals, which in many cases are located in or adjacent to existing railroad freight yards. A listing of the terminals includes but is not limited to Chicago, Oakland, Louisville, Detroit, Jeffersonville, Indiana, Kansas City, Dallas, and Harrisburg, Pennsylvania.⁶⁷

Maintenance Bases. Amtrak owns maintenance facilities in Boston, New York City, Washington, D.C., and Wilmington and Bear, Delaware, whose futures will be brighter if they are run by an innovative franchise operator. Amtrak's heavy overhaul base at Beech Grove, Indiana, has potential as a privatized operation, particularly as Amtrak has assigned to the facility contact work on transit cars used in city subway systems. Other maintenance facilities serve routes with a high likelihood of continued operation under a franchise system and include Chicago, Hialeah, Florida, Los Angeles, New Orleans, Niagara Falls, Oakland, Rensselaer, New York, Seattle, and Washington, D.C.⁶⁸

Commuter Operating Contracts

It should be noted that Amtrak is peripheral to the operations of the three largest commuter rail systems in the United States—the Long Island Rail Road in New York, which carried 85.3 million people in 2000;⁶⁹ Metro-North Railroad, also serving New York, which carried 71.8 million passengers last year;⁷⁰ and Chicago's Metra Commuter System, which served 82 million passengers.⁷¹ Some commuter lines that are dependent on Amtrak already have sought greater control over their own operations. An exam-

ple is the New York Metropolitan Transportation Authority, which on behalf of the Long Island Rail Road has attempted to gain control of two of the tunnels that lead into Manhattan's Penn Station.⁷²

On some commuter rail systems elsewhere, Amtrak provides various degrees of train dispatching, ticket collection, and maintenance services. It is virtually certain that the private sector will be interested in bidding on those contracts, and private companies now operate parts of commuter train operations in Chicago, Los Angeles, San Diego, San Jose, and Dallas.

Amtrak commuter contracts (operations and/or maintenance) are⁷³

- Maryland Rail Commuter Service (Maryland and District of Columbia)
- Massachusetts Bay Transportation Authority (Massachusetts, Rhode Island)
- Metrolink (Los Angeles)
- The Coaster (San Diego)
- CalTrain (San Francisco–San Jose)
- Virginia Railway Express (Virginia and District of Columbia)
- Shoreline East (Connecticut)
- Sound Transit (Seattle)⁷⁴

Potential Purchasers and Franchise Operators

There has been significant private-sector interest in the potential for rail franchising in the United States. Domestic companies examining such options include Peter Pan Bus Lines and Railway Service Corporation, and overseas interest is being expressed by British train operators Great Western Trains, Stagecoach, Virgin Management Group, and GB Rail. The possible candidates for assuming the contracts for commuter rail operations include Herzog Transit Services of Missouri, which already holds commuter train contracts in Florida, Texas, and California, and Connex, which is examining state-contracted regional trains as well as commuter trains.⁷⁵

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Amtrak assets and operating authority should be sold or transferred to private innovative organizations committed to providing rail passenger service.

American freight railroads play a major role in commuter rail service in Chicago and to a lesser extent in California, Washington, Texas, Florida, Virginia, and Maryland. The degree to which the industry's role may expand as a result of an Amtrak liquidation remains to be seen. It should be noted, however, that Guilford Rail System of Massachusetts recently expressed interest in running the Northeast Corridor.⁷⁶ Also, the trade publication *Railway Age* indicated that the industry's focus this year is on Amtrak. The magazine, in mentioning the Burlington Northern Santa Fe, CSX, Union Pacific, and Norfolk Southern railroads, opined: "Maybe it's time for them to, under the right circumstances, take back the passenger trains. What would they require?" At least one railroad chairman, Canadian National's executive vice president E. Hunter Harrison, "thinks the idea has merit."⁷⁷

Conclusion

Amtrak's three-decade record of losses and poor performance makes clear that no government reorganization or short-term fix will make it into a profitable and efficient operation. Perpetuation of Amtrak will endanger the future of rail passenger service in America. The best hope for passenger rail is to align service with contemporary and future American market demands at an affordable cost to the public. To reach those objectives, Amtrak assets and operating authority should be sold or transferred to private innovative organizations committed to providing rail passenger service. It is in the public interest to use existing bankruptcy laws to liquidate the failed government enterprise known as Amtrak.

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24. Amtrak Reform and Accountability Act of 1997 (P.L. 105-134), Title II, Fiscal Accountability, sec. 204(c)(2).

25. John Fund, “Railing against Reform,” *Wall Street Journal, Online Opinion Journal*, January 3, 2002, <http://interactive.wsj.com>.

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27. U.S. General Accounting Office, “Issues Associated with a Possible Amtrak Liquidation,” p. 2.

28. Robert P. Murphy, general counsel, U.S. General Accounting Office, Letter to Rep. Bud Shuster, chairman, House Committee on Transportation and Infrastructure, October 20, 1997, p. 6.

29. 11 U.S.C. § 1101 et seq.

30. Bankruptcy Reform Act of 1978, as amended, codified at 11 U.S.C. § 101 et seq. Cited hereinafter as Bankruptcy Code.

31. The haste with which new track was laid and railroad lines expanded during this period was

characteristic of similar increases in capital investment that have followed other technological advances both prior and subsequent to the 19th-century rail boom. Promoters of rail expansion “continually stressed the need to act quickly in order to outstrip various dangers they feared could overtake the nation. . . . If there was one theme that pervaded all the literature, it was that the nation had to change—and quickly. To stand still, promoters claimed, would be fatal.” J. A. Ward, *Railroads and the Character of America, 1820–1887* (Knoxville: University of Tennessee Press, 1986), p. 7.

32. Douglas G. Baird, “The Hidden Virtues of Chapter 11: An Overview of the Law and Economics of Financially Distressed Firms,” Chicago Working Paper in Law and Economics, March 1997, pp. 20–21. T. G. McCulloh, president of the Cumberland Valley Railroad, lamented the fact that the urgent drive to expand rail service during this period had caused his company’s line to be built in a substandard fashion. Pennsylvania, House, “Annual Report of the Cumberland Valley Rail Road Company to the Legislature,” *Journal 2* (1838–39): 153, cited in Baird, p. 22.

33. S. Daggett, *Railroad Reorganization* (Chevy Chase, Md.: Beard Books, 1999), p. v.

34. Among the railroads that were reorganized in this fashion were the Richmond & West Point Terminal, the Reading, the Erie, the Northern Pacific, the Atchison, the Baltimore & Ohio, the Norfolk & Western, the Louisville, New Albany & Chicago, the Ann Arbor, the Seattle, Lake Shore & Eastern, the Pecos Valley and many smaller lines. *Ibid.*

35. According to the GAO, only 5 of Amtrak’s 40 routes account for half of its revenues. Fund.

36. U.S. General Accounting Office, “Issues Associated with a Possible Amtrak Liquidation,” p. 14.

37. Baird, p. 21. See also *Fosdick v. Schall*, 99 U.S. 235 (1878).

38. Typical modifications to 19th-century railroad bonds included a reduction in the rate of interest payable, a reduction in principal or deferral of principal payments, and conversion of interest obligations from an absolute right of bondholders to one contingent upon the railroad’s ability to generate revenues at an agreed-upon level. Creditors also agreed to a reduction in the priority of their claims from debt to preferred stock. Baird, p. 25.

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40. U.S. General Accounting Office, "Issues Associated with a Possible Amtrak Liquidation," p. 12.

41. Bankruptcy Code, § 1171(b). The priority is narrowly drawn, however, and depends on the existence of a current debt fund from which a creditor expected to be paid. It is unclear whether Amtrak has in fact created such a fund.

42. Phyllis F. Scheinberg, "Intercity Passenger Rail: Amtrak's Financial Crisis Threatens Continued Viability," Statement before the U.S. Senate Committee on Finance, April 23, 1997, Appendix V, Amtrak's Working Capital Surplus/Deficient, Fiscal Years 1987-96.

43. See *In re Albany Partners, Ltd.*, 749 F.2d 670 (11th Cir. 1984).

44. In the case of debtors with 12 or more creditors, an involuntary bankruptcy petition may be commenced by 3 creditors holding claims that in the aggregate exceed the value of any collateral securing the same by at least \$10,775. In the case of debtors with fewer than 12 creditors, a single creditor holding a claim that exceeds any security therefor by at least such amount may file such a petition. 11 U.S.C. § 303(b).

45. Bankruptcy Code, § 109(b)(1).

46. 11 U.S.C. §§ 1161-74.

47. Bankruptcy Code, § 303(h).

48. *Ibid.*, § 362.

49. *Ibid.*, § 362(b)(4).

50. Title 49 U.S.C., Subtitle IV.

51. Bankruptcy Code, § 362(d)(2).

52. *Ibid.*, § 547(f).

53. Such as, in the case of an individual, a transfer of substantial assets by a husband to his wife for no or little payment. See *In re Palavis*, 233 B.R. 1 (Bk. D. Mass. 1999).

54. Bankruptcy Code, § 548.

55. Pursuant to Bankruptcy Code, § 544(b), a trustee in bankruptcy or a debtor in a Chapter 11 case may also use state fraudulent conveyance statutes to recover transfers made more than a year prior to the filing of a bankruptcy petition if a state limitations period is longer.

56. Bankruptcy Code, § 365.

57. *Ibid.*, § 1129(b)(2)(B)(ii), the so-called "absolute priority" rule.

58. Pub. L. 105-134, §415(b) and (c), which appear in a footnote to 49 U.S.C. § 24304.

59. See House Committee on Transportation and Infrastructure, "Hearing on Current Status and Future Prospects of Amtrak and High Speed Rail," Memorandum, July 25, 2001, p. 3; and "Lindner Scoffs at Amtrak Offer," *Cincinnati Enquirer*, December 17, 2000.

60. District of Columbia Code, § 29-101.05.

61. Bankruptcy Code, §§ 547, 548.

62. *Ibid.*, § 363(f).

63. *Ibid.*, § 1167.

64. A similar table will not be provided for real estate or other assets because they are more complex in nature and cannot be fairly covered in a report of this scope.

65. Bankruptcy Code, § 362. Sec. 1168 of the Bankruptcy Code provides special rules for parties with an interest in railroad rolling stock. Under that section, a trustee in a railroad case must, within 60 days after the filing of a Chapter 11 petition, affirmatively agree to perform the railroad's obligations under leases or conditional sale agreements covering railroad rolling stock and make payments to cure any defaults. If it fails to do so, creditors who hold such interests may repossess and sell their collateral without obtaining court permission to do so.

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