

Valuing Rights-of-Way: Lessons from "The Rail Case"

by William R. Perlik
David R. Johnson

The Special Court was required to value a staggering amount of property...over 16,000 miles of rights-of-way and \$15 billion in claimed compensation "taken" by the government.

Mssrs. Perlik and Johnson are members of the Washington, D.C. law firm of Wilmer, Cutler & Pickering, which represents the United States Railway Association in connection with litigation pursuant to the Regional Rail Reorganization Act of 1973.

In the early 1970's, in response to the bankruptcy and near collapse of many large railroads in the Northeast, Congress pass the Regional Rail Reorganization Act of 1973.¹ The "Rail Act" created Conrail and required the bankrupt railroads to transfer their properties, including rights-of-way, to this new entity. The Rail Act also set up a Special Court and charged it with the mission of awarding constitutionally adequate compensation to the owners of the transferred properties. That valuation exercise—known as "The Rail Case" to those who have participated in it—is now drawing to a close.² The Special Court's opinions have significance for many different types of cases involving the acquisition, use or valuation of property, particularly rights-of-way, especially by bodies with the power of eminent domain.³

The Special Court was required to value a staggering amount of property. The Penn Central, Erie Lackawanna, Reading, Lehigh Valley, Central of New Jersey, Ann Arbor and other railroads together transferred over 16,000 miles of rights-of-way and claimed over \$15 billion in compensation for the properties "taken" by the government.⁴ The size of the case allowed (and, indeed, required) the parties to engage in a thorough exploration of basic valuation issues. The Special Court, a distinguished panel of judges

(Henry J. Friendly, John Minor Wisdom, and Roszel C. Thomsen), received thousands of pages of briefs and has now issued hundreds of pages of major opinions. That exhaustive inquiry produced a most detailed articulation of theories particularly relevant to the valuation of rights-of-way.

I. Selection of a Measure of Value

In every condemnation case, the Court must select the measure of value that will provide "just compensation" within the meaning of the Fifth Amendment. The Special Court wrote extensively on this issue.

A. Endorsement of Value to the Owner. Perhaps the most important aspect of the Rail Case opinions is the Court's affirmation, in the face of broad and highly creative attacks, of the principle that "value to the owner"—not "value to the taker"—should determine the basic measure of just compensation.⁵ Various claimants contended that, as a matter of constitutional law, compensation had to take into account the costs that the government would have faced had it been required to construct from scratch the rail system it created intact in Conrail by use of the eminent domain and commerce powers. The Special Court soundly rejected claims for "reconstruction costs" on the

ground that this would be a form of "value to the taker." It held that the relevant measure of compensation was the value *realizable by the condemnee in the absence of the taking*—a concept it came to analyze in terms of an "alternative scenario" (i.e., a hypothetical "world" in the absence of the Rail Act, in which various sets of sales for rail and nonrail use might have occurred). The Court also recognized that justice might require the award of a value determined on some other basis (specifically, Original Cost New Less Depreciation and Deterioration) if the claimants could not show that the alternative scenario value to which they were entitled totaled to an amount the Court believed was substantial enough to be fair.⁶ But, subject to this potential exception, the entire case proceeded on the basis that the condemnee must show what value he would have been able to realize from his property if it had not been taken for public use.

B. Rejection of "Reified" Value. The "alternative scenario" measure of value implies an important corollary: compensation may not be established with reference to any "values" not capable of being obtained in the marketplace (the Court called these "reified" values). Thus, although various claimants contended that their properties had "social value," "value in use," "book

value," and a large number of other "values," the Court channeled the proof narrowly towards the question who would have paid how much for particular properties, had it not been for the federal taking.⁷

C. Rejection of Assemblage Value. The Special Court's opinions articulate a fundamental valuation rule of special importance in condemning an existing right-of-way: the mere fact that a right-of-way has been assembled is not significant unless there is a nonspeculative likelihood of sales in the private marketplace for amounts higher than those that could be realized by disassembling the right-of-way and selling it as separate parcels.⁸ Moreover, although the ability of the condemnee to use his right-of-way to generate earnings value must be taken into account, it is not appropriate to award earnings value for one portion of the properties and liquidation values for another portion where these could not be realized simultaneously by any private owner.⁹ The "assemblage" of rights-of-way may thus be a disadvantage where there is no private buyer willing to pay a premium for the opportunity to use the corridor, since values realizable by the owner of the right-of-way must in that case be reduced by the costs and delays that would have been encountered in "disassembling" the right-of-way and converting it to a non-corridor use.

D. Relevance of Alternative Sales to Public Bodies. Determining compensation with reference to the condemnee's alternative had a somewhat surprising wrinkle in the Rail Case: some railroads claimed that, in the absence of the taking by the federal government, their properties would have been condemned (or purchased through negotiations) by state and local public bodies. This claim gave rise to a set of factual issues concerning the likelihood that, absent federal intervention to solve the rail crisis of the 1970's, the states would have intervened. The claimants asserted they could have obtained amounts from state and local public bodies greater than those that they could otherwise have re-

alized in the private marketplace. The Court heard but ultimately did not need to reach various legal arguments to the effect that the federal government need not pay compensation for preventing the realization of values only attainable through state governmental purchases at prices greater than those provided by federal condemnation law. On the facts, the Court found that state and local public bodies could not have been "held up" and would themselves have paid prices determined entirely with reference to the amounts realizable in the private marketplace alternative facing the transferors.¹⁰ The Court's analysis raises the caution that, on different facts, the valuation award could be affected by a demonstrated likelihood of another governmental purchase (or, perhaps, purchase by the same government for a different purpose) in the absence of the "taking" for which compensation is being determined.

II. Determination of Value to the Owner

Having concluded that each railroad was entitled only to the value it could have realized if Congress had not responded to the rail crisis, the Special Court then had to evaluate evidence regarding hypothetical dispositions of properties in this "alternative scenario." The Court's implementation of the "alternative scenario" concept holds many lessons for future valuation cases.

A. Selection of a Starting Date. Since the relevant valuation question is the amount the condemnee would have realized in the absence of the condemnor's project, a valuation court must explicitly or implicitly establish a "starting date" after which the imminence of the project began to affect the owner's opportunities and thus, after which, for valuation purposes, all real-world effects of the project are to be factored out.¹¹ The Special Court picked a "starting date" of February 1973--when new federal legislation first became a serious possibility (long before the April 1,

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1976 conveyances under that new legislation). Thus, even though all values were to be determined "as of" April 1, 1976, the parties were free—and to some extent were required—to postulate that events in the "alternative scenario" would have differed from those that occurred in the real world, beginning on the earlier "starting date." The Court's handling of this issue may provide useful guidance to property owners likely to become the subjects of a condemnation: it may be wise to make a clear record that pendency of a project has effectively foreclosed valuable alternatives, even before the project is finally authorized, because the ultimate valuation of property may well reflect alternatives foreclosed at an earlier date.

B. Taking Account of Preexisting Legal Constraints. The Court's opinions make clear that realizable value is to be calculated with reference to preexisting legal barriers facing the condemnee.¹² In the Rail Case, the parties argued at length regarding the extent to which permission was required from the Interstate Commerce Commission before abandonment of a losing railroad right-of-way. The Court

assessed the time required to obtain such permission, including the time to comply with applicable environmental protection laws, and took this time into account in measuring realizable values. Similarly, the Court weighed arguments as to the likelihood that preexisting legal obligations would require payment of labor protection in connection with the abandonment of a portion of a railroad right-of-way. The Court also concluded that the antitrust laws might come into play, albeit in a somewhat relaxed fashion given the extent and severity of the crisis that a sudden collapse of the northeast rail system would have caused. Thus, in order to take into account the legal constraints on the condemnees' ability to realize values from their properties, the Court was called upon to resolve a wide range of hypothetical and interdependent legal questions.

C. Taking Account of Bargaining. Since value was to be determined by reference to sales that would have occurred but for the taking, the Court was faced with the need to determine prices that would have prevailed in sales for rail use. This necessarily raised questions

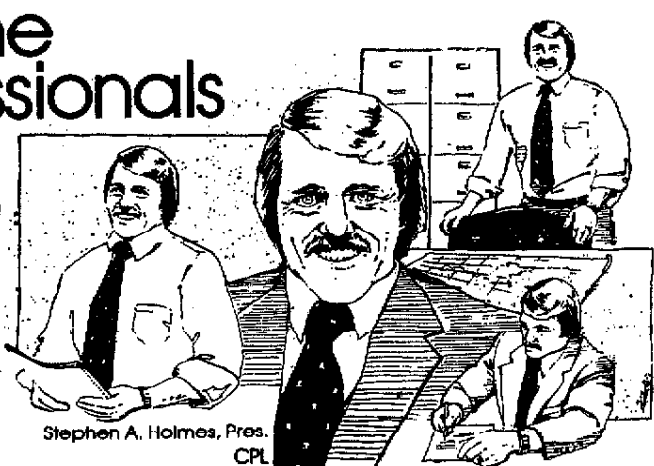
concerning the relative bargaining strength of potentially interested parties: bankrupt railroads facing the alternative of scrapping their lines, potential private purchasers facing a need to bid against each other for some lines, state governments that might be the only potential purchasers for continued rail use of many other lines, labor unions able to shut down operations but facing a loss of jobs, and so forth. The Court considered general theories of bargaining and analyzed the likely bargaining strength of various parties.¹³ Its opinion will be a vital starting place for future valuation cases involving potential sales in markets where prices would be importantly influenced by bargaining strength.

D. Rejection of "Cherry-picking." The Special Court was confronted with a host of questions posed by the claimants' efforts to value selected portions of their properties without regard to the context in which all of their lines would be liquidated — a set of issues labeled "cherry-picking." For example, the railroads sought earnings values for western lines carrying traffic originated on eastern lines, but did not wish to take account of losses incurred on that same traffic as it traveled over the eastern portions of their systems. The Court in general resisted the transferors' efforts to ignore the interdependence of their properties.¹⁴ Since the value of operations on any part of an assembled right-of-way are uniquely interdependent with other parts of the right-of-way, and with other properties, these questions are likely to play a prominent role in future cases concerning the valuation of existing corridors.

E. Arguments Regarding "Negative Values." The claimants urged the Court to disregard the "negative values" that would have been created by the dismantlement of railroad bridges in the event that such dismantlement would have been required by law but that salvage proceeds fell short of the costs of dismantling.¹⁵ The claimants argued that such "negative values" should

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be ignored because the transferor could have abandoned such bridges and because it was somehow unfair to value any specific, large tangible asset at a negative figure. Although the Special Court did not have to resolve this particular problem,¹⁶ the parties' arguments on this issue will likely prove instructive in future right-of-way valuation cases - particularly where bridges are involved.

F. Taking Account of Multiple Alternatives. The Special Court had to confront a particularly difficult set of questions concerning how to analyze the many different alternative opportunities allegedly available to the claimants. Since so many condemnees were involved, the Court was quite naturally faced with numerous inconsistent contentions concerning the events that would have occurred in the absence of the taking.¹⁷ Even for one particular railroad, more than one set of sales might have been more or less likely, depending on how the Court resolved a host of interrelated factual questions. The Court needed to develop a method of analysis designed to resolve conflicts among the bankrupts and/or to take appropriate account of the likelihood and value of various possible alternative outcomes. Should the Court develop a weighted average value of all reasonably probable outcomes? Should it insist on consistency and reject entirely all but one set of allegations? The alternatives presented by various parties for dealing with these difficulties provide a rich array of potential litigation strategies available for use in similar complex valuation cases involving many condemnees or multiple possible alternatives. (Settlement of the largest group of claims before the Court finally had to "sort out" the problem of inconsistent contentions reduced the importance of the problem to the Rail Case itself.)

III. Statutory vs. Constitutional Measure of Value

The Special Court faced a series of

questions relating to the potential difference between the measure of value provided by the Rail Act ("Net Liquidation Value" plus "Compensable Unconstitutional Erosion" minus the "Value of Other Benefits") and the constitutional measure of value assured by the Fifth Amendment.¹⁸ Although the Court was able to read the statute and the Constitution as providing for the same basic measure of value, its need to undergo that analysis is highly instructive: Congress need not limit itself to providing the "constitutional minimum value" as compensation for a federal taking. Correspondingly, however, Congress may reduce the risk of a judicial finding that it has intended to be more generous than the Constitution requires, by specifying that the standard of value it intends to have applied is "constitutional minimum value."¹⁹

IV. Implications for Future Cases

The Special Court's opinions have implications for a number of different types of right-of-way valuation cases likely to arise in the

future. For example, as various railroad rights-of-way are abandoned around the country, electrical and other utilities that have relied upon contractual arrangements to cross over or to follow along these rights-of-way as routes for their lines and pipes may need to renegotiate these existing contracts-or to pursue their condemnation options-in order to preserve their corridors. Similarly, legislation is presently pending in Congress that would give coal pipeline companies the right to use federal eminent domain power to assemble their rights-of-way, and they may well do this by condemning easements along and/or across existing rights-of-way.²⁰ Wherever the public interest requires the creation or use of a corridor, the lessons of the Rail Act will come most directly into play.

While the implications of the Rail Case cannot be fully anticipated without reference to the specific facts of each future case, some generalizations can be made concerning the key lessons of the Rail Case for future right-of-way valuations. First, claims to "assemblage value"

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that do not rest on a proven ability to realize such values in the private marketplace will likely confront very substantial difficulties. Second, condemnor and condemnee alike should analyze valuation questions with reference to the possibility that another level of government might have acted in the absence of the taking and might have paid a price different from that available in the private marketplace.²¹ Third, since the Rail Case will help support a finding that the public could not have been "held up" (and since applicable legal rules may well prohibit payments to private owners to compensate for a lost opportunity to take advantage of public necessity), the grant of condemnation power to right-of-way acquirers will continue to prove useful in allowing public purposes to be fulfilled at minimum cost. Fourth, planning for a valuation case should include a careful assessment of the date on which the prospect of the condemnation began to effect the values realizable on the marketplace, the nature of likely bargaining between various poten-

tial purchasers and the condemnee in the absence of the taking, and the existence of various legal barriers to the conversion of the property to a more valuable use. Fifth, potential condemnees should pay attention to the valuation standard provided by legislation authorizing a taking of which they may become the target: Congress is free to provide a standard of valuation more generous than might be constitutionally required (and it is able, on the other hand, to make clear that it does not intend to make the condemnee any better off than he can prove he otherwise would have been).

The Rail Act may provide important lessons even in instances in which condemnation is not available or has long been forgotten as an option for parties engaged in the sale or lease of rights-of-way (or crossings or longitudinal occupancies thereof). For example, many utility companies now make payments for the use of railroad right-of-way under formulas that reflect appraised real estate values and other factors such as the power on their

lines, number of wires and so forth. Principles reaffirmed in the Rail Case might be used to argue that payments under existing formulas are often too high and that payments for such use by the utility should reflect only damage suffered by the railroad in its own current rail use of the real estate (unless some showing has been made concerning the likely abandonment and disposition of the property for nonrail use). Similarly, at least with respect to utility companies that could in principle use the condemnation power to obtain needed occupancies, the value to the utility (and, derivatively to the public that uses the utility's services) could be argued to be irrelevant to the amount the utility should pay for use of the railroad's right-of-way. In many instances, existing utilities might be able to save very substantial sums by invoking these principles; and it may not even be necessary actually to condemn needed occupancies in order to bring the weight of these arguments to bear on negotiations regarding the renewal of current agreements.

In sum, the very large amount at stake in the Rail Case made possible an unusually detailed exploration of basic valuation principles that are presented in many right-of-way valuation cases. The Rail Case thus provides a rich array of alternative litigation (and negotiation) strategies, and important precedential guidance, for future cases involving the valuation of rights-of-way.

Footnotes

1. 45 U.S.C. § 701 *et seq.* (the "Rail Act"). This Act was amended in significant respects by the Railroad Revitalization and Regulatory Reform Act of 1976.
2. The Special Court has issued three major opinions and settlements have been reached between the "Government Parties" and the following major "transferor" railroads: Penn Central, Erie Lackawanna, Reading, Lehigh Valley, Ann Arbor, and Lehigh and Hudson River. Litigation continues with respect to the claims of the Central of New Jersey and a few smaller transferors.
3. The three major opinions issued by the Court are reported at 439 F. Supp. 1351 (Sp. Ct. 1977) ("CUE Opinion"); 445 F. Supp. 994 (Sp. Ct. 1977) ("CMV Opinion"); Opinion with Respect to Valuation for Rail Use, _____ F.

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Supp. _____, Sp. Ct. Rptr. N-38196 (Nov. 24, 1981) ("Rail Use Opinion").

4. Penn Central's claim was by far the largest since it owned approximately 80 percent of the property transferred pursuant to the Rail Act. In January 1981, Penn Central and the Government Parties consummated a settlement with respect to these properties based on an April 1, 1976 value of approximately \$1.46 billion. (Interest brought the total payment to approximately \$2.1 billion.)

5. CMV Opinion at 1011-16.

6. CMV Opinion at 1030.

7. CMV Opinion at 1036-37. The diversity of the railroads' claims showed vividly that, as Justice Brandeis once aptly remarked, "value" is a word of many meanings." Missouri ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n, 262 U.S. 276, 310 (1923) (dissenting). Given the complexity of the Rail Case, the Special Court saw a need to specify the relevant valuation standard at the outset and rejected any notion that the condemnees were free to introduce evidence on any theories of value they might choose to contend were relevant.

8. See, e.g., Rail Use Opinion at 220.

9. CMV Opinion at 1028, n.45; Rail Use Opinion at 219-20.

10. The Court did reject the railroads' contention that public bodies would fear having to pay more than realizable nonrail use values in light of the decisions that had been reached in PATH (in re Port Authority Trans-Hudson Corp.), 20 N.Y.2d 457, 285 N.Y.S.2d

24, 231 N.E.2d 734 (1967), cert. denied, 390 U.S. 1002, 88 S. Ct. 1244, 20 L.Ed.2d 103(1968)) and Fifth Avenue Coach (In re Fifth Avenue Coach Lines, Inc.), 18 N.Y.2d 212, 273 N.Y.S.2d 52, 219 N.E.2d 410 (1966), appeal dismissed, 386 U.S. 778, 87 S. Ct. 1480, 18 L.Ed.2d 524 (1967).) While phrased as a finding of fact regarding the likely state of mind of public officials in the absence of the Rail Act, this could equally be interpreted as a legal ruling concerning the continuing vitality of those two decisions.

11. See, e.g., CUE Opinion at 1373. This requirement can cut in favor of either side, depending on the facts. For example, if it can be shown that the anticipation of the taking caused private marketplace interest in a certain property to evaporate, the owner is entitled to values that could have been realized in the absence of such a "chilling effect." By the same token, if the initiation of a public project enhances value, the owner is not entitled to the increase in value attributable to the project.

12. CMV Opinion at 1009. The Court rejected various arguments that preexisting legal constraints were themselves unconstitutional. CMV Opinion at 1022, n. 35. Of course, no valid "alternative scenario" could incorporate unconstitutional legal constraints.

13. Rail Use Opinion at 39-45, 232-37.

14. See, e.g., Rail Use Opinion at 231-33.

15. See CMV Opinion at 1029, n. 47.

16. Most parties, including those who have not settled, ultimately stipulated that

salvage proceeds from bridges should be deemed to offset related dismantlement costs.

17. The Court faced the threshold question whether and how to try to take account of the fate of all condemnees' properties in the absence of the Rail Act when valuing each railroad's lines. In general, the Court resolved this by requiring each railroad to present its case in one unified proceeding and by analyzing the arguments of the parties regarding the extent to which these claims were consistent with one another. See CMV Opinion at 1009.

18. CMV Opinion at 1004-16.

19. Of course, the courts rather than the legislature have the final say on what the constitutional minimum standard of value is. However, legislative language can readily be fashioned, as it was in the Rail Act, that does not produce a conflict between the judicial and legislative branches. The Rail Case provides substantial support for the argument that that minimum level is fully satisfied if compensation leaves the condemnee no worse (albeit no better) off than he would have been but for the condemnation.

20. See, e.g., H.R. 4230, 97th Cong., 2d Sess. (1982).

21. Potential condemnors may wish to act jointly, since it is clear that the condemnor will not itself be considered an alternative purchaser in any valuation hypothetical, whereas potential purchases by other public bodies may be considered.

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