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## The Penn Central Reorganization: A New Look at Section 10 of the Clayton Act

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## THE PENN CENTRAL REORGANIZATION: A NEW LOOK AT SECTION 10 OF THE CLAYTON ACT

The Clayton Act<sup>1</sup> supplements the Sherman Act<sup>2</sup> by proscribing specified trade practices<sup>3</sup> that encourage the growth of monopolies.<sup>4</sup> Section 10 of the Clayton Act<sup>5</sup> prohibits dealings in securities, supplies, or other articles of commerce between a common carrier and a corporation with which it shares directors,<sup>6</sup> unless the dealing was conducted pursuant to competitive bidding. This section has received

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1. Ch. 368, 38 Stat. 730 (1914) (codified in scattered sections of 15, 18, 29 U.S.C.).

2. 15 U.S.C. §§ 1-7 (1970).

3. The Act declares illegal four specific types of restrictive or monopolistic practices, including price discrimination, § 2, 15 U.S.C. § 13 (1970), exclusive dealing and tying contracts, § 3, 15 U.S.C. § 14 (1970), acquisitions of competing companies, § 7, 15 U.S.C. § 18 (1970), and interlocking directorates, §§ 8, 10, 15 U.S.C. §§ 19, 20 (1970).

4. The preamble to the original Clayton bill explained that its purpose was "to prohibit certain trade practices which . . . singly and in themselves are not covered by the [Sherman Act] . . . and thus to arrest the creation of trusts, conspiracies and monopolies in their incipency and before consummation." S. REP. NO. 698, 63d Cong., 2d Sess. 1 (1914).

5. 15 U.S.C. § 20 (1970). That section provides:

No common carrier engaged in commerce shall have any dealings in securities, supplies, or other articles of commerce . . . to the amount of more than \$50,000, in the aggregate, in any one year, with another corporation . . . when the said common carrier shall have upon its board of directors . . . any person who is at the same time a director, manager, or purchasing or selling officer of, or who has any substantial interest in, such other corporation . . . unless and except . . . such dealings shall be . . . ascertained by competitive bidding under regulations to be prescribed . . . by the Interstate Commerce Commission.

Further, the ICC is empowered to refer any matter to the Attorney General if it believes a violation has occurred. Section 10 also prescribes a fine to be levied against the carrier and criminal penalties against the directors of the carrier in the event of violation; it is the only section of the Clayton Act authorizing criminal sanctions directed against a specific anticompetitive practice.

6. Interlocking directorates can be between either competitors in the same industry (horizontal) or entities in different industries that have a commercial relationship (vertical). Section 10 generally has been read to apply to vertical interlocks, *see Note, Interlocking Directorates: A Study in Desultory Regulation*, 29 IND. L.J. 429 (1954), but in *Klinger v. Baltimore & O.R.R.*, 432 F.2d 506, 511 (2d Cir. 1970), it was applied to a horizontal interlock. Cf. 1 R. CALLMAN, *UNFAIR COMPETITION, TRADEMARKS AND MONOPOLIES* § 15.3(d) (4)d., at 416 (1967, Supp. 1975).

scant attention from commentators<sup>7</sup> or courts<sup>8</sup> in the 62 years since its enactment. Consequently, litigation connected with the bankruptcy of the Penn Central Railroad raises questions concerning Section 10 that never have been resolved.

In the reorganization proceedings subsequent to bankruptcy,<sup>9</sup> Penn Central Company stock holders<sup>10</sup> and court-appointed representatives of certain secured creditors<sup>11</sup> filed petitions attacking the validity<sup>12</sup> of a \$300,000,000 credit agreement between Penn Central and First National City Bank, which acted for itself and as agent for forty-seven "lender" banks and five "participant" banks. Each of the participant banks shared common directors with Penn Central. Additionally, late

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7. See, e.g., J. VAN CISE, UNDERSTANDING THE ANTITRUST LAWS 52-53 (1973 ed.) ("The common-carrier requirements in section 10, although containing criminal sanctions, are of so little interest . . . that they will be passed over.")

8. The Supreme Court has decided only three cases involving alleged violations of section 10, and in none of these did the Court engage in a substantive analysis of the statute. See *Bangor Punta Ops., Inc. v. Bangor & A.R.R.*, 417 U.S. 703 (1974); *United States v. Boston & Me. R.R.*, 380 U.S. 157 (1965); *Minneapolis & St. L. Ry. v. United States*, 361 U.S. 173 (1959).

9. On June 21, 1970 the Penn Central Transportation Company filed a petition for voluntary bankruptcy under section 77 of the Bankruptcy Act, 11 U.S.C. § 205 (1970), which permits reorganization of railroads under the supervision of court-appointed trustees. Unlike ordinary bankruptcies, section 77 does not provide for liquidation; rather, during the period of trusteeship virtually all debts and obligations of the railroad are held in abeyance. See J. DAUGHEN & P. BINZEN, *THE WRECK OF THE PENN CENTRAL* 305-07 (1971) [hereinafter cited as DAUGHEN & BINZEN].

10. This group (known as the Robinson petitioners) consists of six former stockholders of the Pennsylvania Railroad or the New York Central Railroad who acquired stock in the parent Penn Central Company formed as a result of the 1969 merger of those lines. That they are not direct creditors of the bankrupt railroad raises some question as to their standing in the reorganization proceeding. See Memorandum of First National City Bank in Opposition to Robinson and Special Representatives Petitions at 46-50, *In re Penn Cent. Transp. Co.*, No. 70-347 (E.D. Pa., filed Oct. 19, 1972) [hereinafter cited as Memo of FNCB].

11. This group of petitioners (known as the Special Representatives) represents creditors whose claims were secured by specific railroad assets. Most of these assets have so declined in value as to be practically worthless, and to this extent these holders are in the position of general unsecured creditors. See Pre-Hearing Memorandum in Support of Special Representatives' Petition at 2-3, *In re Penn Cent. Transp. Co.*, No. 70-347 (E.D. Pa., filed Oct. 5, 1972) [hereinafter cited as Memo of Special Representatives].

12. While the main thrust of petitioners' attack is based upon an alleged violation of section 10, the Robinson petitioners, see note 10 *supra*, also allege fraud and misrepresentation by the banks in their dealings with Penn Central and with the ICC. See Petitioners' Pre-Trial Memorandum in Support of Petition for Declaration of Invalidity of Credit Agreement Dated as of April 1, 1969, and Other Relief at 22-30, *In re Penn Cent. Transp. Co.*, No. 70-347 (E.D. Pa., filed Sept. 19, 1972) [hereinafter cited as Memo of Robinson Petitioners].

in the negotiations between Penn Central and First National City Bank a director of one of the lender banks was elected to the board of Penn Central.<sup>13</sup> Penn Central issued \$300,000,000 in promissory notes<sup>14</sup> pursuant to the credit agreement and agreed to an immediate pledge of 100% of its stock in Pennsylvania Company (Pennco), a subsidiary,<sup>15</sup> upon the first takedown under the loan.<sup>16</sup> When Penn Central filed for bankruptcy on June 21, 1970, the entire \$300,000,000 had been taken down by the railroad and no repayment of any portion had been made.<sup>17</sup> Both groups of petitioners contend that section 10 of the Clayton Act was violated by the interlock between the lender bank and the railroad and by the interlocks between the five participant banks and the rail-

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13. A distinction has been drawn between "direct" and "indirect" dealing for purposes of section 10, *see* Memo of FNCB, *supra* note 10, at 36. The election of a lending bank director to the Penn Central board prior to the closing date of the credit agreement created an interlock between direct dealers (a "direct" interlock), and arguably constituted a violation of the Clayton Act, *see* Memo of Special Representatives, *supra* note 11, at 7-8; Memo of Robinson Petitioners, *supra* note 12, at 34-35. *But see* Memo of FNCB 38.

Although the participant banks had existing direct interlocks with Penn Central, their mere sharing in the loans advanced by the lending banks was thought to take those "indirect" interlocks out of the prohibition of section 10, *see* Memo of FNCB 38. Petitioners allege that the device of participation coupled with the characterization of the interlocks as indirect was designed to circumvent the statute and did not reflect the economic reality of the transaction, *see* Memo of Special Representatives 6; Memo of Robinson Petitioners 30-33. The five participant lenders actually advanced \$62,000,000; adding the direct advance by Irving Trust (which, at the time of the closing of the credit agreement, had a director in common with Penn Central), the total sum "tainted" by interlocking directorates amounted to \$77,000,000, *see* Memo of Special Representatives 7-8.

14. Penn Central's application to the Interstate Commerce Commission for permission to issue notes pursuant to section 20a of the Interstate Commerce Act, 49 U.S.C. § 20a (1970) (set out in part at note 23 *infra*), was granted. Penn Cent. Transp. Co.—Notes, Finance Docket No. 25622 (May 16, 1969). Petitioners allege that the application was fraudulent, thus vitiating the ICC approval. *See* note 33 *infra*.

15. After the merger of the Pennsylvania and New York Central railroads in 1968, the corporate structure of Penn Central was essentially three-tiered. The Penn Central Company was a holding company whose major asset was the railroad, the Penn Central Transportation Company. As the second tier, the railroad owned or controlled 186 subsidiary companies, including the Pennsylvania Company (Pennco), the third tier. This investment company owned most of the nonrail assets and was worth an estimated \$980 million at the time of the pledge. The Pennco stock was the last unencumbered asset of the railroad. *See* DAUGHEN & BINZEN, *supra* note 9, at 206-08, 230.

16. It appears that this agreement was considered interim financing while Penn Central endeavored to effect a long-term blanket mortgage bond. Repayment of the \$300,000,000 was to be refinanced out of the proceeds of the bond issue because Penn Central could not repay that amount from its cash flow. *See* Memo of FNCB, *supra* note 10, at 27, 32.

17. Memo of FNCB, *supra* note 10, at 32.

road because there was no competitive bidding during any stage of the transactions.<sup>18</sup> They seek to have the entire agreement nullified, thereby disallowing the banks' claim against Penn Central. In the alternative, petitioners request to have the banks' claims subordinated to the claims of all other secured and unsecured creditors, with the elevation of the stockholders to the status of general creditors.<sup>19</sup> Because the Pennco stock pledged as security for the credit agreement was the last unencumbered asset of the railroad, the petitioners will be relegated to deficiency claims unless they can take priority over the banks.

The dispute over the Penn Central credit agreement and stock pledge raises a number of issues with regard to section 10 of the Clayton Act, including: whether the transaction constituted a dealing in "securities," whether the participant banks were "dealing" if the credit arrangement did involve securities, and whether section 10 was intended to encompass such indirect interlocks. Additionally, the Penn Central litigation raises the issue of what remedies are available under the section; the petitioners' request for nullification of the credit agreement is a novel one. The far-reaching ramifications of this aspect of the reorganization proceedings demand serious inquiry into the continuing viability of section 10. This Note addresses each of these issues.

### *Definition of Securities*

The initial difficulty in applying section 10 to a transaction is that the term "securities" has not been defined either by that provision<sup>20</sup> or by case law. A strong policy argument, however, can be advanced that remedial legislation should be construed broadly to effectuate its purposes. Therefore, the scope and meaning of "security"<sup>21</sup> should be determined by reference to substance, not form, and by focusing on the economic realities of the transaction.<sup>22</sup>

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18. Memo of Robinson Petitioners, *supra* note 12, at 30; Memo of Special Representatives, *supra* note 11, at 1.

19. Memo of Robinson Petitioners, *supra* note 12, at 2; Memo of Special Representatives, *supra* note 11, at 1.

20. The relevant text of section 10 is set out at note 5 *supra*.

21. The Court of Appeals for the Second Circuit gave only summary consideration to this question in *Klinger v. Baltimore & O.R.R.*, 432 F.2d 506 (2d Cir. 1970). The challenged transaction was the purchase, without competitive bidding, by one railroad of its co-owner railroad's one-half interest in a produce terminal. The court simply noted that "the notes and shares here certainly fit within any normal and reasonable meaning of the word [securities]." *Id.* at 510.

22. This approach in the context of the Securities Exchange Acts was reflected in the observation of the Supreme Court in *Tcherepnin v. Knight*, 389 U.S. 332 (1967), that

The use of "security" in section 10 is analogous to use of that term in section 20a of the Interstate Commerce Act.<sup>23</sup> This analogy is especially appropriate in view of the special policing function of the ICC under section 10<sup>24</sup> and the complementary relationship between that provision and section 20a of the Interstate Commerce Act.<sup>25</sup> Specifically, section 20a prohibits a carrier from issuing or assuming a security without the approval of the ICC.<sup>26</sup> The ICC has recognized that a loan agreement may constitute a "security" within the meaning of section 20a even though the evidence of indebtedness is not negotiable.<sup>27</sup> Moreover, in *Watt Transport, Inc.*,<sup>28</sup> involving loan agreements between a bank and a transportation company, which were secured by guaranties giving the bank a high degree of control over the carrier, the agency in reaching its conclusions emphasized its right to look at the circumstances of the transaction, including the apparent intent of the parties.<sup>29</sup>

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"[a]s used in both the 1933 and 1934 Acts, security 'embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits.'" *Id.* at 338, quoting *SEC v. W.J. Howey Co.*, 328 U.S. 293, 299 (1946).

23. 49 U.S.C. § 20a(2) (1970) provides in pertinent part:

It shall be unlawful for any carrier to issue any share of capital stock or any bond or other evidence of interest in or indebtedness of the carrier (hereinafter in this section collectively termed "securities") or to assume any obligation or liability as lessor, lessee, guarantor, indorser, surety, or otherwise, in respect of the securities of any other person, natural or artificial . . . unless and until . . . the commission by order authorizes such issue or assumption.

The purpose of section 20a is to aid in the development of a national transportation system by maintaining a sound economic foundation to support railroad credit and to protect investors in railroad securities against incompetent and dishonest financing. *See Chicago S. Shore & S. Bend R.R. v. United States*, 221 F. Supp. 106, 108 (N.D. Ind. 1963).

24. *See* note 5 *supra*.

25. *See* note 23 *supra*.

26. This relationship has been noted repeatedly by the Commission. *See, e.g., Columbia Terminals Co.—Issuance of Notes*, 40 I.C.C. (M.C.C.) 288, 293 (1945). *See also* C. FULDA, *COMPETITION IN THE REGULATED INDUSTRIES, TRANSPORTATION* 54 (1961).

27. *Transcontinental Bus System, Inc., Notes*, 80 I.C.C. (M.C.C.) 54, 55-56 (1959). *Compare Interstate Investors Inc. v. United States*, 287 F. Supp. 374, 387 (S.D.N.Y. 1968), *aff'd*, 393 U.S. 479 (1969) (per curiam) and *Capital Transit Co.—Issuance of Securities*, 40 I.C.C. (M.C.C.) 17, 20 (1944) with *Ex Parte No. 275*, Expanded Def. of Term "Securities," 348 I.C.C. 288, 289 (1975).

28. 338 I.C.C. 338 (1971).

29. *Id.* at 343. In finding the loan agreements to be securities, the Commission did not adopt the reasoning of the hearing examiner that determinative of what constituted a security or evidence of indebtedness was the impact of the document in question upon the capital structure of the carrier. Rather, it was influenced by Watt's prior

This substance over form approach to credit transactions was adopted formally by the ICC in *Ex Parte No. 275, Expanded Definition of Term "Securities"*.<sup>30</sup> The ICC broadened the term to include, without limitation, advances, loan agreements, credit agreements, mortgages, chattel mortgages, deeds of trust, equipment trusts, security agreements, and purchases by means of some deferred payment scheme of property having a useful life in excess of one year.<sup>31</sup> This interpretation substantially extended the definition of securities under which regulated carriers had been operating.<sup>32</sup>

The promissory notes issued by Penn Central pursuant to the credit agreement are certainly securities under section 20a as construed presently.<sup>33</sup> Given the negotiable character of those notes, the broad ap-

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acquiescence in the characterization of the loan agreement by the Small Business Administration as a note. Maintaining that its decision could be grounded on adequate precedent, the ICC limited its holding to the specific facts of the case, acknowledging, however, that in light of contemporary practices this problem might merit more detailed analysis in a future rulemaking proceeding. This attention was accorded in *Ex Parte No. 275, Expanded Def. of Term "Securities,"* 348 I.C.C. 288 (1975), see notes 30-32 *infra* & accompanying text. *Ex Parte No. 275*, 348 I.C.C. 288 (1975).

30. 348 I.C.C. 288 (1975).

31. *Id.* at 311. The Commission noted that it was not practical to attempt to list all transactions that might come within the scope of "other evidence of interest in or indebtedness of the carrier," as those who sought to avoid the consequences of the statute invariably would create different forms of transactions to avoid the regulated forms. Rather, the enumeration of financial arrangements to be considered securities was intended to serve as a guideline for the agency in carrying out congressional intent. *Id.* at 307.

32. *Cf.* note 23 *supra* & accompanying text. *Ex Parte No. 275* has had an interesting history. The ICC instituted the proceeding in 1971, and in its order, 340 I.C.C. 817 (1972), confined the definition of securities to stocks, bonds, and promissory notes, including loan agreements definite as to terms and purposes. Three months after the entry of that order, the proceeding was reopened, resulting in a second order, 344 I.C.C. 114 (1973), expanding the definition of securities to insure flexibility to deal with increasingly common methods of railroad financing. Strong adverse industry reaction caused the ICC to stay the effective date of its second order. After reconsideration, the agency promulgated a third order, 348 I.C.C. 288 (1975), which was essentially the same as the second. This order, however, recently was stayed pending judicial review. 40 Fed. Reg. 51199 (1975).

33. Indeed, Penn Central applied to the ICC under section 20a for authority to issue the promissory notes. See note 14 *supra*.

The petitioners contend that the ICC approval was invalid on the grounds that the commitments to participate by banks having interlocking directors with the railroad were not disclosed in the application to the agency, and that the agency was not notified of the subsequent election of a director of one of the lender banks to Penn Central's board prior to the closing of the credit agreement. Petitioners claim that these facts made the application materially false and misleading. See Memo of Robinson Petitioners, *supra* note 12, at 9, 21, 34, 50.

proach taken toward the term "securities" by the ICC in applying section 20a, and the complementary relationship existing between that provision of the Interstate Commerce Act and section 10 of the Clayton Act, they should be considered securities under section 10 as well. The pledge of Pennco stock also should be classified as a security under section 10, as illustrated by *Klinger v. Baltimore & Ohio R.R.*,<sup>34</sup> in which the Court of Appeals for the Second Circuit held that notes and shares of a railroad's noncarrier subsidiary were securities under that section.

### *Definition of Dealing*

Although section 10<sup>35</sup> prohibits dealing in securities between a common carrier and its interlocks, the reach of this section is unclear, for the term "dealing," as used in the provision, has not been defined statutorily or judicially. Administrative decisions in this area indicate that dealing does include the issuance of preferred stock,<sup>36</sup> common stock,<sup>37</sup> and promissory notes<sup>38</sup> by a railroad, as well as the purchase of maintenance material by a railroad.<sup>39</sup> These decisions, however, involved direct sales to or purchases from an interlocked corporation. The arrangement between Penn Central and the participant banks constituted an indirect transaction; the participant banks acquired their interests from the lender banks rather than as direct lenders. The question presented is whether this transaction constituted a "dealing" between the railroad and the interlocked participant banks, bringing it within the ambit of section 10.<sup>40</sup> Of secondary concern is whether the dealings contem-

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34. 432 F.2d 506, 510 (2d Cir. 1970).

35. That section is set out in part at note 5 *supra*.

36. See, e.g., Securities of W. Pac. R.R., 145 I.C.C. 750, 751 (1928) (by implication).

37. See, e.g., Securities of Va. Cent. Ry., 154 I.C.C. 437, 440-41 (1929) (by implication).

38. See, e.g., Mississippi Export R.R.—Note, Finance Docket No. 20022 (April 22, 1958).

39. Cf., e.g., *Independent Iron Works, Inc. v. United States Steel Corp.*, 322 F.2d 656, 668-69 (9th Cir.), *cert. denied*, 375 U.S. 922 (1963); *Beegle v. Thompson*, 138 F.2d 875, 880 (7th Cir.), *cert. denied*, 322 U.S. 743 (1943).

40. Cases arising under the Federal Bankruptcy Act have considered an analogous question of whether a participant in a loan agreement is a creditor of the debtor corporation. A bank having a simple participation interest in a debtor's note generally is not a creditor. Compare *In re Yale Express System, Inc.*, 245 F. Supp. 790 (S.D.N.Y. 1965) with *In re Erie Forge & Steel Corp.*, 456 F.2d 801 (3d Cir. 1972).

The participation agreements ancillary to the Penn Central credit agreement expressly left the participant banks "at risk" with the railroad: the lending banks were not acting as guarantors. See Memo of Special Representatives, *supra* note 11, at 5. But the partici-



plated by section 10 are limited to those involving the carrier's own securities,<sup>41</sup> and if so, whether the participations offered by the lending banks were really Penn Central securities.<sup>42</sup> An examination of the legislative history of section 10 helps to define the intended scope ascribed by Congress to the phrase "dealings in securities, supplies, or other articles of commerce."

In the late nineteenth and early twentieth centuries, the railroad system in the United States was intertwined not only with large banking interests but also with the industries that supplied railway maintenance material. Frequently, the same men or corporations controlled all three component organizations, resulting in the financial abuse of railroads which were caught in the middle of "a web of entangling alliances."<sup>43</sup> Louis D. Brandeis, a close advisor to President Wilson and a strong opponent of what he termed the "Money Trust," published a series of articles<sup>44</sup> that decried the dangers of one man controlling such vast systems. Brandeis urged that to break the Money Trust, the system of interlocking directors must be prohibited: "Applied to corporations which deal with each other, it [the practice of interlocking

pant banks could assert no rights against the debtor railroad in the event of its default. See Memo of FNCB, *supra* note 10, at 37, 39(a).

41. This interpretation was implied by the Supreme Court in *Minneapolis & St. L. Ry. v. United States*, 361 U.S. 173 (1959):

[T]he language of the several drafts of § 10, together with the types of abuse cited in support of its enactment, suggests strongly that the words "dealings in securities" were intended to cover only a carrier's dealings with related persons in its *own* securities.

*Id.* at 190-91 n.13 (dictum) (emphasis supplied). *Accord*, *Klinger v. Baltimore & O.R.R.*, 432 F.2d 506, 518 (2d Cir. 1970) (Friendly, J., concurring). This approach does not square with the expansive concept of securities adopted by the ICC in applying section 20a of the Interstate Commerce Act. See notes 30-31 *supra* & accompanying text.

42. Cf. *Lehigh Valley Trust Co. v. Central Nat'l Bank*, 409 F.2d 989, 992 (5th Cir. 1969) (distinction drawn between participation interest and promissory note underlying primary loan).

43. *In re Financial Transactions of the N.Y., N.H. & H.R.R.*, 31 I.C.C. 32 (1914). The commission found that this railroad system controlled over 300 subsidiary companies largely through interlocking directorates, many of which were created and operated to conceal transactions detrimental to the carrier. The report strongly condemned the practice of one man serving on many boards of directors who, through bank deposits and security sales, wielded control over large amounts of banking capital as well as great railroad systems. *Id.* at 66.

Both the potential for abuse and the economic advantage available to the individuals who control these structures are obvious, the latter making interlocking directorates such a desirable business practice. Cf. Note, *Interlocking Directorates: A Study in Desultory Regulation*, 29 IND. L.J. 429, 443 (1954).

44. L. BRANDEIS, *OTHER PEOPLE'S MONEY* (Harper Torchbook ed. 1967) (originally published as *Breaking the Money Trusts*, HARPER'S, Nov. 22, 1913 to Jan. 17, 1914).

directorates] tends to disloyalty and to violate the fundamental law that no man can serve two masters.”<sup>45</sup> Such arguments prompted President Wilson to ask Congress for legislation protecting the railroads from further financial abuse by other industries through interlocking directorates.<sup>46</sup>

The House version of section 10 contemplated an absolute prohibition of interlocks between railroads and banks dealing in the securities of the railroad.<sup>47</sup> The Senate, however, substantially altered this version and proposed the requirement of competitive bidding and supervision by the ICC in lieu of a complete proscription of interlocking directors.<sup>48</sup> Senator Chilton, a proponent of the Senate version, explained the purpose and contemplated effect of the provision:

[I]nstead of undertaking to regulate the matter of interlocking directors through the personnel of the board, it [the Senate bill] dealt directly with the evil, which was the objectionable transaction. . . . If a common carrier has bonds to sell, it can not sell them to a bank which has as its director or manager or purchasing officer anyone who at the same time occupies a trust capacity or is interested in another corporation with which the dealings may be had, unless the transaction is open and fair, and the common carrier, after competition, gets the best prices for the bonds. . . .<sup>49</sup>

The allowance of dealings between carriers and interlocked corporations conditioned upon competitive bidding was incorporated into the final enactment.

Thus, although the Clayton Act was intended to supplement the Sherman Act in an effort to arrest monopolies and trusts in their incipency,<sup>50</sup> not all transactions between interlocked carriers and corporations are forbidden. Rather, section 10 seeks to protect carriers by requiring arm's length dealing to preclude overreaching. But nothing

45. *Id.* at 35.

46. 51 CONG. REC. 1978-79 (1914). The President's address stressed the need to correct the harm done to railroads caused by their financial structure:

It [business] waits for acquiescence . . . for laws which will effectually prohibit and prevent such interlockings of the *personnel* of the directorates of great corporations . . . as in effect result in making those who borrow and those who lend practically one and the same . . . .

*Id.* at 1978.

47. H.R. REP. NO. 627, 63d Cong., 2d Sess. (1914).

48. S. REP. NO. 698, 63d Cong., 2d Sess. 47-48 (1914).

49. 51 CONG. REC. 16002-03 (1914). This example prophetically foreshadowed the transaction between the Penn Central and the banks.

50. S. REP. NO. 698, 63d Cong., 2d Sess. 1 (1914).

in the statutory language or the legislative history of that provision suggests that it is to be limited to transactions between direct interlocks. The Senate's emphasis on the "objectionable transaction" itself as the evil to be eradicated illustrates the need to dissect the form of the transaction to lay bare its purpose and effect. The potential for financial abuse of the railroad is present in both direct and indirect interlocking relationships,<sup>51</sup> suggesting that the focus in determining whether section 10 is applicable should be on the substantive impact of the transaction rather than on its form.

Penn Central negotiated solely with First National City Bank, a non-interlocked corporation.<sup>52</sup> The magnitude of the loan, however, necessitated the participation of other banks in the transaction.<sup>53</sup> The interlocking participant banks were committed to their shares of the lender bank advances before the credit agreement was closed. The participants were equally "at risk" with the lenders,<sup>54</sup> and although most of the substantive terms of the agreement were negotiated through FNCB as agent, the railroad did negotiate directly the amounts it would deposit in accounts with the participant banks as compensating balances.<sup>55</sup> Insofar as the participant banks were involved in the negotiations concerning the credit agreement prior to closing, then, they appear to stand on equal footing with the lender banks in having dealt in securities of the carrier.<sup>56</sup> The indirect nature of the participants' role in the credit

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51. This view is supported by a report of the Staff of the House Committee on the Judiciary: "Competitive bidding is Section 10's only recognized safeguard against vertical interlocks otherwise prohibited. Removal of this safeguard, of course, provides opportunity for abuse." STAFF OF HOUSE COMM. ON THE JUDICIARY, 89TH CONG., 1ST SESS., REPORT ON INTERLOCKS IN CORPORATE MANAGEMENT 31 (Comm. Print 1965).

In the first case brought under section 10, *In re Missouri Pac. R.R.*, 13 F. Supp. 888 (E.D. Mo. 1935), the court found that section 10 clearly applied to a railroad purchase of stock of an interlocked real estate corporation. Responding to the argument that such a sale was not amenable to competitive bidding, the court stated: "[I]f . . . no competitive bids are possible, then the statute forbids the deal absolutely." *Id.* at 893.

52. The railroad had engaged in substantial prior dealings with First National with regard to its own financing and financing for its subsidiaries. See DAUGHEN & BINZEN, *supra* note 9, at 192, 256 n.2, 206. When Penn Central went bankrupt its indebtedness to First National alone exceeded \$300,000,000. *Id.* at 259.

53. During the period of negotiations over the credit agreement, FNCB was within \$35,000,000 of its legal lending limit. By the terms of the agreement, however, it was committed to advance \$92,000,000. The difference had to be covered by participation agreements with other banks. See Memo of Special Representatives, *supra* note 11, at 5-6.

54. See note 36 *supra*.

55. See Memo of Robinson Petitioners, *supra* note 12, at 36.

56. The practice of a carrier issuing commercial paper through an agent who then places the paper with otherwise disqualified institutions was criticized recently as clearly

transaction could not preclude the potential for abuse inherent in an interlocking relationship when those banks, having made commitments to share in the advances under the final agreement, were apprised of the underlying negotiations.<sup>57</sup> Negotiations leading to a final operating agreement are merely one step in its consummation; in essence, there is only one transaction.<sup>58</sup>

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frustrating the purpose of section 10. STAFF STUDY FOR THE SPECIAL COMM. ON INVESTIGATIONS OF THE HOUSE COMM. ON INTERSTATE AND FOREIGN COMMERCE, 92D CONG., 1ST SESS., INADEQUACIES OF PROTECTION FOR INVESTORS IN PENN CENTRAL AND OTHER ICC-REGULATED COMPANIES 7 (Subcomm. Print 1971).

Further, the prohibitory language of section 10 is directed toward the carrier's own action. Thus, it is immaterial whether after consummation of the credit agreement the interlocking participant banks, through FNCB, merely were "holding" Penn Central securities or actually were "dealing" in them, as the violation consisted of the railroad's prior negotiations with the participants over compensating balances. *But cf.* Interstate Investors, Inc. v. United States, 287 F. Supp. 374 (S.D.N.Y. 1968).

57. If the participant banks acquire participation in the loan in a secondary transaction after the terms of the loan are finalized, however, the potential for abuse is no longer present. The participant banks should be held to have had no dealings with the carrier.

58. In *Chicago & Nw. Ry.—Proposed Competitive Bidding Exemption*, 328 I.C.C. 625 (1966), the railroad applied for authority to issue a new series of first mortgage bonds to holders of its series B bonds and proposed to negotiate privately with these bondholders. Because several of the investment companies holding series B bonds had interlocks with the railroad, the railroad requested an exemption from the competitive bidding requirement of section 10. In denying the railroad's application, the Commission stated:

It is clear that, without exemption from competitive bidding, applicant may not discuss or negotiate the terms of the proposed sale of bonds with the present holders of its bonds. The terms which would be under discussion are an integral part of the terms of sale of the proposed bonds. . . . Negotiations with respect to such financial transaction[s] are but the first step in a chain of events leading to the actual issuance of the security itself, and exemption should not be granted when the actual sale of the bonds . . . must be through competitive bidding.

*Id.* at 628-29.

Petitioners also assert that the election of a director of one of the lender banks to the board of the Penn Central three days prior to the signing of the final agreement violated section 10. *See* note 13 *supra*. At this time, however, all negotiations regarding these agreements were completed. By its terms, section 10 prohibits a dealing in securities when "the . . . common carrier shall have upon its board of directors . . . any person who is at the same time a director . . . of . . . such other corporation . . ." 15 U.S.C. § 20 (1970) (emphasis supplied). Inasmuch as the negotiations were completed by the time the bank's director was elected to the Penn Central's board, this director was not serving during the dealing. Section 10 creates no liability unless an interlocking relationship exists at the time of the alleged violation. *See Beegle v. Thompson*, 138 F.2d 875, 880 (7th Cir.), *cert. denied*, 322 U.S. 743 (1943).

*Section 10 Comprehends Indirect Interlocks*

The legislative history of section 10<sup>59</sup> clearly indicates a national policy to protect the public from the results of fraud and overreaching in the financing of railroads. This policy should justify extending the scope of the statute to all situations in which an interlocked corporation participates in the sale or distribution of carrier securities in what is essentially one transaction.<sup>60</sup>

Such an expansive reading does not conflict with the operative interpretation of section 10 as a "narrow prohibition applicable to activity that is conceptually within the antitrust philosophy."<sup>61</sup> Among the evils sought to be curtailed by section 10 are sales of securities or supplies to or by common carriers for excessive<sup>62</sup> or inadequate<sup>63</sup> consideration, respectively, at the insistence of interlocking directorates. The primary purpose of the statute is to ensure that carriers are financially able to provide the public with efficient, economical transportation. That interest can be affected as much by indirect dealings as by direct dealing with interlocks if the decisions to buy and sell or to borrow and lend in reality are made by common directors. A construction of section 10 that excludes "indirect" interlocks from its operation clearly

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59. See notes 43-51 *supra*.

60. For example, in *Pennsylvania O. & D.R.R. Bonds*, 254 I.C.C. 473 (1943), the railroad applied for authority to issue first and refunding mortgage bonds guaranteed by the Pennsylvania Railroad, P.O. & D.'s lessee. The bonds were sold, subject to ICC approval, to an investment house with which the railroad had been negotiating. No other investors were consulted. A Pennsylvania stockholder intervened, alleging that the purchase of the bonds from the investing house by financial institutions having interlocks with the guarantor railroad would violate the spirit and intent, if not the letter, of section 10. The Commission declined to decide this question. Commissioner Mahaffie dissented, stating:

Considering the broad public interest, I do not regard as a healthy condition in railroad financing a situation where, in the sale of securities by private negotiation, the same person, although he takes no part in the particular transaction, is serving as an officer or director of the carrier issuing or guaranteeing the securities and as an officer or director of a company participating in the sale and distribution of those securities. This is true whether such officer or director doubles as underwriter, sub-underwriter, member of the selling group, or *immediate purchaser from any of these instrumentalities since all are engaged in what is essentially one transaction.*

*Id.* at 484 (emphasis supplied).

61. *United States v. Boston & Me. R.R.*, 380 U.S. 157, 162 (1965); *accord*, *Klinger v. Baltimore & O.R.R.*, 432 F.2d 506, 516 (2d Cir. 1970) (Friendly, J., concurring).

62. See *Minneapolis & St. L. Ry. v. United States*, 361 U.S. 173, 190 (1959).

63. See *Klinger v. Baltimore & O.R.R.*, 432 F.2d 506, 510 (2d Cir. 1970).

frustrates the purpose of the statute. Although section 10 may be drawn narrowly, a restrictive interpretation of the section affronting the purpose for which it was enacted, protection of carrier assets, is unwarranted.<sup>64</sup>

Thus, transactions between carriers and indirect interlocks should be analyzed carefully<sup>65</sup> for evidence of dealing in securities or supplies between them. The mere presence of a third party intermediary should not give rise to a per se determination that a railroad has not dealt with an interlocked corporation; section 10 does not make the intervention of a third party an alternative to compliance with the competitive bidding requirement.<sup>66</sup> If, then, prior to the closing of a loan agreement between an agent bank and a carrier, an interlocking bank should play any role in the underlying negotiations, discuss with the carrier proposals ancillary to the agreement, or commit itself to participation in advancing funds under the agreement, the lender-participant arrangement becomes merely an avoidance scheme that should not shield a substantive violation of section 10.

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64. *Cleary v. Chalk*, 488 F.2d 1315, 1322 (D.C. Cir. 1973), *cert. denied*, 416 U.S. 938 (1974).

65. One commentator has suggested that the very existence of an interlock is indicative of the fact that the corporations intend to deal with each other to a greater extent than they would if no interlock existed. Travers, *Interlocks in Corporate Management and the Antitrust Laws*, 46 TEXAS L. REV. 819, 851 (1968). Dealings between interlocks therefore should be subjected to careful scrutiny to prevent transactions that are unfairly advantageous to the greater corporation without adequate benefit to the smaller.

As a result of Penn Central's bankruptcy, the ICC's regulation of carrier financing was criticized strongly for failure to investigate sufficiently. STAFF STUDY FOR THE SPECIAL SUBCOMM. ON INVESTIGATIONS OF THE COMM. ON INTERSTATE & FOREIGN COMMERCE, 92D CONG., 1ST SESS., INADEQUACIES OF PROTECTIONS FOR INVESTORS IN PENN CENTRAL AND OTHER ICC-REGULATED COMPANIES (Subcomm. Print 1971).

66. Once the need for competitive bidding is established, the issue is whether the interlock itself must bid or whether this requirement is satisfied if an intermediate party does the bidding and then sells participation to interlocks. For a discussion of this collateral issue in the context of financing through equipment trust certificates and conditional sales agreements, see Comment, *Railroad Equipment Financing: Clayton § 10 and Dealings Between Interlocks*, 45 TEMP. L.Q. 370 (1972).

One court has stated that section 10 imposes a duty upon the interlock not to deal with the carrier except through competitive bidding. *Klinger v. Baltimore & O.R.R.*, 432 F.2d 506, 510 (2d Cir. 1970). It would appear consistent with the purpose of section 10, however, for an independent investment banking company to bid for the carrier's securities and, through a bona fide secondary transaction, to sell these securities to interlocks. The carrier is protected by competitive bidding, and the possibility of detrimental influence on the carrier by the interlock is minimized by the intervening secondary transaction.

*Immunity from Antitrust Laws*

Assuming that the Penn Central credit agreement did constitute a violation of section 10 of the Clayton Act, ICC approval of the issuance of promissory notes by the railroad<sup>67</sup> may have exempted that action from the antitrust laws by reason of section 5(11) of the Interstate Commerce Act.<sup>68</sup> Section 5(11) provides that commission approval of a transaction directed toward carrier consolidation supersedes the operation of the antitrust laws, including, by judicial construction,<sup>69</sup> section 10 of the Clayton Act. Thus, in *Denver & Rio Grande Western Railroad Co. v. United States*,<sup>70</sup> the Supreme Court indicated that an issuance of securities in accordance with section 20a of the Interstate Commerce Act might be protected from antitrust sanctions if the promulgation were in furtherance of a consolidation approved by the ICC under section 5.<sup>71</sup> The court emphasized, however, that section 5 immunity must be the result of a careful administrative consideration of the anti-competitive effects of the transaction.<sup>72</sup>

The ICC adopted the Supreme Court's reading of sections 5 and 20a to protect an issuance of promissory notes from attack on section 10 grounds in *Railway Express Agency, Inc., Notes*.<sup>73</sup> It has not, however, extended the section 5 umbrella to transactions not involving some aspect of carrier consolidation. Thus, in a 1966 case in which carrier consolidation was not involved, the Commission held that it had no power to suspend the requirement of competitive bidding when it

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67. See note 14 *supra*.

68. 49 U.S.C. § 5(11) (1970). That provision states:

The authority conferred by this section shall be exclusive and plenary . . . and any carriers or other corporations . . . participating in a transaction approved or authorized under the provisions of this section shall be and . . . are relieved from the operation of the antitrust laws . . . .

69. See *Minneapolis & St. L. Ry. v. United States*, 361 U.S. 173, 190-91 (1959); cf. *Quirke v. Chessie Corp.*, 368 F. Supp. 558, 562 (S.D.N.Y. 1974).

70. 387 U.S. 485 (1967).

71. The Court emphasized that section 20a of the Interstate Commerce Act, under which the Commission had acted, by its terms did not create an exemption as did section 5. Public benefits derived from an integrated national transportation system were more likely to result from the consolidations of carriers at which section 5 was directed than from the mere issuance of stock by carriers. When the issuance of stock was pursuant to a consolidation plan, however, the Commission could exempt the transaction under section 5 after weighing the anticompetitive impact against the public interest. *Id.* at 496-97.

72. 387 U.S. at 498; *McLean Trucking Co. v. United States*, 321 U.S. 67, 87 (1944).

73. 348 I.C.C. 157, 211-12 (1975).

otherwise would be applicable, as the statute itself made no provision for exemption.<sup>74</sup>

Although the ICC therefore does have the power to immunize a transaction otherwise prohibited by section 10, it can do so only after balancing the anticompetitive impact against the public benefit, and only if the dealing is an integral part of a carrier consolidation.<sup>75</sup> In the section 20a proceeding approving the issuance of the Penn Central notes, the ICC could not have considered adequately the anticompetitive impact as it was not aware that interlocked participant banks were involved in the transaction.<sup>76</sup> Furthermore, the notes were not issued as part of a consolidation, merger, or unification agreement such as is contemplated by section 5.<sup>77</sup> Thus, ICC approval of the railroad's promissory notes should not legitimize the credit agreement and pledge of Pennco stock if they otherwise violate section 10.

### *Remedies*

The shareholders and the special representatives seek to have the credit and pledge agreements declared invalid as violative of the Clayton Act and to have the banks' claims for repayment of the \$300,000,000 disallowed or subordinated. Section 10 itself provides for criminal sanctions against the carrier and any directors of the carrier who knowingly voted for or directed the objectionable transaction.<sup>78</sup> Civil liability also attaches through section 4 of the Clayton Act,<sup>79</sup>

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74. *Chicago & Nw. Ry.-Proposed Competitive Bidding Exemption*, 328 I.C.C. 625, 630 (1966); cf. note 71 *supra*.

75. For a general discussion of the power of regulatory agencies to immunize against operation of the antitrust laws, see Schwarzer, *Regulated Industries and the Antitrust Laws—An Overview*, 41 ICC PRAC. J. 543 (1974).

76. See Memo of Special Representatives, *supra* note 11, at 7.

77. Cf. note 71 *supra* & accompanying text.

78. The pertinent portion of that statute reads:

If any common carrier shall violate this section, it shall be fined not exceeding \$25,000; and every such director, agent, manager, or officer thereof who shall have knowingly voted for or directed the act constituting such violation . . . shall be deemed guilty of a misdemeanor and shall be fined not exceeding \$5,000 or confined in jail not exceeding one year, or both, in the discretion of the court.

15 U.S.C. § 20 (1970).

79. 15 U.S.C. § 15 (1970), provides that:

Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy,



which allows treble damages to any person injured "by reason of anything forbidden in the antitrust laws."<sup>80</sup> Thus, section 10 by its terms does not provide for cancellation of the agreement as a remedy, and there are no cases reaching this result.

An analogy can be made, however, to the defense of illegality to a contract action under the Sherman Act. This approach has not been favored,<sup>81</sup> but the cases do indicate that it is properly applicable when public policy considerations demand that the contract not be enforced.<sup>82</sup> The Supreme Court has stated that it will entertain the defense only when the contract sued upon is intrinsically illegal and is in direct contravention of an express statutory prohibition.<sup>83</sup> Although in the instant case the question of illegality is raised as the basis for an affirmative claim rather than as a defense, analogy to cases under the Sherman Act is still appropriate. If the Penn Central credit agreement was in violation of section 10 and the court declines to invalidate it, the result will be judicial allowance of the enforcement of an illegal contract. The mere fact that section 10 is silent on this point should not require such a result.<sup>84</sup> Moreover, this proceeding arises under section 77 of the Bankruptcy Act,<sup>85</sup> which gives the court broad equitable power to effect a rehabilitation of the railroad's financial structure.<sup>86</sup> Therefore,

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and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee.

80. Section 10 has been recognized to be an antitrust provision for purposes of section 4; see *United States v. Boston & Me. R.R.*, 380 U.S. 157, 160 (1965) *quoting* *Minneapolis & St. L. Ry. v. United States*, 361 U.S. 173, 190 (1959).

81. See, e.g., *Kelly v. Kosuga*, 358 U.S. 516, 518 (1959). One reason for the court's unfavorable response to the defense is that it often is raised by a defendant who has participated knowingly in the illegal transaction, and then asserts the illegality to avoid paying for goods or services already received. As noted by the Court in *Kelly*, to allow the defense in these cases as a collateral means of enforcing the antitrust laws would create "a very strange class of private attorneys general." *Id.* at 520.

82. See, e.g., *Continental Wall Paper Co. v. Louis Voight & Sons Co.*, 212 U.S. 227, 262 (1909); cf. *McMullen v. Hoffman*, 174 U.S. 639, 669 (1899).

83. *Bruce's Juices, Inc. v. American Can Co.*, 330 U.S. 743, 755 (1947). The defense in this case was that the contract violated the Robinson-Patman Act; the Court reached its conclusions, however, by analogizing to the defense of illegality under the Sherman Act.

84. Justice Murphy, dissenting in *Bruce's Juices, Inc. v. American Can Co.*, 330 U.S. 743 (1947), noted that: "Where a contract is outlawed by statute or is otherwise contrary to public policy, the illegality may be set up as a defense to a suit for enforcement despite the absence of a legislative recognition of that defense." *Id.* at 761. Cf. *D.R. Wilder Mfg. Co. v. Corn Prods. Ref. Co.*, 236 U.S. 165, 174-75 (1915).

85. 11 U.S.C. § 205 (1970). See note 9 *supra*.

86. "The purpose of a § 77 reorganization is to produce a viable corporate enterprise

the court has the power to void the credit and pledge agreements as unlawful<sup>87</sup> under section 10 of the Clayton Act.

The banks argue that the railroad suffered no damage as a result of the \$300,000,000 loan transaction, and that consequently, petitioners are not entitled to a remedy even if there was a technical violation of section 10.<sup>88</sup> Several courts, faced with section 10 violations, have reached this result.<sup>89</sup> These courts apparently have adopted a fair value test to determine damages, concluding that if the carrier received or paid fair market value in the transaction there was no damage, despite the absence of competitive bidding.<sup>90</sup> These cases, however, involved plaintiffs seeking recovery under section 4 of the Clayton Act,<sup>91</sup> which allows "any person who shall be *injured*" to "recover threefold the *damages* by him *sustained*."<sup>92</sup> Thus, these decisions are not controlling on a suit brought under section 10 that seeks to invalidate an allegedly unlawful transaction as part of a reorganization proceeding.<sup>93</sup>

Moreover, the legislative history of section 10<sup>94</sup> indicates that the congressional purpose was deterrence, not compensation. In this respect, section 10 resembles a conflict of interest statute such as that involved in *United States v. Mississippi Valley Generating Co.*,<sup>95</sup> in which the Supreme Court noted the legislative intent to adopt an objective standard of conduct since actual corruption or loss were not made elements of a statutory offense. Any deviation from that standard is a per se violation subjecting the offender to the imposition of penalties.<sup>96</sup> Both

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capable of supplying adequate transportation services to the public . . . ." *In re Penn Cent. Transp. Co.*, 358 F. Supp. 154, 180 (E.D. Pa. 1973).

87. *Cf. Pepper v. Litton*, 308 U.S. 295 (1939). *But cf. In re Bichel Optical Labs., Inc.*, 299 F. Supp. 545 (D. Minn. 1969) (antitrust claim not available to debtor as defense to claims in involuntary bankruptcy proceeding); *accord, In re Otto's Liquor, Inc.*, 321 F. Supp. 160 (D. Minn. 1970).

88. Memo of FNCB, *supra* note 10, at 41-42.

89. *See, e.g., Bangor Punta Ops., Inc. v. Bangor & A.R.R.*, 417 U.S. 703, 715-16 & n.12 (1974); *Cleary v. Chalk*, 488 F.2d 1315, 1323 & n.55 (D.C. Cir. 1973), *cert. denied*, 416 U.S. 938 (1974); *Klinger v. Baltimore & O.R.R.*, 432 F.2d 506, 512-16 (2d Cir. 1970); *Schleiff v. Chesapeake & O. Ry.*, 43 F.R.D. 175, 180 (S.D.N.Y. 1967).

90. The ICC also has taken this approach in authorizing the issuance of securities under section 20a despite a potential violation of section 10, because the negotiated price was fair and reasonable. *Pennsylvania, O. & D.R.R. Bonds*, 254 I.C.C. 473, 478 (1943) (by implication).

91. 15 U.S.C. § 15 (1970), set out at note 79 *supra*.

92. *Id.* (emphasis supplied).

93. *See Bangor Punta Ops., Inc. v. Bangor & A.R.R.*, 417 U.S. 703, 725-32 (1974) (Marshall, J., dissenting).

94. *See* notes 43-51 *supra* & accompanying text.

95. 364 U.S. 520 (1961).

section 10 and conflict of interest statutes are premised on the theory that no man can serve two masters, and the language of section 10 does not specify actual damage as a requisite for imposition of the criminal penalties. Therefore, mere violation of section 10 should engender some remedy.

Finally, it is doubtful that the relatively minor criminal penalties provided in the statute<sup>97</sup> serve as an effective deterrent. The strong public policy underlying section 10 can be vindicated only through a private suit seeking either damages or nullification of the unlawful transaction. To preclude such action on the equitable basis that there has been no damage would frustrate the purpose of that section.<sup>98</sup> As previously noted, the goal of section 10, and other statutes dealing with common carriers, is to encourage the development of an efficient and responsive system of national transportation. The banks argue that they contributed to this goal by providing Penn Central with "the largest single railroad financing ever implemented in the United States" at a time when its operating position was deteriorating and the avail-

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96. *Id.* at 548-51. In *United States v. Boston & Me. R.R.*, 380 U.S. 157 (1965), the Court determined that section 10 was "not strictly a conflict of interest statute" such as that involved in *Mississippi Valley Generating Co.*, 380 U.S. at 160. The question before the Court, however, was whether particular conduct came within the statutory prohibition, not whether penalties for a clear violation could be foreclosed by an absence of demonstrable injury. Application of this rule of strict construction of criminal laws, undeniably proper for purposes of determining the scope of permissible conduct, is not compelled when imposition of sanctions is at issue.

97. The carrier can be fined a maximum of \$25,000, and any director who knowingly voted for the unlawful act is subject to an additional fine of \$5,000 plus one year in jail. *See* note 78 *supra*.

No case has extended the criminal sanctions of section 10 beyond the clear language of the statute; however, civil liability in the form of treble damages has been held applicable to the interlock on the theory that such liability, to be effective, must reach both parties to the transaction. *See Klinger v. Baltimore & O.R.R.*, 432 F.2d 506, 512 (2d Cir. 1970).

98. *See Bangor Punta Ops., Inc. v. Bangor & A.R.R.*, 417 U.S. 703, 725-32 (1974) (Marshall, Douglas, Brennan, & White, JJ., dissenting). This action was brought by the railroad against its former owners for alleged antitrust violations occurring during the period of their control. Reasoning that the real party in interest was the investment corporation that had purchased the carrier for a fair price, the majority denied the claim on the grounds that the corporation had no standing to complain of prior abuses, and that if recovery on behalf of the railroad was allowed, the benefit would go to its owner, constituting unjust enrichment. *Id.* at 710-13.

Neither of these objections are applicable to the Penn Central facts as petitioners are creditors and stockholders who held their interests at the time of the transaction, *see* Memo of Special Representatives, *supra* note 11, at 2-3; Memo of FNCRB, *supra* note 10, at 2, and if the relief sought is granted, no windfall will result.

ability of credit from any other source was doubtful.<sup>99</sup> Although the banks did not use their interlocking directorates to the detriment of the railroad, their credit extensions did not redound to the benefit of the public. Most of these funds were diverted into unprofitable outside enterprises: little was spent to maintain or upgrade railroad equipment and service.<sup>100</sup> There is no evidence that the banks had knowledge, in 1969, of the full magnitude of Penn Central's financial difficulties;<sup>101</sup> it is at least arguable, however, that absent the interlocking relationships<sup>102</sup> the banks would have made a more thorough inquiry before agreeing to give the railroad further credit. And as noted by the Special Representative, the banks should have known that other Penn Central creditors were secured by worthless assets, and would have to look to the Pennco stock, the carrier's last unencumbered asset, for their security.<sup>103</sup> Thus the existence of interlocking directorates between Penn Central and the banking community helped to create the exact situation that Congress intended to avoid by section 10.

### CONCLUSION

The collapse of the Penn Central Railroad has fostered much concern regarding the practicability of retaining private control of the major rail systems. Some congressional inquiry has focused specifically on the role played by the interlocking directorates and their effect on the railroad's demise.<sup>104</sup> The magnitude of the collapse, however, demands that Congress give this problem serious attention.

That the financial abuse of railroads through manipulation by interlocks is of continuing concern today is illustrated by the Penn Central litigation; the public has been deprived of an efficient rail system pre-

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99. Memo of FNCB, *supra* note 10, at 42.

100. See DAUGHEN & BINZEN, *supra* note 9, at 137-41.

101. See *id.* at 230-31.

102. During the pertinent period of 1969 two-thirds of Penn Central Transportation's Board of Directors had interlocking bank relationships. This built-in conflict of interest, according to the Robinson petitioners, resulted in a "banking attitude" instead of a "railroading attitude" in the decisions made by Penn Central. Memo of Robinson Petitioners, *supra* note 12, at 4-5.

103. Memo of Special Representatives, *supra* note 11, at 2.

104. STAFF REPORT OF THE SEC TO THE SPECIAL SUBCOMM. ON INVESTIGATIONS OF THE HOUSE COMM. ON INTERSTATE & FOREIGN COMMERCE, 92D CONG., 2D SESS., THE FINANCIAL COLLAPSE OF THE PENN CENTRAL COMPANY (Subcomm. Print 1972); STAFF STUDY FOR THE SPECIAL SUBCOMM. ON INVESTIGATIONS OF THE HOUSE COMM. ON INTERSTATE & FOREIGN COMMERCE, 91ST CONG., 1ST SESS., INADEQUACIES OF PROTECTIONS FOR INVESTORS IN PENN CENTRAL AND OTHER ICC-REGULATED COMPANIES (Subcomm. Print 1971).

dominantly because of the diversion of large amounts of capital from the maintenance of the system.<sup>105</sup> The inquiry must not end with a mere affirmation of the viability of section 10, however. The scope and implementation of the section need clarification. It appears that the practice of a carrier issuing commercial paper through an agent who then places the paper with otherwise disqualified institutions is used frequently to circumvent the prohibitions of section 10.<sup>106</sup> Affirmative legislative action is needed to eradicate this practice when implemented in other than a bona fide secondary transaction. The absence of competitive bidding should constitute a per se violation of the section sufficient to give rise to at least the imposition of the criminal penalties of that section.<sup>107</sup> With respect to such penalties, the legislature should act affirmatively to clarify its intent; it does not appear that the Department of Justice ever has brought a criminal action against a railroad's directors under section 10.

Appropriate civil remedies for a section 10 violation must be ascertained. First, any penalty, to serve as an effective deterrent, should reach the interlock as well as the railroad. Judicial sanction of a section 10 violation in which the court determines that the railroad suffered no damage because it received fair market value in the transaction should be disfavored. This approach fails to indicate the strong public interest inherent in the operation of public transportation systems. Likewise, the ICC should not be authorized to approve such a transaction on the basis of a fair market value test. Although the relief sought by petitioners is novel, nullification of the agreement should be allowed to prevent judicial sanction of an illegal contract and to fulfill the deterrent purpose of the section.

Thus, the bankruptcy of the Penn Central demands congressional re-examination of section 10, closer supervision of the ICC, and responsible judicial effectuation of the provisions of that section. Serious enforcement of section 10 is necessary to prevent manipulation of railroads for the profit of those who control them, at the expense of the public.

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105. See notes 100-102 *supra* & accompanying text.

106. See STAFF STUDY FOR THE SPECIAL COMM. ON INVESTIGATIONS OF THE HOUSE COMM. ON INTERSTATE & FOREIGN COMMERCE, 92D CONG., 1ST SESS., INADEQUACIES OF PROTECTION FOR INVESTORS IN PENN CENTRAL & OTHER ICC-REGULATED COMPANIES 7 (Subcomm. Print 1971).

107. See STAFF OF HOUSE COMM. ON THE JUDICIARY, 89TH CONG., 1ST SESS., REPORT ON INTERLOCKS IN CORPORATE MANAGEMENT 31 (Comm. Print. 1965).