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**THE INTERSTATE COMMERCE COMMISSION**

THE  
INTERSTATE COMMERCE  
COMMISSION

A STUDY IN ADMINISTRATIVE LAW  
AND PROCEDURE

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## FOREWORD

THE Legal Research Committee of the Commonwealth Fund has continued the work, begun about thirteen years ago, of an examination of the field of administrative law. It was intended to secure a general survey of administrative powers revealing, so far as the face of legislation can reveal it, the extent to which administrative control has, by modern legislation, been in fact conferred. It was intended to follow this with a series of special studies disclosing the actual workings of carefully selected administrative organs, it being deemed that such intensive studies in administrative law and practice are the prerequisite to an appraisal of what administrative law really does and a guide to what ought yet to be done. The general survey above referred to resulted in the publication of the study by Professor Ernst Freund, *Administrative Powers Over Persons and Property*. The first of the intensive studies was that of *The Federal Trade Commission*, by Gerard C. Henderson, and others have followed. The present study of *The Interstate Commerce Commission*, by Professor I. L. Sharfman, is the result of research continued for nearly ten years past. Parts I and II were published in 1931; Part III will be in two volumes, of which that now published is the first; Part IV, concluding the study, is in preparation. While the study has been conducted under the auspices of the Legal Research Committee and is published by the Commonwealth Fund, the author has been allowed entire freedom and the responsibility for the statements of fact and for the opinions expressed is fully and solely his own.

*January, 1935*

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# THE INTERSTATE COMMERCE COMMISSION

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## INTRODUCTORY NOTE

**B**OTH in Part I and Part II of this study, dealing respectively with the legislative basis of the Commission's authority and the scope of the Commission's jurisdiction, some attention was necessarily given to the character of the Commission's activities, since the analysis of developments in the above directions was grounded in the Commission's experience as a functioning tribunal. In the first two parts, however, the examination of the administrative record with respect to specific types of activity was largely incidental to tracing the evolution of legislative policy and of the sweep of authority, on a jurisdictional basis, exercised in conformity therewith; in this part of the study we deal directly with the character of the Commission's activities. A general survey of the entire field, disclosing the extent and diversity of the Commission's tasks, is followed by a detailed analysis and appraisal of the Commission's policies and practices in the major spheres of valuation, organization and finance, and rate control. In view of the extensive and complicated character of the Commission's determinations, and in view of the necessity of analyzing processes as well as results, Part III is presented in two volumes, the first of which (III-A) embraces, in addition to the general survey, the valuation project and the control of organization and finance, and the second of which (III-B) deals with rate regulation, from the standpoint of both the general level of charges and their interrelationships.

## CHAPTER XI

### THE EXTENT AND DIVERSITY OF THE COMMISSION'S TASKS

- §1. Rates and Traffic
- §2. Organization and Finance
- §3. Valuations of Carrier Property
- §4. General Investigations
- §5. Service and Safety
- §6. Accounts and Reports
- §7. Prosecuting Activities
- §8. Miscellaneous Tasks
- §9. Summary and Conclusion



CHAPTER XI  
THE EXTENT AND DIVERSITY OF THE  
COMMISSION'S TASKS

THE analysis and appraisal of the Commission's activities, to which this part of the study is devoted, can best be introduced by a survey of the extent and diversity of the Commission's tasks. The very growth and magnitude of these tasks, as reflected in statistical measurements, disclose the heavy burdens borne by the Commission, with their inevitable influence upon the effectiveness of its labors; and the varied nature of these tasks, in terms of both the subject-matter to which they apply and the types of governmental authority involved in their performance, provides concrete evidence of the sweep of power entrusted to the Commission and of the marked departure from traditional legal processes characteristic of the administrative justice sought to be achieved. Such a survey necessitates a consideration, along these lines, of the entire range of the Commission's activities; but from the standpoint of the more significant aspects of administrative law and procedure, a differentiation may well be made between those tasks which involve formally litigated controversies and find expression in published reports, and those which are normally disposed of, in coöperation with the interests affected and largely by way of routine, through the various internal boards and bureaus.

The judicial and legislative aspects of the Commission's work manifest themselves chiefly, and in any event most significantly, in contested cases. These cases generally involve the adjustment of differences between the carriers and the users of their service, and the promulgation, in the premises, of rules of future conduct. Although complaints may be brought and participation may be had in these proceedings by a great variety of interests, and although the Commission may act on its own initiative, the controversies usually concern the relationships, both as to the past and for the future, between the carriers and their patrons. Such proceedings are predominantly determined on the Commission's formal docket, although numerous simi-

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lar controversies are also settled informally, without strict delimitation of issues, without public hearing, and without binding effect. The formal cases embrace, for the most part, matters of rates and charges, together with such questions of service and problems of traffic as bear upon the establishment of reasonable and equitable rates and charges. In addition to these so-called formal cases, furthermore, there are the proceedings resulting from protests against proposed changes in rates and charges, which are determined on the investigation and suspension docket. These proceedings are essentially of the same character as the formal cases, both as to subject-matter and manner of adjustment, and they likewise fall within the category of controversies which involve the mandatory exercise of administrative power and which normally result in official orders and published reports. But the Commission's rate and traffic activities do not exhaust the group of tasks subject to such formal disposition. Distinct series of finance reports and of valuation reports are also issued. The subject-matter of these finance and valuation reports is sufficiently indicated, at this juncture, by their titles; but it must be noted that the mode of approach and character of action in these proceedings differ in important respects from those involved in the rate and traffic cases. In matters of organization and finance *ex parte* applications for approval of proposed courses of action, rather than complaints or independent investigations, constitute the usual starting-point for the exercise of the Commission's authority, and the execution of the proposed policies, especially when modified by the Commission, generally depends upon the volition of the applicants; and in the valuation proceedings the Commission acts not in the general enforcement of the duties of the carriers as defined by statute, but under a specific mandate to ascertain a special body of facts, and its findings, even when they purport to establish final single-sum values, but constitute ancillary determinations subject to attack in the courts only when actually used in the regulatory process. But the finance and valuation proceedings, no less than those dealing directly with rates and traffic, serve to illustrate the nature of the Commission's functioning as an administrative body. These three fields, taken together and broadly conceived, embrace most of the published decisions and provide the essential materials for an analysis and appraisal of the Commission's performance.

In the chapters that follow, therefore, concerning the substantive character of the Commission's activities, attention will be confined to the valuation project, the control of organization, with reference to extensions and abandonments and intercorporate relations, and of finance, with reference to the issuance of securities and assumption of obligations, and the regulation of rates, from the standpoint of both the level of charges and their interrelationships. At this point these matters will be dealt with only in terms of their volume or magnitude.

But this introductory survey, even on such a basis, cannot be restricted to these fields. Since the objective, here, is to indicate, largely through statistical means, the extent and diversity of the Commission's tasks in their entirety, this preliminary analysis must necessarily comprehend all of its important fields of action, and not merely those, noted above, which are actively controversial in character and which issue in formally published determinations. By way of supplement to its disposition of complaints, applications, and investigations dealing with rates and traffic, organization and finance, and valuations of carrier property, the Commission is engaged in a vast body of activities which are largely of a routine administrative character—although, even in these instances, the assertion of quasi-judicial and legislative authority is by no means always absent, and the results frequently find their way into the published reports. The chief expressions of this activity consist in the exercise of general investigatory power, the regulation of service, both under normal conditions and in emergency situations, the enforcement of the safety acts, the promulgation and supervision of accounting practices and the compilation of statistical data, participation in penalty suits and criminal prosecutions, and the administration of numerous miscellaneous enactments. The present survey of the extent and diversity of the Commission's tasks will include these various administrative activities, along with the major fields previously indicated which will be subjected to analysis and appraisal, from a substantive standpoint, in succeeding chapters. While little emphasis will be placed at this juncture upon the direction which the performance of all these tasks has taken, an indication of their character and, wherever possible, some measurement of their volume, will help focus attention upon the variety of undertakings with which

the Commission is charged and upon the aggregate load which it is compelled to carry.

#### §1. RATES AND TRAFFIC

The settlement of rate controversies has, from the beginning, constituted the Commission's central task, and it remains its dominant activity to the present time. But no exact measurement is available of the volume of the Commission's work involving problems of rates and traffic. Neither formal nor informal cases, running in the aggregate into many thousands annually, are classified on the basis of subject-matter. Since, however, the vast bulk of the proceedings handled by the Bureau of Formal Cases and by the Bureau of Informal Cases does in fact deal with controversies as to rates, charges, and traffic practices, the growth and present extent of the complaints coming before these bureaus provide a reasonably adequate index of the magnitude of the Commission's rate-regulating activity.

The Bureau of Informal Cases seeks, among other things, to adjust rate differences, particularly those centering about the interpretation of tariffs, between carriers and shippers, by means of correspondence.<sup>1</sup> No formal procedure is followed, no orders are issued, and no

<sup>1</sup> The earliest reference to the work of this bureau, which was then simply a part of the Operating Division, was as follows: "One method of the Commission requires special notice; that is, the informal investigation of grievances set forth in the correspondence of shippers. The usual course is to verify the statement of the complainant as far as it is possible to do so in the office of the Commission; then if the complaint appears to possess merit the carriers concerned are called upon to make a statement in relation to the matter or settle with the complainant if the facts so require. This endeavor to adjust differences between carriers and shippers without formality, delay, or expense has been attended with very satisfactory results, and this is especially true of the settlement of overcharges." *Annual Report, 1892*, p. 9. In a later report the Commission made clear the difference between these informal proceedings and the regularly contested cases, indicating the legal basis for this differentiation: "The work of the Commission which pertains directly to regulation involves two distinct kinds of procedure: One based upon formal petitions filed with the Commission under section 13 of the law, and involving regular hearing and investigation, the preparation of a report setting forth the material facts found and conclusions reached by the Commission, and issuance of an order dismissing the case or directing the carrier or carriers complained against to correct the rate or practice which may be held unlawful. The other kind of procedure arises in the performance by the Commission of its duty, under the twelfth section, to 'execute and enforce the provisions of the act,' and relates to complaints presented by letter, the examination of tariffs on file in the office in connection with such complaints, and correspondence with shippers and carriers concerning the same. Complaints of the latter class are called informal complaints to dis-

binding effect attaches to the resulting adjustments.<sup>2</sup> In addition to the disposition of such complaints, this bureau also entertains special docket applications, whereby shippers, with the consent of the carriers, seek through informal procedure to collect reparation claims resulting from admitted overcharges.<sup>3</sup> The Bureau of Formal Cases, on

tinguish them from the formal petitions or complaints which constitute the basis of contested cases." *Annual Report, 1901, p. 17.*

<sup>2</sup> The character of these informal complaints has been further described by the Commission as follows: "No order can be issued upon an informal complaint and inquiry. The main object of that method of procedure is the speedy disposition, through settlements, readjustments plainly required by the statute, or advice given by the Commission, of matters in which regulation is demanded, and thus to limit the number of contested cases upon the docket. It would be an injustice to complaining shippers and communities, amounting frequently to denial of relief, to compel the institution of a regular proceeding every time cause of complaint is brought to the attention of the Commission; and the number of cases requiring the hearing of witnesses, oral or written argument, and formulated decision would probably be greater than the Commission could dispose of properly or without intolerable delays. The great mass of complaints are handled and disposed of by the Commission by preliminary investigation and correspondence or conference with carriers and shippers. The matters considered and acted upon in this way range from overcharges upon small shipments to rate relations affecting the interests of entire communities, and are of the same nature as those which find their way to the regular case docket of the Commission." *Ibid.* See, also, *Annual Report, 1907, p. 120.*

<sup>3</sup> So important did these proceedings become, that a special Division of Claims was established, "charged with the investigation of claims involving reparation by the carrier to the shipper on account of alleged overcharge due to the application of excessive and unreasonable rates, misrouting, etc., which may be settled on informal complaint and are adjustable under the rules promulgated by the Commission." *Annual Report, 1908, p. 10.* This Division of Claims was later made part of the Division of Correspondence and Claims (*Annual Report, 1916, p. 2*), and is now the Special Docket section of the Bureau of Informal Cases (*Annual Report, 1920, p. 42*). The origin of this Special Docket has been described by the Commission as follows: "Soon after the passage of the Hepburn Act the Commission announced that in order to assist in the settlement of certain claims of shippers against carriers, and as a practical means of disposing with promptness of all informal complaints that might otherwise develop into formal complaints, and in connection with which the unreasonableness of the rate or regulation is admitted by the interested carrier or carriers it would on full information authorize adjustment by special order if all the facts and conditions warranted such action. A special docket was, therefore, provided for this branch of the Commission's work, and all claims involving reparation on informal complaint were placed upon this docket, given a number, and investigated. This docket has grown from No. 1, on January 1, 1907 (the date on which the Commission's first reparation order was issued), to No. 8755, on December 1, 1909." *Annual Report, 1909, pp. 58-59.* The Commission found warrant for its action in these reparation cases on the Special Docket in the same authority which it exercised in formal proceedings. "It might be well to state," the Commission continued, "that while cases coming forward on this docket are adjusted in an informal manner, this special docket is not an informal docket except in respect to the form of pleadings and the character of the

the other hand, is concerned with proceedings which involve contested issues and which result in the Commission's published reports. The handling of these proceedings generally follows the formal course of complaint, answer, hearing, argument, and decision—necessitating, in most instances, the issuance of an order; and it is the disposition of these cases, in face of complicated and far-reaching controversies as to the reasonableness, both absolute and relative, of charges and practices, that constitutes the Commission's major task in the field of rates and traffic.

The following table presents data evidencing the growth and present volume of the Commission's work as reflected in these informal and formal proceedings. They include, by years, as far as available, the number of informal complaints, the number of special docket applications, the number of formal complaints, the number of hearings, and the number of pages of testimony taken.<sup>4</sup>

This table (p. 9) indicates at a glance both the growth of the Commission's formal and informal dockets and the magnitude of the prevailing task in this field. The course of formal complaints, which impose the most important demands upon the Commission, reveals these elements with particular significance. It is obvious that the volume of the Commission's work came to assume substantial proportions with the passage of the Hepburn amendments in 1906, when the Commission's jurisdiction was extended and mandatory powers were conferred upon it. During 1907, the first full year of the operation of these amendments, the number of informal complaints grew from 1,002 to 4,382—more than a four-fold increase in the single year. But

hearing. The Commission can not on the special docket exceed the authority exercised by it on the formal docket, nor may it omit any requirement with respect to cases on the special docket that the law imposes on it in the disposition of cases on the formal docket. In all cases, whether on the formal or the informal docket, the law requires a complaint and answer and a full hearing, and provides that where damages are awarded the report of the Commission shall include the findings of fact on which the award is made. The Commission has endeavored to simplify the procedure on the special docket by accepting the application of the carrier as the equivalent of a complaint and answer, and by accepting as a sufficient compliance with the requirements of section 15 for a full hearing its admission that the rate charged under the circumstances then existing was unreasonable." *Ibid.*, p. 59.

<sup>4</sup> The figures in this table, as well as in all subsequent tables appearing in this chapter, have been compiled from the Commission's annual reports to Congress. While some minor inconsistencies appear in the figures as presented in the reports, their utility for our purposes is not impaired thereby.

RATES AND TRAFFIC

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TABLE I  
INFORMAL AND FORMAL CASES

<i>Year</i>	<i>Informal complaints</i>	<i>Special docket applications</i>	<i>Formal complaints</i>	<i>Hearings held</i>	<i>Pages of testimony taken</i>
1900			20		
1901			19		
1902	351		38		
1903	462		84		
1904	425		62		
1905	503		65		
1906	1,002		82		
1907	4,382		415		
1908	4,640	3,789	554		
1909	4,435	4,406	1,097		
1910	3,840	5,102	660	737	65,190
1911	4,325	5,653	881	943	95,000
1912	6,550	6,009	755	1,154	125,000
1913	7,600	6,730	1,023	1,401	140,000
1914	7,880	5,991	1,154	1,607	179,569
1915	6,500	6,690	964	1,543	200,438
1916	4,939	6,040	854	1,485	154,488
1917	5,300	4,883	651	1,228	210,133
1918	5,458	2,761	456	596	104,983
1919	4,450	1,885	838	839	106,591
1920	4,208	1,798	1,040	1,303	150,986
1921	7,811	2,350	1,487	1,616	185,111
1922	4,371	4,692	1,264	1,862	227,037
1923	6,405	5,543	1,160	1,883	248,383
1924	6,876	7,098	1,343	1,479	226,234
1925	6,871	7,032	1,505	1,502	246,069
1926	7,840	8,076	1,524	1,584	302,875
1927	7,578	9,393	1,561	1,600	291,299
1928	8,211	11,722	1,693	1,415	319,557
1929	7,339	11,843	1,520	1,355	219,519
1930	6,651	11,568	1,412	1,491	217,621
1931	6,352	10,736	1,021	1,188	206,407
1932	4,159	8,362	971	1,192	239,812
1933	3,164	7,801	741	1,028	184,476

even a sharper increase in formal complaints followed: their number grew from 82 to 415, more than a five-fold increase as between 1906 and 1907; and these 415 formal complaints exceeded the aggregate of such complaints filed during the preceding seven years. From then on the growth in volume has been persistent and substantial. The apparent drop in 1910, as compared with 1909, was due to the consolidation of all cases involving substantially the same subject-matter into the same docket number, on and after July 2, 1909. The decreases during the war years were the result of the abnormal situation then prevailing. These were years of industrial prosperity, with constantly rising prices, and the level of railroad rates, as evidenced by the large financial deficits incurred during the period of Federal Control, failed to reflect the increased operating costs incurred by the carriers. Furthermore, the roads were managed by the Government for a period of more than two years, with the authority of the Commission subordinated to that of the Railroad Administration in many respects; and patriotic motives as well as motives of business expediency were largely operative: some interests withheld complaints because of a desire to cooperate with the authorities under the exigencies of war conditions, while others preferred to wait till the roads were returned to their private owners in the expectation that success would more readily attend their efforts at rate readjustments with the carriers rather than the Government as the defending parties. But with the termination of Federal Control, with the passage of the Transportation Act, and with the extension of the Commission's authority resulting from the new enactment, the number of complaints, both formal and informal, sharply increased. The complete effect was not felt till 1921, the first full year of the operation of the statute; and, with some fluctuations, there were further substantial increases in the years following. Only with the great curtailment of traffic resulting from the economic depression did a marked decline follow in these various indices of the extent of the Commission's tasks. It is significant, as bearing upon the permanence of the regulatory process, that after more than forty-five years of activity on part of the Commission, the complaints and applications involving rates and charges and the controversies springing therefrom are as numerous as they are now. Since 1920 the Commission has received annually, on the average,



6,274 informal complaints, 7,715 special docket applications, and 1,303 formal complaints; and each year during that period, on the average, it has held 1,464 hearings and has taken 233,242 pages of testimony.

The proceedings handled by the bureaus of formal and informal cases, it has been pointed out, are not confined to matters involving rates and traffic. As a means, therefore, of indicating the volume of some of the Commission's work which is specifically applicable to this field, reference will also be made to the extent of the more important activities of the Bureau of Traffic, which has jurisdiction "over all matters dealing directly with the charges for transportation and transmission, by freight, passenger, express, pipe-line, and telegraph service, other than proceedings on the formal docket and complaints handled by the bureau of informal cases."<sup>5</sup> The units of this bureau the work of which is measurable to some extent in statistical terms are the Section on Tariffs, the Released Rates Committee, the Suspension Board, and the Fourth Section Board. The Section on Tariffs not only receives, checks, classifies, and files tariff schedules and other documents, but handles applications for authority to publish rates and charges on less than the statutory notice of 30 days and for waiver of the usual rules of tariff publication; the Released Rates Committee considers applications for authority to establish rates dependent upon the declared or agreed value of the commodity trans-

<sup>5</sup> *Annual Report, 1921*, p. 34. The Division of Rates and Transportation, mentioned as early as 1892, of which this bureau is an outgrowth, was originally described as follows: "The division of rates and transportation has charge of the tariffs, contracts, classifications, and other documents filed with the Commission under section 6 of the act. The general work of this division includes the recording and acknowledgment of documents received from the carriers, the examination, indexing, and filing of the various papers, and the correspondence resulting from failure on the part of carriers to meet the requirements of the act and orders of the Commission in the construction and filing of tariffs; also the preparation of data and information regarding rates for use in connection with complaints, and keeping of various records and other special work." *Annual Report, 1899*, pp. 49-50. In 1920 the Bureau of Traffic as such was established, and many significant activities growing out of the development of the Commission's powers were entrusted to it. "In the rearrangement of our forces to meet the increased duties laid upon us by the transportation act and contemporaneous legislation," said the Commission, "the bureau of traffic was organized. In this bureau we have consolidated the several boards, sections, and divisions which have heretofore dealt with the publication and filing of tariffs; the suspension of rates pending investigation; applications for relief from the provisions of section 4 of the act; the classification of freight; express charges; and practically all matters affecting charges for transportation other than proceedings on our formal docket, and complaints of an informal character handled by our bureau of informal cases." *Annual Report, 1920*, p. 42.

ported; the Suspension Board handles requests for the suspension of proposed changes in rates and charges; the Fourth Section Board, as its name implies, considers applications for authority to depart from prohibitions of that section, and particularly for relief from the so-called long-and-short-haul clause. In connection with these activities, in so far as they involve the exercise of discretionary power rather than mere administrative routine, the bureau simply acts in an advisory capacity to the Commission, as it does also in formal rate proceedings involving large matters of policy. "In dealing with these matters it investigates, conducts hearings when necessary, prepares reports, and makes recommendations concerning their disposition."<sup>6</sup> In the following tables data are presented indicating the volume of these activities.

Table II (p. 13) shows, for the years 1920 to 1933, inclusive, the number of tariff publications filed annually which contain changes in freight, passenger, express, and pipe-line rates and in classification ratings; the number of certificates of concurrence filed in connection with the publication of joint rates; the number of tariff schedules rejected because of failure to give the required statutory notice; the number of applications for authority to file changes in rates, fares, and charges without the required statutory notice or without adherence to other rules of tariff publication; and the number of rate memoranda prepared for the use of shippers, the Commission, or other departments of the Government.

From the standpoint of the sheer volume of activity involved, these figures speak for themselves. Their fluctuations can be largely explained as the effects of far-reaching rate determinations by the Commission, or as the results of unstable economic and transportation conditions. The large number of tariff publications filed in 1920 and 1922, for example, sprang from the exigencies of the general rate ad-

<sup>6</sup> *Annual Report*, 1925, p. 42. "The bureau also acts in an advisory capacity," continued the Commission, "in connection with the disposition of many formal cases, especially those involving general policies and the more important and extensive rate adjustments. In connection with suspended rate schedules and with other rate adjustments contemplated by the carriers, or sought by shippers, it has been instrumental in an increasing number of instances in securing a satisfactory informal adjustment of disputes between carriers and shippers, thus avoiding the delay and expense incident to the disposition of formal proceedings."

TABLE II  
TARIFF ACTIVITIES

Year	Tariffs filed	Concurrences filed	Tariffs rejected for want of required notice	Applications to file without required notice	Rate memoranda prepared
1920	135,426	87,763	3,306	2,524	5,146
1921	103,748	201,656	2,165	4,609	6,574
1922	135,433	98,082	2,034	5,475	8,537
1923	94,780	67,200	1,919	4,167	9,307
1924	89,955	64,169	1,101	4,784	12,430
1925	90,045	44,754	977	5,560	12,717
1926	84,748	42,833	968	5,216	8,336
1927	94,942	35,680	1,144	5,549	12,284
1928	93,672	29,185	970	6,317	12,188
1929	100,569	39,085	1,066	6,096	10,879
1930	110,583	37,813	1,327	6,534	9,786
1931	110,420	26,833	1,319	8,287	9,893
1932	156,994	23,988	6,345	11,829	
1933	114,287	38,757	1,006	12,569	6,426

vances<sup>7</sup> and general rate reductions<sup>8</sup> of those years. More recently, the pressure of competition by alternative carrying agencies, particu-

<sup>7</sup> *Increased Rates, 1920*, 58 I.C.C. 220. Note the following: "The work of the bureau has been especially heavy and important during the past year. The increases authorized in *Increased Rates, 1920, supra*, were allowed to become effective by the publication of supplements to all existing tariffs, the supplements containing percentage tables under which the increased rates are computed. As anticipated, these general increases not only have called for many important readjustments of the rates themselves . . . but, because of the impossibility of publishing the increased rates specifically and the necessity of using percentage tables, have added greatly to the difficulty of ascertaining the legal rates and charges, thereby materially increasing the number of controversies between shippers and carriers. . . . To remove the difficulties caused by use of percentage tables in increasing the rates we have required carriers to reissue their tariffs as promptly as possible and therein to state the rates specifically. Tariffs containing 432,220 pages of rates, rules, and regulations were so supplemented following *Increased Rates, 1920, supra*, and of these tariffs 300,220 pages have been reissued to bring them into conformity with our tariff rules up to and including September 1, 1921, the latest period available, leaving 132,209 pages yet to be reissued. This work under our instructions should be completed by March 1, 1922." *Annual Report, 1921*, p. 35.

<sup>8</sup> *Reduced Rates, 1922*, 68 I.C.C. 676. Note the following: "During June approxi-

larly under the prevailing conditions of greatly restricted traffic, has not only expanded the number of rate changes filed, but has increased very substantially the number of applications for authority to depart from the statutory requirements with respect to notice; and these developments have been in harmony with the Commission's policy of expediting specific rate readjustments, especially in a downward direction, which are designed to enhance railroad revenues.<sup>9</sup> Some of the tariff activities represented by the above figures, while

mately 34,000 tariff publications comprising in the aggregate 375,397 pages were filed, most of them in compliance with our findings in *Reduced Rates, 1922*. To afford shippers the benefit of the reduced rates at the earliest possible date and to minimize the expense to the carriers, these reduced rates were allowed to be filed on short notice, the Commission waiving its rules governing the construction of tariffs for the purpose, with the proviso that within a specified period new tariffs must be filed conforming with our rules." *Annual Report, 1922*, p. 46.

<sup>9</sup> During the depression of 1921 the Commission said: "It has been our policy, in dealing with rate readjustments, to encourage such changes as would tend promptly to relieve the existing depression of business in so far as changes in transportation charges may effect this result. Pursuant to this policy we have allowed changes in rates to be published upon less than the statutory 30 days' notice in a greater number of cases and under more liberal rules than heretofore. The requests therefor received from carriers numbered 4,609 as compared with 2,524 in the preceding year, and approximately 95 per cent were granted. In addition, 2,165 schedules tendered for filing were rejected as compared with 3,306 in the preceding period." *Annual Report, 1921*, p. 35. A similar policy has been followed in the current depression. In 1931, out of 8,287 applications for special permission to establish rates or fares on less than statutory notice, or for waiver of other tariff-publishing rules, 7,091 were granted by specific orders; in 1932, 10,209 were granted, out of 11,829; in 1933, 11,190 were granted, out of 12,569. *Annual Reports: 1931*, p. 64; 1932, p. 85; 1933, p. 71. Note, also, the following from *Fifteen Per Cent Case, 1931*, 178 I.C.C. 539, at pp. 577-578: "In addition to these pending revisions and others which are in progress on our docket, we believe that the traffic departments of the railroads should address themselves to the task of making such changes in the rates on particular kinds of traffic as will, in their judgment after careful analysis of all attendant circumstances, produce additional revenue and which can be supported as reasonable under existing conditions. This does not necessarily mean increases in rates. It is quite likely that there are now many rates which will produce more revenue if they are reduced, and we include in this category rates which we ourselves have prescribed as maxima. Some such rates have already been reduced, but we fear that there is at times a reluctance on the part of traffic officers, because of possible contingent effects, to cut below these rates even when they believe that the result would be to railroad advantage. But in addition to reductions it is not at all unlikely that there are a considerable number of rates which can reasonably be advanced substantially, even under present conditions. If tariffs are filed, in accordance with this suggestion, proposing changes in rates upon particular movements or kinds of traffic, we shall be guided, in determining whether they shall be suspended, not only by the statements filed in support and protest, but also, in part, by our own general knowledge and the record in this proceeding as bearing on the particular kind of traffic in question. . . . And to the extent that suspension proceedings are initiated, we shall expedite their disposition."

largely handled by subordinates under supervision, are not merely routine matters, nor are they clearly separable from the Commission's other regulatory processes.

Table III sets forth, for the years 1920 to 1926, inclusive (no data being published for later years), the number of applications received annually by the Commission seeking authority to establish and maintain rates dependent upon declared or agreed values.

TABLE III  
RELEASED RATE APPLICATIONS

	1920	1921	1922	1923	1924	1925	1926
<i>Applications filed</i>	128	210	163	165	61	56	44

It will be recalled that limitations upon the liability of carriers for full loss, damage, or injury caused by them to commodities transported is prohibited, but that such liability may be limited in case of rates dependent upon declared or agreed values, provided such rates are authorized by the Commission.<sup>10</sup> The number of these applications has varied, during the period, from a maximum of 210 to a minimum of 44, and the applications for approval have generally been disposed of without formal hearing.<sup>11</sup> Both the relatively small numbers of these applications and their noticeable decline in the latter portion of the period can be explained, in considerable measure, by the Commission's issuance of general orders, rather liberal in character, which removed the necessity of filing applications in many instances.<sup>12</sup>

<sup>10</sup> See Part I, chap. iii, note 5.

<sup>11</sup> But see *Released Rates on Stone in the Southeast*, 93 I.C.C. 90 (1924).

<sup>12</sup> By *Released Rates Order No. 331*, for example, it was provided that where authority had once been granted to establish and maintain released rates, "changes in rates, ratings, or carload minimum weights may be established thereafter and filed under authority of the original order without securing new released rates orders, providing that rules, regulations, or descriptions of the commodity or commodities to be affected or the declared or agreed value or values on which the same are dependent are not changed, and, provided further, that other routes or points of origin or destination are not added." But for the promulgation of this order, "probably more applications would have been made." *Annual Report, 1921*, pp. 41-42. Subsequently the situation was still further liberalized. In the words of the Commission: "Our released rates orders have hitherto been limited in their application to specific routes and points of origin and destination, but during the past year we have issued orders granting general twentieth section relief in connection with the transportation of livestock

Table IV presents data, for the years 1910 to 1933, inclusive, as far as available, concerning suspension proceedings.

TABLE IV  
SUSPENSION PROCEEDINGS

Year	Suspensions requested	Suspensions granted	Suspensions refused	Protects otherwise disposed of	Proceedings instituted on I. & S. docket
1910					25
1911					43
1912					120
1913					159
1914					204
1915					199
1916					223
1917					196
1918					10
1919					0
1920	140	66	70	4	66
1921	444	207	168	69	207
1922	570	257	181	132	257
1923	639	270	201	168	270
1924	667	316	180	171	316
1925	656	275	201	180	275
1926	643	268	169	206	268
1927	590	215	183	192	215
1928	541	195	165	181	195
1929	539	193	165	181	193
1930	487	157	187	143	157
1931	439	123	195	121	123
1932	626	198	266	162	175
1933	461	105	232	124	98

chiefly valuable for racing, breeding, show purposes, or other special uses, and of household goods or emigrant movables. . . . A number of individual applications for relief from the provisions of section 20 as to these commodities were withdrawn when the general orders were issued, and it is believed that these orders will result in a substantial decrease in the total number of applications filed in the future." *Annual Report, 1923*, p. 42. For a decrease, as a result of the Commission's decision in *Gold Hunter Mining Co. v. Director General*, 63 I.C.C. 234 (1921), of the number of applications covering ores and concentrates, see *ibid.*, pp. 42-43.

The power to suspend changes in rates, charges, and tariff provisions, pending investigation, was first conferred upon the Commission in 1910; and the present extent of the Commission's activity in this field, as in that of formal and informal cases, can best be gauged in terms of its growth from the very beginning. The exercise of the suspension power involves two distinct stages: first, a decision, with or without hearing, as to whether the protested change will be suspended; and second, in the event of suspension, the disposition of the case after investigation as in other formal proceedings. Accordingly, data are presented not only as to the number of instances, annually, in which changes were protested and suspensions asked, but also as to the number of proceedings instituted, as a result of suspensions granted, on the Investigation and Suspension Docket. Up to 1920, only the latter information is available; for the period since that time, the information includes also the number of suspensions requested and their preliminary disposition. It will be noted that there has been a marked growth in both directions, despite the sharp break of the war period and the fact of some decline during the past few years. In 1910 the proceedings instituted on the Investigation and Suspension Docket numbered 25; in 1933 the number was 98, but during intervening years it had grown to twice or three times this number. Similarly, the number of suspensions requested grew from 140 in 1920 to 461 in 1933, with intervening periods of considerably greater volume. From the standpoint of the extent of the Commission's tasks, it is significant to note that, in addition to complaints received in informal and formal cases, requests for suspension have averaged 531 annually since 1920, and formal proceedings resulting therefrom have averaged 201 annually.

Finally, Table V (p. 18) presents data for the years 1910 to 1933, inclusive, as far as available, concerning fourth-section applications.

While a long-and-short-haul clause had been included in the original Act to Regulate Commerce, its effectiveness, as we have seen, was destroyed by judicial interpretation. Not until 1910 was this species of local discrimination and certain allied practices prohibited in unequivocal terms, with express authority in the Commission, upon application and after investigation, to grant relief from the operation of the section and to prescribe the extent of such relief. Essentially the

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TABLE V  
FOURTH-SECTION APPLICATIONS

Year	Applications filed	Total orders entered	Orders in response to original 5,031 applications	Orders in response to subsequent applications	Number of original 5,031 applications remaining
1910	5,031				
1911	693	450			
1912	1,993	1,828			
1913	1,252	1,256			
1914	950	1,086			
1915	673	822			
1916	524	1,028			
1917	299	713			
1918	265	453			
1919	51	182			
1920	201	200	88	107	
1921	409	426	46	380	2,269
1922	180	330	114	216	1,767
1923	219	357	277	80	1,240
1924	116	217	136	79	1,068
1925	226	332	58	268	927
1926	209	192	50	138	889
1927	276	248	41	205	802
1928	329	285	13	266	776
1929	370	290	44	239	711
1930	239	240	60	175	649
1931	362	271	74	197	554
1932	363	311	50	261	107
1933	422	336			41

situation has remained unchanged since that time, although the Transportation Act of 1920 imposed certain specific limitations, which had been previously applied in considerable measure, upon the exercise of the Commission's discretion.<sup>18</sup> It is necessary, however, to differentiate between the applications filed immediately following the enactment of the 1910 legislation and those subsequently submitted. The amended long-and-short-haul provisions were to become effec-

<sup>18</sup> See *Annual Report*, 1920, pp. 47-48.



tive sixty days after June 18, 1910, the date of the approval of the act; but no changes in rates or fares then in force were to be required by reason of the amendment for a period of six months, nor until applications for relief filed with the Commission had been acted upon. In other words, the filing of applications served to stay the statute—that is, as far as then-existing violations of the fourth section were concerned, carriers were protected by their applications until each had been investigated and acted upon by the Commission. Under these terms, the carriers had until February 17, 1911, to file applications for relief; and during this period 5,031 such applications were filed, many of them "exceedingly voluminous and intricate, involving thousands of rates and many different situations."<sup>14</sup> Subsequent applications for fourth-section relief have been designed to meet newly developing situations. It will be noted that for a number of years new applications on this docket were forthcoming in very large numbers, rising as high as 1993 and 1252, respectively, in 1912 and 1913. With the development of the Commission's policies and practices in the premises, the numbers of new applications have shown a marked decrease, though they still add very substantially to the weight of the Commission's tasks. Since 1920 these new applications, generally involving formal disposition, have averaged 280 annually.<sup>15</sup> It is worthy of note, furthermore, as bearing upon the extent and difficulty of this administrative task, that despite the growing crystallization of the Commission's views and the sweeping rate readjustments effected in many

<sup>14</sup> *Annual Report, 1911*, p. 20.

<sup>15</sup> The sharp decrease in the number of applications during the war years, and particularly in 1919, was due in large measure to the policy of the Railroad Administration: "The operation of the transportation systems of the country by the Director General of Railroads under the Federal control act has had a marked effect upon the applications for relief from the requirements of the fourth section of the act to regulate commerce. The Director General has, in important instances, declined to defend carriers' applications for relief under the fourth section, but requested relief in a few instances. The applications filed have been in the main on behalf of carriers not under Federal control, and as these carriers form in the aggregate but a small part of the transportation system of the country, and have comparatively few situations where such relief is necessary, the number of applications has been less than in previous years." *Annual Report, 1919*, p. 26. In the year following, however, the Commission declared: "Since the return on March 1 last of the transportation systems to corporate control and the renewal of more active competition between individual carriers there has been a great and growing increase in the number of these applications." *Annual Report, 1920*, p. 48.

parts of the country, the complete disposition of the original 5,031 applications was not effected till 1934, after the lapse of almost a quarter of a century.

### §2. ORGANIZATION AND FINANCE

Not until the passage of the Transportation Act of 1920 was the Commission endowed with power over matters of organization and finance; the Commission's activity in this field constitutes one of the newer phases of its prevailing authority. The 1920 legislation, as has been indicated, involved the assumption of affirmative public responsibilities toward the carriers. This was made manifest by many of its provisions, and particularly by those establishing a rule of rate-making, those looking to the formulation and execution of a consolidation plan, and those involving the control of service and facilities. But in order that this end of maintaining an adequate national transportation system might be effectively achieved, it was also necessary that additional restraints be imposed upon the carriers. These restraints, touching largely upon matters of organization and finance, were directed against the managements of the roads in relation to the properties under their control, as distinguished from the restraints which had been traditionally imposed upon the carriers in relation to their dealings with shippers and other users of the transportation service. In order, for example, that the railroads might be permitted to earn the fair return contemplated by the statute, it was deemed essential that the construction of unnecessary new lines be prevented; similarly, in order that the credit of the carriers might be maintained and the continuous flow of necessary new capital might be forthcoming, it was deemed essential that unsound financial structures and speculative manipulation of securities be prevented. With such considerations by way of impetus, numerous powers and duties were conferred upon the Commission in this field. The activity incident to these duties and powers involves participation in a wide range of managerial affairs (for the most part by passing upon applications of the carriers for authority to pursue proposed courses of action), and necessitated the organization, in 1920, of a new administrative unit, the Bureau of Finance, for these special tasks.<sup>16</sup>

<sup>16</sup> See *Annual Report, 1920*, pp. 26-33.

In this bureau was vested jurisdiction over a great variety of matters: the issuance of certificates of public convenience and necessity for new lines, extensions of old lines, acquisitions for operation, and abandonments; the approval of acquisitions of control of one carrier by another, and the authorization of consolidations; the recovery of earnings in excess of a fair return, and the maintenance and administration of a general railroad contingent fund with the proceeds of such recovery; the regulation of security issues and of the assumption of financial obligations; the reimbursement of deficits incurred during the period of Federal Control, the execution of the guaranty of income made available to carriers for six months after the termination of Federal Control, and the extension of loans to carriers during the period immediately following the resumption of private operation. Similar in character to the execution of some of the above functions, is the activity of the Commission in authorizing interlocking directorates and pooling arrangements. In the aggregate these activities not only constitute a highly significant extension of the bounds of the regulatory process, but they have added strikingly to the weight of the Commission's administrative tasks. Our primary concern here is to indicate their volume as far as possible. Even from the standpoint of their mere extent, however, it will be helpful to resort to some degree of classification of subject-matter. The Commission's activities which centered about the termination of Federal Control, for example, were obviously of a purely transitional character. While they involved much exacting labor, they are for the most part concluded and now possess only an historical interest.<sup>17</sup> Of the remaining activi-

<sup>17</sup> The three major tasks involved in effecting the readjustments growing out of Federal Control were: first, the reimbursement of deficits; second, the administration of the transitional guaranty; and third, the extension of loans to carriers. *First*: Section 204 of the Transportation Act provided that such carriers as had operated their own lines during any portion of the period of Federal Control should be reimbursed for the deficits sustained during such portion of the period. This provision was designed to meet the difficulties of the short lines which had been relinquished from control by the Director-General and had competed or connected with lines operated by the Government. By the end of 1931 an aggregate of 461 claims amounting to \$28,978,173 had been filed; 451 claims, including 180 dismissals and 10 withdrawals, had been examined and settled; the certificates issued in settlement amounted to \$10,428,289.71; 10 claims, requiring approximately \$500,000, remained outstanding. *Annual Report*, 1931, pp. 10-11. See, also, *Annual Reports*: 1932, pp. 46-47; 1933, pp. 40-41. For the development of the Commission's views as to the meaning of "deficit" in this connection, see *Construction of the Word "Deficit"*, 66 I.C.C. 765 (1922);

ties, one group deals largely with matters of organization and the other with matters of finance. An attempt will be made to indicate the magnitude or extent of the demands made upon the Commission

*Deficit Status of Bingham & Garfield Ry. Co.*, 99 I.C.C. 724 (1925); *Deficit Settlement with B. & P. Ry.*, 117 I.C.C. 780 (1927), affirmed in *Butte, Anaconda & Pacific Ry. Co. v. U. S.*, 61 Fed. (2d) 587 (1933). *Second*: Section 209 of the Transportation Act provided for a guaranty to the carriers during the six months immediately following the termination of Federal Control of an amount equal to one-half of the annual standard return guaranteed during the Federal Control period. This provision was designed to overcome the difficulties of transition to private management before the necessary rate readjustments had been effected, and its applicability to any carrier was conditioned upon the filing of an acceptance of its terms by such carrier on or before March 15, 1920. It was the duty of the Commission to ascertain the amounts due and to certify them to the Secretary of the Treasury. The number of carriers availing themselves of this guaranty was 667; and claims were filed aggregating \$680,000,000 under instructions promulgated in *Final Settlements under Section 209*, 70 I.C.C. 711 (1921). By the end of 1931 an aggregate of 663 claims had been settled, including 140 dismissals; the total amount certified in connection with these claims was \$528,985,521.20, and the aggregate sum disallowed was \$150,881,923.45; 4 claims, requiring approximately \$200,000, were still pending. *Annual Report, 1931*, pp. 11-12. See, also, *Annual Reports: 1932*, p. 47; 1933, p. 41. For the nature of some of the issues involved in these proceedings, see *Guaranty Settlement with G. N. Ry. Co.*, 99 I.C.C. 231 (1925), 111 I.C.C. 318 (1926); *United States v. Great Northern Ry. Co.*, 287 U.S. 144 (1933). *Third*: Section 210 of the Transportation Act set up a revolving fund of \$300,000,000, to be used for the extension of loans to necessitous carriers during the period of transition. After hearing the Commission tentatively apportioned the fund to various purposes for which loans were to be made, and in passing upon applications of the carriers it also availed itself of the assistance of the Association of Railway Executives and of the American Short Line Association. Since no applications for loans could be entertained unless made prior to February 28, 1922, the fund has been in liquidation since that date. By the end of 1933, of the loans aggregating \$350,600,667, a total of \$317,438,709.39 had been repaid, together with interest amounting to \$89,663,047.10; unmatured loans amounted to \$28,842,102.94, and carriers were in default to the extent of \$4,319,854.67 on principal and \$7,654,289.26 in interest payments. *Annual Report, 1933*, pp. 41, 129. For the character of the Commission's activities in connection with loans to the railroads under the Reconstruction Finance Corporation Act of January 22, 1932, see *Annual Reports: 1932*, pp. 12-15, 258; 1933, pp. 21-22, 129. At the end of 1933 the Commission summarized its activities as follows: "The aggregate amount of loans approved by us under this act is \$436,405,523. . . . Since work under this act was initiated in February 1932, applications for loans have been filed by 145 carriers or their receivers or trustees. Loans to 81 of these applicants have been approved. For various reasons we were unable to approve loans on the applications of 41 others, and in 23 cases the applications were dismissed usually with the consent of the applicants. Some of the carriers have received more than one loan. In a few instances the diminishing resources of the carriers and their inability to furnish acceptable security for additional loans, have required denials where earlier applications have been approved. Due apparently to an improvement in business conditions affecting the carriers, the need for financing them under this act has diminished, as indicated by the declining number of applications and the withdrawal of others" (pp. 21-22).

in connection with each of the more important constituents of these two groups of activities.

One source of the Commission's control of the organization of the carriers lies in its authority to grant or deny certificates of public convenience and necessity for extensions, abandonments, and acquisitions for operation. Without prior application to the Commission and favorable action thereon, no carrier by railroad subject to the Interstate Commerce Act can proceed in these ways to extend or curtail its operating plant or service. Although financial problems are inevitably involved in connection with every such application for authority, and although the administration of the relevant provisions is entrusted to the Bureau of Finance, the question of sanctioning or restraining the policies of the management with respect to organization for service constitutes the dominant issue in such proceedings, from the standpoint both of substantive ends and of the regulatory process. Because the welfare of entire communities may be involved, as against the property rights and managerial independence of the owners of the transportation mechanism, extended inquiry and delicate adjustments become necessary. Similarly, while the various tasks performed by the Commission which bear upon intercorporate relationships generally cannot escape the pressure of financial complications, the essential problem is one of organization, in terms both of maintaining such competitive freedom as is deemed necessary and of effecting such unification of the transportation system as is believed to be in the public interest. The prohibition of pooling as between different and competing railroads, except upon specific approval of the Commission, and the requirement that no person shall hold the position of officer or director of more than one carrier, except upon authorization of the Commission, but provide a basis for regulating informal coöperative activity. In addition, the provisions dealing with the consolidation of the carriers into a limited number of systems, and with acquisitions of control through lease, stock ownership, or any other method not involving consolidation into a single system for ownership and operation, constitute a more definite departure from the traditional policy of enforced competition, and are designed, through the supervised reorganization of carrier ownership and control, to

promote on a more permanent basis the affirmative purposes of the Transportation Act. In all these matters of organization the Commission has been functioning actively since 1920.

Table VI shows, for the years 1920 to 1933, inclusive, as far as the data are available, the number of applications filed for authority to construct new lines or to extend existing lines, together with the railroad mileage involved; the number of applications filed for authority to abandon railroad lines or portions thereof, together with the mileage involved; and the number of applications filed for authority to operate or to acquire and operate railroad lines, together with the mileage involved.

TABLE VI  
CERTIFICATES OF CONVENIENCE AND NECESSITY

<i>Year</i>	<i>Applications for extensions</i>	<i>Miles of road involved</i>	<i>Applications for abandonments</i>	<i>Miles of road involved</i>	<i>Applications for operation</i>	<i>Miles of road involved</i>
1920	16		9			
1921	39		40			
1922	53	2,941.28	47	808.46		
1923	50	2,914.51	36	964.94	28	780.44
1924	42	2,564.66	52	949.82	26	2,052.56
1925	73	3,512.50	57	883.21	37	2,935.40
1926	51	1,280.52	46	937.19	39	2,149.29
1927	41	1,257.73	56	792.26	49	15,340.51
1928	46	1,380.79	53	752.21	58	3,301.48
1929	79	3,307.26	69	834.92	58	3,190.83
1930	37	737.83	75	980.83	56	1,829.57
1931	21	319.39	88	1,075.53	44	2,945.94
1932	9	850.86	114	2,281.42	34	2,019.83
1933	12	491.29	153	3,263.21	40	1,536.11

It appears from the above table that on the average approximately 150 applications for certificates of convenience and necessity have been filed annually. The recent shrinkage in the number of applications for extensions, as a result of the depression and of the competition of other carrying agencies, has been more than offset by the increased number of applications for abandonments. During the period as a whole, on the basis of these somewhat incomplete figures, there

has been an aggregate of 1,933 applications for certificates—569 for new construction, 895 for abandonments, and 469 for operation—the proposed extensions involving 21,559 miles of line, the proposed abandonments involving 14,524 miles of line, and the requests for authority to operate or to acquire and operate involving 38,082 miles of line.<sup>18</sup>

Turning, now, to the activities touching upon intercorporate relationships, we will note, first, the extent to which the Commission has been resorted to in connection with pooling arrangements and interlocking directorates—the loose expedients involving some measure of carrier coöperation. Pooling arrangements can be disposed of summarily at this point. In view of the general prosperity of the roads prior to 1930, and in view of the possibility of preventing unduly low charges through the Commission's power over minimum rates, there have been but few proceedings requiring the Commission's approval of agreements or combinations for the pooling of freights or earnings, and these proceedings neither require, nor afford a basis for, statistical measurement.<sup>19</sup> In the case of interlocking directorates, on the other hand, there have been numerous requests for the Commission's authorization, upon a showing, as required by statute, that neither public nor private interests would be prejudiced thereby. Since the statutory prohibition did not become effective till after December 31, 1921, the data in Table VII below are for the years 1922 to 1933,

<sup>18</sup> In the disposition of these proceedings the Commission has received the assistance of the local authorities. The following is typical: "We have continued the practice of enlisting the cooperation of the State commissions in these cases. In 57 of them hearings have been held for us by State commissions, and in most of such cases in which a decision has been reached their recommendations and our conclusions have coincided." *Annual Report, 1933*, p. 37. The numbers of hearings held by the state commissions during the preceding years have been as follows: 15 in 1921; 24 in 1922; 18 in 1923; 45 in 1924; 54 in 1925; 41 in 1926; 18 in 1927; 38 in 1928; 36 in 1929; 41 in 1930; 25 in 1931; and 19 in 1932.

<sup>19</sup> See *Division of Traffic G. & N. Ry. and Connections*, 74 I.C.C. 444 (1922); *Puget Sound-Portland Joint Passenger-Train Service*, 96 I.C.C. 116 (1925), 128 I.C.C. 149 (1927), 167 I.C.C. 308 (1930); *Joint Passenger-Train Service*, 107 I.C.C. 493 (1926), 112 I.C.C. 403 (1926), 132 I.C.C. 413 (1927), 161 I.C.C. 1 (1930); *Pooling Ore Traffic in Wisconsin and Michigan*, 201 I.C.C. 13 (1934); *Pooling Passenger-Train Revenues and Service*, 201 I.C.C. 699 (1934). In all these proceedings, under the terms approved, the arrangements were found to be in the interest of better service or of economy of operation and not unduly restrictive of competition. But see *Union Belt of Detroit Pooling of Revenues*, 201 I.C.C. 577 (1934), in which the application was denied.

inclusive. They show the number of applications received annually from individuals, the number of applications received annually from carriers, and the number of persons to whom these applications, in the aggregate, related. On the average, 410 applications, relating to 902 different persons, have been received annually during this period. The sharp decline in carrier applications, beginning in 1923, was the result of changes in the Commission's regulations.<sup>20</sup> The total numbers of applications for authority have thus been numerous, although the Commission's denials have been very few.<sup>21</sup>

TABLE VII  
INTERLOCKING DIRECTORATES

<i>Year</i>	<i>Applications from individuals</i>	<i>Applications from carriers</i>	<i>Number of persons involved</i>
1922	430	319	2,349
1923	402	13	653
1924	324	9	770
1925	361	14	914
1926	471	17	1,167
1927	410	14	796
1928	323	15	723
1929	478	12	837
1930	473	10	1,099
1931	220	3	240
1932	361	6	612
1933	228	7	667

<sup>20</sup> These changes have been explained as follows by the Commission: "Our regulations governing procedure in cases of this nature were revised by our order of June 19, 1922. Formerly, applications could be made either by interested carriers or by individuals. Under the revised regulations applications can be made only by the individuals concerned, and each application must be confined to one person. There is one exception. Where all the carriers involved may be regarded as parts of a single system, application may be made by an interested carrier in behalf of any number of persons for general authority to hold positions with any or all of the companies of the system." *Annual Report, 1922, pp. 33-34.*

<sup>21</sup> During this entire period there have been only seventeen outright denials of authority as prayed for in the applications. The Commission has pointed out repeatedly that this result arises from the fact that the statutory provision, as construed, has been accepted as controlling both by the carriers and by the individuals involved. The following is typical: "As stated in our last report, the effect of the statute can not be measured by the number of cases in which we have refused to grant authority. It may be assumed that in many instances the law has exercised a controlling influence in the selection of individuals for positions with carriers having conflicting interests. Com-



The more significant tasks imposed upon the Commission in the matter of intercorporate relationships—those designed to effect permanent unifications among the carriers—are concerned with the consolidation of the railroads into a limited number of systems and with acquisitions of control of one carrier by another, short of consolidation into a single system for ownership and operation. The consolidation of railroads into a limited number of systems was conditioned upon the formulation by the Commission of a complete plan to which consolidations must conform. While an elaborate investigation was made for this purpose and a tentative plan was formulated as early as August 3, 1921,<sup>22</sup> followed by extensive hearings and the building up of a voluminous record,<sup>23</sup> the Commission for a number of years delayed the adoption of a final plan, and did not announce one till late in 1929.<sup>24</sup> Since the period of the depression, because of financial and other difficulties, was not conducive to effecting consolidations, actual performance in this field of corporate combination of railroads has been largely confined, since 1920, to a consideration of requests for acquisitions of control.<sup>25</sup>

paratively few applications for authority to serve such carriers have been filed with us." *Annual Report*, 1932, p. 46.

<sup>22</sup> *Consolidation of Railroads*, 63 I.C.C. 455 (1921).

<sup>23</sup> See *Annual Reports*: 1921, pp. 9-10; 1922, p. 22; 1923, p. 12; 1924, p. 13. The hearings were completed December 4, 1923; oral argument was had during the week beginning January 7, 1924; briefs were to be filed not later than February 9, 1924; and the proceeding was submitted as of that date. The record comprised 54 volumes, including 11,713 pages of testimony and 711 exhibits.

<sup>24</sup> The Commission became convinced that the adoption of a complete plan to which future consolidations must conform was not a wise method of securing unification of the railroad systems of the country; and on February 4, 1925, it addressed a communication to the chairman of the Senate Committee on Interstate Commerce explaining this conclusion and the reasons therefor. To this communication was also attached a proposed amendment to section 5 of the Act, whereby the Commission would be relieved of the duty of adopting a complete plan and the process of consolidation would be "permitted to develop, under the guidance of the Commission, in a more normal way." *Annual Report*, 1925, pp. 13-14. Formal recommendation to this effect was included in the Commission's annual reports through 1928; but while bills were proposed and legislative hearings held, no action was taken by Congress. In the summer of 1929 announcement was made by the Commission that it would proceed with the formulation of a consolidation plan under existing law, and the plan formally appeared on December 9th of that year. *Consolidation of Railroads*, 159 I.C.C. 522.

<sup>25</sup> But mention should be made at this point of the Commission's activity in the matter of authorizing consolidations of telephone companies, under paragraph (9) of section 5 of the Act, added June 10, 1921 (42 Stat. 27). By the end of 1933 a total of 287 applications for authority had been received, distributed as follows: 3 in 1921;

Table VIII below shows, for the years 1920 to 1933, inclusive, the number of applications filed, the number of authorizations issued, and, as far as data are available, the number of miles of line affected by such authorizations. It will be noted that, despite the uncertainty during most of the period as to the relation of such acquisitions of control to the ultimate plan of consolidation, an aggregate of 451 applications was received during this period, with favorable action in 394 proceedings; and that, despite the denial of authority for some of the major proposals, the authorizations issued since 1923 involved 57,442 miles of line.<sup>26</sup>

TABLE VIII  
ACQUISITIONS OF CONTROL

<i>Year</i>	<i>Applications filed</i>	<i>Authorizations issued</i>	<i>Miles of line affected</i>
1920	2	2	
1921	25	19	
1922	28	24	
1923	24	16	4,009.95
1924	34	33	10,928.62
1925	39	26	2,883.13
1926	51	48	6,328.18
1927	44	55	7,105.59
1928	45	31	4,874.09
1929	56	44	8,207.57
1930	33	47	5,105.25
1931	29	14	1,685.35
1932	26	26	4,498.08
1933	15	9	1,815.38

Finally, data will be presented with regard to those of the Commission's activities which concern primarily matters of finance. These activities embrace, first, the exercise of authority over the issuance of

13 in 1922; 18 in 1923; 20 in 1924; 23 in 1925; 25 in 1926; 26 in 1927; 41 in 1928; 43 in 1929; 34 in 1930; 19 in 1931; 16 in 1932; and 6 in 1933.

<sup>26</sup> The total mileage involved through 1933 probably exceeds 64,000, as mileage data do not appear in the annual reports prior to 1923. In *Annual Report*, 1926, p. 18, the Commission declared: "Since the effective date of paragraph (2) of section 5 we have authorized thereunder acquisition of control over approximately 31,000 miles of line." The total in Table VIII through 1926 is 24,150 miles.

securities; and, second, the administration of the provisions for the recapture of excess earnings. The functions performed in these two fields are essentially distinct: the regulation of security issues involves control of the financial structures of the carriers; the recovery of excess earnings involves control of the net railway operating income accruing to particular carriers under the rate adjustments prescribed or sanctioned by law. In both cases, however, the determination of questions of policy, as well as the exercise of routine supervisory powers, is necessary; and since both fields concern the finances of the carriers, from the standpoint of capital or income, jurisdiction in each case was entrusted to the Bureau of Finance. In the matter of security regulation the authority of the Commission became effectively operative from the very beginning; all of the vast financing of the carriers since the enactment of the 1920 legislation has been subject to the Commission's approval, on the basis of the legitimacy of the purposes of the issues, their size, the types of instruments employed, and their terms and conditions. In the administration of the recapture provisions, on the other hand, despite the early establishment of the constitutionality of the enactment,<sup>27</sup> some of the dominant issues—such as what the value base shall be for the computation of excess earnings<sup>28</sup> and under what circumstances a group of carriers shall be deemed under common control and management and operated as a single system<sup>29</sup>—remained largely undetermined throughout the life

<sup>27</sup> *Dayton-Goose Creek Ry. v. U.S.*, 263 U.S. 456 (1924).

<sup>28</sup> See *Excess Income of St. Louis & O'Fallon Ry. Co.*, 124 I.C.C. 3 (1927), and *St. L. & O'Fallon R. Co. v. U.S.*, 279 U.S. 461 (1929), in which the Supreme Court condemned the valuation procedure employed by the Commission for recapture purposes. On the practical aspect of the problem, note the following: "We again call attention to the fact that the excess income reported has not been computed upon values fixed by us. Under our orders carriers have been permitted to compute their claimed values upon such basis as they deem proper. Under this procedure many different bases have been used. When values shall have been fixed by us the number of carriers found to have earned excess income and the amount thereof may differ from the results shown in carriers' reports." *Annual Report*, 1929, pp. 84-85. Also: "While the carriers reported a total excess income of only \$23,548,871.76, one-half of which is subject to recapture, for the period 1920 to 1931, inclusive, our estimates of recapturable excess income for the period 1920 to 1930, inclusive, amount to considerably over \$300,000,000." *Annual Report*, 1932, p. 93.

<sup>29</sup> The statute provided that such commonly controlled and operated properties shall be treated as a single system, in the determination of both the value base and the net operating income, "irrespective of the separate ownership and accounting returns of the various parts of such system." Sec. 15a, par. (6). On the resulting situation,

of the experiment; in 1933, moreover, the recapture provisions were retroactively repealed.<sup>80</sup> But while thus lacking in contemporary significance, the heavy labors of the Commission for many years in matters of recapture, as in the more far-reaching and currently important field of security regulation, require notice. In the following tables various data are presented indicating the extent or magnitude of the tasks imposed upon the Commission in connection with these two aspects of carrier finance.

Table IX (p. 31) shows, for the years 1920 to 1933, inclusive, certain measures of the extent of the Commission's activity with regard to the issuance of railroad securities. The figures present the number of applications for authority, including supplements, received annually, the amounts of the authorizations granted, exclusive of no-par shares, and the amounts of the certificates of notification filed which represent note issues maturing in two years or less.<sup>81</sup> These data do not disclose, of course, the great variety of the types of securities authorized or the great diversity of the purposes for which the issues were approved. During the year 1930, for example, before the capital market had become largely sterile as a result of the depression, the authorizations embraced preferred stocks, common stocks, mortgage bonds, income-mortgage bonds, debentures, secured and unsecured notes, equipment obligations, drafts, receivers' notes, and receivers'

note the following: "Many of the reports filed include groups of carriers claimed by respondents to have been under common control and management and operated as single systems. . . . The question of grouping into systems is being reserved for disposition in proceedings had for the determination of the amount of liability in individual cases." *Annual Report*, 1932, p. 93.

<sup>80</sup> Emergency Railroad Transportation Act of June 16, 1933, Public No. 68, 73d Congress. In its last regular report to Congress prior to the repeal of the recapture provisions, the Commission described the status of payments on account of recapture as follows: "Since our last report three carriers have paid us \$3,300.96. . . . These payments, added to the \$10,681,249.90 paid prior to November 1, 1931, make the total payments of excess income \$10,684,550.86. . . . As stated in our previous reports, the bulk of these payments were made under formal protests and reservations. Consequently the general railroad contingent fund . . . has not been available for the purposes contemplated by the statute." *Annual Report*, 1932, p. 94.

<sup>81</sup> Under paragraph (9) of section 20a note issues maturing in not more than two years and aggregating, together with all other such short-term notes then outstanding, not more than 5 per cent of the par value of the outstanding securities of the carrier, do not require the Commission's authorization. But certificates of notification must be filed with the Commission with regard to such note issues, setting forth the same matters required in applications for authority to issue other securities; and in any subsequent funding of these notes the Commission's full powers become applicable.

certificates; and the purposes of the issues embraced additions and betterments, acquisitions of property other than equipment, acquisitions of equipment, acquisitions of securities of other companies, construction of new lines and extensions of existing facilities, payment of maturing capital obligations, extensions of matured debts, refunding of matured obligations, conversion of securities, exchange of securities, payment of advances, reimbursement of the treasury, pledge, stock dividends, reorganizations, and general corporate purposes. It will be noted from the table below that an aggregate of more than 3,000 applications, including supplements, was filed during this period, averaging 215 annually; and that for the thirteen years beginning in 1921 an aggregate in excess of \$16,000,000,000 of securities was authorized, exclusive of more than 8,000,000 shares of stock without nominal or par value, averaging an annual authorization of \$1,230,000,000.

TABLE IX  
SECURITY ISSUES

<i>Year</i>	<i>Applications received</i>	<i>Amount of authorizations</i>	<i>Amount of certificates of notification</i>
1920	61		
1921	283	\$1,715,601,624	\$137,502,723
1922	195	889,719,710	54,141,584
1923	268	1,213,054,783	65,902,381
1924	283	1,795,027,403	137,438,523
1925	281	907,777,854	78,270,289
1926	206	862,628,862	120,922,525
1927	238	1,157,368,222	114,628,526
1928	229	1,871,200,315	125,480,048
1929	232	1,160,383,991	43,201,576
1930	223	1,723,543,133	185,106,370
1931	168	750,092,636	314,932,044
1932	223	1,398,870,789	248,548,944
1933	126	565,363,923	166,419,449

Finally, Table X (p. 33) presents, for the years 1920 to 1931, inclusive, some of the more significant data concerning the administration of the recapture provisions. These data include not only the response of the carriers to the Commission's general orders with regard to the

recovery of excess earnings, but the extent of the Commission's activities in checking the returns. There is shown the number of reports submitted by the carriers for each period; the amount of excess income reported for each period; and the number of accounting examinations completed annually for checking the returns of the carriers. In some parts of the period the accounting examinations required under these provisions became so urgent and were accelerated to such an extent that practically the entire field force of the Commission was utilized for this purpose.<sup>82</sup> It should be noted, also, that prior to the repeal of the recapture provisions very substantial progress had been made in the holding of hearings on matters of value and other controversial issues and in the preparation of reports actually fixing the net railway operating income subject to recapture.<sup>83</sup>

<sup>82</sup> At the end of 1926 the Commission said: "Our duties under section 15a of the interstate commerce act have made it necessary to confine the field work of our bureau of accounts almost exclusively to examinations of carriers' accounts in connection with possible recapture by the Government of excess earnings under that section." *Annual Report*, 1926, p. 85. This situation continued for a number of years. In its summary of this accounting work prior to the repeal of the recapture provisions, the Commission reported as follows: "Our bureau of accounts during the year made 202 examinations of the accounts of steam railroads for the purpose of determining correct net railway operating income, bringing the total number of examinations thus far made for recapture periods from 1920 to 1931 to 4,068. In 3,306 cases the net railway operating income has been reported by the bureau. In 2,080 of these cases the figures stated by the carriers have been increased \$72,345,335.11, and in 977 cases they have been reduced \$53,035,944.13. In 249 cases the carriers' figures were not changed by our examinations. In 762 cases final reports have not been made, but the net railway operating income has been tentatively determined, with the result that in 452 cases an increase of \$80,650,745.37 is indicated, and in 277 cases a decrease of \$40,473,120.81. In 33 cases the carriers' figures are not changed. Combining the results set forth in final reports with the tentative determinations, our accounting examinations result in increasing the net railway operating income \$152,996,080.48 in 2,532 cases and decreasing it \$93,509,064.94 in 1,254 cases, a total net increase of \$59,487,015.54." *Annual Report*, 1932, p. 95. Subsequently 143 additional recapture examinations were made, bringing the total number of accounting examinations for recapture purposes to 4,211. *Annual Report*, 1933, pp. 35-36.

<sup>83</sup> The procedure originally adopted in the disposition of recapture cases, through hearing and issuance of proposed reports as in formal proceedings, did not prove satisfactory, and in 1930 a change was instituted: "Formerly a case was set down for hearing on the returns of the carrier showing property value, net railway operating income, and excess income for each year, and after the taking of testimony an examiner's proposed report was issued to which the parties were permitted to file exceptions. After a consideration of these exceptions it was contemplated that a final report would issue. Thirty-seven cases have been handled in this way, although only one has reached the final-report stage. This procedure, however, was found to be unsatisfactory and in lieu thereof we have substituted a new one modeled after the valuation procedure prescribed in section 19a. Proceedings are now initiated by a tentative recapture report

TABLE X  
RECOVERY OF EXCESS EARNINGS

Year	Reports from carriers	Amount of excess income reported	Accounting examinations
1920	993	\$2,505,006	
1921	975	458,535	
1922	931	1,867,239	
1923	902	6,909,296	14
1924	902	1,196,261	271
1925	897	2,402,198	354
1926	882	1,090,490	421
1927	870	177,566	732
1928	851	1,115,087	813
1929	843	5,378,101	595
1930	810	381,266	168
1931	753	67,821	202

### §3. VALUATIONS OF CARRIER PROPERTY

Valuations of carrier property are closely related to the performance of some of the more important of the regulatory tasks surveyed in the preceding two sections. Such valuations were essential to effective rate control, in the establishment of the general level of charges and in the disposition of the flow of earnings resulting therefrom under

setting forth the results of our ex parte investigation into the subjects of value, income, and resultant recapture liability, which is served on the carrier and other interested parties and becomes a final determination if no protest is filed within a specified time. If a protest is filed, a hearing is had, briefs filed, followed by oral argument when requested, and by a final report." *Annual Report*, 1930, p. 85. In the final summary of this aspect of its labors, under both procedures, the Commission reported as follows: "Hearings have been completed in all cases remaining to be disposed of under the old procedure. The number of such cases was reduced to 34, the estimated recoverable excess income being \$17,835,848. Twenty-two proposed reports have been served and six made final. Under the new procedure 63 tentative reports were served during the year, involving approximately \$31,991,632 recapturable excess income. This brings the total number of tentative reports served to 136, and the approximate recapturable excess income to \$54,795,794. No protests were filed in 11 cases. Hearings have been completed or are in progress on 90. Ten are final by decision. Eleven additional tentative reports involving an estimated \$2,302,815 of recapturable excess income have been prepared but not yet served, and 64 tentative reports involving approximately \$25,715,740 are in course of preparation. The combined proposed and tentative report cases upon which action has been and is being taken now number 245, with estimated recapturable excess approximating \$100,650,197." *Annual Report*, 1932, pp. 95-96.

the mandates of the Transportation Act, as well as for the execution of the consolidation provisions and for the regulation of security issues. The Commission's activity in this field, therefore, is but ancillary to the continuous exercise of its major powers in other spheres. Valuations are not ends in themselves, nor do they, as such, involve restrictions upon management or adjustments between the carriers and the users of their service. In making valuations the Commission is engaged, essentially, in a research undertaking—an undertaking which, in its organization and conduct, is distinctly separable from the remainder of the Commission's work. Yet the tasks involved and the administrative mechanism required are not of temporary duration. With a stupendous amount of inventorying, pricing, and accumulation of accounting and historical data to be accomplished, the project required initially a much more elaborate organization and a much more extensive personnel than is now necessary or will be needed in the future; but since the Commission was charged with keeping these valuations up to date, in order that they may be available for current use in the various regulatory processes to which they are pertinent, the valuation work constitutes a permanent aspect of the Commission's administrative functions.<sup>84</sup>

The Commission's activity in this field dates from the passage of the Valuation Act of March 1, 1913. The purpose here is merely to indicate the progress of this activity from the standpoint of the magnitude of the undertaking. The data presented will deal, primarily, with the extent of performance of the principal tasks required for the determination of final single-sum values; but they will be supplemented by figures as to the number of employees engaged and the amount of expenditures incurred because of their bearing upon the vastness of the project.

The determination of single-sum values, even as of primary valuation dates, necessitated the ascertainment of the underlying figures,

<sup>84</sup> Compare the following: "By the act of March 1, 1913, the Commission is required to value the property of all common carriers subject to the act to regulate commerce. . . . For the purpose of executing the provisions of this act the Commission organized, within the 60 days, a division of valuation, corresponding with its divisions of statistics, accounts, tariffs, etc. Since, after the initial valuation has been made the Commission is required to keep the same up to date, this division will be permanent and will embrace an important part of the work of the Commission." *Annual Report*, 1913, p. 75.



the establishment of tentative valuations on the basis thereof, and, after protest and hearing, the announcement of final valuations. The most laborious portion of the work, though perhaps not the most difficult and certainly not the most significant in terms of principle and policy, was that involved in ascertaining the underlying figures. These figures represented the elements of cost and of value expressly required to be found by the provisions of the statute. They were embraced, for the most part, in the underlying engineering reports, covering reproduction costs, both new and less depreciation, the underlying accounting reports, covering original costs and matters of financial and corporate history, and the underlying land reports, covering the required costs and values of carrier lands.<sup>85</sup> The progress of the valuation work is first indicated in terms of these underlying reports.

Table XI (p. 37) shows the status of the Commission's work in ascertaining the underlying figures, as evidenced by the number and scope of the underlying engineering, accounting, and land reports completed by the end of each year, beginning in 1921 and extending to 1926.<sup>86</sup> The data presented include the number of reports made, the number of corporations embraced therein, the number of miles of road covered thereby, and the percentage of the total railroad mileage involved. Detailed comparable data along these lines were first available for 1921. It will be noted that by the end of that year, almost nine years after the initiation of the valuation project, only about one-half of the engineering reports and only about one-quarter of the accounting and land reports had been completed;<sup>87</sup> and that not until

<sup>85</sup> Compare the following: "Broadly speaking, the present work of the Commission under this act falls under two general heads: First, ascertainment of the cost of reproduction of the property new, and also less depreciation; second, ascertainment of the original cost of the property to date, together with certain information as to its financial and corporate history. The first is largely engineering, the second accounting. The act also requires certain specific information as to lands, rights of way, and terminals. The value of these is a considerable part of the total value of a railway property. It follows that the work of the division of valuation is done through three subdivisions—engineering, accounting, and land." *Annual Report, 1914*, pp. 61-62.

<sup>86</sup> In accordance with the Commission's usual practice, the period covered by these data ends in each instance on October 31—that is, the annual periods extend from November 1 of one year to October 31 of the year following.

<sup>87</sup> In considerable measure the war period interfered with more prompt performance, both because of the difficulty of securing competent men, especially for the accounting section, and because of the higher costs involved. See *Annual Reports: 1917*,

the end of 1926, after a period of almost fourteen years, were substantially all of the underlying figures ascertained.<sup>88</sup> The magnitude of the undertaking is clearly evidenced by the fact that when this task was entirely completed, with all underlying engineering, accounting, and land reports "served on the carriers concerned and

p. 52; 1918, p. 56; 1919, p. 52; 1920, p. 69. Furthermore, it must be remembered that the valuation work is cumulative and cannot be measured entirely by the number of completed reports. As early as 1917, for example, the Commission directed attention to the following significant considerations: "It would be highly desirable in the prosecution of this work to finish each property before proceeding to the next, but this has been found impracticable in actual experience. The carriers are required to furnish certain information, and the work of the Commission upon a particular property cannot be completed until that information has been furnished. The inability of the carriers to promptly give this information has rendered it impossible to complete reports upon their properties. For example, each carrier is required to file a schedule of its equipment, stating, among other things, the original cost of each piece of equipment as shown by its books. It is required to file another schedule showing its lands and the cost of each parcel when disclosed by its records. While this looks simple in the statement it is a very extended process in fact. The number of men who can be employed upon the records of the carrier in searching out these facts is limited so that in case of systems of considerable size a great deal of time is required. And yet no final report can be prepared by either the engineering, land, or accounting sections until these returns have been received. This has made it necessary to pass on to other carriers before completing work on those first undertaken and the actual situation today is that the Commission is engaged in the valuation of nearly every railroad system of any importance in the entire country, although scarcely any of those systems have been completed." *Annual Report*, 1917, p. 53. See, also, *Annual Report*, 1918, pp. 56-57. That the number of completed reports did not measure fully the progress made in ascertaining the underlying figures was further evidenced by the status of the field work at the end of 1921: "The work of the bureau of valuation divides itself, in all sections, into two broad classifications, field and office. In the engineering section, which required a larger and more expensive organization than either the land or accounting sections, all field work has been completed and the parties have been disbanded. In the accounting section approximately 98 per cent of the field work has been completed and the balance will be finished in the current year. . . . In the land section, on a basis of mileage, the field work is 98 per cent completed and the personnel reduced to about one-fifth of its quota at the beginning of the year." *Annual Report*, 1921, pp. 55-56. Finally, it should be noted that, despite the incompleteness of the underlying reports as a whole, 151 tentative valuation reports had been issued at that time, representing the properties of 193 carriers, and covering 24,493 miles of road. *Annual Report*, 1922, p. 71.

<sup>88</sup> By that time, however, 894 tentative valuation reports had been served, embracing 1,328 corporations and covering 160,486 miles of road—constituting about two-thirds of the entire railroad mileage; hearings on protests against tentative valuations had been concluded in 439 cases, covering 97,005 miles of road, or 39.69 per cent of the total mileage, with 63 cases, covering 37,884 miles of road, or 15.50 per cent of the total mileage, partly heard; and valuations had become final, either upon decision after protest or upon failure to file protest within the statutory period, in 445 cases, covering 17,974 miles of road, or 7.3 per cent of the total railroad mileage. *Annual Report*, 1926, pp. 13-14.

VALUATIONS OF CARRIER PROPERTY

revised or otherwise made final for use in preparing tentative valuations," 1,047 reports were made, listing 1,697 corporations and covering an aggregate of 243,397 miles of road, exclusive of the mileage of additional main tracks or sidings.<sup>89</sup>

TABLE XI  
UNDERLYING VALUATION REPORTS

<i>Year</i>	<i>Number of reports</i>	<i>Number of corporations</i>	<i>Miles of road</i>	<i>Percentage of total mileage</i>
ACCOUNTING				
1921	273	444	61,731	24.89
1922	555	953	151,572	61.11
1923	903	1,474	233,444	90.09
1924	1,034	1,707	243,605	99.70
1925	1,073	1,750	244,110	99.89
1926	1,113	1,771	244,200	99.93
ENGINEERING				
1921	423	755	133,139	53.68
1922	636	1,155	179,475	72.37
1923	912	1,516	223,796	90.24
1924	953	1,610	235,088	96.20
1925	1,040	1,742	243,042	99.45
1926	1,079	1,792	244,325	99.98
LAND				
1921	371	565	71,558	28.85
1922	671	1,063	144,411	58.23
1923	1,051	1,522	219,426	88.47
1924	1,106	1,672	233,247	95.40
1925	1,123	1,764	244,045	99.86
1926	1,125	1,766	244,101	99.90

The underlying figures as to specific cost and value elements, together with the general information as to financial status and corporate history contained in the engineering, accounting, and land reports, provided the necessary data for the determination of tentative single-sum values. By the end of 1927 all tentative valuation reports had been served upon the carriers. Table XII below indicates

<sup>89</sup> *Annual Report, 1927*, pp. 59-60.

the course of development of this aspect of the valuation work. These data show, for the years 1920 to 1927, inclusive, the number of reports completed by the end of each period, the number of corporations embraced therein, the number of miles of road involved, and the percentage of the total mileage covered thereby. The relative rapidity with which these tentative valuations were completed, once ascertainment of the underlying figures was well under way, illustrates further the cumulative character of valuation performance.<sup>40</sup> Prior to November 1, 1920, only 55 tentative valuation reports, representing the properties of 70 carriers, had been issued; by the end of 1926, when the underlying reports were substantially completed, tentative valuations had been served for approximately two-thirds of the mileage; and during the single year following, all of the remaining reports were issued. The tentative valuation reports completed during the two years 1926 and 1927 covered almost one-half of the entire railroad mileage of the country.

TABLE XII  
TENTATIVE VALUATION REPORTS

Year	Number of reports	Number of corporations	Miles of road	Percentage of total mileage
1920	55	70		
1921	151	193	24,493	9.86
1922	287	400	39,956	16.11
1923	327	468	54,622	22.03
1924	386	568	75,375	30.84
1925	657	981	125,758	51.46
1926	885	1,318	160,453	65.92
1927	1,047	1,697	243,397	100.00

But both the underlying reports and the tentative valuation reports are but preliminary stages in the determination of final single-sum values. These final values are established either after hearing, upon protests filed against the tentative valuations served, or upon failure to file protest within the statutory period of thirty days. The first of the final single-sum value reports was issued July 11, 1922. By October 31, 1929, hearings on protests had been concluded for all of the tentative valuations, these hearings embracing 766 cases and covering

<sup>40</sup> See notes 37 and 38, *supra*.

234,859 miles of line; and during the year 1932 the last of the primary valuations of the 1,685 steam railroads listed for appraisal as existing on March 1, 1913, was completed, the results being incorporated in 1,035 final valuation reports.<sup>41</sup> The work of the Commission in this field is now almost exclusively devoted to bringing the primary valuations to date,<sup>42</sup> and its progress has been so substantial that it is in position to make current valuation data readily available.<sup>43</sup>

<sup>41</sup> But there were further primary valuations to be made, involving inventories and the ascertainment of underlying figures, in connection with new roads. At the end of 1928 the Commission reported as follows: "We are now engaged in making field inventories of 191 properties, representing 5,377 miles of main track, which have come into existence since the original field work was completed, or which were for some reason omitted from our original program." *Annual Report, 1928*, p. 56. These properties later increased to 198, involving 5,843 miles of line, and by the end of 1930, 124 engineering, 120 accounting, and 187 land reports had been served, and 37 tentative valuation reports had been prepared. *Annual Reports: 1929*, p. 64; 1930, p. 59. Attention should also be directed to the fact that, although the statute required valuations of the property of all carriers subject to the Commission's jurisdiction, the preceding pages have dealt only with steam railroads. There has been substantial accomplishment, in so far as appropriations would permit, in connection with other types of carriers. See *Annual Reports: 1922*, pp. 72-73; 1927, p. 60; 1928, pp. 56, 57. In its latest report the Commission commented as follows: "Section 19a is applicable to all carriers subject to the provisions of the act. Insufficient appropriations have prevented us from proceeding with the valuations of carriers other than railroads with the exception of the Pullman and telegraph companies. The valuation of these latter companies is being prosecuted as far as appropriations permit. Requests for additional appropriations to value other carriers such as pipe lines and telephone companies have been made from time to time." *Annual Report, 1933*, p. 76.

<sup>42</sup> The dates of the primary valuations range from June 30, 1914, to June 30, 1921, with June 30, 1916, as the average date. In order to make valuations currently usable in the tasks of regulation it is essential that the inventories be corrected and the values revised from time to time. Toward these ends the Commission has sought, through Valuation Order No. 3, issued June 25, 1914, to keep itself informed concerning changes in the properties of the carriers; and through experts in its Bureau of Valuation it has been continually making studies of price changes. The results are very far advanced. See *Annual Report, 1932*, pp. 88-91. Moreover, the Commission is no longer required by law to revise all valuations as a matter of course, or to proceed "in like manner" as in the original valuations in bringing them down to date. By the Emergency Railroad Transportation Act of 1933 (Public No. 68, 73d Congress), section 19a was so amended as merely to require the Commission to keep itself informed concerning property changes subsequent to the original valuations, costs of additions and betterments and investment changes, and current changes in costs and values of railroad properties, "in order that it may have available at all times the information deemed by it to be necessary to enable it to revise and correct its previous inventories, classifications, and values of the properties"; and it "may revise, correct, and supplement any of its inventories and valuations" only "when deemed necessary" (Sec. 208). This amendment, coupled with the repeal of the recapture provisions by the same legislation, has greatly simplified the valuation task. See *Annual Report, 1933*, pp. 73-74.

<sup>43</sup> Thus: "Already this work has progressed to such a point that in the consideration

Finally, as further evidence of the extensiveness of the valuation project, Table XIII below presents data, from the beginning, as to the number of employees on the valuation rolls and as to the amounts expended by the Commission in prosecuting the work. It will be noted that, starting with a skeleton organization of 13 employees in 1913, the personnel reached its peak of between about 1,000 and al-

of the petition of the carriers in 1931 for a 15 per cent increase in all freight rates, within a period of six weeks we prepared and presented in that proceeding an exhibit presenting all of the studies, records and data necessary for reaching conclusions as to value of the railroads as a whole and by recognized rate-making groups. The details of this exhibit reveal the extent to which we stand ready to respond to practical requirements in the field of valuation. . . . As stated in hearings before committees of the Senate and House, we are now in a position on 60 days call to make complete reports, extending even farther than that contained in the exhibit in the *Fifteen Per Cent Case*, necessary for the fixation of the value of the property of the steam carriers as a whole and by recognized rate-making groups, and in many cases of individual carriers." *Annual Report, 1932*, pp. 90-91. Again: "With original, or primary, valuations completed, our present valuation activities fall under the direction of the above referred to amendments. [See note 42, *supra*.] To meet such requirements the bureau is perfecting a perpetual current inventory of the property of each carrier. This has been accomplished to such an extent that the bureau is now in a position to furnish the valuation elements specified by the act within a period of 60 days which, it is expected, will, during the next year, be reduced to 30 days or less. The bureau also is perfecting original cost records and estimates and bringing to currency the investment records. As the result of recording all reconstruction and replacements in the perpetual inventory, the record of original cost, which a few years ago was largely unknown, now is a known factor to the extent of approximately 70 percent. Continuation of the valuation processes will ultimately result in complete original cost and investment records. . . . Through the inspections, together with a study of maintenance expenditures and other pertinent data, we are kept informed as to the condition of the property and the amount of existing depreciation. Through the studies of cost engineers and land appraisers we are kept informed of current railroad construction costs and changes in land values. In this way the elements that are essential in ascertaining the present value of the property of carriers as a whole, by recognized rate groups, and individually are readily developed. From information gathered in this manner, the bureau prepared an exhibit for use in the *General Rate Level Investigation, 1933*. . . . In summary form, it set forth, as of December 31, 1932, estimates of the cost of reproduction new and reproduction less depreciation, original costs, present value of lands, and the amounts necessary for working capital, including material and supplies, for all class I, II, and III carriers, including switching and terminal companies. . . . Among the various purposes for which carefully prepared information regarding the value of the carriers' properties is desirable are to be included reorganizations under the recent amendment of the Bankruptcy Act. In these proceedings new capital structures are to be set up and new issues of securities authorized; and questions arise as to the separate and relative values and earning power of parts of systems covered by different mortgages and other liens. Several of our largest railroad systems are in the process of reorganization under this statute. The bureau is giving priority to these properties in its current investigations. Progress so far achieved leads us to believe that full and complete data concerning these properties will be available for use in these reorganization proceedings." *Annual Report, 1933*, pp. 73-75.

most 1,600 during the period when chief stress was being placed upon the field work and the completion of the underlying reports; that a brief period of substantial contraction followed, largely in the interest of governmental economy; that with the initiation of the three-year program for the completion of the primary valuations by June 30, 1928, the personnel expanded once more; that further expansion marked the period of emphasis upon recapture proceedings; and that, with the completion of the primary valuations, the repeal of the recapture provisions, and the amendment of the Act with respect to revision of values, the force of employees was sharply reduced.<sup>44</sup> The same course of development is apparent in connection with ex-

TABLE XIII  
EMPLOYEES ENGAGED AND EXPENDITURES INCURRED  
IN VALUATION WORK

<i>Year ending June 30</i>	<i>Number of employees</i>	<i>Expenditures</i>
1913	13	\$ 10,366.33
1914	429	456,565.32
1915	1,261	2,131,924.74
1916	1,480	2,984,332.83
1917	1,562	3,283,883.91
1918	1,573	3,384,444.31
1919	1,530	3,560,308.88
1920	990	2,956,736.08
1921	996	2,728,656.45
1922	585	1,595,488.89
1923	543	1,293,526.16
1924	415	1,245,718.33
1925	439	1,064,654.57
1926	542	1,593,830.36
1927	535	1,712,051.74
1928	667	2,067,141.17
1929	641	2,332,013.13
1930	708	2,534,978.57
1931		3,246,694.09
1932	910	3,199,491.04
1933	381	2,645,653.18

<sup>44</sup> In its latest report to Congress the Commission commented as follows on the reduction of its valuation force: "The amendment above referred to, together with re-

penditures, which started with a sum for the initial period of but slightly more than \$10,000 and reached a peak in excess of \$3,500,000 in 1919. The Commission's aggregate expenditures on the valuation project to June 30, 1933, have been approximately \$46,000,000.

#### §4. GENERAL INVESTIGATIONS

In addition to the numerous specific proceedings in matters of rates and traffic, organization and finance, and valuation of carrier property to which attention has been directed in the preceding pages, general investigations which partake of the nature of both formal determinations and routine administrative tasks are conducted by the Commission in a great variety of directions. These general investigations constitute a sort of transitional field, involving the subject-matter and methods of disposition characteristic of the activities already discussed as well as of those yet to be considered. Sometimes they are undertaken in fulfilment of express Congressional mandates of general applicability, as under the Hoch-Smith Resolution in the matter of regulating rate relationships, or in compliance with the provisions on depreciation in the matter of exercising accounting control, or in the determination of efficiency and economy of management in the matter of establishing rate levels; sometimes they are undertaken on the Commission's own motion, in connection with various aspects of the regulatory process, either in the absence of all complaint, or by so broadening the issues in proceedings arising from specific complaints as to include other matters than those expressly raised and other carriers than those initially involved; sometimes they constitute a response to special requests of Congress for inquiry and information with regard to any matter within the scope of the Commission's jurisdiction. The fact that it is within the duties and powers of the Commission to keep itself informed concerning the business

peal of provisions of section 15a relating to excess net railway operating income, greatly simplify the valuation work. Together with the completion of the primary valuations it has enabled us to reduce materially the personnel and expenditures in the bureau. The reduction was possible, also, because of the progress made in correcting and revising the original inventories and underlying records and data. For the last fiscal year (1932-33) the appropriation for the bureau was \$2,750,000. Its personnel on June 1, 1933, consisted of 910 employees. The appropriation for the current fiscal year (1933-34) is \$1,000,000, and its active personnel on July 1, 1933, consisted of 381 employees." *Annual Report, 1933, p. 74.*



of the carriers subject to its control provides the unifying element in all these investigations, however varied they may be in character and sweep and importance. The results of these investigations generally find their way into the formally published reports, with express findings and mandatory orders not unlike those arising in contested cases; in many instances, however, the facts found are merely filed by way of record or transmitted to Congress in the form of special reports. It is obvious that these investigatory activities, in view of the diversity of their origin and disposition and the miscellaneous range of matters with which they deal, do not lend themselves to the method of statistical measurement. It will suffice, for our purpose, to provide some concrete indication of their character and scope; and this end will be served adequately by illustrating each of the principal categories of investigation referred to above.

First, brief reference may be made to investigations undertaken by the Commission in response to special requests of Congress. Such requests, which are always complied with, have been numerous throughout the history of the Commission, and they have often been made without much regard to whether the proposed investigation was essential or whether the administrative burden imposed thereby would interfere with pressing duties in other directions. They have dealt with a great variety of problems, as will appear from the subject-matter of some of these inquiries which have been concluded in recent years. The following are illustrative: ascertainment of the facts in connection with existing or prospective ownership or control of railway lines in the United States by the Government of Canada;<sup>45</sup> investigation as to living conditions of trainmen who are compelled to lie over at terminals between trips and as to the feasibility of the railroad companies furnishing suitable accommodations in the circumstances;<sup>46</sup> inquiry as to the causes of freight congestion in the principal cities of the United States and as to the measures that have been taken or may be taken to relieve the situation;<sup>47</sup> ascertainment

<sup>45</sup> Pursuant to Senate Resolution No. 222 of October 30, 1919; report was made to the Senate December 3, 1919. *Annual Report*, 1920, p. 38.

<sup>46</sup> Pursuant to Senate Resolution No. 267 of January 16, 1920; report was made August 3, 1920. *Living Conditions of Railway Trainmen*, 58 I.C.C. 761 (1920).

<sup>47</sup> Pursuant to Senate Resolution No. 362 of May 14, 1920; report was made to the Senate December 9, 1920. *Annual Report*, 1921, p. 29.

of the cost of railroad fuel for the year 1920 over such cost for the year 1919;<sup>48</sup> investigation as to the organization, management, and control of the Trans-Continental Freight Bureau;<sup>49</sup> inquiry as to feasibility and advisability of ordering an embargo upon shipments of anthracite coal to foreign countries, and as to the steps taken or which may be taken for the establishment of transportation priorities and equitable distribution of such coal and for the prevention of its purchase or sale at unreasonably high prices;<sup>50</sup> provision of information as to the extent to which the railroads serving the Northwest Pacific states failed to supply adequate transportation facilities during the crop season of 1922, with an analysis of causes and a suggestion of remedies designed to prevent a repetition of such failure or inadequacy of transportation facilities;<sup>51</sup> provision of information with regard to the administration of the fourth section of the Interstate Commerce Act;<sup>52</sup> inquiry as to the assessed valuation, as used for taxation purposes for the year 1923, of all the property of each of the railroads in the United States acting as a common carrier;<sup>53</sup> the preparation, by October 1, 1927, of a manuscript suitable for publication as a Senate document, covering the various acts administered by the Commission and related provisions of law and annotated with digests not only of all pertinent decisions of the Commission, including its regulations, but of the courts and other administrative agencies;<sup>54</sup> investigation

<sup>48</sup> Pursuant to Senate Resolution No. 412; report was made to the Senate April 4, 1921. *Ibid.*, p. 30.

<sup>49</sup> Pursuant to Senate Resolution No. 194 of December 15, 1921; report was made February 3, 1923. *Trans-Continental Freight Bureau*, 77 I.C.C. 252 (1923).

<sup>50</sup> Pursuant to Senate Resolution No. 418 of January 23, 1923; report was made to the Senate February 28, 1923. *Annual Report*, 1923, p. 31.

<sup>51</sup> Pursuant to Senate Resolution No. 414 of January 20, 1923; report was made February 4, 1924. *Transportation Facilities in Northwest Pacific States*, 87 I.C.C. 472 (1924).

<sup>52</sup> Pursuant to Senate Resolution No. 472 of March 3, 1923; report was made February 11, 1924. *Administration of Fourth Section*, 87 I.C.C. 564 (1924).

<sup>53</sup> Pursuant to Senate Resolution No. 199 of March 28, 1924; report was made to the Senate February 9, 1925. *Annual Report*, 1925, p. 34.

<sup>54</sup> This compilation and annotation of statutes was originally directed by Senate Resolution No. 334 of January 25 (calendar date, January 28), 1927. The Commission found it impossible to comply with the request within the allotted time and proceeded without regard to the time limit. Moreover, it recommended that the resolution be amended in certain particulars: "The resolution calls for a great amount of work. We doubt whether the result would warrant the labor and expense involved as to certain of the matters contemplated. Thus, the resolution calls for digest of 'all

as to the effect upon operation, service, and expenses of applying the principle of the 6-hour day in the employment of railroad labor.<sup>55</sup> The staff and facilities of the Commission are thus freely resorted to in connection with transportation matters and their control which happen to enlist the interest of the legislative branch of the Government.<sup>56</sup> While such miscellaneous requests for investigation but infrequently require the personal attention of the commissioners or involve the time-consuming processes of contested cases, they serve to add to the burdens of the administrative personnel and to the responsibilities of the Commission.

The investigations undertaken by the Commission on its own mo-

pertinent decisions of the courts and the commission and other administrative agencies. Decisions of the State courts construing the Federal statutes and decisions of the administrative agencies other than this commission are of doubtful assistance, and might well be omitted. They are relatively the least important, but the most difficult to compile." It was recommended, too, that the Commission be directed to "comply with the request as soon as possible, rather than by any certain time limit." *Annual Report, 1927*, p. 64. By Senate Resolution No. 17 of December 6 (calendar date, December 9), 1927, the Commission's recommendations were substantially adopted. With regard to the extent of the task, the Commission said: "Some idea of the volumetric mass of the undertaking can be secured from the number of points of material which have been assembled. To date these exceed 120,000, and before the completion of the manuscript several thousand more will be added." *Ibid.*, p. 65. This work was completed and transmitted to the Senate December 31, 1929. It has been published in five volumes as *Interstate Commerce Acts Annotated*, Sen. Doc. No. 166, 70th Cong., 1st Sess., prepared by and under the direction of Commissioner Clyde B. Aitchison. It is planned to keep this valuable work current through the issuance of supplements. *Annual Report, 1930*, pp. 73-74.

<sup>55</sup> Pursuant to Public Resolution No. 13 of March 15, 1932; report was made to Congress December 13, 1932. *Effect of 6-Hour Day for Railway Employees*, 190 I.C.C. 750 (1932).

<sup>56</sup> The Commission not only conducts investigations at the behest of Congress, but it also provides considerable assistance in connection with Congressional investigations. Note the following, for example, with regard to the investigation of stock ownership in railroads, especially by holding companies, conducted by the House Committee on Interstate and Foreign Commerce (House Report No. 2789, 71st Cong., 3d Sess.): "We have been kept advised as to the progress of that inquiry, and in connection with it have given the House committee the services of various members of our staff." Again, in surveying the work of its Bureau of Accounts for the same period, the Commission said: "Our accountants have also assisted the House Committee on Interstate and Foreign Commerce in its investigation of holding companies in their relation to railroads and a special committee of the Senate in its investigation of the railroad operated by the Government in Alaska." *Annual Report, 1930*, pp. 80, 1. Furthermore, the Commission is frequently called upon to consider and appraise new legislative proposals, and the performance of this important function, generally through its Committee on Legislation, makes substantial inroads upon the time of individual commissioners and of the body as a whole.

tion, though often impelled by the filing of complaints, are very numerous, touching upon almost every aspect of the regulatory process, and they generally result in binding readjustments in the prevailing relations between the carriers and the users of their service. Authority to act upon its own motion, with power of disposing of the issues involved coextensive with that exercised in complaint proceedings, was vested in the Commission in order that it might discharge effectively its affirmative responsibilities toward the transportation system as a whole, restricted neither by the necessity of specific complaints nor by the scope of the complaints actually filed. The need of spontaneous action or of sweeping inquiry is constantly arising, and the Commission has responded sensitively to the demands of developing situations. Mere reference to some of the more important investigations entered into upon the Commission's own motion and concluded since 1927 will reflect the broad extent and far-reaching significance of the exercise of this investigatory power. Such investigations of the following matters, among many others, have been completed during this period: class rates in southern territory; class rates in eastern territory; rates and practices governing the transportation of anthracite coal, bituminous coal, fertilizers, cotton, wool, and sugar; refrigeration charges on fruits and vegetables; charges for wharfage, handling, storage, and other accessorial services; divisions of joint rates; private passenger-train cars; extra fares on passenger trains; car-hire rules; off-track stations and the transfer of freight; rates and practices in connection with the use of car-container equipment; railroad practices in the purchase of equipment, materials, and supplies; railroad practices affecting operating revenues and expenses; motor bus and motor truck operations, with special reference to their coordination with rail and water transportation; the financial affairs of a great railroad system; and the general level of rates and charges.<sup>57</sup> In addition to conducting inquiries of this varied character, the Commission has been instituting numerous investigations

<sup>57</sup> The results of the above investigations have been incorporated in the following reports: *Southern Class Rate Investigation*, 100 I.C.C. 513 (1925), 109 I.C.C. 300 (1926), 113 I.C.C. 200 (1926), 128 I.C.C. 567 (1927); *Eastern Class Rate Investigation*, 164 I.C.C. 314 (1930), 171 I.C.C. 481 (1931), 177 I.C.C. 156 (1931); *Anthracite Coal Investigation*, 101 I.C.C. 363 (1925), 104 I.C.C. 341 (1925) and 514 (1926), 122 I.C.C. 527 (1927); *Eastern Bituminous Coal Investigation*, 140 I.C.C. 3 (1928);

under section 13 of the act, to determine whether prevailing intrastate rates, as fixed by the carriers or prescribed by state authority, are unduly prejudicial to persons or localities in interstate commerce or constitute unreasonable discrimination against such commerce.<sup>58</sup> Proceedings instituted by the Commission on its own motion, through resort to its broad powers of investigation, have come to be an integral part of the regulatory process. They are not only so great in number and generally so extensive in scope as to add substantially to the Commission's administrative tasks, but they frequently lead to the most significant results, from the standpoint of both the carriers and the public.<sup>59</sup>

Finally, special attention should be directed to certain investigations undertaken by the Commission under specific Congressional mandates of far-reaching importance. These investigations, like those

*Fertilizers between Southern Points*, 113 I.C.C. 389 (1926), 123 I.C.C. 193 (1927), 129 I.C.C. 215 (1927); *Rates on Cotton to Gulf Ports*, 100 I.C.C. 159 (1925), 123 I.C.C. 685 (1927); *Wool Rates Investigation*, 1923, 91 I.C.C. 235 (1924), 120 I.C.C. 493 (1927); *Southeastern Sugar Investigation*, 132 I.C.C. 477 (1927), 142 I.C.C. 459 (1928); *Refrigeration Charges on Fruits, etc., from the South*, 151 I.C.C. 649 (1929), 172 I.C.C. 3 (1931); *Wharfage Charges at Atlantic and Gulf Ports*, 157 I.C.C. 663 (1929), 174 I.C.C. 263 (1931); *Divisions of Freight Rates*, 148 I.C.C. 457 (1928), 156 I.C.C. 94 (1929); *Use of Private Passenger Train Cars*, 155 I.C.C. 775 (1929); *Extra Fares on Passenger Trains*, 186 I.C.C. 40 (1932); *Rules for Car-Hire Settlement*, 160 I.C.C. 369 (1930), 165 I.C.C. 495 (1930); *Transfer in St. Louis and East St. Louis by Dray and Truck*, 155 I.C.C. 129 (1929), 177 I.C.C. 316 (1931); *Constructive and Off-Track Freight Stations*, 156 I.C.C. 205 (1929); *Container Service*, 173 I.C.C. 377 (1931), 182 I.C.C. 653 (1932), 185 I.C.C. 787 (1932); *Reciprocity in Purchasing and Routing*, 188 I.C.C. 417 (1932); *Propriety of Operating Practices—New York Warehousing*, 198 I.C.C. 134 (1933); *Motor Bus and Motor Truck Operation*, 140 I.C.C. 685 (1928); *Coordination of Motor Transportation*, 182 I.C.C. 263 (1932); *Chicago, Milwaukee & St. Paul Investigation*, 131 I.C.C. 615 (1928); *Fifteen Per Cent Case*, 1931, 178 I.C.C. 539 (1931), 179 I.C.C. 215 (1931), 191 I.C.C. 361 (1933); *General Rate Level Investigation*, 1933, 195 I.C.C. 5 (1933).

<sup>58</sup> For complete lists of the investigations, including the numerous intrastate rate proceedings, instituted by the Commission since 1920, see *Annual Reports: 1920*, pp. 38-42; 1921, pp. 29-34; 1922, pp. 40-44; 1923, pp. 30-35; 1924, pp. 30-33; 1925, pp. 34-37; 1926, pp. 33-36; 1927, pp. 72-75; 1928, pp. 69-72; 1929, pp. 74-77; 1930, pp. 69-72; 1931, pp. 75-78; 1932, pp. 32-35; 1933, pp. 26-28. For an extensive survey and analysis of the Commission's exercise of authority over intrastate commerce, see Part II, pp. 191-344.

<sup>59</sup> Reference to some of the outstanding proceedings of this character concluded since 1920, aside from those already indicated for the period beginning in 1927, will disclose even more strikingly the varied nature of these investigations, the extensiveness of their scope, and the significance of their results. See, for example: *Increased Rates*, 1920, 58 I.C.C. 220, 302, 489 (1920); *Express Rates*, 1920, 58 I.C.C. 281, 707 (1920); *Express Classification*, 1920, 59 I.C.C. 265 (1920); *Consolidation of Express*

just dealt with, have been instituted on the Commission's own motion; and the Congressional mandates to which they were a response are an integral part of the law which the Commission administers and are no more binding upon it than those involved in its other general investigations. They are singled out for separate notice, not alone because of the magnitude of the tasks which they involve, but because the method of general investigation, as distinct from the piece-meal disposition of specific complaints, is the contemplated mode of procedure in these instances. The tasks here referred to comprise the rate structure investigation, the determination of depreciation charges, and the establishment of standards of economy and efficiency.

Under the Hoch-Smith Resolution, after the general declaration that "the true policy in rate making" necessitates the consideration of "the conditions which at any given time prevail in our several industries," the Commission was directed to determine the extent of existing maladjustments in rate relationships, to remove such maladjustments in conformity with standards prescribed in general terms, and, "in view of the existing depression in agriculture," to effect such lawful changes in the rate structure as would promote the freedom of movement of the products of agriculture, including livestock, affected by such depression, "at the lowest possible lawful rates compatible with the maintenance of adequate transportation service."<sup>60</sup> The *Rate Structure Investigation* entered upon in compliance with

*Companies*, 59 I.C.C. 459 (1920); *Limitations of Liability in Transmitting Telegrams*, 61 I.C.C. 541 (1921); *Consolidation of Railroads*, 63 I.C.C. 455 (1921), 159 I.C.C. 522 (1929); *Rates on Grain, Grain Products, and Hay*, 64 I.C.C. 85 (1921), 69 I.C.C. 562 (1922), 80 I.C.C. 362 (1923); *Reduced Rates, 1922*, 68 I.C.C. 676 (1922), 69 I.C.C. 138 (1922), 73 I.C.C. 189 (1922), 77 I.C.C. 675 (1923), 81 I.C.C. 170 (1923); *Automatic Train-Control Devices*, 69 I.C.C. 258 (1922), 91 I.C.C. 426 (1924); *Interchangeable Mileage Ticket Investigation*, 77 I.C.C. 200, 647 (1923), 98 I.C.C. 298 (1925); *Assigned Cars for Bituminous Coal Mines*, 80 I.C.C. 520 (1923), 93 I.C.C. 701 (1924); *Express Rates, 1922*, 83 I.C.C. 606 (1923), 89 I.C.C. 297 (1924); *Rates and Charges on Grain and Grain Products*, 91 I.C.C. 105 (1924); *Power Brakes and Appliances for Operating*, 91 I.C.C. 481 (1924); *Rules Governing Ratings of Coal Mines*, 95 I.C.C. 309 (1924); *Charges for Passengers in Sleeping and Parlor Cars*, 95 I.C.C. 469 (1925); *Revenues in Western District*, 113 I.C.C. 3 (1926); *Denver & Rio Grande Investigation*, 113 I.C.C. 75 (1926).

<sup>60</sup> Public Resolution No. 46 of January 30, 1925, 68th Congress, 43 Stat. 801. For an enlightening analysis of the diverse interpretations of the Resolution, see Warren H. Wagner, *The Hoch-Smith Resolution* (1929).

this Resolution involved an inquiry into the propriety of the rates and charges of all the common carriers subject to the Commission's jurisdiction;<sup>61</sup> it was without question the most important and most extensive proceeding ever undertaken by the Commission.<sup>62</sup> In the course of its development the investigation embraced separate inquiries concerning the following class rates or rates on important commodities or commodity groups: western trunk-line class rates, cotton, petroleum and its products, furniture, iron and steel articles, grain and grain products, cottonseed and its products and related articles, livestock, hay, sand and gravel, non-ferrous metals, and salt.<sup>63</sup> These proceedings were very prolonged and extensive,<sup>64</sup> and because

<sup>61</sup> Upon the institution of this investigation, the Commission, in its Order and Notice to Public of March 12, 1925, said: "The joint resolution authorizes and directs the commission to make a thorough investigation of the rate structure of 'common carriers subject to the interstate commerce act.' Accordingly, all pipe-line companies; telegraph, telephone, and cable companies operating by wire or wireless; express companies; sleeping-car companies; and all persons, natural or artificial, engaged in such forms of transportation or transmission, as well as those engaged in the transportation of persons or property by rail or by water subject to the act have been made respondents in this proceeding." In view of the importance and broad scope of the investigation, the Commission created a new division of its membership, designated as Division 6, to direct the proceeding, and it effected cooperative arrangements with the National Association of Railroad and Utilities Commissioners and with representatives of the state regulatory bodies. *Annual Report*, 1925, p. 40.

<sup>62</sup> Compare the following: "In outward appearance innocuous, the Joint Resolution of Congress, popularly known as the Hoch-Smith Resolution, and on the floor of Congress prior to its passage described as a political 'gesture,' has been responsible for what is believed to be the greatest task ever imposed upon the Interstate Commerce Commission since its creation in 1887. And this without additional appropriation. As Commissioner Balthasar H. Meyer has said, 'the tasks imposed upon the Commission by its provisions are Herculean. In fact, literal and complete execution of all its provisions is probably beyond the power of any body of men. . . . I could keep a hundred Solomons busy on this program for a hundred years. . . . Complete compliance with such requirements clearly exceeds the ability of any set of men.' Involving as it does all of the rates of substantially all of the common carriers of the nation, it has been stated by Commissioner Clyde B. Aitchison that the investigation instituted under the Resolution was 'the most far-reaching and important one ever entered upon by the Interstate Commerce Commission or by any other human tribunal among civilized peoples.'" Warren H. Wagner, *op. cit.*, p. 1.

<sup>63</sup> The development of these "Parts" of No. 17000, *Rate Structure Investigation*, is set forth in detail in *Annual Reports*: 1925, pp. 37-41; 1926, pp. 36-39; 1927, pp. 67-72; 1928, pp. 63-68; 1929, pp. 69-73; 1930, pp. 61-68; and 1932, pp. 29-31.

<sup>64</sup> *Western Trunk-Line Class Rates*, 164 I.C.C. 1, 173 I.C.C. 637, 178 I.C.C. 619, 181 I.C.C. 301; instituted October 11, 1926, decided May 6, 1930, April 14, 1931, October 1, 1931, and December 1, 1931; 13,352 pages of transcript and 1,237 exhibits. *Rate Structure Investigation, Part 3, Cotton*, 165 I.C.C. 594; instituted November 26, 1926, decided July 15, 1930; 7,787 pages of transcript and 943 exhibits. *Petroleum and its*

of their unwieldy proportions,<sup>65</sup> the Commission, toward the end of 1933, ordered the investigation discontinued.<sup>66</sup>

*Products*, 171 I.C.C. 286: instituted November 8, 1926, decided January 5, 1931; 7,629 pages of transcript and 1,029 exhibits. *Refined Petroleum Products in the Southwest*, 171 I.C.C. 381, 174 I.C.C. 745: instituted June 4, 1928, decided January 5, 1931, and June 2, 1931; 4,606 pages of transcript and 551 exhibits. *Furniture*, 177 I.C.C. 5: instituted March 1, 1928, decided July 28, 1931; 6,776 pages of transcript and 941 exhibits. *Iron and Steel Articles*, 155 I.C.C. 517, 161 I.C.C. 386, 161 I.C.C. 608, 168 I.C.C. 107: instituted November 18, 1926, decided June 3, 1929, February 24, 1930, March 3, 1930, and October 14, 1930; 4,092 pages of transcript and 685 exhibits. *Grain and Grain Products*, 164 I.C.C. 619, 173 I.C.C. 511: instituted December 30, 1926, decided July 1, 1930, and April 13, 1931; 53,304 pages of transcript and 2,106 exhibits. *Cottonseed, its Products, and Related Articles*, 188 I.C.C. 605: instituted March 14, 1927, decided November 12, 1932; 19,509 pages of transcript and 2,464 exhibits. *Livestock, Southern Territory, Rates*, 171 I.C.C. 721: instituted May 16, 1927, decided December 8, 1930; 2,140 pages of transcript and 280 exhibits. *Livestock—Western District Rates*, 176 I.C.C. 1: instituted May 16, 1927, decided June 8, 1931; 15,699 pages of transcript and 753 exhibits. *Sand, Gravel, Crushed Stone, and Shells*, 155 I.C.C. 247: instituted June 13, 1927, decided June 3, 1929; 1,469 pages of transcript and 175 exhibits. *Sand, Gravel, and Crushed Stone*, 177 I.C.C. 621: instituted October 14, 1929, decided July 7, 1931; 1,551 pages of transcript and 186 exhibits. At time of writing the investigations of rates on hay, instituted June 29, 1927, on non-ferrous metals, instituted March 1, 1929, and on salt, instituted January 4, 1930, had not yet issued in published reports; but the hearings had been completed, and the record consisted, respectively, of 7,695 pages of transcript and 622 exhibits, 8,176 pages of transcript and 1,234 exhibits, and 4,193 pages of transcript and 874 exhibits. See *Annual Report*, 1932, p. 31.

<sup>65</sup> The Commission's general reaction to its experience with the rate structure investigation was first formally stated at the end of 1932: "The Resolution directed us, among other things, to reconstruct the rate structure of the country and to reapportion the burden under it. In a sense, every rate case is a revision of the existing rate structure, but the Hoch-Smith Resolution was apparently intended to hasten that process. Generally speaking, the Docket 17000 cases have developed into unwieldy proportions. Our experience with them has shown that the country is too big to make it generally practicable to deal with it as a whole or even with the major classification territories, except in proceedings especially adapted to large territorial treatment, such as the classifications themselves. Substantial benefits have resulted from the general surveys which have been made in the Hoch-Smith cases, but these have been offset by the disadvantages connected with unavoidable delay because of the protracted character of the hearings in arriving at specific rate changes in particular territories or to meet particular situations." *Ibid.*, p. 30. The contemplated benefits of the Resolution to agriculture did not materialize, largely as a result of the decision of the Supreme Court in *Ann Arbor R. Co. v. U.S.*, 281 U.S. 658 (1930), holding invalid the determination in *Calif. Growers' and Shippers' Protective League v. S. P. Co.*, 129 I.C.C. 25 (1927), 132 I.C.C. 582 (1927), in which the Resolution was so interpreted by the Court as to confer no new power upon the Commission.

<sup>66</sup> Thus: "Experience has shown that necessary changes in the rate structure can be effected by us with the least delay (which is the mandate of the Hoch-Smith resolution) through the usual course of hearing complaints, or by investigations on our own motion, rather than under a general nation-wide investigation which is likely to assume unduly ponderous proportions. In view of all the circumstances we therefore entered an order on October 2, 1933, that except for the orders already made in this proceeding or which may be entered in respect of such orders as supplementary or



A second general investigation of far-reaching importance, though not possessing the direct significance of the rate structure proceeding, was that concerned with the prescription of depreciation accounting. Under section 20, as amended by the Transportation Act, the Commission was directed to prescribe "the classes of property for which depreciation charges may properly be included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property." This Congressional mandate, the execution of which will exert a vital influence upon the determination of the earnings of all carriers subject to the Commission's control, has been found to involve very arduous and highly complex tasks. The Commission wisely proceeded with caution in this technical matter, by slow stages and in thoroughgoing fashion. It entered upon the task promptly, by organizing a Depreciation Section in its Bureau of Accounts;<sup>67</sup> for the first few years preliminary studies and analyses were made, involving "a vast amount of research";<sup>68</sup> during the year 1923 tentative reports were issued for telephone companies and for steam railroads, and public hearings were held for their consideration;<sup>69</sup> during the year 1924 the hearings and argument in the case of telephone companies and steam railroads were concluded;<sup>70</sup> but despite the progress made in connection with these classes of carriers, "the importance and great complexity of the questions involved" delayed final decisions,<sup>71</sup> and not until November 2, 1926, was depreciation accounting prescribed for telephone companies and steam railroads, to become effective January 1, 1928.<sup>72</sup>

ancillary thereto, and except for those parts of the proceeding which have been heard, and not yet submitted, the general investigation be discontinued." *Annual Report*, 1933, p. 12.

<sup>67</sup> *Annual Report*, 1920, pp. 34-35.

<sup>68</sup> *Annual Reports*: 1921, p. 26; 1922, p. 37.

<sup>69</sup> *Annual Report*, 1923, p. 26.

<sup>70</sup> *Annual Report*, 1924, p. 26.

<sup>71</sup> *Annual Report*, 1925, p. 27. The Commission added: "Pending such decisions and the determination of the controlling general principles, it has not been considered advisable to proceed with public hearings for consideration of depreciation charges of other classes of common carriers." Note, also, the following: "Early decision upon this troublesome and involved matter, in so far as steam railroads and telephone companies are concerned, is anticipated and will contain a comprehensive discussion of the general subject of depreciation charges and underlying principles which will so pave the way that progress may be made in promulgating similar rulings with respect to the other classes of carriers subject to our jurisdiction." *Annual Report*, 1926, p. 26.

<sup>72</sup> *Telephone and Railroad Depreciation Charges*, 118 I.C.C. 295 (1926).

But the Commission's report and orders in this proceeding proved only the beginning of a new cycle of investigation. Because of the interest aroused among shippers' organizations and commercial bodies which had not been represented at the original hearings, and in response to requests for rehearing by some of the carriers immediately involved, the railroad and telephone cases were reopened for further hearing, with the effective date of the Commission's orders postponed, first, to January 1, 1929,<sup>73</sup> and then indefinitely, and with the determination of depreciation charges for other carriers held in abeyance pending the establishment of general principles in these proceedings.<sup>74</sup> The Commission's final report on further hearing in the matter of depreciation charges of steam railroads and telephone companies was not issued till July 28, 1931, the orders in pursuance thereof to become effective January 1, 1933;<sup>75</sup> and because of the extraordinary economic conditions of the depression this effective date was subsequently postponed, first to January 1, 1934, and then to January 1, 1935, almost fifteen years after the depreciation provisions of the Transportation Act became operative.<sup>76</sup>

The activities of the Commission in connection with the development of standards of efficiency and economy, with special reference to its formal investigations toward this end, provide the final field for brief notice. The Commission's studies in efficiency and economy,

<sup>73</sup> *Annual Report*, 1927, p. 2.

<sup>74</sup> *Annual Report*, 1928, pp. 1-2; and for subsequent progress of the investigation, *Annual Reports*: 1929, p. 2; 1930, pp. 1-2.

<sup>75</sup> *Telephone and Railroad Depreciation Charges*, 177 I.C.C. 351 (1931).

<sup>76</sup> At the end of 1932 the Commission reported: "Upon consideration of petitions filed by the interested carriers and in recognition of the extraordinary economic conditions now existing which make a change in the practice of carriers with respect to depreciation charges difficult and inadvisable at this time, the effective date of our orders pertaining to the depreciation accounting of telephone and steam railroad companies, which was set for January 1, 1933, has been postponed for one year. Under the circumstances final action in the matter of depreciation charges of other classes of carriers has been held in abeyance." *Annual Report*, 1932, p. 42. And at the end of 1933: "Continuation of the extraordinary economic conditions which . . . brought about postponement of the effective dates of our orders . . . from January 1, 1933, to January 1, 1934, has resulted in further petitions from the interested carriers, and in response to these, postponement for an additional year has been granted." *Annual Report*, 1933, p. 36. Furthermore, pending the actual application of the orders for steam railroads and telephone companies, final action in Dockets 15780, 19157, 19200, 19440, and 19450, dealing with depreciation accounting for water carriers, electric railways, pipe lines, sleeping-car companies, and express companies, has been deferred.

and its establishment of a Section on Efficiency and Economy of Operation in its Bureau of Service, were largely the outcome of the rule of rate-making enacted by the 1920 legislation.<sup>77</sup> Under section 15a, in the adjustment of rates and in the determination of the rate of return, the exercise of the Commission's authority was conditioned upon the requirement of "honest, efficient and economical management." In order that a basis for judgment in this direction might be made available, the Commission entered upon studies in efficiency and economy. For the most part, because of inadequacy of appropriations and the desire to avoid duplicating the work of the railroads' own technical staff, the Commission has confined itself, taking the field as a whole, to statistical studies based upon the operating returns submitted by the carriers.<sup>78</sup> The operating averages of various sorts thus produced provide useful comparative data, though

<sup>77</sup> "The creation of the section of efficiency and economy of operation within the bureau of service . . . has made for increased efficiency and economy. Matters pertaining to car service and to efficiency and economy of operation are so interrelated that work in both lines is being handled cooperatively without overlapping or duplication of effort. Some of the investigations mentioned elsewhere in this report—as, for example, those relating to the Florida congestion, wasteful car handling practices, refrigerator-car distribution, icing, tidewater coal congestions, etc.—are matters involving efficiency and economy of operating in which the combined forces of the bureau have participated." *Annual Report, 1926*, pp. 64-65.

<sup>78</sup> The Commission has explained this delimitation of its activity as follows: "To go into the question of efficiency of management in a thoroughly effective way would necessitate an organization of experts especially qualified to investigate the numerous and complex phases of railroad management, such as shop methods, locomotive performance, road and terminal operation, maintenance of way and structures, purchasing and many others. This would involve a large additional appropriation and would in some degree duplicate the work of the technical staff of the railroads. We have not been convinced that we are called upon to engage in the study of operating efficiency upon this elaborate plan. We have undertaken, however, to emphasize to a greater degree than heretofore the systematic comparison of operating results through statistical reports." *Annual Report, 1922*, p. 25. The operating items measured statistically by periods for these purposes have included the following: net ton-miles per mile of road per day; trainloads, both in gross tons (except locomotives) and net tons; average miles per hour of trains; net ton-miles per car-day; average carload tons; car-miles per car-day; percentage of all car-miles loaded; cars per train; locomotive-miles per locomotive-day; and data have likewise been compiled as to the percentage of locomotives and freight cars in unserviceable condition, fuel consumption of freight locomotives, and railway equipment contracted for repairs in outside construction or repair shops. For comparative operating averages and summaries in terms of these items, see *Annual Reports*: 1922, p. 107; 1923, p. 105; 1924, pp. 8, 113; 1925, pp. 57, 115; 1926, pp. 65-66, 121; 1927, pp. 39, 52, 123; 1928, pp. 44-45, 52, 127; 1929, pp. 51, 57, 135; 1930, pp. 47-48, 55, 148; 1931, pp. 53-54, 62, 170; 1932, pp. 79, 84, 145; 1933, pp. 69, 99.

they are obviously not controlling in matters of efficiency and economy.<sup>79</sup> But the Commission has also instituted, upon its own motion, general investigations of a formal character into the efficiency and economy of management of the carriers. These have concerned the maintenance of equipment, for example, and they have been directed particularly at the propriety of expenditures made for repairs to locomotives and other equipment at outside construction and repair shops. Reports embracing a good many carriers have been issued in these investigations,<sup>80</sup> and substantial excess expenditures, as compared with the costs of similar repairs in railroad shops, have been disclosed.<sup>81</sup> The Commission has also proceeded in other

<sup>79</sup> Compare the following comment by the Commission on the work of its Bureau of Statistics in this matter: "The principal analytical work that is being done is the comparative study of operating averages. An examination is being made of the differences in results obtained by various railroads operated under similar conditions. Although it is difficult to reach final conclusions as to the honesty, economy, and efficiency of railway management from statistical tests in a central office, it is believed that a systematic effort to explain apparently abnormal results will prove of value both to the carriers and to the public." *Annual Report*, 1922, p. 39. Again, in the following year, the Commission said: "Much attention has been given during the year to methods of analyzing current statistics so as to reveal tendencies in the economy and efficiency of management. A compilation of comparative operating averages from this point of view has been published, and it is expected that similar statements will be issued annually in the future. Although there are limitations to the conclusions as to efficiency which can be drawn from a mere comparison of statistical averages, a study of such data, when available for a series of years, will assist in showing which carriers are making the most rapid progress in the efficiency of operation." *Annual Report*, 1923, p. 28.

<sup>80</sup> *Construction and Repair of Railway Equipment: Pennsylvania Railroad Co.*, 66 I.C.C. 694 (1922); *Atlantic Coast Line Railroad Co.*, 66 I.C.C. 727 (1922); *New York Central Railroad Co.*, 66 I.C.C. 732 (1922); *Chicago & North Western Railway Co.*, 69 I.C.C. 143 (1922); *Seaboard Air Line Railway Co.*, 69 I.C.C. 151 (1922); *Central Railroad Company of New Jersey*, 89 I.C.C. 751 (1924), 104 I.C.C. 352 (1925); various railway companies, including *Chicago, Burlington & Quincy Railroad Co.*, *Chicago, Milwaukee & St. Paul Railway Co.*, *Philadelphia & Reading Railway Co.*, *St. Louis-San Francisco Railway Co.*, *Missouri Pacific Railroad Co.*, *St. Louis Southwestern Railway Co.*, and *Texas & Pacific Railway Co.*, 91 I.C.C. 399 (1924); *Erie Railroad Co.*, 93 I.C.C. 646 (1924), and, for Marine Equipment, 128 I.C.C. 323 (1927); *New York, New Haven & Hartford Railroad Co.*, 107 I.C.C. 721 (1926).

<sup>81</sup> Without entering into an analysis of the Commission's findings, it may be noted that the Commission has reported as follows: "The maintenance expenditures on 16 railroads investigated included repairs in contract shops to 1,154 locomotives which exceeded by \$15,283,748.97, an average of \$13,244.15 per locomotive, the cost of similar repairs made to locomotives at the railroad shops." *Annual Report*, 1925, p. 58. Since July 6, 1925, all Class I railroads must file with the Commission copies of contracts and agreements entered into with outside construction or repair shops for the repair or rebuilding of locomotives or other equipment used in the transportation service.

directions,<sup>82</sup> the most significant of which is represented by the investigation, instituted on its own motion July 6, 1931, into the practices of carriers by railroad affecting operating revenues or expenses.<sup>83</sup>

#### §5. SERVICE AND SAFETY

In passing to a brief consideration of the Commission's activities in connection with matters of transportation service and safety of operation, we enter upon a survey of the Commission's more purely administrative tasks, which are performed, in large measure, through the routine of its bureaus, in coöperation with the carriers. While

The Section on Efficiency and Economy of Operation checks and analyzes these contracts, and conducts such field investigations in connection with them as may be necessary. On the basis of these results the Commission extends its formal inquiries from time to time. See *Annual Reports*: 1927, p. 39; 1928, pp. 44-45; 1929, p. 51; 1930, p. 47; 1931, pp. 53-54; 1932, p. 79; 1933, p. 69.

<sup>82</sup> See, for example, *Maintenance of Way Expenditures: P. & L. E. R. R. Co.*, 136 L.C.C. 527 (1928), in which, upon investigation, the Commission found the practice of the carrier in paying labor contractors a 10 per cent allowance of the monthly earnings of its track and roadway laborers, including those employed in a supervisory capacity and in connection with camp and commissary, to be inconsistent with efficient and economical management.

<sup>83</sup> *Ex Parte 104: Practices of Carriers Affecting Operating Revenues or Expenses.* The character of the investigation was early described by the Commission as follows: "It should be understood that this proceeding is not intended as an exhaustive investigation into the economy and efficiency of railroad management and operation. We are not equipped for such an undertaking, and, indeed, our facilities are limited for the investigation which we have instituted, making it necessary to carry it on piecemeal, step by step. The purpose is to investigate definite practices of the carriers which we have reason to believe may be unduly depleting operating revenues or increasing operating expenses. They will chiefly be practices brought about by the pressure of competition. In such situations it is often difficult for the carriers to discontinue a particular practice, even if they realize that it is exerting an adverse effect upon income, but this difficulty may be overcome by public disclosure of the facts, provided the facts show need for discontinuance. The investigation will not be confined, however, to practices of this character, but will embrace such other matters as we believe merit investigation and which we have facilities to investigate." *Annual Report, 1931*, p. 79. The investigation was divided into six parts: Part I, Railroad Fuel; Part II, Terminal Services of Class I Carriers; Part III, Construction and Maintenance of Private Side Tracks for Shippers; Part IV, Traffic Expenses; Part V, Private Freight Cars; and Part VI, Warehousing and Storage of Property by Carriers at the Port of New York. The results of the last of these parts appear in *Propriety of Operating Practices—New York Warehousing*, 198 L.C.C. 134 (1933). The results of some of the remaining parts, in completed or preliminary form, have been referred to the Federal Coördinator of Transportation, who was charged by the Emergency Railroad Transportation Act of 1933 (Public No. 68, 73d Congress) with promoting or requiring action by the carriers designed to prevent undue impairment of net earnings and avoidable waste and expense. See *Annual Report, 1933*, p. 29.

ultimate responsibility for these activities, as for those previously considered, rests in the Commission, the Bureau of Service, with its sections on car service, on efficiency and economy of operation, and on transportation of explosives and other dangerous articles, is in direct charge of service matters; and the Bureau of Safety, with its sections on hours of service, on safety appliances, on accident investigation, and on signals and train-control devices, together with the Bureau of Locomotive Inspection, are in direct charge of safety matters. The activities of these bureaus, in so far as they entail the adjustment of controversies and the promulgation of practices for future application, involve the performance of quasi-judicial and legislative functions as well as executive tasks; and formal proceedings are frequently entered upon with respect to these matters, in response to complaints or on the Commission's own motion, with full hearings, published reports, and mandatory findings.<sup>84</sup> Predominantly, however, the duties of the carriers in matters of service and safety are enforced through a continuous process of accommodation between the Commission's representatives, stationed in the field and operating from Washington, and representatives of the roads. It is but necessary for our present purposes to indicate the character and extent of these administrative activities.

The Commission's control of railroad service, not merely in terms of removing discriminatory practices, but to the end of promoting the reasonable and effective use of available facilities, is of comparatively recent origin. The transportation difficulties of the war period

<sup>84</sup> See, for example, the following: *Safety Appliances*, 58 I.C.C. 655 (1920); *Automatic Train-Control Devices*, 69 I.C.C. 258 (1922), 91 I.C.C. 426 (1924), 148 I.C.C. 188 (1928); *Hastings Commercial Club v. C., M. & St. P. Ry. Co.*, 69 I.C.C. 489 (1922), 107 I.C.C. 208 (1926); *York Mfrs. Assn. v. P. R. R. Co.*, 73 I.C.C. 40 (1922); *Port Arthur Chamber of Commerce v. T. & F. S. Ry. Co.*, 73 I.C.C. 361 (1922); *Assigned Cars for Bituminous Coal Mines*, 80 I.C.C. 520 (1923), 93 I.C.C. 701 (1924); *Power Brakes and Appliances for Operating*, 91 I.C.C. 481 (1924); *Rules Governing Ratings of Coal Mines*, 95 I.C.C. 309 (1924); *Train Service on Northern Pacific*, 112 I.C.C. 191 (1926); *Handling of Fresh Meat*, 132 I.C.C. 49 (1927); *Cars for Livestock from Southwest*, 136 I.C.C. 61 (1927); *Sample v. A., T. & S. F. Ry. Co.*, 139 I.C.C. 324 (1928); *Port of New York Authority v. A., T. & S. F. Ry. Co.*, 144 I.C.C. 514 (1928); *Chicago & Alton R. R. Co. v. T., P. & W. Ry. Co.*, 146 I.C.C. 171 (1928); *Johannesburg Mfg. Co. v. Michigan C. R. Co.*, 151 I.C.C. 61 (1929); *Transportation of Strawberries by Express*, 151 I.C.C. 553 (1929), 156 I.C.C. 4 (1929); *Excelsior Coal Co. v. Midland Valley R. Co.*, 160 I.C.C. 275 (1929); *Laughlin v. Aberdeen & Rockfish R. Co.*, 161 I.C.C. 157 (1930); *Rules for Car-Hire Settlement*, 160 I.C.C. 369 (1930), 165 I.C.C. 495 (1930).

led to the passage of the Esch Car Service Act of 1917 and to the establishment of the Bureau of Service;<sup>85</sup> and, upon the reconstitution of the regulatory structure by the Transportation Act of 1920, the powers conferred by the earlier legislation were further enlarged, and the activities of the Bureau of Service were correspondingly expanded.<sup>86</sup> The Commission's authority over service is now essentially coextensive with its rate-making power even under normal conditions; and in emergency situations it exercises a jurisdiction so sweeping, in the interest of general transportation needs, as virtually to dominate the movement of property by rail and the utilization of its instrumentalities. Nominally, aside from authority to require the joint use of terminals when deemed practicable and in the public interest, the duties of the carriers and the powers of the Commission are restricted to "car service"; but since the term "car service," as employed in the statute, embraces the use, control, supply, movement, distribution, exchange, interchange, and return of all vehicles—including cars, locomotives, and special equipment—and the supply of trains, it is obvious that all physical instrumentalities as well as all important service relationships, between carriers and shippers and amongst the carriers themselves, are thereby subjected to the Commission's jurisdiction. The initiative in furnishing safe and adequate service and in maintaining just and reasonable arrangements rests in the roads; but on complaint or on its own motion, the Commission may, after hearing, prescribe the rules, regulations, and practices that shall govern. In performing this normal regulatory task, however, the Commission has avoided formal proceedings as far as possible. From the beginning, it has achieved its ends very largely through coöperation with the carriers.<sup>87</sup> But the Commission also possesses extensive emergency powers over service, in the event of shortage of equip-

<sup>85</sup> See *Annual Report, 1917*, pp. 62-68.

<sup>86</sup> See *Annual Report, 1920*, pp. 11-25, 56-57.

<sup>87</sup> When, in 1917, the Commission first organized its Bureau of Car Service as the agency for the transmission of its directions in matters of service, it laid down a co-operative procedure which has been largely followed since that time. "Where occasion requires," it said, "orders or directions will issue under the car service act and directly to the carrier or carriers concerned." But it then continued as follows: "Subject to this fundamental principle, the Commission is availing itself, and will continue to avail itself, of cooperative effort on the part of the carriers' commission on car service. . . . The Commission is advised that the carriers have appointed local car service committees at some 30 points throughout the country, and that the National Industrial Traffic

ment, congestion of traffic, or any other circumstance requiring immediate action, and these powers may be exercised summarily. They extend to the suspension of existing car-service rules and practices; to the enforcement of such arrangements, irrespective of the ownership of facilities, as will promote service in the interest of the public and the commerce of the people; to the requirement of such joint or common use of terminals as will best meet the emergency in terms of

League has appointed similar committees of shippers at the same points, the aim being to secure harmony and cooperation between shippers and carriers. The Commission suggested that these committees should meet jointly where necessary to adjust local affairs; any irreconcilable difference which might arise to be referred to the carriers' commission on car service or to the bureau of car service for adjustment." *Annual Report, 1917*, p. 66. Again in 1920, when the Bureau of Service was first organized under the provisions of the Transportation Act, the Commission likewise stressed its reliance upon informal cooperation with the carriers: "The railroads, realizing the necessity for fair and equitable distribution of cars, voluntarily established a car service division of the American Railroad Association. . . . By voluntary action of the carriers by railroad that division has been given power to issue directions to them in the matter of car distribution, which they have undertaken to follow. It also acts as the statutory agent for the members of the association in receiving service of orders entered by us; and, by its officers and committees, speaks to us the collective voice of its constituents as to all matters of car service. . . . We have cooperated with the railroads in transportation matters through that agency." *Annual Report, 1920*, p. 13. Through the organization, by the carriers' car service division, of regional advisory boards, composed of railroad and shipper representatives, and through the stationing of the Commission's service agents at all important gateways, this cooperative procedure has been further promoted. The regional advisory boards, organized in large measure for the purpose "of anticipating car requirements and overcoming car-service and operating difficulties which can be worked out locally," enable carriers and shippers to "understand more clearly each other's problems" and to "harmonize their differences." *Annual Report, 1923*, p. 54. And the achievements of the Commission's service agents are noteworthy: "Our definite policy of seeking to bring about the greatest possible measure of cooperation between shippers and carriers has contributed largely to efficiencies and economies of operation and has facilitated transportation. Our service agents are constantly assisting in the adjustment of differences and complaints of a local nature between shippers and carriers. . . . The immediate attention so given at an incipient stage frequently results in bringing the parties together and, in nearly all such instances, satisfactory adjustments are reached, thereby obviating the filing of formal complaints and the resulting expense to the shippers, the carriers and the commission." *Annual Report, 1926*, p. 59. See, also, *Annual Reports: 1927*, p. 35; 1928, pp. 41-42; 1929, p. 47; 1930, p. 44; 1931, p. 50; and note the following from *Annual Report, 1932*, at p. 77: "With the general decrease in the amount of traffic handled by rail throughout the country there has come to this bureau [of service] an increased amount of work. Due to curtailments of train service, changes in schedules, closing of stations, and abandonment of lines the bureau has received and acted upon an unusual number of informal complaints and protests. We have received requests from carriers, shippers, chambers of commerce, and other civic organizations for assistance in adjusting local controversies relating to service matters. Our service agents are successful in bringing about many amicable settlements."



public need; to the establishment of priorities, embargoes, and transportation under permit; to the control of the handling, routing, and movement of traffic in the public interest. In these various ways, under emergency conditions, the Commission in effect serves as a super-directorate of the carriers as a whole in matters of transportation service. The situations requiring the exercise of these extraordinary powers generally affect a considerable section of the country and do not lend themselves to the informal accommodation which so frequently composes local differences. While the Commission's close contact with transportation conditions and its coöperation with the carriers may often exert a preventive influence, the actual development of such emergencies usually results in resort, through service orders, to the Commission's mandatory powers.

Neither the Commission's normal car-service activities nor those called forth by emergency situations lend themselves to effective statistical treatment. It is sufficient to give a brief indication of their character. The Commission, in coöperation with the carriers and shippers and their representatives, seeks continuously not only to stimulate improvement in operating efficiency, but "to eliminate misunderstandings and secure the best possible distribution of cars and the freest practicable movement of traffic."<sup>88</sup> Emphasis is placed upon heavier car loading, increased car mileage, preclassification of cars in freight trains, decreased percentage of bad-order cars, reduced cross-hauling of empty cars, prompt release of equipment by shippers, anticipation of car requirements, enforcement of car-service rules.<sup>89</sup> Not

<sup>88</sup> *Annual Report, 1923*, p. 54.

<sup>89</sup> See *Annual Reports*: 1920, pp. 23-25; 1923, pp. 54-56; 1925, pp. 54-58; 1926, pp. 59-60. By way of illustration of a few of these matters, note the following: "The necessity for prompt release of cars by shippers and consignees is constantly emphasized, especially as to refrigerator cars, the demand for which is increasing. The haul from the point of production of perishables to consuming markets is often long, and prompt unloading and movement is necessary. This is generally recognized, but nevertheless many consignees are prone to use the cars for salesrooms and storage purposes. The resulting delay in return to originating territory is in some measure responsible for seasonal car shortages. In an effort to speed up the release of refrigerator cars committees of the principal fruit and vegetable shippers and receivers in each city have been formed by the regional advisory boards. Their efforts have resulted in more prompt release of refrigerator cars this season, and it is hoped that this plan will be continued. The delay in the release of such cars, however, is still excessive, and if the practice is persisted in it may be that more effective steps will become necessary." *Annual Report, 1925*, p. 56. The following with regard to the observance of car-service rules concerns

only have substantial general results been achieved through these means, but the difficulties of special situations have been repeatedly removed through informal methods, without the exercise of mandatory power. Merely by way of illustration, among numerous other service difficulties adjusted by the Commission in various parts of the country and with respect to various types of traffic, reference may be made to the relief of the freight congestion in Florida,<sup>90</sup> to the de-

carriers rather than shippers: "During the year it was found that carriers generally in the Chicago district were not observing the provisions of certain car-service rules in forwarding merchandise traffic from their different freight houses. The rules contemplate that when cars are unloaded at destination they will be forwarded either loaded or empty in the direction of the owning road, or returned to the owner over the route traversed by the outbound shipment. In many instances carriers having lines extending west from Chicago forwarded under load to eastern destinations their own and other cars, which, under the rules, should have gone west, and at the same time were returning empty from Chicago cars belonging to eastern carriers. The eastern carriers were following similar practices. The cars so loaded and forwarded in violation of the car-service rules constituted a considerable portion of the total number of cars loaded at and forwarded from Chicago on a majority of the larger lines. In other instances, the practices followed, although not directly in violation of the car-service rules, were not conducive to economical operation. Obviously such practices result in unnecessary movement of empty cars and other avoidable expense. The action taken to bring about observance of these rules resulted within two months in substantial reduction of the number of violations. Investigations followed at other terminals with like results." *Annual Report, 1926, p. 60.*

<sup>90</sup> The Florida freight congestion of 1925 and 1926, involving chiefly the Florida East Coast Railway and resulting in an embargo on carload freight for points on that line, was largely relieved through the efforts of the Commission, in cooperation with carriers, shippers, civic organizations, and local authorities: "We held conferences with the principal operating officials of the railroads serving Florida and with representatives of the car-service division of the American Railway Association. Much stress was laid by the carriers' representatives upon certain development work in progress and in contemplation, such as double tracking, new yards and terminals, new and larger motive power, and other equipment. But looking to the future did not help the present situation. Traffic was not being handled currently. Operating efficiency was at low ebb. Loads into Florida continued to accumulate at the various gateways and terminals. The unloading of cars and the return of empties was not being facilitated. Daily checks of yards and terminals were not made. The entire area lacked coordination with the result that much effort was misdirected and lost. The local shippers blamed the carriers. The carriers contended that shippers were not unloading promptly, and the country at large was clamoring to get commodities into Florida. The embargoes were still in effect in January, 1926. Our director and an augmented force of service agents were sent into Florida to work cooperatively with carriers and shippers. Their efforts were directed toward obtaining facts and figures which were used in conferences with carriers and consignees. Interest of civic organizations and municipal authorities in the matter of releasing cars was created or revived. By February the situation was approaching normal, and on February 22 the state-wide embargo was modified so that it remained effective only on building and road-construction materials. In March the embargo was practically lifted." *Annual Report, 1926, pp. 61-62.* See, also, *Annual Report, 1925, pp. 60-61.* It should be noted that two service orders, in the exercise of the Commis-

velopment of a car-distribution plan for the movement of grapes from California,<sup>91</sup> to the removal of congestion on the Belt Railway of Chicago<sup>92</sup> and at the port of Houston,<sup>93</sup> to the adjustment of dif-

sion's emergency powers, were issued in connection with the Florida situation. By Service Order No. 42 (entered December 4, 1925, and vacated March 19, 1926), the Seaboard Air Line Railway was directed to divert certain traffic over the newly constructed Brooksville and Inverness Railway; and by Service Order No. 43 (entered December 28, 1925, and vacated as of April 8, 1926), all railroads south of the Ohio and east of the Mississippi were directed "to forward traffic to and from destinations in the State of Florida by the routes most available to expedite its movement and prevent congestion, without regard to the routing thereof made by shippers or by carriers from which the traffic was received, or to the ownership of the cars, and suspended all conflicting rules, regulations, and practices of those carriers with respect to car service." *Annual Report, 1926*, pp. 62-63.

<sup>91</sup> "During 1925 and previous years we received many complaints from California shippers of grapes that available refrigerator cars were not being equitably distributed. With a view to obviating similar difficulties this year, a member of our field force made detailed study of the situation and submitted an outline of a plan of car distribution. This outline was submitted by us to the car-service division for consideration by it, the railroads, and the private-car lines, as well as the growers and shippers of the State through the medium of the Pacific coast regional advisory board. The necessary details in carrying out the plans were worked out by cooperation between these various interests, and the plan as a whole has been approved by railroads, private-car lines, and the large majority of growers and shippers in the State." *Annual Report, 1926*, pp. 63-64, 63. See, also, *Annual Reports: 1927*, pp. 37-38; 1928, p. 43. In the latter report the Commission said: "One of the most intensive movements of perishable freight is the transportation of grapes from California to eastern markets. The grape car plan mentioned in our last two reports was continued this year with some minor modifications. This plan operates only during periods of car shortage, but by reason of the plan requiring advance information as to car requirements for a definite period the carriers can better meet the needs. Furthermore, inflated car orders so common in the past are greatly curtailed. Our service agents give particular attention to the return movement of the empty refrigerator cars and whenever they find the movement sluggish corrective action is taken."

<sup>92</sup> "A congestion occurred on the Belt Railway of Chicago due in part to the holding of cars for Chicago & North Western delivery. Certain industries located on the Chicago & North Western had heavy accumulations which interfered with the making of prompt placements by the carrier, and resulted in the placing of a hold order against the Belt. Investigation by our service agent at Chicago and conference with the railroads involved brought about better classification of cars and the detouring of empty refrigerators and line-haul business to an outer line, instead of being handled over the North Western. This relieved the situation." *Annual Report, 1927*, p. 38.

<sup>93</sup> "During the heavy movement of export cotton through the port of Houston there was an accumulation of nearly 3,000 cars of cotton held in yards due to inability of compresses and warehouses to unload. In addition there were 1,036,000 bales in storage. The greater portion of this congestion was due to the limited terminal facilities of the International Great Northern and the dumping on that line by connecting carriers of cotton consigned to three of the five large shipside compresses. Our service agent joined with the port authorities and the carriers in an investigation of conditions at this port which resulted in plans for increasing the classification and storage facilities, zoning of their industrial work, and operating yard engines on a schedule which will result in improved service." *Ibid.*

ferences with regard to the handling of livestock,<sup>94</sup> the weighing of vegetables,<sup>95</sup> and demurrage and storage.<sup>96</sup> Through such activity in matters of car service, the Commission is removing maladjustments and promoting movement of traffic, composing service differences and facilitating efficiency and economy of operation.<sup>97</sup>

But the Commission is also exercising its emergency powers, through the issuance of service orders. On two occasions the difficulties resulting from shortage of equipment and congestion of traffic were so broad in their scope and so serious in their effect that the Commission asserted its authority over railroad facilities and transportation service in vigorous and far-reaching manner. The first of these country-wide emergencies developed in the spring of 1920,

<sup>94</sup> "In response to numerous informal complaints filed with us concerning unsatisfactory freight service provided by the railroads for the transportation of livestock originating in the State of Wisconsin, this bureau [of service] in cooperation with the Wisconsin Railroad Commission conducted an exhaustive investigation into the subject, and through informal handling with the carriers brought about a general readjustment of practically all livestock schedules from shipping stations in the State of Wisconsin to Chicago. . . . The new schedules are so arranged that livestock taken from farms to railway loading stations during morning hours can be marketed at Chicago the following day. Heretofore, such livestock ordinarily reached Chicago the second day after leaving the farms, and the running schedules were such that frequently it was necessary to unload shipments one or more times while en route for feed, water, and rest. . . . The necessity of holding stock in station pens for long periods will now be avoided, and it is estimated by the shippers that under the new arrangements they will save from \$50 to \$150 or more per car, account less shrinkage, depending on whether shipments consist of hogs, cattle, calves, or sheep. The expense of feeding in transit will also be avoided. In addition to the foregoing, informal complaints that were filed concerning the handling of livestock between certain points in Iowa and Illinois were investigated and practical and satisfactory adjustments arranged." *Annual Report*, 1929, pp. 47-48. See, also, *Annual Reports*: 1928, p. 42; 1930, p. 46.

<sup>95</sup> "A controversy of long standing regarding the weights of vegetables was settled in informal conference. Competition among vegetable growers and shippers and the abuse of the bulge pack resulted in a wide range of weights covering the same kind of vegetables in similar containers from the same district. In conference the sizes of various containers were agreed to as were estimated weights to be used for billing purposes for the several commodities. Tariffs were changed in accordance with the agreement reached." *Annual Report*, 1928, p. 42. See, also, *Annual Reports*: 1929, p. 47; 1930, p. 45; 1931, p. 52; 1932, p. 78.

<sup>96</sup> "In our last three reports the fact has been mentioned that the bureau [of service] is examining all complaints concerning demurrage and storage which are presented, and disposing of such as will permit of informal handling. This plan is proving acceptable, effective, and economical. In some cases it permits of informal handling of cases submitted originally for the formal docket, and in others the parties take the initiative in suggesting that expense for all concerned be minimized by such adjustment." *Annual Report*, 1932, p. 78.

<sup>97</sup> For a consideration of the special undertakings of the Section on Efficiency and Economy of Operation, see pp. 52-55, *supra*.

soon after the Commission's new powers had become effective. The intensification of business activity, in face of an inadequate car supply, was itself producing a condition of car shortage; but the congestion that accompanied the switchmen's strikes of that period so far reduced the available supply of equipment and so greatly accentuated the difficulties of operation that disruption of the transportation service was threatened.<sup>98</sup> Under these circumstances, upon petition of the principal roads, the Commission declared an emergency to exist and took summary steps to relieve the situation. Numerous service orders were entered.<sup>99</sup> All roads were directed to forward traffic, regardless of instructions received from shippers or carriers and without respect to the ownership of cars, by routes most available to expedite movement and relieve congestion;<sup>100</sup> the relocation of equipment between eastern and western carriers was formally required;<sup>101</sup> and through the establishment of priorities, and otherwise, the shipment of coal was facilitated, especially to the Northwest and to New England, and for use by public utilities and by public institutions.<sup>102</sup>

<sup>98</sup> The transportation conditions prevailing at this time are fully described by the Commission in *Annual Report, 1920*, pp. 11-23.

<sup>99</sup> "As occasion showed the necessity, these orders have been continued, amended, modified, suspended, or superseded. The foundation of each of these orders has been the finding that, because of shortage of equipment and congestion of traffic, an emergency has existed which required immediate action and order. These service orders being of an emergency character have generally been made to run until our further order. In making the orders we have felt it incumbent upon us to act promptly. We have kept informed currently as to service conditions so that with improved conditions we could with equal promptness modify or suspend the action taken by us." *Ibid.*, p. 14.

<sup>100</sup> Service Order No. 1, entered May 20, 1920. The rerouting privilege thus conferred brought about a marked reduction in terminal congestion. The accumulations of freight which amounted to 103,237 cars on February 27, 1920, which rose to more than 287,000 cars immediately following the outbreak of the strike, and which averaged 208,698 cars for the entire month of April, were reduced to a daily average of 101,612 cars for the month of July, and by October 22 these accumulations amounted to only 39,807 cars, "which approximates normal conditions." *Ibid.*, p. 16.

<sup>101</sup> Service Order No. 2 and Service Order No. 3, entered May 20, 1920. By the first of these orders western carriers were required to deliver about 30,000 open-top cars to their eastern connections; by the second order eastern carriers were required to deliver about 20,000 box cars to their western connections. This relocation of equipment was continued through the directions of the carriers' car-service division, without further formal orders from the Commission. The initial relocation of 19,800 box cars, for example, was followed, in continuance of the Commission's policy, by the voluntary relocation of 109,830 box cars. *Ibid.*, p. 15.

<sup>102</sup> Despite an insistent demand that priority orders be issued with regard to all "essential" commodities, the Commission confined its exercise of this power to the transportation of coal. "The petition of the carriers by railroad," said the Commission, "suggested the setting up of a list of essential commodities entitled to priority in the

The second of the two outstanding occasions for the use of the Commission's emergency powers developed in the summer of 1922. On April 1 of that year there was a general strike of union miners in both the bituminous and anthracite coal fields; and this was followed, on July 1, by a general strike of railroad shopmen. These two strikes exerted a seriously disrupting influence upon industrial activity, and they even threatened domestic hardship. As a result of deterioration of railroad facilities and impairment of transportation service, coupled with sharp curtailment of coal production, the country found itself in the midst of a very grave situation.<sup>108</sup> As in 1920, the Commission proceeded under these circumstances to assert its powers of

use of transportation. Following the filing of that petition, requests and demands of most insistent character for priority orders, so called, were laid before us from every quarter and as to substantially every important commodity. It appeared to us that the attempt to classify commodities generally, and to assign relative priorities to them for either the supply or movement of cars, would create an unnecessary confusion and disturbance of industry, and would add to the existing congestion and decrease the aggregate amount of tonnage which could be moved. But we were impressed with the imperative need of special consideration for the movement of coal. . . . Not only was there an urgent call for unusually large amounts of coal on the part of the railroads, public utilities, and industries generally, but it soon became apparent that unless we took special measures to insure the movement of coal to certain sections the coal which must go into these sections would be forced through unusual routes, with loss of efficiency of equipment and further congestion of already clogged gateways. We felt it to be our duty to avoid such effects by adopting appropriate means within our emergency powers to insure a prompt, steady, and economical use of transportation facilities in the movement of coal." *Ibid.*, pp. 16-17. Accordingly, through Service Orders No. 7, No. 9, and No. 20, the Commission defined "coal cars" and issued directions for their preferential use in the transportation of coal. "The effect of these orders was to require coal-loading carriers to use coal cars primarily for the transportation of that commodity and to require roads not loading coal to deliver such cars to their coal-loading connections, to the extent of the ability of such connecting lines to receive and absorb that class of equipment. The railroads were also required to place an embargo upon consignees who detained coal cars unreasonably." *Ibid.*, pp. 17-18. The Commission also took steps to meet special situations in connection with the movement of coal. For example: by Service Orders No. 5 and No. 10 railroads serving Lake Erie ports were directed to give preference to carload shipments consigned to the manager of a pool of lake cargo and bunkerage coal which had been formed upon the urgent advice of the Commission; by Service Orders No. 6 and No. 11 similar preferential arrangements were made effective with regard to the shipment of coal to New England, in order that the use of the tidewater route, in place of the congested all-rail channels, might be stimulated; by Service Orders No. 9 and No. 16 the carriers were authorized, with necessary safeguards against abuse, to provide a sufficient supply of cars to meet the coal needs of public utilities and public institutions. In due course, as the emergency was relieved, all of these priority orders were vacated.

<sup>108</sup> For the detailed facts concerning this emergency, including statistical data with regard to the effect of the strikes upon coal production, condition of motive power, freight accumulation, and car supply, see *Annual Report, 1922*, pp. 9-16.

immediate action and summary control. The devices utilized were those of unrestricted routing and preferential service. All carriers were required to forward traffic, regardless of shipping instructions or car ownership, in the interest of free and expeditious movement,<sup>104</sup> and each carrier, to the extent that it was unable to move all the traffic offered, was required to give preference and priority to the transportation of designated commodities or types of traffic (including food for human consumption, feed for livestock, livestock, perishable products, coal, coke, and fuel oil), and to rendering available, by interchange and return, empty cars for the movement of these commodities and types of traffic.<sup>105</sup> The expedients thus employed in the country-wide emergencies of 1920 and 1922 constitute the most sig-

<sup>104</sup> Service Order No. 22, entered July 25, 1922.

<sup>105</sup> By Service Order No. 23, entered July 25, 1922, these requirements were made applicable to roads east of the Mississippi, including the west bank crossings; by Service Order No. 24, entered August 30, 1922, they were made applicable, with some modifications, to carriers west of the Mississippi. Subsequently, by amendment of Service Order No. 24 and through Service Order No. 25 which superseded Service Order No. 23, "the priority lists were made uniform and the following commodities added: Mine supplies, medicines, fertilizers, seeds, newsprint paper, fuel other than coal and coke, and petroleum and its products in tank cars." *Annual Report, 1922*, p. 11. It will be noted that this use of the priority power was much more extensive than it had been in the 1920 emergency: instead of being confined to the preferential movement of coal, it embraced an extensive list of commodities and types of traffic which were deemed "necessaries." Basic differences in the transportation situation account for the divergence in policy: "The emergency here sought to be met was due to the inability of the rail carriers to supply transportation for all essential commodities. The accumulations of freight during the present emergency were due entirely to the carriers' disability, and did not cause congestion at the large terminals as was the case in 1920. Loaded cars accumulated at intermediate terminals or were set out at sidings along the line. It was apparent that the carriers would be unable to move all freight offered, and that accumulations would increase rapidly, so that the movement of the essential commodities vital to the welfare of the individual and of the nation, or required by humanitarian dictates, would be seriously impeded. The prompt return movement of empty cars for loading such commodities, and the restriction of their use to that character of service, were indispensable to the carrying out of a program intended to insure the continuous movement of the necessities of life." *Ibid.*, p. 10. In the case of coal, however, because of "the menacing domestic and industrial consequences of the coal miners' strike" and "the inability of the carriers to supply adequate transportation service for the operating coal mines," special provisions were necessary. Not only were the carriers required to furnish open-top cars for the loading and transportation of coal in preference to any other use, but as a means of supplying the essential industries with coal, such cars were to be assigned in the order of importance of certain designated purposes as classified by the Commission. *Ibid.*, pp. 11-13. For the cancellation of these general service orders growing out of the 1922 emergency, see *Annual Report, 1923*, pp. 51-52; for the character of service orders Nos. 26 to 39, entered in most instances upon recommendation of the Federal Fuel Distributor and designed to meet special situations, see *ibid.*, pp. 52-53.

nificant expression of the Commission's extraordinary powers over railroad service. But these powers have served as a continuing source of service authority, and they have been exercised from year to year, as circumstances have demanded, in more restricted situations.<sup>106</sup> In sum, then, the Commission is asserting a large measure of affirmative control over railroad facilities and transportation service, both under normal conditions and in emergencies, not only by maintaining equitable relationships between carriers and shippers and as amongst the carriers themselves, but by promoting efficiency of operation and free movement of traffic.<sup>107</sup>

<sup>106</sup> Service Order No. 40, entered March 27, 1924, directed the Kansas City Terminal Railway Co. to permit the use of the Union Passenger Station and other terminal facilities at Kansas City, Missouri, by the Missouri-Kansas-Texas Railroad; Service Order No. 41, entered August 8, 1925, directed the Missouri Pacific to divert certain of its oil traffic over other lines; Service Orders No. 42 and No. 43 facilitated the relief of the 1925 and 1926 freight congestion in Florida (see note 90, *supra*); to meet the operating conditions growing out of the Mississippi floods of the spring of 1927, Service Order No. 44, entered April 23, 1927, required the carriers to utilize such routes as would expedite movement and prevent congestion, free from the ordinary restrictions, and Service Order No. 45, entered May 23, 1927, authorized the Texas & New Orleans to install and operate a new service by water, as a substitute for rail service, between New Orleans and the ports of Galveston and Houston; Service Order No. 46, effective August 8, 1927, required the Toledo, Peoria & Western to permit the continued use of certain of its tracks by the Chicago & Alton; to meet the operating conditions growing out of the New England floods of the fall of 1927, Service Order No. 47, entered November 8, 1927, imposed the usual rerouting requirement, in the interest of free and expeditious movement, upon all lines serving New England; Service Order No. 48, entered January 24, 1929, authorized the Wheeling & Lake Erie to utilize temporarily the tracks and station facilities of two other railroads in Cleveland because of the unsafe condition of its passenger station; Service Order No. 49, entered March 27, 1929, authorized rerouting on the part of the Central of Georgia because of flood conditions in Alabama; in 1930, because of the closing of the Mexican consulate at Laredo, Texas, a number of railroads were directed by Service Order No. 50 to reroute traffic destined for Mexico via Laredo, as a means of expediting its movement and preventing congestion; Service Order No. 51, entered May 22, 1931, directed the Galveston Terminal Railway Co. to accord use of its terminals and terminal tracks to the Burlington-Rock Island Railroad; Service Order No. 52, entered August 6, 1932, directed the Gainesville Midland Railway to permit the Gainesville & Northwestern Railroad to use certain tracks and terminal facilities; Service Order No. 53, entered March 8, 1933, directed the Southern Railway, because of the destruction of a bridge, to forward traffic by way of open routes at rates applicable on the normal route; and Service Order No. 54, likewise entered in 1933, directed the Kansas City Terminal Railway Co. to permit the receivers of the Wabash to continue to use the Union Passenger Station at Kansas City, Missouri.

<sup>107</sup> In concluding this survey of the Commission's service activities, and as a transition to the consideration of safety matters, reference may be made to the Section on Transportation of Explosives and Other Dangerous Articles. This section was made part of the Bureau of Service in the reorganization effected in 1925, although the



The functions and activities of the Commission with reference to matters of safety have been set forth at length in an earlier chapter and require no detailed elaboration at this point.<sup>108</sup> While a considerable amount of discretion resides in the Commission even with regard to safety requirements,<sup>109</sup> especially in connection with the approval of devices and the enforcement of their installation under the train-control provisions enacted in 1920,<sup>110</sup> the performance of its duties as to safety is largely of a routine administrative character, which can be entrusted, under general oversight and control, to its clerical force and technical staff. The chief processes employed involve the receipt and checking of carrier reports and the inspection of equipment in the field; the investigation of safety devices, operating methods, and rail accidents, and the publication of results; the discovery of infractions of statutory requirements and administrative regulations and the report of violations of law for prosecution. These activities, predominantly of a policing character, have been pursued

Commission's functioning in this matter, to facilitate safety of operation, dates from 1908. See Part I, chap. vi, note 57; and *Annual Report*, 1925, pp. 54-55. The Commission's chief task is to formulate regulations for the safe transportation of explosives and other dangerous articles, including inflammable liquids, inflammable solids, oxidizing materials, corrosive liquids, compressed gases, and poisonous substances. These regulations affect service as well as safety. The extent of recent activity along these lines is indicated by the following: in 1925, the regulations were amended by 5 orders containing 165 changes in the requirements; in 1926, by 11 orders containing changes in 248 paragraphs of the requirements; in 1927, by 4 orders containing 142 new or changed paragraphs and 23 new or changed specifications for containers; in 1928, by 3 orders containing 43 new or changed paragraphs and 16 new or changed specifications for containers; in 1929, by 2 orders containing 13 new or changed paragraphs and 19 specifications for containers; and in 1930 the regulations were generally revised, a procedure was perfected whereby, through periodic conferences between shippers and carriers, proposals for new or changed regulations might be accorded more uniform and thorough investigation before being presented to the Commission, and work was started in formulating regulations for bus and truck transportation of dangerous articles and for water-borne traffic. In addition, investigations are conducted into the character and causes of accidents resulting from such transportation of explosives and other dangerous articles, and for the improvement of devices used therein. See *Annual Reports*: 1925, pp. 64-65; 1926, pp. 66-67; 1927, p. 40; 1928, pp. 45-46; 1929, pp. 51-52; 1930, pp. 48-49; 1931, pp. 55-56; 1932, pp. 79-80; 1933, p. 68.

<sup>108</sup> See Part I, pp. 245-281.

<sup>109</sup> For the formal adjustment of controversies, see for example: *Rules for Testing Other than Steam Power Locomotives*, 122 I.C.C. 414 (1927); *Wisconsin R. R. Commission v. A. & R. R. Co.*, 142 I.C.C. 199 (1928); *Public Utilities Commission of Ohio v. Pennsylvania R. Co.*, 151 I.C.C. 448 (1929).

<sup>110</sup> See *Automatic Train-Control Devices*, 69 I.C.C. 258 (1922), 91 I.C.C. 426 (1924), 148 I.C.C. 188 (1928).

from the beginning as a rather distinct aspect of the Commission's work, unrelated to the larger regulatory tasks with which it is charged.<sup>111</sup> They now embrace the fields of safety appliances, hours of service, accident investigation, and signals and train-control devices, under the jurisdiction of the Bureau of Safety, together with the field of locomotive inspection, under the jurisdiction of a separate bureau of that name.<sup>112</sup> The extensiveness of each of these phases of safety administration throws additional light upon the sweep of undertakings for which the Commission is ultimately responsible. It may be noted, for example, that during the year ending June 30, 1933, the latest period for which figures are available, approximately 1,300,000 cars and locomotives were inspected, with the disclosure of 23.91 safety-appliance defects per 1,000; that 87,658 steam locomotives were inspected, with 8,388 found defective; that hours-of-service reports were filed by 905 railroads, 192 of which showed 3,202 instances of excess service; that 59 train accidents, including 28 collisions and 31 derailments, in which 68 persons were killed and 389 persons injured, were investigated; and that by June 30, 1933, automatic train-control devices installed under the Commission's orders comprised 8,951.7 miles of road, 16,501.8 miles of track, 6,520 locomotives, and 337 motor cars.<sup>118</sup> In the aggregate these activities constitute an important part of the Commission's administrative responsibility.

#### §6. ACCOUNTS AND REPORTS

The Commission's administrative activities in connection with accounts and reports are of the utmost importance. They not only assure publicity of carrier operations, as a basic safeguard against

<sup>111</sup> Although the Commission summarizes outstanding safety developments in its annual reports to Congress, detailed surveys of the activities of both the Bureau of Safety and the Bureau of Locomotive Inspection are published separately. It will be recalled, also, that aside from the train-control provisions, which are incorporated in the Interstate Commerce Act, the safety legislation which the Commission administers consists of a series of separate and distinct statutes.

<sup>112</sup> Until October 1, 1928, there was also a separate Bureau of Signals and Train Control Devices. Since, by that time, inspections and tests had been completed on more than 85 per cent of the installations required by the Commission's orders, this bureau, in the interest of economy, "was merged with the bureau of safety as a section thereof." *Annual Report*, 1928, p. 38.

<sup>118</sup> See *Annual Report*, 1933, pp. 59-67.

improper conduct, but they are indispensable to the exercise of the Commission's regulatory functions. Without complete control of accounting practices and free access to financial and operating results, the extensive system of regulation which now prevails would be virtually impossible. The controlling data utilized in the establishment of rates, in the limitation of profits, in the ascertainment of property values, in the disposition of proposed extensions and abandonments, in the approval of unifications, in the authorization of security issues, in the control of service practices, and in the performance of many allied tasks, are dependent, in very considerable measure, upon reliable and comparable accounting records and statistical compilations. In recognition of this fact, provisions with respect to accounts and reports are now almost universally embraced in public service laws, as applied to state and local as well as to national utilities; and, it may be noted, the classifications and practices developed by the Commission serve as the principal pattern for the application of these provisions. Nor do the activities with regard to accounts and reports involve the exercise of administrative functions in any purely ministerial sense. The Commission, with almost unlimited latitude, prescribes classifications and practices as well as enforces them; and the adjustments involved in these classifications and practices frequently constitute a prejudgment as to conflicting rights and interests, and may affect favorably or adversely, among other things, the revenues to be derived by carriers and the charges to be paid by users of the service. Although, for the most part, the processes employed are those of continuing supervision and the agencies utilized are those of subordinate rank, the performance of the Commission's tasks even in this sphere impinges closely upon the exercise of other than strictly administrative functions.<sup>114</sup> Without analysis of the substantive content or the technical character of these accounting and statistical activities, their course of development and present status may be briefly indicated.

The work of formulating and enforcing accounting practices and of receiving and analyzing carrier reports, though closely related in many respects, is now vested in two distinct bureaus: the Bureau of

<sup>114</sup> Compare, for example, the following comment, made by the Commission more than a quarter of a century ago: "The financial accounts for all agencies of transporta-

Accounts and the Bureau of Statistics. The use of this two-fold organization is the outcome, after a long experience, of the extension of the Commission's powers and the growth of its administrative tasks in this field.<sup>115</sup> From its inception the Commission has been vested with authority to require annual reports from the carriers subject to its jurisdiction and to exercise some measure of accounting control. But while reports were received, compiled, and analyzed from the beginning,<sup>116</sup> and some degree of accounting uniformity was secured through the medium of the required reports,<sup>117</sup> the Commission's original powers of accounting control, in the absence of punitive sanctions and enforcing machinery, were found inadequate

tion have been brought to a point at which general questions of public policy, as well as technical questions of accounting, claim consideration. It is regarded as a significant fact, and one which suggests the possibilities of supervisory control which lie in the administration of a prescribed system of accounting for public-service industries, that the further accounting orders of the Commission involve broad and comprehensive questions of public policy." *Annual Report*, 1908, p. 82.

<sup>115</sup> Shortly after the organization of the Commission in 1887 a Division of Statistics was created. Its chief functions, till 1906, were to examine the annual reports of the carriers and to compile statistical data based thereon. Because of the increased responsibilities imposed by the 1906 amendments to section 20 of the Act, its functions were extended to the supervision of accounts and it was designated as the Bureau of Statistics and Accounts. In 1911, as the work grew in volume, this bureau was separated into two divisions—the Division of Statistics and the Division of Carrier Accounts. When the Commission's administrative forces were reorganized in 1920, these two components of the Bureau of Statistics and Accounts were set up as separate bureaus. See *Annual Reports*: 1908, p. 82; 1911, p. 60; 1920, p. 34.

<sup>116</sup> The annual publication of *Statistics of Railways in the United States* was begun in 1888.

<sup>117</sup> Under section 20 of the Act, as originally passed, it was provided that the Commission "may, within its discretion, for the purpose of enabling it better to carry out the purposes of this act, prescribe (if in the opinion of the Commission it is practicable to prescribe such uniformity and methods of keeping accounts) a period of time within which all common carriers . . . shall have, as near as may be, a uniform system of accounts, and the manner in which such accounts shall be kept." The cautious wording of this provision, unaccompanied by any stipulations as to manner of enforcement, led the Commission to seek its results through the indirect channel of controlling the character of the required carrier reports: "This clause of the law has received the serious consideration of the Commission for a number of years, and some steps have been taken toward the attainment of uniformity in the rules adopted by auditors and comptrollers. If the accounts of the railways in the United States in 1887 be compared with their accounts at the present time there will be observed some considerable tendency toward uniformity. This has come about in large measure through the persistent though courteous insistence on the part of the statistical division that annual reports of carriers be drawn in accordance with the 'Instructions' prescribed by the Commission." *Annual Report*, 1895, pp. 61-62.

either to mold basic accounting principles or to achieve uniformity of accounting practice.<sup>118</sup> Not until 1906 did the Commission's recommendations for added authority bear fruit; and it is significant that strict control of accounts was vested in the Commission by the same statute through which it was first endowed with mandatory rate-making authority. Essentially, aside from the new grants as to depreciation accounting contained in the 1920 legislation,<sup>119</sup> the powers then conferred upon the Commission have remained the effective source of its prevailing accounting activity. In conformity with the statutory authorization, supported by heavy penalty provisions, both to establish and enforce uniform accounting rules and practices, this activity has taken two directions: the prescription of the forms of all accounts, records, and memoranda to be kept by the carriers, and the policing of these accounts, records, and memoranda, through special agents or examiners designated for the purpose.

Through the Bureau of Accounts, under these powers, comprehensive classifications have been prescribed for the carriers from time to time, and in their revised form, made effective July 1, 1914, these classifications are largely in force today;<sup>120</sup> their further revision,

<sup>118</sup> This method of indirection was not calculated to achieve effectively the desired end of securing sound and uniform accounting practice, and the Commission urged strongly upon Congress the necessity of strengthening the law: "Although the wording of the law seems to be clear as to the right of the Commission to prescribe uniform accounting, it may be doubted whether the section of the law which confers this right is sufficiently broad and comprehensive to justify positive action. The Commission should have not only the right to prescribe a uniform system of accounting, it should be given authority to enforce the acceptance of such a system by simple process as well. It should be made a misdemeanor for an accounting officer to deviate from the rule prescribed. Moreover, provision should be made for a system of inspection similar to that of the Comptroller of the Currency over the accounts of national banks; in no other way can the Commission be placed in easy and sure possession of the facts necessary to the performance of the duties imposed upon it. It is believed that provisions of this sort are logically bound up in the twentieth section . . . and the Commission recommends that this section be so amended as to leave no doubt as to the purposes of Congress in this regard." *Ibid.*, p. 62. In the following year the Commission urged once more its need of power "to exercise a direct and controlling influence in railway accounts." *Annual Report*, 1896, p. 103.

<sup>119</sup> For a consideration of the character of the Commission's activity in the matter of depreciation accounting, see pp. 51-52, *supra*.

<sup>120</sup> The course of development of these classifications can be traced by reference to the Commission's annual reports to Congress, from 1906 to 1914, inclusive, and to its annual statistical reports for the same period. For the basic principles employed in the formulation of these classifications, see especially *Annual Report*, 1906, pp. 59-62, and *Statistics of Railways in the United States*, 1906, pp. 9-13.

undertaken in 1921, was still incomplete at the end of 1933.<sup>121</sup> They provide accounting rules for steam roads, electric railways, carriers by water, express companies, pipe-line companies, sleeping-car companies, telephone companies, and telegraph and cable companies; and they include classifications for operating revenues and expenses, investment in road and equipment, balance sheet, and income and

<sup>121</sup> The need for further revision arose from the Commission's rich experience in connection with the valuation work and with its activities incident to the period of Federal Control, and was accentuated by the depreciation provisions enacted in 1920. "During the year," said the Commission in its report for 1921, "work was begun on the revision of our accounting regulations. Those now in effect were last revised as of July 1, 1914. A further revision is imperative to make them responsive to requirements imposed by new legislation and to improve them further in the light of the experience gained in their practical application during the past 7 years." *Annual Report, 1921*, p. 26. By the end of 1925 tentative revisions of all classifications for steam roads had been completed. These were submitted to interested parties for criticisms and suggestions; conferences concerning them were held with railway accounting officers; and they were considered in detail by representative committees of the Railway Accounting Officers Association. In 1927 public hearings were begun thereon, in compliance with requests of shippers' organizations for an opportunity to present proposals for fundamental changes in the accounting systems to be prescribed by the Commission, and the completion of the task further awaited the Commission's final conclusions in the matter of depreciation accounting. See *Annual Reports: 1924*, p. 26; *1925*, p. 27; *1926*, p. 26; *1927*, p. 2. The status of this undertaking, as of October 31, 1928, was described by the Commission as follows: "The revision of our accounting classifications for steam railroads . . . has been carried forward to the point where further progress depends upon the conclusions to be reached with respect to depreciation accounting and upon the results of hearings which have been held during the year upon the general plan which the classifications should follow. At these hearings . . . representatives of shippers' organizations have urged that a system of cost accounting be adopted and have presented detailed evidence in support of this recommendation. Elaborate evidence has been presented in this connection with reference to the cost-accounting systems now in use by many private industries. Somewhat similar suggestions have been made by representatives of State commissions. All of these proposals are receiving consideration." *Annual Report, 1928*, p. 2. In the years following, primary emphasis was placed upon the revision of classifications for steam railroads and telephone companies, as in connection with the prescription of depreciation accounting, and the factors of delay previously noted embraced both undertakings and incidentally subordinated the revisions for other types of carriers. As of October 31, 1933, the Commission reported as follows: "Revision of our accounting classifications . . . for telephone companies has been completed. The revised issue has been made effective January 1, 1933, for class A companies . . . and January 1, 1934, for class B companies. . . . The revised system of accounts is not prescribed for class C companies. . . . Little remains to be done with respect to the revised issue of our accounting classifications for steam roads. . . . Tentative drafts of revised accounting classifications for sleeping-car companies, carriers by water, and pipe-line companies have been prepared and are under discussion with representatives of these classes of carriers, preliminary to their submission to State commissions and others interested." *Annual Report, 1933*, p. 36.

profit and loss accounts.<sup>122</sup> In the development of these classifications, the Commission has consistently availed itself of the judgment and advice of competent and interested outsiders: close coöperation has been maintained with the accounting officers of the carriers and with state authorities,<sup>123</sup> and in addition, more recently, the procedure of holding public hearings has been followed.<sup>124</sup> Accounting

<sup>122</sup> For a complete list of the Commission's accounting publications, see *Annual Reports*: 1915, p. 42; 1916, p. 37.

<sup>123</sup> The coöperation of the accounting officers has been utilized from the beginning, and they have played a large part in the development of uniform accounting practice. Note the following declaration, made by the Commission when it first entered upon its task: "Since the organization of the Commission in 1887 there has been the most hearty cooperation between the accounting officers and the statistical branch of the Commission's service in all matters respecting which the Commission had an undoubted right to exercise a final judgment; and now that the authority of the Commission has been extended to cover the entire field of railway accounting the railway accounting officers have expressed a willingness to place their expert knowledge at the disposal of the Commission to the full extent that the Commission may desire. As a means of giving formal expression to this purpose a committee of twenty-five was appointed by the Association of American Railway Accounting Officers with instructions to cooperate in the organization of a uniform system of accounting so far as they may be invited thereto by the Commission." *Annual Report*, 1906, p. 60. The Commission availed itself of this offer of assistance, and coöperative procedure has been maintained to the present day. For the emergence of coöperation with the state commissions, particularly in the formulation of classifications for electric railways, see *Annual Report*, 1907, pp. 142-146.

<sup>124</sup> For example: in No. 14700, *Depreciation Charges of Telephone Companies*; in No. 15100, *Depreciation Charges of Steam Railroad Companies*; in Ex Parte 91, *General Revision of Accounting Rules for Steam Railroads*. In his Proposed Report in Ex Parte 91 (August 15, 1929), Commissioner Eastman described the circumstances which led to the holding of public hearings in the course of the Commission's revision of railway accounting rules. First, he indicated the searching character of the Commission's processes even under the procedure traditionally followed: "In the past the work of formulating the accounting classifications for steam railroads has been carried on largely in cooperation with the Railway Accounting Officers Association. No public hearings have been held, but every effort has been made to keep the State commissions informed of the progress of the work, and their advice has been sought and has been of much help. Similar procedure has been followed in the case of others known to be students of the subject. In other words, the work has been done informally through conference and correspondence, but, nevertheless, it has been brought to public attention, and help has been sought wherever it might be available. The same procedure was at the outset followed in preparing the revisions now under consideration. Numerous conferences were held between committees representing our Bureau and committees of the railway accounting officers, and also of the State commission accountants, and various tentative drafts were given widespread circulation with requests for criticism" (p. 3). He then indicated the Commission's willingness, when circumstances demanded, to modify and extend its usual procedure: "In 1927, however, we were informed that the National Industrial Traffic League, an organization representing many important shippers of freight, was prepared to submit for our consideration an accounting system

practices have thereby been unified and standardized—without sharp break with the past, and with an unquestioned trend toward improvement.<sup>125</sup>

For the enforcement of these practices, the method of test examination and field inspection by the Commission's board of examiners was early recognized as indispensable and has been uniformly pursued, as far as adequacy of staff, in view of other demands being constantly made upon it, would permit.<sup>126</sup> These examinations have

for steam railroads representing a radical departure from the existing classifications and also from the tentative revision prepared by our Bureau. It sought an opportunity to present this new system at a public hearing. Requests for such a hearing had also been received from other commercial and farm organizations. This was the first time in our experience in which an active interest in accounting systems had been manifested by shippers, and it was welcomed. The law does not require public hearings as a prerequisite to the promulgation of accounting regulations, but leaves us free to secure in any way that we see fit the information necessary in the performance of this administrative duty. Nevertheless, we deemed it desirable to accede to these requests and to make the general revision of the steam railroad classifications the subject of a public hearing at which every interested party would have an opportunity to be heard. We also deemed it desirable, because of the necessary interrelation, to hold this hearing in connection with the further hearings in No. 14700 . . . and No. 15100. . . . This was the origin of Ex Parte 91" (pp. 3-4).

<sup>125</sup> While the Commission has confined itself to a system which provides "for the classified recording, by time periods and in terms of money, of the cost of the property owned by the carrier, the revenues received or receivable, the expenses of operation incurred, and the results in income or deficit and in profit and loss, together with a balance sheet statement of all assets and liabilities at the close of each period," and has made no effort to have the accounts show "unit costs and receipts" (the establishment of cost accounting, which was one of the basic issues in Ex Parte 91), much progress has none the less been made in the development of the prevailing classifications. Without entering upon a consideration of technical details, it may be noted, in the words of the Commission, that "additional accounts have been provided, instructions have been amplified, item lists extended, and the terminology simplified and made more descriptive." *Annual Report, 1914*, p. 39. Similarly, in the pending revision, the primary aim of the tentative classifications prepared by the Bureau "was to simplify and clarify, so far as possible, and to introduce new accounting features" made necessary by the depreciation provisions or by the Commission's experience. See Proposed Report in Ex Parte 91, p. 4.

<sup>126</sup> The need and importance of such inspection were strongly emphasized by the Commission when it first undertook the task of organizing a board of special examiners: "The examination contemplated will enable the Commission to enforce conformity to the rules of accounting that have been prescribed, and to ascertain whether or not the net revenues accruing from operation, or the profit and loss which appears on the balance sheet, as published by the carriers and reported to the Federal and State Governments, are correctly stated. This is a result of paramount interest to every investor in railway securities, as well as to the public at large, for the reason that it tends to give greater stability to commercial conditions and greater security to railway investments. Such an examination as is contemplated by the law will also furnish added security to the shipper, in that it will disclose unlawful practices in case such practices



been both general and special. The general examinations of carrier accounts have sought to determine how far the accounting rules and transportation practices prescribed by the Commission are being observed and to what extent irregularities prevail; the special examinations, which are essentially independent investigations, have sought to gather information concerning specific aspects of the accounts and operations of the carriers, usually for use by the Commission in connection with particular proceedings.<sup>127</sup> The effective policing of accounting classifications and practices is largely dependent upon the frequency with which general examinations are made; but because of the diversion of the examining staff to other pressing tasks there has been a progressive neglect of this important activity. Not only have special investigations encroached upon it,<sup>128</sup> but the extraordi-

exist. . . . The Commission fully appreciates the purpose of Congress in making provision for a thorough and systematic examination of railway accounts, and has already taken steps for the organization of a bureau to have this matter in charge." *Annual Report, 1907*, p. 149. And twenty-five years later, in protesting against a sharp reduction of appropriations for the Bureau of Accounts, the Commission not only pointed out that one of the normal functions of the bureau is "to enforce these systems of accounts by test examinations and field inspections from time to time, inasmuch as no system of accounts, however well devised, is self-enforcing or will produce reliable results without some degree of policing," but declared that "adequate examination and surveillance of accounts lies at the very root of effective public regulation of carriers." *Annual Report, 1932*, pp. 40, 42.

<sup>127</sup> Such irregularities as are disclosed by report of the examiners are either discontinued or corrected, after conference and correspondence, or they are made the subject of prosecution for violation of law. The primary purpose of the examinations, however, is preventive rather than punitive. Note, for example, the following: "The significance of the work of the board of examiners . . . should not be measured by the number of irregularities reported which may be made the occasion of prosecution. This, undoubtedly, is an important feature of the work undertaken, but it should not be regarded as its chief aim, nor as providing a final test of its success. The ultimate purpose of the task assigned to the board of examiners is to create a condition in which improper practices will not take place because of the certainty of their discovery and exposure, and to provide a means by which the Commission can satisfy itself that such administrative rulings and transportation principles as it lays down are in fact observed by all carriers." *Annual Report, 1909*, p. 58.

<sup>128</sup> In 1914, for example, the Commission reported: "The board of accounting examiners was established . . . for the principal purpose of assisting the Commission in enforcing the observance of its accounting regulations through the inspection of carriers' accounts. For the past three years, however, there has been an increasing demand on the division's accountants to assist in the investigation of formal cases before the Commission. During the past year the field force of the division has been largely employed in such investigations, and as a result the field examination of carriers' accounting practices has been curtailed." *Annual Report, 1914*, p. 40. And in 1932, in directing attention to the inadequacy of its accounting staff as curtailed by reduced appropriations, the Commission said: "In this connection, attention may be called to the

nary demands of the war period, in connection with Federal Control and its aftermath,<sup>129</sup> as well as the permanent requirements of the 1920 legislation, particularly in connection with the enforcement of the recapture provisions,<sup>180</sup> have sharply interfered with the regular policing of carrier accounts.<sup>181</sup> The Commission has not only shown

work performed by this bureau, prior to 1918, in the investigations of the financial operations of the New Haven, the Rock Island, the Frisco, the Pere Marquette, the Cincinnati, Hamilton & Dayton, the Milwaukee, the Louisville & Nashville, and the Wabash-Pittsburgh terminal, to its special investigation of the pipe-line situation, to its elaborate investigation into the cost of transportation of coal (which had most important rate results), and to its investigation of the express-rate situation which led to a complete revision of the express-rate structure. Some of these investigations were among the outstanding accomplishments of the commission during that period." *Annual Report, 1932*, p. 42. While, as will appear presently, the Federal Control Act of 1918 and the Transportation Act of 1920 diverted the energies of the bureau in large measure to new tasks, much assistance has continued to be rendered on such special investigations since these enactments. See cases cited in notes 57 and 59, *supra*, and the surveys of the work of the Bureau of Accounts in the Commission's annual reports to Congress.

<sup>129</sup> In 1920, for example, the Commission reported: "During the greater part of the year this bureau . . . has been occupied with the examination of the accounts relating to operating income for the three years ended June 30, 1917, of carriers whose properties were taken under Federal control. This work, which was necessary to enable us to certify to the President the amount of average annual operating income for the test period, was undertaken as soon as practicable after approval of the Federal control act and has been carried forward without interruption. . . . During the more recent months as the investigation necessitated by the Federal control act neared completion the bureau has also been actively engaged in accounting examinations for the purpose of enabling us to certify the amounts payable to carriers under sections 204 and 209 of the transportation act, 1920." *Annual Report, 1920*, p. 34. These special tasks continued to absorb the whole or the larger part of the time of the bureau for a number of years. See *Annual Reports: 1921*, pp. 25-26; 1922, p. 37; 1923, p. 26; 1924, p. 26. For the nature of the Commission's work under sections 204 and 209 of the Transportation Act, see note 17, *supra*.

<sup>180</sup> The special accounting examinations for determining the amount of excess railway operating income recoverable under the provisions of section 15a were begun in 1923, and once they were well started they constituted the bureau's most exacting task. In 1926 the field work was confined "almost exclusively" to these examinations; in 1927 they continued "practically to monopolize" the services of the field force; in 1928 "substantially all of the time" of the field force was devoted to this work; and this situation continued till the recapture provisions were repealed. In 1932 the Commission declared that the new duties imposed by the Federal Control Act and the Transportation Act "have largely engrossed the attention of the bureau since 1918." *Annual Report, 1932*, p. 41.

<sup>181</sup> The fact that the performance of these various tasks has been accomplished at the expense of general examinations of carrier accounts, and often to their complete exclusion, has been repeatedly emphasized by the Commission. The following is typical: "No general examinations of carriers' accounts were made during the year. This part of our work has been omitted for the past few years owing to the necessity of applying practically all of the appropriation available for field work to accounting ex-

itself fully aware of the seriousness of the problem,<sup>182</sup> but when appropriations for the Bureau of Accounts were severely curtailed, it frankly apprised Congress of the impairment of the accounting work that must inevitably follow.<sup>183</sup>

aminations necessitated under the recapture clause of section 15a. We have thus been compelled, except to the limited extent that these special examinations serve the same purpose, to forego the policing of carriers' accounts. . . . Adequate appropriations are indispensable if we are to perform properly the duties imposed on us by section 20, and to make the special accounting investigations which are frequently required by other phases of our work." *Annual Report, 1927*, pp. 2-3. See, also, *Annual Reports: 1928*, pp. 2-3; 1929, p. 2; 1930, p. 2; 1931, p. 2.

<sup>182</sup> Thus: "We must repeat the statement made in previous annual reports that no general examinations of carriers' accounts were made during the year. We regard this omission as seriously impairing the effectiveness of our regulation of carriers' accounts under section 20 of the act, an important feature of which is the policing of carriers' accounts. Experience has demonstrated that our general examinations afford the only satisfactory means of performing this duty." *Annual Report, 1928*, pp. 2-3. Again: "At a time when intense competition among themselves for traffic was inducing the carriers to extend various concessions, direct and indirect and in the nature of rebates, to large shippers in bidding for traffic—concessions which were wasteful and harmful in the long run to the railroad industry as well as to the general public—we were unable to give this matter the degree of attention which it would have had if the accountants had not been otherwise engaged. At a time, also, when many of the carriers were enjoying a prosperity which tempted them to unnecessary and wasteful expenditures of capital for various purposes, we were for the same reason unable to keep ourselves adequately informed in regard to these activities." *Annual Report, 1932*, pp. 41-42.

<sup>183</sup> When appropriations were sharply cut, even prior to the repeal of the recapture provisions, the Commission gave detailed attention to the resulting difficulties: "For the fiscal year ended June 30, 1932, the appropriation for our Bureau of Accounts was \$1,504,420 and its actual expenditures were \$1,407,896.48. For the current fiscal year the Bureau of the Budget recommended an appropriation of \$1,383,560, but this was reduced by the Congress to \$683,560. This reduction of more than 50 per cent has made drastic changes necessary, impairing the ability of the bureau to perform the duties which it should perform. . . . This severe reduction in appropriation was due, we believe, to a misunderstanding in regard to the functions of the bureau and the purposes for which it was created. At the time of the Hepburn amendment to the act to regulate commerce in 1906, the Congress recognized that an essential to adequate and effective regulation of carriers is provision for uniform and reliable accounts and records. This principle is basic. . . . It was the intent that uniform accounts should be not only prescribed but policed, and that our force of accountants would further be available for the special investigations necessary to prevent rebating, direct or indirect, and in the performance of our other duties. . . . With the force which we had in active service on June 30, 1932, it is estimated that a test examination of the accounts of each Class I railroad could not be made more often than once in three years, if our accountants did nothing else. Allowing for the fact that they have numerous other duties, the best that could be done would be a test examination once in five years, and this assumes confining attention to the railroads without consideration of the other classes of carriers under our jurisdiction. An appropriation of \$1,383,560, as recommended by the Bureau of the Budget last year, may seem large when considered alone,

The work of the Bureau of Statistics has naturally expanded with the extension of accounting control. The Commission early recognized that "the best fruit of correct accounting is correct statistics,"<sup>184</sup> and statistical tabulations reflecting both financial and operating developments have increased in number and completeness.<sup>185</sup> In addition to annual reports the carriers are now required to file monthly and special reports, and the data thus made available are subjected to analysis and published regularly. For the calendar year 1932, for example, the bureau received 1,938 comprehensive annual reports—embracing not only those of steam railroads, but those of all the other

but it assumes small proportions when compared with operating revenues of the rail carriers amounting in 1930 to \$5,343,000,000 and with operating expenses aggregating \$3,975,000,000. . . . Recapture has not as yet been repealed, and, therefore, the duties of the bureau have in no way been lightened so far as this matter is concerned. If recapture is repealed, however, as we recommend, we challenge the assumption that our force of accountants ought for that reason to be cut to small proportions. The special duties . . . have been necessary duties which we believe have been well performed, but they have in fact diverted the bureau from the normal functions for which it was originally intended, and to the detriment of adequate public regulation of the carriers." *Annual Report, 1932*, pp. 39-41. Upon repeal of the recapture provisions the Bureau of Accounts was enabled to resume performance of its normal functions, but the Commission again stressed the difficulties springing from retrenchment: "While the bureau has returned to its regular duties, its effectiveness has been much impaired through the necessity of greatly reducing its personnel. . . . With the means at our disposal for the work of the bureau thus reduced, we were obliged during that year [ending June 30, 1933] to furlough without pay 108 of our accountants and impose a heavy administrative furlough on the remainder of the force. . . . With an appropriation of \$750,000 for the current year [ending June 30, 1934] we have been obliged to continue the retrenchment measures of the preceding year." *Annual Report, 1933*, p. 35.

<sup>184</sup> *Annual Report, 1906*, pp. 61-62.

<sup>185</sup> The rapid increase in the number of reports required from the carriers has often been the subject of criticism, as involving the imposition of unnecessary clerical burdens. Note the following comment of the Commission with regard to these strictures: "The increased duties imposed upon us by the transportation act, 1920, have necessarily increased the amount of statistical work to be done. The marked growth in the number of clerks employed by railroads frequently gives rise to the suggestion that perhaps much unnecessary information is being collected by the Government. Careful consideration is given to all such comments and from time to time requirements are eliminated where the data are no longer needed. The annual report form for 1917 was thoroughly revised from this standpoint. In 1920 the distribution of locomotive-hours was eliminated. Proposals for important additions to statistical requirements are discussed before adoption with representatives of railroads to ascertain the cost of compiling them. . . . Much of the accounting and statistical burden felt in recent years by railroads is due to the passage of the properties from private to public control and back again to private control." *Annual Report, 1921*, pp. 28-29. It may be noted, for example, that whereas 3,156 annual reports from all types of carriers were received by the bureau for the year 1920, the number was only 1,938 for the year 1932.

types of carriers subject to the Commission's jurisdiction.<sup>186</sup> Besides these annual reports, the Class I steam roads file monthly reports of revenues and expenses, operating data, wages, fuel consumed by locomotives, and railway accidents, as well as quarterly reports of commodity statistics and occasional special reports; and telephone, telegraph, and express companies, as well as the Pullman Company, also file monthly reports of certain of their operations.<sup>187</sup> On the basis of the data thus received the bureau issues its statistical publications. The most important of these is the annual report on *Statistics of Railways in the United States*,<sup>188</sup> but there are many other annual reports issued by the bureau, as well as quarterly and monthly reports.<sup>189</sup> These publications have been developed, not only as a means of providing full current information concerning the status and activities of the carriers, but to facilitate efficiency and economy of operation and to assist the Commission in the performance of its regulatory tasks. Increasing emphasis is constantly being placed upon analysis and research. The separation of operating expenses between freight and passenger services and attempts at similar separation between terminal and line-haul services, for example, as well as the

<sup>186</sup> *Annual Report*, 1933, p. 70.

<sup>187</sup> See *Annual Report*, 1928, p. 50.

<sup>188</sup> This publication, which has been issued without interruption since 1888, now also contains statistics based upon the quarterly and monthly reports of the steam roads, together with selected data concerning the operations of other classes of carriers. "It is based on the sworn annual returns of the railway companies and constitutes a permanent official record of the progress of the steam railroad industry in its public aspects, presenting data concerning mileage, receiverships, equipment, employees, capitalization, traffic, operation, revenues, expenses, and financial condition of the railway companies." *Annual Report*, 1924, p. 28.

<sup>189</sup> The following reports are regularly prepared for publication by the Bureau of Statistics: *Annual*: (1) comprehensive report on statistics of railways; (2) accident bulletin; (3) comparative statement of operating averages; (4) freight commodity statistics; (5) preliminary abstract of statistics of common carriers; (6) preliminary report of capitalization and income; (7) operating revenues and expenses by class of service; (8) wage statistics; and (9) selected items from the annual reports of carriers by water, telegraph and cable companies, pipe-line companies, electric railways, and telephone companies. *Quarterly*: (1) freight commodity statistics; and (2) accident statistics. *Monthly*: (1) operating revenues and expenses by districts and regions; (2) operating revenues and expenses for individual railways; (3) freight and passenger service operating statistics by districts and regions; (4) operating statistics for individual railways; (5) fuel for locomotives; (6) wage statistics; (7) revenue traffic statistics; (8) revenues and expenses of telephone companies; and (9) summary of accidents. *Annual Report*, 1930, pp. 51-52. For subsequent minor changes and additions, see *Annual Reports*: 1931, p. 58; 1932, p. 81; 1933, p. 69.

computation of comparative operating averages, exemplify this emphasis;<sup>140</sup> and special studies involving such matters as the development of standards of maintenance, the formulation of indices of price changes, and the construction of rate scales—which analyses are undertaken not only as a routine activity but in connection with rate cases and other investigations—tend to achieve like purposes.<sup>141</sup> The activities of the bureau are the prime source of publicity of carrier operations and an integral part of the regulatory process, and they are being adjusted, from time to time, to the demands of changing circumstances and conditions.

#### §7. PROSECUTING ACTIVITIES

The mixed character of the Commission's functions has been disclosed repeatedly in the foregoing survey of its principal activities. They involve the settlement of controversies, the promulgation of rules of conduct for future application, and the administrative enforcement of statutory requirements. The fact that, with reference to the most significant matters within the bounds of its jurisdiction, the Commission, though the adjudicating tribunal, may proceed on its own motion as well as upon complaint accentuates its distinctive character. But the Commission's tasks involve a still further departure from usual legal processes: it participates in prosecuting violations of the various legislative enactments which it administers. The Commission is not only "authorized and required to execute and enforce" the provisions of the Interstate Commerce Act, but "upon the request of the Commission," United States attorneys, acting under the direction of the Department of Justice, must institute and prosecute all necessary proceedings "for the enforcement of the provisions of this Act and for the punishment of all violations thereof."<sup>142</sup> The same situation prevails with respect to allied statutes conferring administrative power upon the Commission. In point of fact, the Commission not only asserts initiative in criminal prosecutions and penalty suits, but renders substantial assistance to the Department of Justice in the preparation and conduct of such pro-

<sup>140</sup> See *Annual Reports*: 1920, p. 36; 1922, p. 39.

<sup>141</sup> See *Annual Reports*: 1922, p. 39; 1923, pp. 28-29.

<sup>142</sup> Sec. 12, par. (1).

ceedings. While this participation in prosecuting activities may be thought, on principle, to endanger the impartial exercise of the Commission's quasi-judicial functions, the actual performance of these punitive tasks appears to have exerted no influence upon its determination of independent controversies. The Commission has manifested a far-sighted restraint in its treatment of alleged violations of law—achieving significant results, particularly in the absence of wilful intent, through the method of informal conference and correspondence; and yet, because of the Commission's intimate knowledge of transportation conditions and carrier methods, its coöperation with the Department of Justice has added markedly to the effective disposition of such violations as have been carried to the stage of formal prosecution.

The Commission's prosecuting activities are largely pursued through its Bureau of Inquiry.<sup>148</sup> Through this bureau the Commission investigates alleged violations of the penal provisions of the law (whether such violations are brought to its attention by its own staff, by shippers, or by carriers), and, if the facts warrant such action, submits its findings to United States attorneys or to the Department of Justice with a view to securing indictments or having civil suits instituted for the collection of penalties. From the outset the Commission's policy has been directed to the elimination of unlawful practices rather than to the punishment of every offense, regard-

<sup>148</sup> This bureau must be distinguished from the Bureau of Law, which is charged with defending the Commission's orders against injunction or other proceedings instituted by the carriers, and which serves as a general aid to the Commission and the various branches of its organization in connection with the legal aspects of their activity. The Bureau of Inquiry is an outgrowth of the Division of Prosecutions organized in 1907, which was designed to facilitate the general enforcement of the Act to Regulate Commerce, and particularly the prohibitions against rebating, which was still the subject of special concern, despite the strengthening of the law by the Elkins and Hepburn acts. The functions of the Division of Prosecutions were essentially identical with those of the present Bureau of Inquiry: "Early in the present year the Commission organized a new division, known as the 'division of prosecutions,' to take full charge of investigations into criminal violations of the act to regulate commerce. On receipt of information of any violation of the act amounting to a criminal infraction of the law, it becomes the duty of this division to make such investigations as may be necessary to determine whether or not the matter is one proper to be brought to the attention of the Department of Justice. In any case where it is finally determined by the Commission that a criminal prosecution is proper, it is the duty of the division to prepare the case for presentation to the United States attorney in the district having jurisdiction." *Annual Report, 1907, p. 105.*

less of the source of difficulty, which might involve some infraction of law.<sup>144</sup> In the vast majority of instances the method of informal procedure, without actual prosecution, has proved an adequate means of securing correction or discontinuance of improper practices. "The division of inquiry," the Commission has said, "has to do with seeming violations of the act to regulate commerce, and of the Elkins act, which come to the attention of the Commission. Perhaps 90 per cent of the matters so investigated and considered are disposed of without resort to the courts, and in great part through correspondence or conference with the carriers or shippers involved. A staff of special agents is employed almost continuously in field work. A staff of attorneys analyzes the evidence gathered, participates in the correspondence and conferences, and, in instances where prosecution is recommended by the Commission, prepares cases for presentation to grand juries and assists United States attorneys in such presentation and in the subsequent proceedings in the courts."<sup>145</sup> And even where resort is had to the courts, the Commission has shown no disposition to make a prosecuting "record," either in the number of grounds of complaint or in the size of the penalties imposed.<sup>146</sup> For each of the

<sup>144</sup> This policy is grounded in the application of good sense to the peculiar circumstances which often surround infractions of law, particularly in matters of rates and charges. There are thousands of tariffs, naming millions of rates, together with a vast mass of rules and regulations affecting them. In theory, and as a matter of law, every one is presumed to know the published rate which is lawfully applicable to any given transaction; as a practical matter, however, with many thousands of employees acting on behalf of carriers and shippers in innumerable transactions, the best that can be done is to apply the published rates as accurately as possible. Moreover, the tariffs are occasionally so indefinite or ambiguous that men expert in their interpretation are unable to agree as to the applicable rate in particular instances. In the ordinary course of events, therefore, even with every desire to conform to the law, there are bound to be numerous departures from the published rates as authoritatively construed, involving both overcharges and undercharges. In circumstances such as these it would not only be unjust to prosecute purely technical infractions of the law, but such action might render convictions difficult, if not impossible, and thereby hamper the general enforcement of essential public policies.

<sup>145</sup> *Annual Report, 1915*, p. 16.

<sup>146</sup> Note the following, for example: "The indictments returned during the past year have each contained a comparatively small number of counts. The penalties imposed upon the pleas of guilty received have also been in every case moderate in amount. This is due to the policy followed since this division of prosecutions was organized. It is believed that the most satisfactory results in the way of enforcement of the law can be reached by means of frequent prosecutions for moderate penalties rather than by means of a smaller number of prosecutions for large penalties. With the class



years ending October 31, 1930, 1931, 1932, and 1933, for example, the indictments returned and informations filed for violations of the Interstate Commerce Act and related statutes aggregated but 34, 33, 51, and 51; and the fines and penalties imposed in the cases concluded during each of these years aggregated but \$197,700, \$71,500, \$111,910, and \$27,750, together with the imposition of "several substantial sentences of imprisonment" in all but the last period.<sup>147</sup> But offenses of sufficient gravity to defeat the manifest intent of the law, and when committed by shippers as well as by carriers, have elicited the Commission's active concern.<sup>148</sup> The charges embraced in the prosecutions instituted in recent years have included the following: engaging in transportation without the filing of tariffs; failure of carriers to observe their tariffs; the granting of concessions by carriers and their acceptance by shippers; violation of the long-and-short-haul and aggregate-of-intermediates provisions; unlawful extension of credit for freight charges; falsifying of carrier records; unlawful use of interstate passes; false billing of shipments; filing of false claims for loss and damage; frauds in connection with the issuance and use of bills of lading; violation of regulations governing the transportation

of offenders here to be dealt with it is true, as elsewhere, that certainty of punishment is a more effective deterrent from crime than severity of punishment. This class of offenders is almost entirely composed of men of standing and respectability. The finding and publication of an indictment against them, or against a corporation for their acts, is in itself a substantial punishment. In any case of continued violation of the act after the infliction of a penalty, greater severity would of course be shown." *Annual Reports*, 1909, p. 19.

<sup>147</sup> *Annual Reports*: 1930, p. 16; 1931, p. 14; 1932, pp. 50-51; 1933, p. 44. There have been no startling variations from these figures in recent years. See *Annual Reports*, since 1920, under *Bureau of Inquiry*.

<sup>148</sup> In order more effectively to prevent shippers from defeating the published rate by false billing and other dishonest practices, the Commission has recommended that section 10 of the Interstate Commerce Act be so amended as to provide for a minimum penalty of \$500 for each offense, in addition to the maximum penalty of \$5,000 which it now carries: "The purpose of the section . . . obviously is to maintain the integrity of published tariff rates, and to prevent and punish unjust discrimination and favors granted or received by means of false billing, false weights, claims, or other device. Experience shows that this section is violated by shippers more frequently than any other section of the act. Such violations are profitable, not only because of the saving in freight charges, by defeating the applicable rates, but also because of the advantage thus obtained by the violator over his competitor. The railroads themselves maintain a force to police billing and weights, but a great many violations go undetected despite their efforts. We feel certain that the establishment of a minimum as recommended would result in greater harmony than exists now between the fines im-

of explosives; operation of a railroad without a certificate of convenience and necessity; embezzlement and misapplication of carrier funds; extension by carriers of facilities not covered by tariffs; provision of false weights by shippers.<sup>149</sup> Such matters, as already indicated, are handled through the Bureau of Inquiry. In addition, however, information as to violations of the Safety Appliance Acts, the Hours of Service Act, and the Locomotive Inspection Act is lodged with appropriate United States attorneys by the bureaus in charge of these safety matters, and assistance is rendered by them in the preparation and conduct of the resulting proceedings. For each of the years ending June 30, 1930, 1931, 1932, and 1933, for example, the number of cases of violation of the safety-appliance laws transmitted for prosecution were 124, 101, 94, and 103, comprising, respectively, 327, 249, 170, and 174 counts;<sup>150</sup> and while prosecutions for violation of the hours-of-service law and of the locomotive-inspection law were much fewer in number, they have also constituted a regular aspect of the duties of the bureaus involved.<sup>151</sup>

All in all, in view of the highly technical character of the violations generally sought to be reached and the necessity for continuous contact with the circumstances out of which they arise, the Commission's participation in criminal proceedings and penalty suits has proved almost indispensable to the wise and effective enforcement of the various regulatory acts to which the carriers are subject. While actual prosecution rests, as it should, in the Department of Justice, the Commission exerts a thoroughly informed influence both upon the initiation of proceedings and upon their successful consummation. The

posed by courts in different jurisdictions and practically eliminate violations of law which involve only comparatively small amounts of money. . . . Section 10 is vitally important in maintaining the regular tariff rates by compelling accurate and truthful description and classification by shippers of their property. Providing a minimum penalty of not less than \$500 for each violation thereof, will render far more effective the efforts of the Commission to enforce that section." *Annual Report*, 1928, pp. 16-17.

<sup>149</sup> See *Annual Reports*: 1926, pp. 57-58, 81-87; 1927, pp. 13-14, 85-91; 1928, pp. 15, 87-93; 1929, pp. 14, 93-99; 1930, pp. 16, 101-108; 1931, pp. 13-14, 127-132; 1932, pp. 49-51, 105-111; 1933, pp. 43-44, 78-81.

<sup>150</sup> *Annual Reports*: 1930, p. 37; 1931, p. 45; 1932, p. 72; 1933, p. 61. These figures constitute a reasonably representative measure of the Commission's prosecuting activity in this direction. See *Annual Reports*, since 1920, under *Bureau of Safety*.

<sup>151</sup> See *Annual Reports*, since 1920, under *Bureau of Safety* and under *Bureau of Locomotive Inspection*.

administrative burden involved appears to be fully justified by the salutary results which have been achieved.

#### §8. MISCELLANEOUS TASKS

At least summary reference should be made, by way of concluding this general survey of activities, to some of the miscellaneous tasks with which the Commission is charged. It is one of the outstanding characteristics of the Commission's experience that its functions have been very sharply expanded in the course of its history. But this expansion has not been confined to the development of its major activities to their present stage of maturity: the extension of duties and powers in specific directions has not merely concerned the Commission's primary tasks of maintaining just and reasonable relationships between the individual carriers and the users of their service, exercising general supervision over the transportation system as a whole, and enforcing measures for the safety of persons and property. Most of the activities previously considered fall, directly or indirectly, into one or another of these categories. But there have also been numerous enactments, largely unrelated to the main fabric of the legislative structure, whereby the Commission's services have been utilized in a variety of miscellaneous directions. In many of these instances the Commission has been resorted to chiefly because of the very existence of its organization, the accumulated knowledge in its possession, and the general competence it has shown in the disposition of public business. From the standpoint of securing informed and intelligent handling of the particular matters involved, this ready utilization of the Commission and its facilities has proved to be an effective procedure; but it has added measurably to the responsibilities and labors of this overburdened tribunal, and it has thereby accentuated the difficulties increasingly encountered of maintaining the performance of the Commission's major regulatory tasks on a reasonably current basis.

The mere mention of some of these special activities will indicate their heterogeneous character and the nature of the tasks involved in their execution. They embrace, or have embraced, for example, such divergent duties, both permanent and temporary, as participa-

tion in the award of medals of honor for extreme daring in connection with railroad accidents;<sup>152</sup> review and revision, upon complaint, of the rates and conditions prescribed by the Secretary of the Navy for certain uses of radio stations and apparatus owned by the United States;<sup>153</sup> the prescription of a system of accounts for corporations in the District of Columbia engaged in the manufacture of gas and electricity;<sup>154</sup> the issuance of regulations governing nominations for appointment to the now defunct Railroad Labor Board.<sup>155</sup> Such matters are of relatively minor importance, but they evince a disposition, not unlike that reflected in many of the special investigations required by Congress, to turn the Commission into a general service agency of the Government instead of permitting it to confine its energies within the bounds of its primary jurisdiction. Much more difficult and onerous tasks have been imposed upon the Commission in connection with changes in parcel post rates and classifications,<sup>156</sup> the adjustment of railway mail pay as between the Government and the carriers,<sup>157</sup> including urban and interurban electric railways,<sup>158</sup> and the definition of the limits of the standard time zones into which the country is divided.<sup>159</sup> The adjustment of railway mail pay, for

<sup>152</sup> From the passage of the Medals of Honor Act of February 23, 1905 (33 Stat. 743) to the end of 1933, 62 applications for medals had been filed, of which 39 had been approved and 23 denied. *Annual Report*, 1933, p. 67. See, also, Part I, chap. vi, note 25.

<sup>153</sup> Under the provisions of the Joint Resolution of June 5, 1920 (41 Stat. 1061), as amended April 14, 1922 (42 Stat. 496).

<sup>154</sup> Under the Act of March 3, 1919 (35 Stat. 703).

<sup>155</sup> See *Annual Report*, 1920, pp. 1-3.

<sup>156</sup> Under the provisions of the Post Office Department Appropriation Acts of August 24, 1912 (37 Stat. 558), and July 28, 1916 (39 Stat. 412); and also under section 7 of the Parcel Post Act of May 29, 1928 (45 Stat. 942). See *Annual Report*, 1913, pp. 79-80; and *Proposed Changes Affecting Fourth-Class Mail Matter*, 176 I.C.C. 659 (1931), *Changes in Rates on Fourth-Class Mail Matter*, 182 I.C.C. 187 (1932).

<sup>157</sup> Under the provisions of the Post Office Department Appropriation Act of July 28, 1916 (39 Stat. 412).

<sup>158</sup> Under the provisions of the Post Office Department Appropriation Act of July 2, 1918 (40 Stat. 748).

<sup>159</sup> Under the provisions of the Standard Time Act of March 19, 1919 (40 Stat. 450), as amended by the Act of August 20, 1919 (41 Stat. 280), and the Act of March 3, 1923 (42 Stat. 1434). Note the following: "There are now pending before us applications for changes in the boundary line between the United States standard eastern and central time zones through the States of Ohio and Michigan, which indicate that a serious and irreconcilable conflict exists between the standard time zone act of Congress . . . and recent legislation of some of the States. In addition, either by local consent or pursuant to State laws, the practice of daylight saving inaugurated by the

example, has involved elaborate investigations, extended hearings, formal findings, and numerous revisions.<sup>100</sup> Similarly, the definition of the boundaries of the various time zones by order of the Commission, with due regard to "the convenience of commerce and the existing junction points and division points of common carriers," has necessitated comprehensive inquiry, full hearings, widespread publicity, and numerous modifications.<sup>101</sup> The Commission is also engaged in a considerable range of activities which bear a closer relationship to its primary tasks, but to which no reference has been made in the preceding survey. The more important of these activities arise under the provisions of the Panama Canal Act of 1912 and the Clayton Anti-Trust Act of 1914. In each case the scope of the Commission's jurisdiction is extended beyond the fields heretofore specifically considered, and the exercise of the powers involved generally issues in formal determinations. The proceedings instituted in pursuance

original standard time zone act and repealed by the act of Congress passed over the veto of the President August 20, 1919 . . . is annually reinstated in large portions of the country and also in widely scattered communities. The Supreme Court has held that under existing law there is no conflict between the standard time zone act and the State statutes for daylight saving (*Massachusetts State Grange v. Benton*, 272 U.S. 525), but the conflicts in authority are now sufficiently acute as to warrant us in recommending that the field be either more completely occupied by the act of Congress or that the matter be left wholly to the States." *Annual Report*, 1931, p. 83. See, also, *Annual Report*, 1933, p. 34.

<sup>100</sup> The Commission's original reports were *Railway Mail Pay*, 56 I.C.C. 1 (1919), and *Electric Railway Mail Pay*, 58 I.C.C. 455 (1920). For subsequent revisions and increases of rates, see 85 I.C.C. 157 (1923), 95 I.C.C. 204, 493 (1925), 96 I.C.C. 43 (1925), 98 I.C.C. 737 (1925), 104 I.C.C. 521 (1925), 109 I.C.C. 13 (1926), 112 I.C.C. 151 (1926), 120 I.C.C. 439 (1927), 123 I.C.C. 33 (1927). On July 24, 1925, in response to applications of numerous carriers, the entire problem of railway mail pay was reopened. Data as to costs were prepared by the Post Office Department and the carriers, and hearings were held by the Commission. In *Railway Mail Pay*, 144 I.C.C. 675 (1928), the prevailing rates were found to be inadequate and higher rates were established, with retroactive payments upon prescribed terms. For later orders, see 151 I.C.C. 734 (1929), 165 I.C.C. 774 (1930), 174 I.C.C. 781, 796 (1931), 185 I.C.C. 715 (1932).

<sup>101</sup> The Commission's original report was *Standard Time Zone Investigation*, 51 I.C.C. 273 (1918). The statute provided that the Commission's order might be modified from time to time, and by the end of 1932 twenty supplemental reports had been issued in order to effect changes deemed to be desirable for the greater convenience of commerce. See 51 I.C.C. 499, 555 (1918), 53 I.C.C. 208 (1919), 57 I.C.C. 455 (1920), 59 I.C.C. 249 (1920), 64 I.C.C. 281 (1921), 66 I.C.C. 566 (1922), 73 I.C.C. 78 (1922), 78 I.C.C. 606 (1923), 88 I.C.C. 135, 343 (1924), 91 I.C.C. 686 (1924), 122 I.C.C. 122 (1927), 129 I.C.C. 209 (1927), 140 I.C.C. 679 (1928), 142 I.C.C. 279 (1928), 159 I.C.C. 297 (1929), 169 I.C.C. 95 (1930), 185 I.C.C. 266 (1932), 190 I.C.C. 223 (1932).

of these powers concern, respectively, the maintenance of competition between rail and water lines and the regulation of the physical connections and rate practices of joint rail-and-water carriage,<sup>162</sup> and the prevention of unlawful resort to intercorporate stockholding and to interlocking business and financial transactions.<sup>163</sup> By the 1933 amendments to the Bankruptcy Act, furthermore, the Commission was vested with important new powers in the field of railroad reorganization.<sup>164</sup> It is but necessary for our present purposes to note that these enactments add measurably to the Commission's functions and its docket of activities.

Taken as a whole, these miscellaneous tasks, varying in importance and in their relevancy to the basic ends of the regulatory process, provide a further reflection of the volume and variety of the labors for which the Commission finds itself continuously responsible.

#### §9. SUMMARY AND CONCLUSION

When these various activities are viewed in their entirety, the magnitude and complexity of the Commission's tasks become startlingly clear. The statistical measurements alone, even when confined to formal proceedings in which the exercise of quasi-judicial or legislative authority is involved, disclose the institution annually of a tremendous volume of complaints and applications. It may be recalled, for example, that during the year 1930, before the inroads of the depression made themselves sharply felt, 1,412 formal complaints were filed and 1,491 hearings were held; 487 rate suspensions were requested and 157 proceedings were instituted with respect thereto; 239 fourth-section applications were filed and 240 orders were entered; 168 applications were received for certificates of convenience and necessity; 33 applications were filed for railroad unifications and 34 for consolidations of telephone companies; and 223 applications for authority to issue securities were received, resulting in actual authorizations in

<sup>162</sup> See Part I, pp. 105-111, and Part II, pp. 17-57.

<sup>163</sup> See Part I, pp. 111-117. Clayton Act proceedings will be further noted in a subsequent chapter, in connection with the Commission's control of cooperation and combination.

<sup>164</sup> Act of March 3, 1933, Public No. 420, 72d Congress, 47 Stat. 1474. The details of this enactment will be set forth in a subsequent chapter, in connection with the Commission's control of the issuance of securities and assumption of obligations.

excess of \$1,700,000,000. The volume of these complaints and applications is reasonably representative of the normal demands upon the Commission, but it by no means reveals the extent of even its formal tasks. No attempt was made, for example, to measure statistically the vast labors involved in the general investigations, which cover a great diversity of very significant undertakings, or in the revision of the primary valuations of carrier property. Moreover, even such of the Commission's activities as are predominantly administrative in character frequently necessitate extended inquiries and formal determinations. There was a very substantial measure of direct participation by the Commission in the establishment of controlling principles for the recapture of excess earnings, in the adjustment of many matters of service and safety, in the formulation of basic accounting standards, in the exercise of much of its miscellaneous authority. And even the disposition of the numerous tasks which are generally handled through the routine of the Commission's boards and bureaus—such matters, for example, as informal complaints, special docket applications, requests for the filing of tariffs without the required statutory notice, applications with regard to interlocking directorates, and the institution of criminal prosecutions and penalty suits—is not altogether lacking in policy-making elements. No clear-cut separation can be made, therefore, between the Commission's tasks and those of its administrative staff, although the flow of formal proceedings unquestionably imposes the most pressing and most significant demands on the Commission's time and thought. Ultimate responsibility for the performance of all of the numerous duties under the Interstate Commerce Act and allied statutes rests in the Commission; and despite the tremendous weight of the burden resulting therefrom, the Commission has shown a praiseworthy disposition to recognize and assume this composite responsibility, as far as possible, rather than to build up a system of virtually independent bureaucratic control by subordinate officials and clerical employees.

The Commission's activities, as thus conceived, have grown to their present proportions through the successive expansion of its duties and powers—particularly as a result of the enactments of 1906, 1913, and 1920. This growth shows itself not only in the course of the various statistical indices of complaints, applications, and other proceedings

already noted, but in the sharp increase in volume of published decisions and in amount of expenditures and size of personnel. From the organization of the Commission in 1887 to August, 1906, a period of somewhat more than 19 years, only 11 volumes of reports were issued; from September, 1906, to February, 1920, a period of somewhat more than 13 years, 45 volumes of reports were issued—more than a fourfold output during an interval only about two-thirds as long; and from February, 1920, to December, 1930, a period of less than 11 years, 113 volumes of reports were issued—about double the aggregate output of the preceding 33 years. The growth in activity, embracing the entire complex of the Commission's tasks, is also evidenced by the course of expenditures and of personnel. In 1888, the first full year of the Commission's existence, its expenditures, in round numbers, were \$113,000; in 1907, the first full year after the passage of the 1906 legislation, expenditures amounted to \$538,000; in 1920 they reached the figure of \$5,542,000; in 1930 they stood at \$8,124,000. The aggregate expenditures for the first period (1887 to 1906, inclusive) were approximately \$4,600,000; during the second period (1907 to 1919, inclusive) they were somewhat in excess of \$35,000,000; during the third period (1920 to 1930, inclusive) they approached \$68,000,000. After 1913, it should be noted, a large proportion of the Commission's outlays were consumed by the valuation project. On the whole the growth of personnel tells the same story of rapid expansion. In 1887 the Commission's entire staff consisted of 11 employees; by 1906 the number had reached 221, with very substantial additions in the years immediately following, as the tasks imposed by the 1906 legislation and by the amendments of 1910 made themselves felt; by 1913 the Commission's employees numbered 731. Then a very sharp increase ensued, the number of employees reaching a maximum of 2,254 in 1917, largely as a result of the extensive tasks imposed by the Valuation Act; and in 1930 they stood at approximately 2,000. All of these measurements reflect the marked development of the Commission's activity.

But the sweep of the Commission's responsibilities does not depend solely upon the sheer volume of its tasks. The scope of these responsibilities is inseparable from the diversity of its duties and the variety of the processes involved in their performance. In the first place, the



types of carriers subject to some measure of control are many, including electric railways, water carriers, express companies, sleeping-car companies, pipe lines, and, until very recently, telephone, telegraph, and cable companies; and with regard to carriers by railroad, which constitute the chief source of activity, the field of intrastate as well as of interstate commerce is largely occupied. But the many-sidedness of this control, in terms of the business operations encompassed thereby and the regulatory methods employed therein, is of primary importance. Almost every significant aspect of the business of the rail carriers is subject to general supervision or mandatory control. Entrance into the field, extensions and abandonments of line, issuance of securities and assumption of obligations, intercorporate relationships in a variety of forms, the level of rates and the relativity of charges, the extent and disposition of operating income, the adequacy, economy, and safety of service, the publicity of operations and the character of accounting procedure—all these significant aspects of railroad activity in their numerous and complex manifestations, as well as many others of more limited scope, are embraced within the Commission's functioning jurisdiction. This diversity of subject-matter with which the Commission must deal, involving the exertion of a dominant influence upon virtually all major managerial policies of the carriers that are pregnant with actual or potential conflict between private rights and public interests, not only issues in a heavy volume of proceedings but necessitates the employment of a great variety of regulatory methods.

For effective maintenance of reasonable relationships between the carriers and the users of their service, and for any measurable furtherance of affirmative public ends in the development of the transportation system, the exercise of mixed governmental functions appears to be unavoidable; and the concrete expedients adopted in the exercise of these functions are necessarily numerous and varied. First, a vast body of basic facts is continuously maintained as an essential instrument of intelligent control—not only through the orderly development of extensive "records" in specific proceedings, but through the exercise of the general power of investigation, through the checking of tariffs, contracts, and other returns and arrangements, through the prescription of accounting practices and the requirement of car-

rier reports, through the valuation of all properties used and useful in the performance of the transportation service. The simplest of the methods of actual regulation are directed to the enforcement of the general standards established by law and of the specific prohibitions contained therein—largely in matters of rates, classifications, and practices, and in connection with the transportation service and its instrumentalities—to the end that unreasonable and discriminatory adjustments may be eliminated. But the Commission does not confine itself to condemning existing relationships; it also prescribes affirmative action. It asserts mandatory power over both the rate structure and the level of charges, as a means of maintaining adequate service on an equitable basis; and, more directly, it exercises positive power over the use of plant and equipment, with authority to order extension of lines and acquisition of facilities as well as to regulate "car service." Of no less importance, furthermore, is the broad range of proceedings in which the Commission's findings are permissive rather than mandatory. With power of approval, disapproval, or modification, it passes upon an extensive group of applications seeking authority to pursue proposed courses of action. This group embraces, among others, such significant aspects of carrier activity as new construction, abandonment of lines, issuance of securities, consolidation of properties, acquisitions of control, establishment of pooling arrangements, utilization of interlocking personnel, maintenance of railroad ownership of water lines. In connection with the exercise of both its mandatory and permissive powers, moreover, the Commission finds itself under necessity not only of meeting specific situations, but of supervising the transportation system as a whole—acting, as it were, in the capacity of a super-directorate of all the carriers constituting the national railroad system, in order to promote unity of public policy despite the fact of multiple corporate ownership and the pressure of private ends. The administration of the rule of rate-making, with the maintenance of carrier credit as an explicit objective; the apportionment of joint rates on the basis of public interest rather than of carrier bargaining power; the subordination of intrastate adjustments to the demands of interstate commerce; the control of railroad unifications, free from the inhibitions of the anti-trust laws, in terms of public advantage

rather than of private strategy; the potential utilization of all the instrumentalities of carriage for the furtherance of common ends, regardless of ownership or contract or shipping instructions; the correlation of rail and water transport, with powers of compulsion as to the provision of connecting physical facilities—these are among the more important policies necessitating the exercise of “fostering guardianship and control” of the transportation system as a whole. Nor, in the employment of many of these regulative methods, is the Commission required to await the filing of complaints or the receipt of applications; in connection with its most significant policies it proceeds on its own motion, as well as upon the initiative of the interests directly concerned. And, finally, despite the fact that it adjudicates controversies and formulates rules of conduct, it also participates in the prosecution of violations of the statutory requirements subject to its jurisdiction and of the administrative orders which it promulgates. It is the heterogeneous and complex character of these activities and processes, quite as much as the sheer volume of the tasks involved, that reflects the sweep of the Commission's responsibilities and gives rise to questions as to the propriety of its prevailing status.

The problem of the pressure of the administrative burden will receive detailed consideration, at the conclusion of this study, in connection with the matters of organization and procedure. Our present concern is primarily with the character of the Commission's activities. It should be noted at this point, however, as an evidence of the practical importance of the extent and diversity of the Commission's tasks, that various steps to meet the situation have been taken in the past, and that proposals for further relief are being urged in many quarters. The funds made available to the Commission and the size of its subordinate staff have steadily grown, except for the retrenchments induced by the depression; the internal structure has been reorganized from time to time to facilitate administrative efficiency; the membership of the Commission has been increased, by successive stages, from five to eleven; the Commission has been authorized to act through divisions of its membership, and to assign or refer certain of its duties to individual commissioners or boards of employees; a “shortened procedure,” dispensing with hearings and substituting

sworn statements of fact therefor, and a "modified procedure," confining the hearings to points upon which agreement cannot be reached informally, have been utilized in considerable measure. But additional changes, of more drastic character, have been proposed from time to time. Perhaps the expedient most commonly suggested is that regional commissions be established, with the Commission turned into an appellate body. Proposals have also been made looking to the complete transfer of some of the Commission's existing functions to new agencies. It has been suggested, for example, that regional commissions be clothed with final jurisdiction within a limited sphere; that a department of transportation be established, charged with the administrative and policing duties now largely performed by subordinate employees under the Commission's supervision and control and with the determination of general questions of policy; that a parallel regulatory tribunal be created for the handling of matters of finance, consolidation, and valuation, and that the Commission be reconstituted primarily as a quasi-judicial body concerned with matters of rate control. These proposals have thus far been symptoms of dissatisfaction rather than carefully defined policies, but they serve to indicate that the difficulties springing from the volume and sweep of the Commission's tasks have definitely emerged from the confines of academic comment and are making themselves felt as pressing practical problems.

For the present, however, we must continue our examination of the character of the Commission's activities. In the chapters immediately following the substantive direction of the Commission's performance in each of the major fields will be subjected to analysis and appraisal. These chapters will deal, respectively, with the valuation project, the control of organization and finance, and the regulation of rates and charges.

## CHAPTER XII

### THE VALUATION PROJECT

- §1. The Mechanics of the Task
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## CHAPTER XII

### THE VALUATION PROJECT

A CRITICAL survey of the substantive character of the Commission's major activities may well begin with a study of the valuation project. The execution of this project has constituted the Commission's most comprehensive and laborious single task; its results are fundamentally intertwined with the problems of organization, finance, rates, and earnings to which attention will be directed in subsequent chapters; and the methods employed and the standards developed are richly illustrative of the Commission's performance as an administrative tribunal. The task of valuation, in all its manifold ramifications, is essentially an administrative task. The planning and organization of the vast undertaking, the formulation of principles and processes for the ascertainment, on the basis of hypotheses as well as of recorded data, of the complex body of facts essential to the ultimate findings of value, and the exercise of informed judgment, throughout, with an eye to the demands of public policy and of the regulative scheme as a whole, are all types of activity for which an administrative body like the Interstate Commerce Commission, with its accumulation of experience, continuity of tradition, flexibility of procedure, and expertness of personnel is characteristically well adapted.<sup>1</sup>

#### §1. THE MECHANICS OF THE TASK

Both the circumstances leading to the adoption of the Valuation Act and the detailed provisions of the statute have already been pre-

<sup>1</sup> Despite the close relationship between the ascertainment of fair value and the exercise of control over important aspects of organization, finance, rates, and earnings, the valuation project as such is sufficiently self-contained to be treated as an independent activity. It is essentially a research undertaking, with "fact-finding" as its goal, rather than a process of regulation, either for the settlement of controversies or for decision upon proposed courses of action. Furthermore, the administration of the task is distinctly separable from the remainder of the Commission's work. Save for the exercise of judgment on disputed figures included in the tentative valuations and for the establishment of controlling principles bearing upon the determination of final single-sum values, the work is performed by a separate Bureau of Valuation; the valuation docket is kept distinct from the other dockets; and the individual valuation orders and opinions are grouped together in separate Valuation Reports.

sented.<sup>2</sup> It is sufficient here, as an immediate point of departure, to indicate summarily the nature of the principal mandates which the Commission was required to execute. First, in general terms, it was ordered to investigate, ascertain, and report the value of all the property owned or used by every common carrier subject to its jurisdiction. Then followed specific requirements, related chiefly to the ascertainment of structural costs, figures as to cost and value of lands, and such values as may be ascribed to so-called intangibles. The Commission's report was to disclose in detail, as to each piece of property other than land owned or used for common carrier purposes, the original cost to date, the cost of reproduction new, and the cost of reproduction less depreciation. As to lands, rights of way, and terminals owned or used for common-carrier purposes, the report was similarly to disclose, aside from all improvements, both original cost and present value, "and separately the original and present cost of condemnation and damages, or of purchase, in excess of such original cost or present value."<sup>3</sup> Finally, the report in each case was to include separately "other values, and elements of value, if any."<sup>4</sup> Upon completion of the valuation, the Commission was required to keep itself informed "in like manner" concerning all extensions and improvements or other changes in the condition and value of the property, and to revise and correct its findings from time to time. In the conduct of the investigation the Commission was authorized to employ such experts and subordinates as it deemed necessary, and, within broad limits, to prescribe the procedure to be followed. The express

<sup>2</sup> See Part I, pp. 117-132.

<sup>3</sup> By act of Congress, approved June 7, 1922 (42 Stat. 624), the requirement of separate findings as to the original and present cost of condemnation and damages, or of purchase, in excess of the original cost or present value of land was eliminated.

<sup>4</sup> Among other requirements of the Act which, as will appear subsequently, have come to issue in the course of its administration or have played a part in the Commission's findings, the following may be mentioned: the preparation, in connection with the ascertainment of original cost of the property, of an accounting and historical survey of the corporate organization and financial management of each carrier; the report of the amount and value of aids, gifts, grants of right of way, or donations made to any common carrier or its operating predecessors, from any source whatever, together with the extent of land grants, proceeds therefrom, original and present value of unsold portions thereof, and the amount and value of allowances or concessions made to governmental units by way of consideration therefor; the presentation of the value of the property of each common carrier not only as a whole, but separately by states; and, finally, the investigation and report of the original cost and present value of property held for other than common carrier purposes.

procedural restrictions relate primarily to the right of all interested parties to be heard prior to the issuance of final value reports. Upon the Commission's placing a tentative valuation upon the property of any carrier, for example, notice of such valuation was to be given to the carrier, to the Attorney General of the United States, and to the Governor of any State in which the property is located, in order that protests might be filed and that all interests might be represented in the adjustment of controversies bearing upon any aspect of the Commission's findings. In the absence of any protest within thirty days, the tentative valuation was to become final; upon the filing of protests, on the other hand, hearings were to be held, for the submission of evidence and the presentation of argument, before an order might be issued making such tentative valuation final in either corrected or original form. It is an analysis and appraisal of the performance of the Commission's task as thus briefly defined that will occupy our attention in the pages immediately following.

Required by the Act to commence the investigation within sixty days and to prosecute the work with diligence and thoroughness, the Commission began immediately the task of organization. The country was divided into five districts, each comprising approximately 50,000 miles of railway, with the distribution of roads so arranged that field work could be carried on both during the summer and the winter months.<sup>5</sup> For the actual development of the project, the Commission created a permanent Bureau of Valuation,<sup>6</sup> under the super-

<sup>5</sup> *Annual Report*, 1913, p. 76; *Texas Midland R. R.*, 75 I.C.C. 1, 108 (1918). The five territorial districts thus established were the Eastern, Southern, Central, Western, and Pacific. The districts were generally adjusted along state lines, but any given railroad system was usually assigned to a single district, even though it chanced to extend into the territory of another. "The present plan," said the Commission at the inception of its undertaking, "is to select a railroad in each one of these divisions which can be valued in an experimental way. An attempt will be made to choose railroads of different classes so that as great a variety of problems will be presented as possible. This initial work will be undertaken with deliberation, and no attempt will be made to unduly expand or hasten operations until the result of these preliminary studies can be appreciated." *Annual Report*, 1913, p. 78. The roads selected were as follows: the Norfolk Southern, 900 miles in length, for the Eastern District; the Atlanta, Birmingham & Atlantic, 600 miles in length, for the Southern District; the New Orleans, Texas & Mexico, 175 miles in length, for the Central District; the Texas Midland, 122 miles in length, for the Western District; and the San Pedro, Los Angeles & Salt Lake, 1,000 miles in length, for the Pacific District. *Annual Report*, 1914, p. 62.

<sup>6</sup> *Annual Report*, 1913, p. 75. The Bureau of Valuation was originally termed the Division of Valuation, but in common with the Commission's other "divisions" it be-



vision of a Director of Valuation and an Advisory Board.<sup>7</sup> The work of the bureau in collecting the underlying data called for by the Act was differentiated into three types and allocated to sections on engineering, land, and accounting. Each of the five territorial districts served as the scene of activity for a district engineer, a district valuation attorney in charge of land matters, and a district accountant. Five principal engineers, each of whom was placed in charge of one of the districts, were selected to constitute an engineering board which, as a unit, conferred with and advised the director, who had the assistance, also, of a solicitor, a supervisor of land appraisals, and a supervisor of accounts.<sup>8</sup> The general nature of the activities of the engineering, land, and accounting sections can be very briefly stated. The efforts of the engineering section were directed to the preparation of an inventory of the property other than land, and to the ascertainment of the cost of reproduction new and the cost of reproduction less depreciation of such property. Instead of requiring the carriers to file property inventories to be checked by the bureau, the Commission directed the assembly of independent inventories. This procedure was adopted as more likely to result in a record "beyond cavil," and as a means of avoiding unnecessary expense and duplication of effort.<sup>9</sup> The field forces of the engineering section were di-

came a "bureau" as a result of the change of nomenclature following the organization amendment of August 9, 1917 (40 Stat. 270), which enlarged the Commission and authorized it to act by "divisions." *Annual Report*, 1917, pp. 59-61. See, also, Part I, pp. 132-137.

<sup>7</sup> Commissioner Charles A. Prouty was selected as the first Director of the Bureau of Valuation, and served as the guiding genius for the organization and early development of the valuation work. An Executive Order permitted the appointment of a director, an advisory board, five principal engineers and five district engineers, a chief accountant, and a superintendent of land appraisals without the test of a competitive examination, but all other engineers and accountants were obtained through the Civil Service Commission. In the case of engineers whose names were certified by the Civil Service Commission, a further inquiry was conducted by the Interstate Commerce Commission into the standing of these individuals in their respective communities and into their record with past employers. The Commission referred its scheme of organization and plan of procedure, for advice, to an independent committee consisting of John Skelton Williams, Charles F. Staples, Henry C. Adams, Edward W. Bemis, and Oscar T. Crosby. This committee, said the Commission, "after mature consideration, approved our plans with certain suggestions for modification, most of which have been adopted." *Annual Report*, 1913, pp. 76-78, 78.

<sup>8</sup> *Annual Reports*: 1913, pp. 75-79; 1914, pp. 61-64. See, also, *Texas Midland R. R.*, 75 I.C.C. 1, 108 (1918).

<sup>9</sup> *Ibid.*, pp. 109-110.

vided into specialized branches dealing with distinct phases of the inventory and operating independently,<sup>10</sup> and the observations made by these units were assembled and compiled by the office division of this section.<sup>11</sup> The land section devoted itself primarily to the collection of basic data relating to the cost and value of carrier lands and rights of way. With respect to non-carrier property, this section dealt also with all structures upon or connected with the land, including non-carrier structures upon carrier land.<sup>12</sup> The accounting section, finally, gathered such information called for by the Act as could be secured from the books of account and other records of railway lines: the original cost of carrier property; the nature and extent of aids, gifts, grants, and donations; the corporate and financial history of the roads.<sup>13</sup> On the basis of the reports received from the heads of each of the sections, the tentative valuations were prepared at the headquarters of the bureau and served upon the carriers; and in the event of protests thereon, the required hearings were held before the Commission or one of its divisions, or before its valuation examiners, for the determination of final single-sum values. By 1923 the Commission entered upon its preliminary work for bringing the earlier valuations forward to more recent dates;<sup>14</sup> and it is now devoting itself predominantly to the task of revising the primary valuations.<sup>15</sup>

Without anticipating what may be termed the content of the valuation proceedings, it may be noted at this point that in all of the processes employed by the Commission to achieve its substantive results there runs a strain which is dominantly pragmatic in character. Congress, through the valuation amendment, set for the Commission a series of difficult tasks; for the execution of these tasks, the Commis-

<sup>10</sup> The "road and track" party measured and inventoried the roadway and all structures connected therewith (except bridges of over twelve feet in length and buildings); the "bridge" branch dealt with bridges of over twelve feet in length; the "building" branch dealt with all buildings and similar structures, like water and fuel stations; and the "signal" branch handled interlocking plants and signals of all kinds. "Experience shows," said the Commission, "that where properties are at all complicated the work can be more expeditiously, more satisfactorily, and more cheaply done by the several branches acting independently." *Ibid.*, pp. 110-111.

<sup>11</sup> *Annual Reports*, 1915, p. 61.

<sup>12</sup> *Texas Midland R. R.*, 75 I.C.C. 1, 160-176 (1918).

<sup>13</sup> *Ibid.*, pp. 176-182.

<sup>14</sup> *Annual Report*, 1923, p. 17.

<sup>15</sup> See *Annual Reports*: 1931, pp. 68-69; 1932, pp. 86-91; 1933, pp. 73-74.

sion adopted a scheme of organization and procedure which placed distinct stress upon practical considerations. The work was to be done as rapidly, economically, and completely as circumstances would permit, and on the basis of a reasonable, rather than a slavishly literal, interpretation of the Act. The required costs, values, and elements of value were to be so ascertained, expressed, and supported as to be clearly understandable by the various interests concerned, and they were to command confidence if not complete acquiescence.<sup>16</sup> The coöperative relationships maintained between the bureau and the roads throughout the prolonged and complicated undertaking are strikingly illustrative of this approach. Coöperation was expressly enjoined upon the carriers by the statute, and from the outset the Commission availed itself fully of this requirement. In the course of the field work, maps, profiles, and plans were called for by the bureau, and a representative of the carrier known as a "pilot" accompanied each road-and-track party.<sup>17</sup> Carriers were also requested to detail engineers to operate with those of the bureau. Thus, for example, a given bridge or mechanical party came to consist of a commission engineer and a carrier engineer, with others, perhaps, furnished either by the Commission or by the carrier. Charge of the party was taken by the commission engineer, but consultation between the members was free, and field notes as they were completed were furnished to the carrier either for agreement or for dissent.

<sup>16</sup> The first of the Valuation Reports, *Texas Midland R. R.*, 75 I.C.C. 1 (1918), besides embodying an elaborate account of the principles and practices applied to the valuation of that carrier, contains a "Statement of Methods" (Appendix 3, pp. 108-186), which by reference has been incorporated into all subsequent reports. The later reports vary in character and length from mere brief formal orders to orders supported by dozens of pages of argument and treating *in extenso* the conflicting contentions set up by the bureau and by the carriers and other interested parties. The presentation of elaborate opinions, followed frequently by strong dissents and occasionally by special concurring expressions, has rendered the Commission's Valuation Reports a veritable encyclopedia of valuation principles and practice.

<sup>17</sup> "This person is an engineer of experience and ability whose duty it is to point out the property to be inventoried and to see that it is properly measured, inventoried, and classified. Before beginning work he prepares himself by a careful examination of the records of the carrier, by going over the property in advance, and by conferring with others." *Texas Midland R. R.*, *supra*, p. 112. The pilot was presumed to be qualified to "make any statement as to hidden quantities for which the carrier will subsequently make claim. It is considered highly important that this man should accompany the parties, so that it may be known at the time precisely what contentions the carrier makes." *Annual Report*, 1915, pp. 62-63.

Objections made on the spot were investigated, discussed, and frequently adjusted at the time. It was understood between the bureau and the carrier that field notes were to be accepted as correct unless altered by the Commission upon notice to the carrier, or unless objection was filed by the carrier within sixty days. Through such methods the Commission's purpose of obtaining inventories about which a minimum of dispute could arise was largely accomplished.<sup>18</sup> Similarly, at later stages of the proceedings, it became the practice for representatives of the bureau and of the carriers to engage in comparatively informal conferences, in an effort to focus attention upon the dominant issues, and thus not only to conserve the time, extensive enough in any event, devoted by the Commission to formal hearings, but to promote satisfaction with the valuation figures finally reached. Frequently, while a case was before the Commission upon protest of its tentative valuation, the bureau and the carrier would review questions of fact through such conferences, and these deliberations often culminated "in agreement upon the major differences, and a joint recommendation to the commission that the matters so agreed upon be adopted in the final valuation."<sup>19</sup> This procedure, as a modification

<sup>18</sup> "Thus far there has been almost no complaint of omission upon the part of the carrier and comparatively little dispute as to quantities. What dispute has arisen has been as to matters of principle rather than of observation or computation." *Texas Midland R. R.*, *supra*, p. 112; *Annual Report*, 1915, p. 62. But compare the following from H. B. Vanderblue, *Railroad Valuation by the Interstate Commerce Commission* (1920), pp. 25-26: "The procedure, both in the field and in the hearings, is such as to place the carriers at a strategic disadvantage. The government engineer is always in charge, and the burden of dissenting is placed upon the carrier. And in the hearings, even tho the strict rules of evidence may not be applicable, and 'no burden of proof is placed upon the carriers,' as a practical matter the burden of proof does rest upon them. They must attack data presented in mechanically correct tabulations by a subordinate agency of the body which is to make the final judgment." In so far as there is merit in these contentions, it springs from the very nature of the valuation task. The Commission was charged by statute to take the initiative in the investigation, and it could not shift this responsibility to the carriers. But it is apparent throughout that the Commission sought to make the valuations, as far as possible, the joint work of the carriers and the bureau. At all stages of the proceedings, specific data submitted by the carriers were accorded full consideration.

<sup>19</sup> *Winston-Salem Southbound Ry. Co.*, 75 I.C.C. 187, 191 (1918); *Kansas City Southern Ry. Co.*, 75 I.C.C. 223, 225 (1919); *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645, 661 (1923); *Sewell Valley R. R. Co.*, 106 I.C.C. 236 (1925). In many instances these conferences were attended and material assistance was rendered by technical representatives of interested state commissions. *Annual Reports*: 1925, p. 17; 1926, p. 15. The procedure involved has been described by the Commission as consisting of "conferences between our technical representatives and the technical rep-

of the ordinary trial practice, has approved itself both to the Commission and to the carriers. The Commission has noted that the conference plan "has been followed in numerous cases, including those of several of the most important carriers in the country, and thereby the records have been materially shortened and simplified without sacrifice of any essentials or detriment to the public interest"; and that "an increasing number of carriers have indicated their intention of making formal application for reference of their protests to conference as they come on for hearing."<sup>20</sup> These are but a few illustrations of the Commission's pragmatic processes. Neither rigid adherence to abstract preconceptions nor uncompromising enforcement of established practices has been permitted to dominate the situation. While, as will appear in subsequent pages, sharp conflicts of principle and policy have arisen as between the Commission and the carriers, both in the ascertainment of the underlying figures and in the

representatives of the parties to the case with a view to clarification and simplification of the issues, elimination of immaterial matters and of controversy having its source in lack of understanding, and the reaching of agreements or the preparation of statements of fact on technical issues. Under this plan the conferences are merely adjunct to and not substitutes for such hearings as are provided by law. The plan under test provides that conferences can only be authorized at the hearing, where those in opposition may be heard; and that, if conference is authorized, the reports of conferees are to come to the record in such form as to be competent evidence and subject to attack both on hearing and in argument. Conferees can not bind us." *Annual Report, 1924*, p. 15.

<sup>20</sup> See *Annual Reports: 1925*, p. 17; *1926*, p. 14; *1927*, p. 61. Another typical feature of the Commission's procedure, likewise illustrative of a realistic approach and designed to expedite hearings without detriment to the rights of the parties, has been described as follows in *Chicago, Burlington & Quincy R. R. Co.*, 134 I.C.C. 1 (1927), at pp. 4-5: "Although the protests of the carriers raise innumerable issues both as to questions of fact and the methods to be applied thereto, the carriers introduced evidence only with respect to a comparatively few matters contained therein. Counsel for the carriers stated at the hearing that the principles and methods used by us were improper and resulted in invalid final valuations, but that no good purpose could be served by presenting evidence as to these matters of protest, for the reason that we had given consideration to similar contentions in other valuation cases and had passed formally thereon. Therefore, in lieu of introducing evidence as to many matters detailed in the protests, counsel for the carriers requested that they be permitted to reserve their rights to hereafter introduce such evidence as may be necessary in connection with the revision and correction of their valuations, if and when our rulings with respect to these questions may be changed. Thereupon, 22 so-called reservations were read into the record. Counsel were informed at the hearing that in the event the principles upon which the tentative valuations are based are changed, and the carriers so desire, they may bring such matters covered by the reservations to our attention for further consideration. This procedure has our approval."

determination of final single-sum values, the administrative methods employed by the Commission have received general approval. The mechanism of the task has been realistically adjusted to the practical demands of the complex and difficult undertaking, with meticulous regard for both private rights and public interests.

### §2. THE NATURE AND PURPOSES OF THE UNDERTAKING

A critical examination of the Commission's activity in this field must recognize, at the outset, the distinctive character of the valuation project as compared with the Commission's principal regulatory activities. The Commission, in this undertaking, is not directly engaged in the administrative enforcement of the carriers' duties as defined by statute; it is but seeking to ascertain, in compliance with a specific legislative mandate, a special body of "facts" which are deemed essential to the sound and effective performance of its major regulatory tasks. The valuations found by the Commission reach the stage of positive significance only when they come to be utilized as the basis of regulatory orders affecting rates, earnings, consolidations, or security issues. Valuation "orders" as such differ fundamentally from orders requiring carriers either to perform or to refrain from performing some act touching upon their organization, financial structure, or price policies. Strictly speaking, valuation "orders" are not orders at all; they are reports of investigations into the value of carrier property, and they are addressed to the Congress of the United States and to other interested parties as fully as to the carriers immediately concerned. Valuations of public utility properties have long been recognized as necessary instruments in the regulatory process rather than as ends in themselves; railroad valuations play a like rôle in the activities of the Interstate Commerce Commission. Indeed, since the Commission's valuations are not made in connection with specific proceedings, as is so often the case in the public utility field, this ancillary quality of its findings is given special emphasis. The Commission's reported valuation of a particular carrier may never rise above the dignity of mere "information." Only when it is utilized as at least the partial basis of regulatory action does it serve to mold substantive policy. It is apparent, therefore, that while carrier valua-

tions have come to be an almost indispensable tool for the proper exercise of many of the Commission's powers, it is in this auxiliary aspect, and not as an independent goal of administrative activity, that the valuation project must be approached.<sup>21</sup>

Any doubt as to the legal validity of this conception of the valuation task was authoritatively set at rest by the United States Supreme Court in holding non-reviewable an "order" of the Commission fixing the final single-sum value of the San Pedro, Los Angeles & Salt Lake Railroad Company.<sup>22</sup> The case came up on appeal from the decree of the District Court for the Southern District of California, which had sustained a bill to annul and enjoin the enforcement of the Commission's valuation order.<sup>23</sup> The jurisdiction of the District

<sup>21</sup> There is ample evidence in the Valuation Act that Congress regarded the Commission's activity in this field as designed merely to ascertain a special body of facts. The valuation "order" is characterized as "an order making such corrected tentative valuation final"; the Commission is required to report valuations, original and corrected, to Congress; and in the provision that final valuations shall be *prima facie* evidence of the value of carrier property in all proceedings arising under the Act to Regulate Commerce, there is a clear recognition that valuation proceedings are different in kind from the proceedings which come before the Commission for the settlement of controversies or for the approval of proposed courses of action. That this differentiation has guided the Commission itself in the course of its valuation work is indicated, for example, by its answer to a carrier protest against the application of 1914 prices to a 1916 inventory. In *Delaware & Hudson Co.*, 116 I.C.C. 611 (1926), the Commission said (at pp. 614-615): "The application to the engineering inventory of normal 1914 prices fully meets the requirements of the law and imposes no hardship upon the carrier. Carriers would derive no benefit were normal 1916 prices substituted for normal 1914 prices. Both of these years are past, and nothing would be gained by the adoption of normal 1916 prices, inasmuch as no use is being made of the value herein reported for fixation of rates or other purposes enumerated in the interstate commerce act. . . . Pending specific use of the findings in the valuations as made final no advantage accrues to the carrier from the application and use of normal 1916 prices, nor does the carrier suffer any detriment through the use of normal 1914 prices." See, also, the separate concurring opinion of Chairman Meyer in the first of the final single-sum value reports, *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), at pp. 589-590, in which he pointed out that the basic valuation as of the year 1914 was far from valueless, although it could not be utilized as a rate base without a supplementary finding.

<sup>22</sup> *United States v. Los Angeles R. R.*, 273 U.S. 299 (1927).

<sup>23</sup> On June 7, 1923, the Commission reported, as of June 30, 1914, a final single-sum value of the carrier property for rate-making purposes of \$45,000,000. *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923). In the suit to annul and enjoin the enforcement of this valuation "order" brought by the carrier against the United States, the Commission intervened as one of the parties defendant. The court accepted jurisdiction over the objection, by demurrer and by motion, of the defendants. Evidence was introduced into court which had not previously been submitted to the Commission, and this was referred to that body for consideration and action within

Court had been invoked under the terms of the Urgent Deficiencies Act of October 22, 1913, and under the court's general equity powers. The United States contended that the Commission's valuation "order" did not constitute an order within the meaning of the Urgent Deficiencies Act and also challenged the jurisdiction of the court under its general equity powers. The Supreme Court upheld these contentions and reversed the lower court for failure to dismiss the bill.<sup>24</sup>

six months from the date of receipt. *Los Angeles & S. L. R. Co. v. U.S.*, 4 Fed. (2d) 736 (1925). The evidence thus submitted to the Commission led to no change in the original valuation figure, but the proceeding was reopened for the purpose of receiving further evidence with regard to water rights and working capital. *San Pedro, Los Angeles & Salt Lake R. Co.*, 97 I.C.C. 737 (1925). Upon consideration of the evidence at the further hearing, the Commission allowed an additional \$200,000 for working capital, bringing the single-sum value of the carrier to \$45,200,000. *Ibid.*, 103 I.C.C. 398 (1925). In the ensuing court proceeding, as stated above, the valuation order was annulled and the Commission was enjoined from enforcing it in any way. *Los Angeles & S. L. R. Co. v. U.S.*, 8 Fed. (2d) 747 (1925). The court said (p. 756): "The reports of the Commission we think clearly show that its action was based upon the view that the property of the railroad company in question has more than one kind of value. And in our opinion that view constituted its fundamental error, and consists in its failure to do what the statute in express and, as we think, clear and unmistakable terms, authorized and required it to do as the basis upon which to fix the rates to be charged by the railroad company; that is to say, the true actual value of all of the property of the company at the time used in its transportation business." In assuming jurisdiction at all, the court based its action upon the Supreme Court's decision in *Delaware & Hudson Co. v. U.S.*, 266 U.S. 438 (1925). In that proceeding a petition to set aside a tentative valuation issued by the Commission on March 28, 1923 (Valuation Docket No. 328) was dismissed. Apparently the lower federal court construed the language of the Supreme Court as tantamount to a declaration that final valuations, merely as reported and without reference to their use, are necessarily subject to judicial review. The Supreme Court, confining itself to the immediate issue, had said (pp. 448-449): "The 'tentative valuation' of the statute is no more than an *ex parte* appraisal without probative effect. . . . Pending further action by it [the Commission] the tentative valuation will not become final and no proceedings thereon can be taken. Under the circumstances disclosed appellants must pursue the remedy provided by the statute and give the Commission opportunity to take final action before they can properly ask interposition by the courts."

<sup>24</sup> On the matter of jurisdiction within the terms of the Urgent Deficiencies Act, the Supreme Court said: "The District Court rested jurisdiction to entertain a suit to set aside the valuation order largely upon the provisions of paragraph (j), believing that such a suit was within the scope of the words 'upon the trial of any action involving a final value.' That paragraph was intended to apply to actions brought to set aside rate-fixing orders in which the question of the value of the carrier's property would be material. In our opinion it is not applicable to so-called orders fixing only valuations. The objection to entertaining this suit to annul the final valuation is not merely that the question presented is moot . . . or that the plaintiff's interest is remote and speculative. . . . There is the fundamental infirmity that the mere existence of error in the final valuation is not a wrong for which Congress provides a remedy under the Urgent Deficiencies Act." Similarly, the Court found no ground for



The most enlightening portion of the Supreme Court's opinion, delivered through Justice Brandeis, is that differentiating between the character of the Commission's valuation "orders" and of those involved in the exercise of its regulatory powers. On this aspect of the controversy, which discloses the real nature of the valuation project, the Court said:

The final report on value, like the tentative report, is called an order. But there are many orders of the Commission which are not judicially reviewable under the provision now incorporated in the Urgent Deficiencies Act. . . . The so-called order here assailed differs essentially from all those held by this Court to be subject to judicial review. . . . Each of the orders so reviewed was an exercise either of the quasi-judicial function of determining controversies or of the delegated legislative function of rate making and rule making.

The so-called order here complained of is one which does not command the carrier to do, or to refrain from doing, any thing; which does not grant or withhold any authority, privilege or license; which does not extend or abridge any power or facility; which does not subject the carrier to any liability, civil or criminal; which does not change the carrier's existing or future status or condition; which does not determine any right or obligation. This so-called order is merely the formal record of conclusions reached after a study of data collected in the course of extensive research conducted by the Commission, through its employees. It is the exercise solely of the function of investigation. . . . Moreover the investigation made was not a step in a pending proceeding in which an order of the character of those held to be judicially reviewable could be entered later. It was merely preparation for possible action in some proceeding which may be instituted in the future—preparation deemed by Congress necessary to enable the Commission to perform adequately its duties, if and when occasion for action shall arise. The final report may, of course, become a basis for action by the Commission, as it may become a basis for action by Congress or by the legislature or an administrative board of a State. But so may any report of an investigation, whether made by a com-

entertaining the suit under general equity powers: "No basis is laid for relief under the general equity powers. The investigation was undertaken in aid of the legislative purpose of regulation. In conducting the investigation, and in making the report, the Commission performed a service specifically delegated and prescribed by Congress. Its conclusions, if erroneous in law, may be disregarded. But neither its utterances, nor its processes of reasoning, as distinguished from its acts, are a subject for injunction." *United States v. Los Angeles R. R.*, 273 U.S. 299 (1927), at pp. 313, 314-315.

mittee of Congress or by the Commission pursuant to a resolution of Congress or of either branch thereof.

The Valuation Act requires that the investigation and study be made of the properties of each of the rail carriers. There are about 1800. . . . In directing the Commission to investigate the value of the property of the several carriers, Congress prescribed in detail the subjects on which findings should be made, and constituted the "final valuations" and "the classification thereof" *prima facie* evidence, in controversies under the Act to Regulate Commerce. Every party in interest is, therefore, entitled to have and to use this evidence; and the carrier, being a party in interest, has the remedy by mandamus to compel the Commission to make a finding on each of the subjects specifically prescribed. . . . But Congress did not confer upon the Courts power either to direct what this "tribunal appointed by law and informed by experience" . . . shall find, or to annul the report, because of errors committed in making it. Moreover, errors may be made in the final valuation of the property of each of the nearly 1800 carriers. And it is at least possible that no proceeding will ever be instituted, either before the Commission or a court, in which the matters now complained of will be involved or in which the errors alleged will be of legal significance.<sup>28</sup>

The nature of the valuation task, as thus conceived, interposes effective obstacles to premature interference with the Commission's investigatory labors: the validity of its valuation findings cannot be questioned until they are actually utilized in the regulatory process. Eventually, however, these findings must stand the test of economic

<sup>28</sup> *Ibid.*, pp. 309-311. In a similar case, a few months later, the Supreme Court, in a memorandum decision, reversed the action of the District Court for the Western District of Missouri in enjoining the enforcement of the Commission's "order" making final a valuation of \$49,016,268 for the properties of the Kansas City Southern railroad system. On the authority of the decision in the *Los Angeles & Salt Lake* case, the lower court was ordered to vacate the injunction decree and to dismiss the petition for want of jurisdiction. *United States v. Kansas City Southern Ry.*, 275 U.S. 500 (1927). A like position was taken by the Supreme Court, though with three of the seven participating Justices dissenting, in reviewing the reversal of a judgment dismissing a petition for mandamus by which the New Haven sought to compel the Commission to include the value of a perpetual right to use certain trackage and terminal properties in New York and Boston. In concluding the opinion of the Court, Justice Cardozo said: "Public policy forbids that the work of the Commission in the fulfillment of the stupendous task of valuation shall be hampered by writs of mandamus except where the departure from the statute is clear beyond debate. The report is not a stage in a judicial proceeding affecting this carrier or others. It is the exercise solely of the function of investigation." *Interstate Commerce Commission v. New York, N. H. & H. R. Co.*, 287 U.S. 178, 204 (1932).

and legal validity; when they are made to serve as a basis for the performance of any of the Commission's regulatory tasks, the principles and technique employed in their determination are properly subject to attack on grounds of law and policy. And since the propriety of the Commission's determinations is largely dependent upon the uses of the "values" thus found, it becomes essential that consideration be given to the purposes of the valuation project. A realistic appraisal of the quality of the Commission's work in this field must take primary account of the ends which its valuations are designed to serve. As a preliminary, therefore, it is necessary to note the avowed purposes of the Commission's findings, and, in the light of the history and provisions of the Valuation Act and of the legislative mandates subsequently enunciated by the Congress, to reach a judgment as to the propriety of the Commission's delimitation of purposes. The valuation standards and methods employed can then be tested in terms of their validity for these specific purposes.

That valuation is purposive—that a property may have several "values" at a given time, each molded by the character of the end sought—is now more clearly established and more generally accepted than any other single doctrine developed during the past thirty-five years of conflicting discussion in the field of valuation.<sup>26</sup> The use of the term "value," without qualification as to purpose, has been a

<sup>26</sup> In *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), the first important final single-sum value report, the Commission stated the issue as follows (p. 506): "In connection with our conclusion to ascertain and report a final single-sum value of the property owned and used or owned or used by a common carrier we have been obliged to determine whether or not the value of the property of the common carrier is the same for all purposes, irrespective of the use to be made of that value. It has been uniformly the contention of the carriers that this must be so. On the other hand, other parties who have participated in the proceedings in this case and in other valuation cases have contended that values and methods of determining values differ, depending upon the purposes for which they are made. It is the carriers' contention that the property they devote to the public service can have but one value, which they have variously designated as exchange value or real value, and they assert that whatever the purpose for which the value is determined, whether as a rate base or for use in a condemnation or confiscation case, or for any other purpose, there is but one value of the property, and it must always be determined in the same way. On the other hand, our attention has been directed to the fact that public utilities commissions generally and the Supreme Court and other courts of the United States in a number of cases have been particular in instances when they were considering values to specify the purposes for which the values under consideration were to be used." Without arriving at any explicit conclusion as to whether the value of carrier property might vary with the purpose of the valuation, the Commission ascertained and reported a

source of great confusion.<sup>27</sup> The only objective meaning that can be assigned to the term is "exchange value" or "market value." Such values, in the case of complex income-producing properties like railroads and public utilities, are largely dependent upon earnings, actual and prospective, and they can generally be ascertained only through the capitalization of these earnings in the securities markets. They are the results of "commercial valuations," reflecting values as they spontaneously emerge in the market place, rather than of "physical valuations," which contemplate the authoritative determination of results deemed appropriate for particular ends.<sup>28</sup> While the use of

value "for rate-making purposes." Among the Supreme Court decisions recognizing the purposiveness of valuation, the following may be noted: *Willcox v. Consolidated Gas Co.*, 212 U.S. 19 (1909); *Omaha v. Omaha Water Co.*, 218 U.S. 180 (1910); *Minnesota Rate Cases*, 230 U.S. 352 (1913); *S. W. Tel. Co. v. Pub. Serv. Comm.* (especially concurring opinion of Justice Brandeis), 262 U.S. 276 (1923). See, also, David Friday, "An Extension of Value Theory," *Quarterly Journal of Economics*, vol. 36 (February, 1922), pp. 197-219; James C. Bonbright, "The Problem of Judicial Valuation," *Columbia Law Review*, vol. 27 (May, 1927), pp. 493-522; and R. H. Whitten, *Valuation of Public Service Corporations* (Second Edition, 1928, revised by D. F. Wilcox), vol. 1, pp. 37-75.

<sup>27</sup> See, for example, Robert L. Hale, "The Supreme Court's Ambiguous Use of 'Value' in Rate Cases," *Columbia Law Review*, vol. 18 (March, 1918), pp. 208-229, and "The 'Physical Value' Fallacy in Rate Cases," *Yale Law Journal*, vol. 30 (May, 1921), pp. 710-731. Compare, also, A. T. Hadley, "The Meaning of Valuation," *American Economic Review*, vol. 18 (March, 1928, Supplement), pp. 173-180, and discussion by I. L. Sharfman, at pp. 206-207.

<sup>28</sup> In his paper on "The Meaning of Valuation," note 27, *supra*, the late President Hadley decried the use of the term "valuation" to describe the processes employed by courts and commissions in establishing "values" for rate-making purposes, whether they adopt actual cost or reproduction cost as the controlling standard. The results, he rightly insisted, are "costs" and not "values," and the process is one of "assessment" and not "valuation." He distinguished the two as follows (pp. 179-180): "Assessment is the fixing of a price by government authority. It differs radically from value in the fact that it depends on public authority—not on public demand. It is essentially a political term—not a scientific one. We fix an assessment; we ascertain a value. We ascertain the value of a piece of property by the same process of observation and calculation that we use in ascertaining the weight of a mass of metal or the size of a piece of land. Value in the accredited sense of the term . . . is the power which an object confers on its possessor independent of political authority or personal sentiments to command the labor or products of labor of others. It is what an article is worth, sometimes in meeting an individual demand, more often in meeting a public demand, but it depends on demand in either case. Cost of production only enters into value indirectly by limiting the supply. A cost assessment neither produces value nor measures it." These distinctions are essentially sound, and they constitute a necessary caution against the use of the term "value" in a variety of senses and as a single description of a diversity of results. But the conclusions which President Hadley drew from this misuse of terms can hardly command approval. He asserted that "the attempt to use the same word for a true valuation and cost assessment" not only creates

such market values may be entirely proper in the administration of particular tax policies or in compulsory purchases through condemnation proceedings, it is clearly inapplicable for the purposes of rate control: in the one case, the objective is merely to enforce contribution or to provide compensation on the basis of established charges and the income actually realized or in reasonable prospect; in the other, the objective is to determine the propriety of the prevailing rates and flow of revenue.<sup>29</sup> The purpose of the "valuation" becomes

"confusion in thought and error in practice," but that it "clouds our ideas of justice in a way that strikes at the very foundations of constitutional liberty," in that it involves a taking of property without "giving the owner a full commercial equivalent" (pp. 178, 179). In other words, instead of insisting upon a mere clarification of terms—upon the substitution, in rate cases, of "rate base" for "fair value"—he argued for the maintenance of the complete integrity of market value, which involves a virtual abdication of the right to regulate rate levels. The fallacy of this reasoning has been explained elsewhere: ". . . President Hadley has rendered an important service in emphasizing once more that those engaged in the so-called physical valuation of railroads are not seeking value in the traditional sense, as determined by market forces. The end in view is the ascertainment of a rate base—the finding of a figure upon which the accepted percentage of return may equitably be computed, as a guide for the regulation of rate levels and the limitation of profits. The undoubted confusion which has enshrouded valuation proceedings arose originally because of the judicial use of the term 'fair value' in these circumstances; and the confusion has been continued through the statutory adoption of the same phraseology. In recent years, therefore, the term 'fair value' has been generally qualified by the phrase 'for rate-making purposes' or displaced by the more accurate 'rate base.' Because the figure thus sought is the result of authoritative determination rather than of spontaneous emergence in the market, President Hadley insists that 'assessment' rather than 'valuation' is properly descriptive of the process. There need be no quarrel with regard to the suggested terminology. It does not follow, however, that impropriety in the use of words must lead to condemnation of the substance underlying these words. The Interstate Commerce Commission may be making 'assessments' and not 'valuations' in their true significance, but that does not necessarily mean that its activity in this direction is wrong in principle and dangerous in practice. If valuations, in the sense of merely recording market values, do not constitute a proper rate base, then there is no need of making such valuations; and if 'physical valuations,' though in essence but constituting 'assessments,' do provide a proper rate base, then they should not be vitiated by the sole fact that they are misnamed. . . . The necessity for profit limitation in the railroad field was recognized from the beginning and has been cumulatively confirmed by subsequent experience. And the need for physical valuations, which provide the only objective standard for testing the reasonableness of the rate level, sprang from practical administrative and judicial contacts with this regulative process. Once the policy of rate regulation is accepted, the fact that determinations as to the rate base are authoritative 'assessments' rather than market 'valuations' is entirely immaterial. It is but necessary that they be equitable 'assessments'; indeed, if they were to be turned into 'valuations'—establishing estimates of the market value of railroad properties on the basis of value of service and the earning capacity resulting therefrom—they would defeat the very purpose for which they are made." I. L. Sharfman, *ibid.*, pp. 206-207.

<sup>29</sup> Compare the following on "pluralistic valuations," with special reference to the

a controlling factor in the determination of results. In the words of one student of the problem: "The notion that properties contain a value which is the same in all institutions is the source of much of the confusion which now characterizes valuation for purposes of rate making. Commissions in such valuations do not seek an absolute quality of the property which may be denominated its value; they are rather imposing upon the property a fair value which shall express in pecuniary terms all the equitable considerations bearing upon the determination of the mutual rights of public and owner. In arriving at that value the courts and commissions make use of certain market facts, both past and present, but what they are seeking is not a market value, but something different. It is like market value in that it is formulated to realize a purpose in the nature of an end to be attained, just as the market seeks an adjustment of supply and demand. But it is a thing *sui generis*. It has no meaning nor can it be understood except in terms of the purpose of the public regulation and in terms of the technique which has been developed for arriving

relationship between value for rate-making purposes and value for purposes of taxation or compulsory purchase: "The distinction between the tax value and the rate-making value is clearly in order. In fixing the amount of a property tax, the government is trying, not to *regulate* the value of the property but simply to *measure* it. It is interested therefore in estimating the company's earning power under whatever rates the company may actually charge. Whether the earnings are excessive or deficient is therefore no concern of the tax assessor except in so far as it may be assumed that the excess or the deficit represents a merely temporary condition which is not indicative of the long run earning power of the company. The whole problem for the assessor, then, is to value the property on the basis of what it can probably earn in fact rather than on the basis of what it should be allowed to earn if it can. But the rate-making authorities face a very different problem of 'valuation.' They must decide, not what the value *is*, but what it *should be*—not what the company *does* earn, but what it *may* earn. And they may therefore place upon the property a value for rate-making purposes that is either much higher or much lower than its value for tax purposes. . . . Finally there is to be noted the valuation placed upon the properties for purposes of condemnation. In its general principles, this type of valuation would seem to be most nearly akin to valuation for tax purposes. Just as in the tax case, so in this case the problem would seem to be one of *finding* values rather than of *regulating* them. The government is here proposing to take over the private property and to operate it as a public enterprise. The existing owners, therefore, have a claim to be compensated for the loss that is imposed upon them by virtue of the taking. This loss can presumably be measured only by an estimate as to what the company's earning power would have been if the expropriation had not taken place. And in making this estimate, a court, one might suppose, would instruct a jury to take into account the established rate-making value of the property only to the extent that this value would have affected that earning power." James C. Bonbright, "The Problem of Judicial Valuation," *Columbia Law Review*, vol. 27 (May, 1927), pp. 519, 520.

at a pecuniary value which shall serve that purpose."<sup>80</sup> What is sought under such circumstances is a rate base, as a means of regulating earnings, rather than value, as a mere reflection of earnings. The circular reasoning involved in the utilization of market value as a rate base is obvious. The reasonableness of the rates would be tested by reference to a value which is itself dependent upon the rates.<sup>81</sup> In the

<sup>80</sup> David Friday, "An Extension of Value Theory," *Quarterly Journal of Economics*, vol. 36 (February, 1922), pp. 210-211. To the same effect, with special emphasis upon the confusion that results from the use of the term "value" without regard to the purpose of the findings and the disparities between them as applied to an identical property, is the following: "In the writer's opinion, the use by the courts of the single word 'value' to cover such a multitude of different estimates is distinctly unfortunate. It has led to that vicious type of thinking which some people call 'conceptualism'—to a confusion of problems that are essentially distinct simply because they are described by terms that have the same spelling and the same sound. If law students and judges would only abandon the attempt to find out what the value is and would direct their attention to finding out what the practical problem is, they would avoid much of the disheartening obscurantism that has been so prevalent in valuation studies, notably in studies of public utility valuation." James C. Bonbright, "The Problem of Judicial Valuation," *supra*, pp. 521-522.

<sup>81</sup> In the *Minnesota Rate Cases*, 230 U.S. 352 (1913), for example, Justice Hughes said (p. 461): "The value of the use, as measured by return, can not be made the criterion when the return itself is in question. If the return, as formerly allowed, be taken as the basis, then the validity of the State's reduction would have to be tested by the very rates which the State denounced as exorbitant. And, if the return as permitted under the new rates be taken, then the State's action itself reduces the amount of value upon which the fairness of the return is to be computed." For similar reasons, the Commission has uniformly rejected earning power as a basis for determining final single-sum values. Compare the following, for example, from *Kansas City Southern Ry. Co.*, 84 I.C.C. 113 (1924), at pp. 117-118: "A railroad system is not a freely transferable commodity with a recognized commercial value. Its economic value, like its other values, must be a matter of estimate, and the carriers suggest as criteria the capitalization of earning power and the market value of outstanding securities. The carriers contend that our tentative single-sum valuation is faulty in that it wholly ignores earning power, past, present, and prospective. Earning power is itself dependent upon rate making. It can not be estimated until the rate level has been fixed and the value upon which the carrier will be permitted to earn has been ascertained. To make it also the basis for, or a direct element in, valuation would in effect permanently capitalize against the public the profits from any maladjustment in rates, for having once fixed the values of the carriers' property solely on the basis of earning power, we could not thereafter reduce the earnings of the carriers for the reason that such action would automatically reduce such a value. If carriers' theory were correct it would follow that as earnings increase in the future values must be raised on a higher basis to reflect the increased earning power. The result is obvious: A successive increasing of values to higher levels with corresponding increased burdens upon the users of railways without any greater capital investment by the carriers." The Commission's definitive attitude in this regard may be noted from the following terse pronouncement in *Chicago, Burlington & Quincy R. R. Co.*, 134 I.C.C. 1, 53 (1927): "Value for rate-making purposes and commercial value arising from earning power are so wholly different that they can not be reconciled."

light of such considerations, the Commission, from the first, recognized that it was not making universally applicable valuations. It has proceeded upon the principle that the ascertainment of value for the purposes of regulation might differ in both methods and results from its determination for other purposes, such as taxation and condemnation; and in its findings of single-sum values, it has assumed at least implicitly, in all instances, that valuations as fixed by public authority are purposive in character.<sup>82</sup>

<sup>82</sup> In *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645 (1923), for example, the Commission, after noting the stipulations of the statute, concluded as follows (pp. 665-666): "The value we are required to establish, therefore, is a value determined for the specific purposes of governmental regulation under the interstate commerce act. The value must embrace all of the property used by the carrier for purposes of transportation, whether owned by it, or leased from others, and must include any intangible value that inhere in the property because of its use. We are not concerned with a value for purposes of sale or of condemnation, which in either case might well be something different from the value of the same property for the purposes of governmental regulation, for there is in contemplation in such cases the transfer of the ownership of property and of rights in property, and in a case of condemnation the possible destruction of certain property rights, and there must be included the value of noncarrier property." In *Kansas City Southern Ry. Co.*, 84 I.C.C. 113 (1924), the Commission was even more specific in differentiating the various purposes of valuation and the distinctive standards and methods which apply to each. The Commission said (p. 116): "The determination of the methods of valuation for regulatory purposes depends upon the use which is to be made of the resultant figure. Whatever the limitations may have been upon the original meaning of the term value, it is certain that at the time the valuation act was passed the term was generally used with recognized but widely varying meanings. Valuation for capitalization, consolidation, taxation, and rate-making purposes and estimates of exchange value can not all be made upon the same basis. In valuing a railroad for tax purposes it is immaterial to what use the property is put, and no segregation between carrier and noncarrier property is necessary. The value of the physical property is often the primary consideration. In determining purchase and sale values the aggregate value of the physical units becomes less important, and is controlling only where actual replacement or a substitute plant is feasible. The earning power of the property is the primary consideration in such a case. Similarly in condemnation cases, where the whole property, carrier and noncarrier, is taken, the franchise rights destroyed, earning power completely wiped out, and the legal title actually transferred, property value and earning power may be prime considerations. In determining value for rate-making purposes, where there is no transfer of title or destruction of franchise rights, and the property is used but not taken, determination of the fact that specific property is being used in rendering the common-carrier service for which rates are to be charged is of primary importance, and a segregation must be made between carrier and noncarrier property." Compare, however, Commissioner Potter's separate expression, concurring in part, in *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), at p. 581 *et seq.*; and Chairman Meyer's rejoinder, at p. 596 *et seq.* Commissioner Potter, with whom Commissioner Cox concurred, dissented vigorously from the proposition that the statute calls for the determination of "rate value" as distinct from value for other purposes, or that rate-making requires the finding of a special value. "The word 'value' is used in *different*



Assuming, then, that a valuation can properly be placed upon the railroads of the country only with reference to specific ends, what purpose or purposes were to guide the Commission in discharging the duties laid upon it by the Valuation Act? A study of the legislative history of the Act, and of the discussions which developed outside the halls of Congress, discloses that a great variety of purposes crowded the minds of those who urged its passage. The Commission's recommendations prior to the introduction of the bill, the testimony of witnesses appearing before the Senate and House committees investigating the valuation measure and its predecessors, the reports of these committees, and the debates on the floor of Congress, all furnish ample illustration of the multiplicity of the ends which, in the view of the proponents of the Act, were to be served by the proposed valuations.<sup>83</sup> Valuation of carrier property was advocated as a measure of aid to the states for the more uniform enforcement of taxation policies, as a basis for the administration of the depreciation accounts, as a means by which the accuracy of the carriers' asset accounts might be established, as a medium through which the extent and propriety of railroad capitalization might be tested and ultimately controlled. In the welter of recommendation and debate, however, there was always present and frequently uppermost a strong current of demand for a complete and authoritative valuation of carrier property as an indispensable instrument for intelligent and effective rate control. It seems clear that the force of this demand, toward which most of the others converged, was predominantly responsible for the adoption of the Act. The urgency of the valuation need for

*senses,*" he said, "but I am unable to see how we can find *different values* of the same thing to be used for *different purposes*" (p. 583). For a later affirmation of the majority view, in the face of carrier protest, see *Nashville, C. & St. L. Ry.*, 31 Val. Rep. 567, 582 (1930).

<sup>83</sup> See Part I, pp. 117-126. More specifically, see *Congressional Record*, vol. 49, pp. 46-76 (Dec. 3, 1912), pp. 170-176 (Dec. 5, 1912), pp. 3793, 3794-3806 (Feb. 24, 1913); *Report of the Senate Committee on Interstate Commerce*, 62d Cong., 3d Sess., No. 1290, containing, *inter alia*, the testimony of Frank Trumbull, Leonor F. Loree, Frederick A. Delano, Edward W. Bemis, and John R. Commons in the Senate Hearings, and the testimony of Commissioners J. C. Clements and B. H. Meyer in the House Hearings, as well as a report of the National Association of Railway Commissioners; *Report of the Railroad Securities Commission*, 62d Cong., 2d Sess., House Doc. No. 256 (1911); Interstate Commerce Commission, *Annual Reports*: 1903, pp. 26-32; 1907, pp. 149-150; 1908, pp. 83-85; 1909, p. 6; 1910, p. 37; 1911, pp. 93-94; 1912, pp. 70-71.

rate-making purposes, and the magnitude and vitality of the public interests involved therein, could not longer be ignored.<sup>84</sup> And yet, strangely enough, the valuation amendment as passed made no mention of the purposes for which the valuation figures were to be ascertained. Neither by explicit direction nor by necessary inference was the Commission required by the Act to bear in mind during its investigations and deliberations any specific ends which were to be served by its conclusions. A stipulation as to the rule or principle by which single-sum values were to be determined might have afforded a clue; but even in this regard the statute was silent. Indeed, nowhere in the Act is the Commission expressly ordered to ascertain single-sum values. No word on the purposes of the valuation was incorporated in the measure, save the general pronouncement that "all final valuations by the Commission . . . shall be *prima facie* evidence of the value of the property in all proceedings under the Act to regulate commerce . . . and in all judicial proceedings for the enforcement of the Act . . . and in all judicial proceedings brought to enjoin, set aside, annul, or suspend, in whole or in part, any order of the Interstate Commerce Commission."<sup>85</sup> The valuation findings were unquestionably to be utilized for purposes of regulation—in the Commission's enforcement of the provisions of the Act to Regulate Commerce; but in connection with what aspects of the regulatory process they were to be so used, and whether the same valuations were to be equally applicable for all purposes, was not disclosed. It remained for the Commission, in the light of its experienced grasp of the situation as a whole, to execute the valuation mandate without express guidance in these directions.

Construing the reticence of Congress as an implied warrant for the exercise of administrative discretion rather than as a withholding of power, the Commission struck out boldly from the beginning. In the very first of the reported valuation cases it announced its intention ultimately to find a single-sum value for each property;<sup>86</sup> and in

<sup>84</sup> For an analysis of the course of development of this pressure, see Part I, pp. 119-126.

<sup>85</sup> Sec. 19a, par. (1).

<sup>86</sup> "While it may be questioned whether or not the act requires the finding of a single sum as the value of the property, we are of opinion that it authorizes the finding of such value for purposes under the act to regulate commerce, and it is our pur-

denying the claim of the carrier for a separate report as to "the value of the right to use," an intimation was dropped that rate control was to constitute the primary purpose of the findings.<sup>87</sup> Not long thereafter the Transportation Act of 1920 was placed upon the statute books; and in the first important case following this enactment, the intimation contained in the opening report was molded into a definite pronouncement, from which the Commission has not departed in any subsequent proceeding, that it was engaged in ascertaining value for rate-making purposes.<sup>88</sup> Although the Transportation Act, with its imposition of affirmative responsibilities upon the Commission and its explicit enunciation of specific purposes for which valuations of carrier property were to be employed, tended to clear the atmosphere, there was still important work of interpretation to be done. In establishing a positive rule of rate-making, in providing for the recapture of excess earning, and in clothing the Commission with authority to regulate security issues and to control consolidations, the 1920 statute contemplated an extensive utilization of the results derived under the valuation amendment.<sup>89</sup> The new provisions thus added tremendously to the significance of the valuation project; for

pose ultimately to make such finding as to each property. Tentative valuations in which a single sum as the value of the property is not stated will in due course be supplemented by such finding and a final valuation, including a single sum as the value of the property, will be duly issued." *Texas Midland R. R.*, 75 I.C.C. 1, 6 (1918).

<sup>87</sup> The Commission said: "In addition to its claim that the three cost values of the property used but not owned should be included in its inventory, the carrier asserts that it is our duty to report separately a figure as to the value of the right to use. It is a sufficient answer to this contention to state it is now universally accepted that it is the fair value of the property used by the public service corporation in serving the public which is to govern in fixing rates." *Ibid.*, p. 23.

<sup>88</sup> *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923).

<sup>89</sup> In the exercise of the power vested in the Commission so to establish rates that the carriers as a whole, or in rate groups, shall earn an aggregate annual net railway operating income equal to a fair return upon the aggregate value of their property used in the transportation service, and to recapture one-half of the earnings in excess of 6 per cent on the value of its property received by any carrier, the following provision was made with regard to the determination of property values: "For the purposes of this section, such aggregate value of the property of the carriers shall be determined by the Commission from time to time and as often as may be necessary. The Commission may utilize the results of its investigation under section 19a of this Act, in so far as deemed by it to be available, and shall give due consideration to all the elements of value recognized by the law of the land for rate-making purposes, and shall give to the property investment account of the carriers only that consideration which under such law it is entitled to in establishing values for rate-making purposes. Whenever pursuant to section 19a of this Act the value of the railway property of any carrier held

the first time there was express legislative cognizance of specific uses to which the valuation results were to be put. But the Transportation Act did not go beyond a mere recital of various purposes for which valuations were to be used. There was still no enunciation of guiding principle for the ascertainment of single-sum values, and no word as to whether the various purposes were all to be served by a single value figure. It was under these circumstances that the Commission, in order that its efforts might not be rendered futile by a confusing multiplicity of ends, delimited its task in definite fashion. With its characteristic penchant for realities, it did not shirk the responsibility of declaring for the purposiveness of valuation in general, and particularly in relation to its own undertaking. The Commission was engaged, not in a series of unrelated investigations growing out of specific proceedings and to be utilized for a diversity of ends, but in a single inquiry into the value of railroad property, as a general basis for the performance of its regulatory duties. Only, by reference to one unifying purpose could its findings be made in terms of sound and consistent principle and technique; and rate control had constituted the primary activity of the Commission from the beginning of its existence. The enactment of the rule of rate-making and the recapture clause, coupled with the Commission's prior possession of the rate-suspension power, had rendered the regulation of the level of charges of outstanding significance. In confining its determinations to the ascertainment of value "for rate-making purposes," therefore, the Commission was serving the major ends of the regulatory process for which findings of value are relevant. The step was decisive in its nature, but no more sweeping than was demanded by the practical situation with which the Commission was faced. "It is quite evident," said the Commission, "that in enacting paragraph [*sic*] 15a of the act Congress intended that one of the purposes for which we should

for and used in the service of transportation has been finally ascertained, the value so ascertained shall be deemed by the Commission to be the value thereof for the purpose of determining such aggregate value." Sec. 15a, par. (4). In connection with the control over consolidations vested in the Commission, it was enacted that the bonds at par of the corporation becoming the owner of the consolidated properties, together with the outstanding capital stock at par of such corporation, shall not exceed the value of the consolidated properties as determined by the Commission, and it was further provided that "the value of the properties sought to be consolidated shall be ascertained by the Commission under section 19a of this Act." Sec. 5, par. (6), subsec. (b).

ascertain and report the value of the property of common carriers was to arrive at a base for determining the fair return to which carriers were declared to be entitled, and the amount of excess, if any, in their earnings which it became our duty to recover. It is our conclusion, therefore, that the final single-sum value which we shall ascertain and report in this case is the value for rate-making purposes. Having reached that conclusion, it is unnecessary for us to determine now to what extent and in what manner values for other purposes may differ from values for rate-making purposes. Our present problem is to discover and apply the principles which must control in the ascertaining of a value for rate-making purposes."<sup>40</sup> All of the Commission's subsequent findings of single-sum value have been made and reported "for rate-making purposes."<sup>41</sup>

Whether viewed from the angle of the probable intent of Congress in the adoption of the valuation amendment or from that of the situation created by the enactment of the 1920 legislation, the Commission's decision to seek rate value rather than value for other purposes appears both sound and realistic. That the effective performance

<sup>40</sup> *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), at p. 507. See, also, *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645, 665-666 (1923); *Elgin, Joliet & Eastern Ry. Co.*, 84 I.C.C. 587, 611-612 (1924). In the latter proceeding, after referring to its determination in the *San Pedro* case, the Commission said: "For the same reasons the final values we shall state in this proceeding are values for rate-making purposes. . . . That is a value the act under which we administer the affairs of carriers engaged in interstate commerce authorizes us to determine, and it is the only kind of a value which we now deem it necessary to express in a single figure. As occasion arises for us to state single-sum values of the properties of these carriers in proceedings other than those involving the fixing of rates or the ascertainment of excess earnings, we shall do so, having recourse for that purpose to data contained in the record and our report and order in this proceeding and in proceedings supplementary hereto."

<sup>41</sup> See, for example, *Kansas City Southern Ry. Co.*, 84 I.C.C. 113, 116, 145 (1924); *Chicago, Terre Haute & Southeastern Ry. Co.*, 97 I.C.C. 535, 538 (1925); *Mammoth Cave R. R. Co.*, 103 I.C.C. 818, 823 (1925); *DeQueen & Eastern R. R. Co.*, 106 I.C.C. 714, 717 (1926); *Canadian Pacific Ry. Co.*, 108 I.C.C. 373, 379 (1926); *Tennessee, Alabama & Georgia R. R. Co.*, 110 I.C.C. 595, 599 (1926); *Chicago, Burlington & Quincy R. R. Co.*, 134 I.C.C. 1, 54 (1927). Since, under the Transportation Act, the rule for the adjustment of the rate level was essentially a rule for the regulation of earnings, and since the recapture clause was merely a provision for the disposition of earnings in excess of a stipulated return on the value, the Commission quite properly treated value for recapture as identical in composition and amount with value for rate making. *Excess Income of St. Louis & O'Fallon Ry. Co.*, 124 I.C.C. 3, 18 (1927); *Excess Income of Richmond, F. & P. R. Co.*, 170 I.C.C. 451 (1931); *Excess Income of Lake Term. R. Co.*, 175 I.C.C. 754 (1931); *Excess Income of Roscoe, S. & P. Ry. Co.*, 180 I.C.C. 383 (1932).

of the Commission's regulatory tasks required valuations suitable primarily for the control of carrier income is evident; and little serious difficulty is likely to be encountered in utilizing the results in other connections. The extensive record of underlying figures upon which the Commission's findings of rate value are based are available for use in the determination of values for other purposes; and even the final single-sum rate values possess the basic characteristics of all values likely to be utilized by the Commission—namely, that they are authoritative findings designed to serve the ends of regulation, rather than commercial values dependent primarily upon the operation of market forces. In any event, in seeking value for the specific purposes of rate control, the Commission has been enabled to pass intelligently and consistently upon all controversial issues of policy and method. Claims for the inclusion in the final figures of various proposed elements of value have been uniformly subjected to the criteria of their relevancy and suitability as constituent parts of a rate base; and it is in terms of their propriety in the ascertainment of value for rate-making purposes that the Commission's valuation standards and practices must be analyzed and appraised.

### §3. THE PRESSURE OF LEGISLATIVE REQUIREMENTS AND JUDICIAL DETERMINATIONS

In recent years the problem of valuation has called forth a large mass of intensive discussion, from varying points of view, by students of railroad and public utility control.<sup>42</sup> Much of this discussion has dealt with basic principles, in the light of economic analysis and

<sup>42</sup> Among the more important periodical contributions, the following may be noted: J. E. Allison, "Ethical and Economic Elements in Public Service Valuation," *Quarterly Journal of Economics*, vol. 27 (November, 1912), pp. 27-49; John Bauer, "Recent Decisions on Valuation and Rate Making," *American Economic Review*, vol. 14 (June, 1924), pp. 254-282; "Rate Base for Effective and Non-Speculative Railroad and Utility Regulation," *Journal of Political Economy*, vol. 34 (August, 1926), pp. 479-500; "Reproduction Cost and Desirable Public Utility Regulation," *Journal of Land and Public Utility Economics*, vol. 2 (October, 1926), pp. 408-426; Edward W. Bemis, "Going Value in Rate Cases," *Columbia Law Review*, vol. 27 (May, 1927), pp. 530-546; James C. Bonbright, "Progress and Poverty in Current Literature on Valuation," *Quarterly Journal of Economics*, vol. 40 (February, 1926), pp. 295-328; "Depreciation and Valuation for Rate Control," *Columbia Law Review*, vol. 27 (February, 1927), pp. 113-131; *Quarterly Journal of Economics*, vol. 41 (February, 1927), pp. 185-211; "The Problem of Judicial Valuation," *Columbia Law Review*, vol. 27 (May, 1927), pp. 493-552; "Railroad Valuation with Special Reference to the O'Fallon Decision," *American Eco-*

the demands of public policy, but with scant reference to specific statutory mandates or the requirements of judicial precedent. The federal valuation as such, because its status was long incomplete and tentative, has been largely ignored. Outside the official forum occupied by hearings and argument on protests, comparatively little has been written, except by way of illustration of general principles, con-

*conomic Review*, vol. 18 (March, 1928, Supplement), pp. 181-205, reprinted, with modifications, as "The Economic Merits of Original Cost and Reproduction Cost," *Harvard Law Review*, vol. 41 (March, 1928), pp. 593-622; H. B. Brown, "Defects in Mr. Justice Brandeis' Theory of Prudent Investment as a Rate Base," *California Law Review*, vol. 12 (May, 1924), pp. 283-301; H. G. Brown, "Railroad Valuation and Rate Regulation," *Journal of Political Economy*, vol. 33 (October, 1925), pp. 505-530, "Railroad Valuation Again: A Reply," *ibid.*, vol. 34 (August, 1926), pp. 500-508; John G. Buchanan, "The Ohio Valley Company Case and the Valuation of Railroads," *Harvard Law Review*, vol. 40 (June, 1927), pp. 1033-1076; J. M. Clark, "Railroad Valuation as a Working Tool," *Journal of Political Economy*, vol. 28 (April, 1920), pp. 265-306; Leslie Craven, "Railroad Valuation: A Statement of the Problem," *American Bar Association Journal*, vol. 9 (November, 1923), pp. 681-687; Frederic G. Dorety, "The Function of Reproduction Cost in Public Utility Valuation and Rate Making," *Harvard Law Review*, vol. 37 (December, 1923), pp. 173-200; Martin G. Glaeser, "A Focal Point of Conflict in Judicial Opinion on the Valuation of Public Utilities," *Journal of Land and Public Utility Economics*, vol. 1 (April, 1925), p. 250, "The Valuation Doctrine at the Crossroads," *ibid.*, vol. 3 (August, 1927), pp. 240-251; Edwin C. Goddard, "Fair Value of Public Utilities," *Michigan Law Review*, vol. 22 (May, 1924), pp. 652-672 (June, 1924), pp. 777-797, "The Evolution of Cost of Reproduction as the Rate Base," *Harvard Law Review*, vol. 41 (March, 1928), pp. 564-592; John H. Gray, "The Regulation of Public Service Corporations: The Vagaries of Valuation," *American Economic Review*, vol. 4 (March, 1914, Supplement), pp. 18-44; A. T. Hadley, "Principles and Methods of Rate Regulation," *Yale Review*, vol. 16 (April, 1927), pp. 417-432, "The Meaning of Valuation," *American Economic Review*, vol. 18 (March, 1928, Supplement), pp. 173-180; R. L. Hale, "The Supreme Court's Ambiguous Use of 'Value' in Rate Cases," *Columbia Law Review*, vol. 18 (March, 1918), pp. 208-229, "The 'Physical Value' Fallacy in Rate Cases," *Yale Law Journal*, vol. 30 (May, 1921), pp. 710-731; Gerard C. Henderson, "Railway Valuation and the Courts," *Harvard Law Review*, vol. 33 (May, 1920), pp. 902-928 (June, 1920), pp. 1031-1057; Ben W. Lewis, "Going Value and Rate Valuation," *Michigan Law Review*, vol. 26 (May, 1928), pp. 713-746; Nathan Matthews, "The Effect of the Recent Decisions of the Supreme Court on Reproduction Cost as a Test of Value," *Harvard Law Review*, vol. 37 (February, 1924), pp. 431-463; George O. May, "Carrier Property Consumed in Operation and the Regulation of Profits," *Quarterly Journal of Economics*, vol. 43 (February, 1929), pp. 193-220, and "Further Thoughts on Depreciation and the Rate Base," *ibid.*, vol. 44 (August, 1930), pp. 687-697; W. W. Potter, "Going Value," *Michigan Law Review*, vol. 24 (January, 1926), pp. 232-248; Donald R. Richberg, "A Permanent Basis for Rate Regulation," *Yale Law Journal*, vol. 31 (January, 1922), pp. 263-282, "The Supreme Court Discusses Value," *Harvard Law Review*, vol. 37 (January, 1924), pp. 287-300, "Value—By Judicial Fiat," *ibid.*, vol. 40 (February, 1927), pp. 567-582; G. H. Robinson, "Recent Cases on the Public Utility Rate Base: The 'Valuation' War," *Boston University Law Review*, vol. 8 (November, 1928), pp. 255-281; Henry Rottschaefer, "Valuation in Rate Cases," *Minnesota Law Review*, vol. 9 (February, 1925), pp. 211-239; George G. Tunell,

cerning the standards and practices employed by the Interstate Commerce Commission in the execution of its valuation task.<sup>48</sup> While the bulk of valuation literature, therefore, has contributed substantially toward minimizing the confusion of thought that has enveloped prevailing valuation doctrine, it throws little light, at least directly, upon the degree of intelligence, resourcefulness, soundness, and effectiveness with which the Commission, as an administrative tribunal, has functioned in this important field. A fruitful appraisal of the Commission's valuation work must be approached in terms of its specific undertaking. That undertaking cannot be treated *in vacuo*—divorced from the legislation which both conferred power and imposed fetters upon the Commission, and from the course of judicial decisions which of necessity established the legal background conditioning its standards of performance. The main channels of its task were carved out by express statutory enactment, with the courts enunciating more or less controlling valuation doctrines in analogous situations. Moreover, no mere exercise in academic speculation was assigned to the Commission; it was charged with a severely practical task, of great significance to the entire regulative process and of almost overwhelming difficulty. The conduct of the investigation has been so

"Value for Rate Making and Recapture of Excess Income," *Journal of Political Economy*, vol. 35 (December, 1927), pp. 725-775, *ibid.*, vol. 36 (February, 1928), pp. 100-140; Allyn A. Young, "Depreciation and Rate Control," *Quarterly Journal of Economics*, vol. 28 (August, 1914), pp. 630-663. The following are some of the more important books and monographs devoted entirely or predominantly to the problem of valuation: John Bauer, *Effective Regulation of Public Utilities* (1925); H. Floy, *Valuation of Public Utility Properties* (1912), *Value for Rate Making* (1916); C. E. Grunsky, *Valuation, Depreciation, and the Rate Base* (1917); R. L. Hale, *Valuation and Rate Making* (1918); H. H. Hartman, *Fair Value* (1920); R. V. Hayes, *Public Utilities, Cost New and Depreciation* (1913), *Public Utilities, Fair Present Value and Return* (1915); W. H. Maltbie, *Theory and Practice of Public Utility Valuation* (1924); H. E. Riggs, *Depreciation and Its Relation to Fair Value and Changes in the Level of Prices* (1922); H. B. Vanderblue, *Railroad Valuation* (1917). The standard work is R. H. Whitten, *Valuation of Public Service Corporations* (2d ed., 1928, revised by D. F. Wilcox).

<sup>48</sup> H. B. Vanderblue, "Railroad Valuation by the Interstate Commerce Commission," *Quarterly Journal of Economics*, vol. 34 (November, 1919), pp. 22-87, *ibid.* (February, 1920), pp. 260-299, reprinted as a monograph, provides an excellent analysis and appraisal of the Commission's underlying standards and practices. It was published, however, before any of the Commission's final value reports had been issued. The more recent discussions, particularly since the Commission issued its report in *Excess Income of St. Louis & O'Fallon Ry. Co.*, 124 I.C.C. 3 (1927), deal more directly with the federal valuation. See, for example, articles by James C. Bonbright, Edwin C. Goddard, and George G. Tunell, *supra*.



molded, therefore, as not only to meet the demands of practical complications and satisfy the requirements of workable regulatory policy, but also, as a basic factor, to conform, as far as may be, to the alternately strict and loose provisions of a statute constituting a peculiar combination of reticence and effusiveness, and to what has been deemed to be the general tenor of the mass of judicial determinations touching upon the principles and methods of railroad and public utility valuation. Under these circumstances, mere *a priori* reasoning, however valid and enlightening, does not provide an adequate basis for a just critique of the Commission's valuation project.<sup>44</sup>

The Valuation Act may most fittingly be characterized as a statutory replica of the famous pronouncement in *Smyth v. Ames*.<sup>45</sup> The opinion in that case, however troublesome it may have proved in subsequent years, was expressive of two influences which were properly powerful under the conditions there prevailing: first, the recognition that the function of the judiciary is confined to laying down a negative rather than an affirmative rule of rate-making; and second, the natural and commendable hesitancy of a tribunal faced with a then novel problem to formulate a solution in rigidly dogmatic terms. Accordingly, it was held that the courts would deem confiscatory any set of rates which would not permit the carrier to earn a fair return on the fair value of its property; and as a guide for the ascertainment of "fair value," various factors, differing in relevancy and divergent in outcome, were enumerated, without indication as to the relative weight to be accorded to each in the determination of the ultimately operative figure. The factors held by the Court to be matters for consideration included "the original cost of construction, the amount

<sup>44</sup> Compare the following: "In dealing with the problem of railroad valuation, even economists can no longer confine themselves to academic theorizing. For almost fifteen years the Interstate Commerce Commission has been pursuing its laborious and costly task of ascertaining the value of American railroads for rate-making purposes. This task is now approaching completion. The rule of rate-making and the recapture clause of the Transportation Act have imposed upon the Commission the duty of making specific uses of its results. The O'Fallon Case has brought to issue the legal validity of some of the outstanding principles and practices it has employed. The general wisdom and expediency of the Commission's work in this sphere is in the balance, therefore, particularly in its bearing upon the maintenance of a sound policy of rate regulation." I. L. Sharfman, "Valuation of Public Utilities," *American Economic Review*, vol. 18 (March, 1928, Supplement), pp. 208-209.

<sup>45</sup> 169 U.S. 466 (1898).

expended in permanent improvements, the amount and market value of its bonds and stock, the present as compared with the original cost of construction, the probable earning capacity of the property under particular rates prescribed by statute, and the sum required to meet operating expenses." These elements were to be given such weight "as may be just and right in each case," and, by way of foreclosing all possibility of narrow interpretation, the Court added: "We do not say that there may not be other matters to be regarded in estimating the value of the property."<sup>46</sup> Save as these pronouncements necessarily imply the exercise of a wide discretion with respect to the influence to be accorded to the varied and conflicting elements expressly enumerated, they clearly provide no "rule" for the guidance of an administrative tribunal in establishing a value base upon which a structure of rates may be erected.<sup>47</sup> But the problem which faced a hesitant court in *Smyth v. Ames*, when the judiciary was feeling its way toward establishing a test of confiscation and when the subject of valuation was in its infancy, was quite different from the problem with which Congress had to deal some fifteen years later. In the interim, the need of an explicit legislative enunciation of policy was becoming increasingly urgent.<sup>48</sup> Definite standards were imperative

<sup>46</sup> *Ibid.*, pp. 546, 547.

<sup>47</sup> See Part I, chap. ii, notes 4 and 5.

<sup>48</sup> Compare, for example, the following characterization of the difficulties of rate control under the inconclusive doctrine of *Smyth v. Ames*: "The concepts of 'fair value' and 'fair return' were being laboriously developed by courts and commissions through private litigation, while the law-making bodies refrained from enunciating the concrete principles and standards which alone could render public policy in rate regulation reasonably definite and effective. The Interstate Commerce Commission was saddled with the responsibility of fashioning these standards as well as of applying them; yet the doctrine of confiscation, necessarily enforced by the courts with a very measurable degree of flexibility, subjected its orders to the uncertainties and vicissitudes of judicial review. The policy of the commission, even when positive in tone and constructive in content, was but a preliminary and 'advisory' expression of the principles of fair value and fair return that should govern; the final determinations of the courts (because rate-making, in spite of these difficulties, is admittedly a legislative and not a judicial function), were inevitably negative in character. The situation was chaotic. The limitations upon private profit in railroad enterprise were vague and undefined; the minimum return of which capital could not be legitimately deprived was concretely ascertainable only after prolonged litigation." I. L. Sharfman, *The American Railroad Problem* (1921), pp. 57-58. For a many-sided and stimulating discussion of the entire valuation problem, see Proceedings of the Conference on Valuation (held in Philadelphia, November 10 to 13, 1915, under the auspices of the Utilities Bureau), *The Utilities Magazine*, vol. 1 (January, 1916), no. 3, pp. 1-222. On the need of a

as a means of dispelling the perplexing uncertainty which had developed during the preceding decade. An affirmative rule of rate-making was essential, necessitating as an integral part of such rule, a definition of value for rate-making purposes. The performance of this task is unquestionably a legislative function.<sup>49</sup> In the federal sphere, Congress, as the supreme rate-regulating authority, was

legislative rule of valuation, see especially G. W. Anderson, "How to Get Rid of the Reproduction Cost Theory," *ibid.*, pp. 28-36. His position was summarized as follows: "(1) Rate making is a legislative and not a judicial function. This is still asserted by the Supreme Court notwithstanding its contrary practice; and the decisions of that court furnish good ground to believe that the court would welcome an opportunity to be relegated to the performance of judicial functions only. (2) The interference of the courts is solely for the purpose of preventing confiscation,—to prohibit the states from depriving security holders of their property rights without due process of law. (3) In dealing with alleged confiscatory legislation, the courts asserted the fair value basis of rates because the legislatures had failed to provide any basis at all. (4) 'Fair value as a basis,' proving in practice a meaningless euphemism, has laid a specious and plausible foundation for the reproduction cost theory. (5) Now if these propositions are sound, the way to get rid of the reproduction cost theory is for the legislatures to finish their incomplete undertaking of rate making,—that is, declare a basis upon which the aggregate net return shall be computed" (pp. 30-31).

<sup>49</sup> For an examination of legislative responsibility in the matter of valuation, see John Bauer, *Effective Regulation of Public Utilities* (1925), pp. 47-63. "Rate regulation has been recognized as a purely legislative matter. This has been emphasized again and again in court decisions. The general principle is clear that the fixing of rates is a legislative act beyond the control of the courts, except in so far as the rates may result in confiscation, or taking property without due process of law. But if rate making is a purely legislative function, it necessarily extends to the establishment of all the policies, principles, processes and machinery by which rates may be determined. Specifically, it demands from the legislatures, or the authorities with delegated powers, to determine what factors are to be included in rate making, how each factor shall be treated, as well as how the facts shall be determined for the purpose. There is frequently a misunderstanding as to just where the function of the legislature ends and that of the court begins. The view prevails, often unconsciously, that valuation as a part or process of rate making is within the province of judicial decision. But as it is merely a step in the course of rate making, it cannot be differentiated from rate making itself. The step is an integral part of the whole; it is in essence therefore a legislative prerogative, just as rate making as a whole is legislative in character. The legislatures, or the commissions with adequate powers delegated by the legislatures, should determine the basis of valuation and what rate of return is to be allowed. Proper rates manifestly cannot be fixed until these two factors are determined." *Ibid.*, pp. 48-50. Compare, also, the following from Alfred Bettman, "Constitutionality of Historical Cost Method of Public Utility Valuation," *The Utilities Magazine*, vol. 1 (January, 1916), pp. 46-51, at p. 51: "As long as rate regulation is admitted to be a legislative function the question before the Court, when the constitutionality of a rate based on a valuation is attacked, is not what is the correct valuation, but whether the particular theory or method of valuation used by the rate regulating body can be called so capricious, so arbitrary, so lacking in reasoned principle or so necessarily confiscatory as to unquestionably violate the prohibitions of the Fifth and Fourteenth Amendments."

looked to as the necessary source of relief; but the answer of Congress, in the form of the Valuation Act of 1913, was no more conclusive than the judicial dicta of *Smyth v. Ames*. The national legislature assumed responsibility to the extent of ordering a valuation to be made and of specifying the ascertainment of various elements of value; it continued to shift responsibility in so far as it failed to establish any controlling standard of valuation. The Commission was directed, as we have seen, to ascertain and report original costs, costs of reproduction new, costs of reproduction less depreciation, original cost and present value of lands, and such other values or elements of value as it might find, together with detailed historical and financial data reflecting the experience of the carrier corporations; but it was left entirely without guidance as to standards or principles or policies by which these basic findings were to be combined into single-sum values for rate-making purposes. As to the major problem of providing legislative tests of value, the contribution of Congress in the Valuation Act has been characterized as consisting of "nothing more than some question-begging phrases."<sup>50</sup> Nor did the Transportation Act of 1920 clarify the situation. While it specified various purposes for which the results of the Commission's valuations were to be employed, such additional directions as it contained for the finding of value were as vague and indefinite as the original instructions. The rule of rate-making, for example, expressly ordered the Commission to fix such rates as would yield a fair return on the value of the property of the carriers as a whole or in rate-making groups. But there was no definition of value. The Commission was to utilize, as far as available, its findings under the Valuation Act, and, in addition, was to give "due consideration to all the elements of value recognized by the law of the land for rate-making purposes."<sup>51</sup> The latter provision, supplementing the specific requirements of the valuation amendment, is distinctly reminiscent of the blanket stipulation of

<sup>50</sup> F. W. Taussig, *Principles of Economics* (third edition revised, 1921), vol. 2, p. 439. Commissioner Charles A. Prouty, after serving as Director of Valuation for a period of four years, spoke as follows of the Valuation Act: "I would rather undertake to recite the Chinese alphabet backward than read the thing anyway, because it does not mean anything after you have read it." Hearings, *Texas Midland* case, March, 1917, p. 674.

<sup>51</sup> Sec. 15a, par. (4).

*Smyth v. Ames*, supplementing, by way of full measure, the Supreme Court's enumeration of concrete elements of value.

It is by no means certain, however, that the demand for positive and explicit standards of rate valuation was met less effectively through these statutory requirements than it would have been through provisions designed to shift either all or none of the responsibility to the shoulders of an administrative tribunal. The need of a legislative definition of policy was urgent, but it required sound and intelligent and realistic fulfilment more than immediate satisfaction. By enumerating in detail the various elements of value on which the Commission was to report specific findings, Congress made certain that every factor for which claims for consideration were likely to be presented would be officially taken into account.<sup>52</sup> The Commission's findings of value were to be based upon the totality of the situation; its conclusions were not to be declared defective because of any mere failure to "consider" a sufficiently extensive array of elements. But, by refraining from indicating the relative weight to be accorded to the various elements of value, Congress apparently placed in the hands of the Commission, without express restriction, the right to judge and determine the matter of controlling principles, which constituted the central point and purpose of the entire investigation. Such a delegation of legislative authority but reflected faith in the appropriateness of the administrative method under the prevailing circumstances. The task of arriving at controlling standards of valuation, for existing properties as well as for future acquisitions, necessitated detailed study and analysis of highly complicated situations by technically qualified experts, and it involved judgments thereon by men acquainted with the history and status of the railroads and experienced in the objects and processes of railroad regulation. That the Commission was better fitted for the performance of such a task than the Congress can scarcely be questioned. A definite and reasonably stable rate base is indispensable to effective regulation; but it is equally essential that the established rate base constitute an equitable,

<sup>52</sup> It was admittedly the purpose of the late Senator Robert M. LaFollette, who was largely responsible for the passage of the bill, to secure a report on all elements of value for which reputable claims were likely to be set up, regardless of his own opinion as to their suitability in a valuation for rate-making purposes. See, for example, *Congressional Record*, vol. 49 (February 24, 1913), p. 3797.

realistic, and practicable adjustment of private rights and public interests. The seemingly uncharted discretion vested in the Commission, therefore, may well have served as a necessary preliminary to the ultimate enunciation of positive policy. Whatever valuation standard may finally prevail, and whether it is achieved through judicial determination or through express legislative enactment, the independent study and deliberation of the Commission will have contributed immeasurably to the richness of its content and the significance of its use.

It appears, then, that although the Commission was required by statute to engage in minute research on a large number of specifically designated matters and to prepare reports thereon, it found itself singularly free from legislative direction or restraint with respect to the crowning phase of its task—the formulation of a standard of fair value for rate-making purposes and the ascertainment of single-sum values in terms thereof. None the less, even on this aspect of its labors the Commission has not been entirely without guidance or control. At the very point where Congress cast upon the Commission the greatest freedom and responsibility the voice of the judiciary has been most outspoken. The Commission took up the reins of valuation some fifteen years after the pronouncement of the United States Supreme Court in *Smyth v. Ames*, and its first final value reports were not issued till more than ten years later.<sup>68</sup> During this period of a quarter of a century, the courts of the country had made numerous determinations involving railroad, and particularly public utility, valuations.<sup>64</sup> A few clear-cut principles emerged: that the value to be ascertained is that prevailing at the time of the inquiry; that the ascertainment of such value is not a matter of rule or formula, but is dependent upon the exercise of reasonable judgment; that in the

<sup>68</sup> *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (June 7, 1923); *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645 (July 20, 1923).

<sup>64</sup> Among the more important Supreme Court decisions, the following may be noted: *Willcox v. Consolidated Gas Co.*, 212 U.S. 19 (1909); *Minnesota Rate Cases*, 230 U.S. 352 (1913); *Galveston Elec. Co. v. Galveston*, 258 U.S. 388 (1922); *Newton v. Consolidated Gas Co.*, 258 U.S. 165 (1922); *S. W. Tel. Co. v. Pub. Serv. Comm.*, 262 U.S. 276 (1923); *Georgia Ry. v. R. R. Comm.*, 262 U.S. 625 (1923); *Bluefield Co. v. Pub. Serv. Comm.*, 262 U.S. 679 (1923). The most significant later decisions bearing upon the validity of the Commission's valuation methods are *McCardle v. Indianapolis Co.*, 272 U.S. 400 (1926), and *St. L. & O'Fallon R. Co. v. U.S.*, 279 U.S. 461 (1929).

exercise of such judgment due consideration must be given to all relevant facts. Among the "matters for consideration" stipulated in *Smyth v. Ames*—and hence constituting relevant facts—were not only "the original cost of construction" and "the amount expended in permanent improvements," which might measure the actual cost of the properties, but also "the present as compared with the original cost of construction," which, in more recent terminology, might measure the cost of reproducing the properties. With the gradual rise of the price level beginning in the late nineties and with the extraordinary upturn of prices accompanying the period of the Great War, increasing pressure was exerted by the utilities toward the adoption of the cost of reproduction theory of valuation. In the railroad field, in connection with the Commission's federal valuation, this movement culminated in insistence upon the acceptance of "cost of reproduction new at current prices to the exclusion of everything else, or at least of everything that might tend to a lower value," as the basic measure of "fair value."<sup>55</sup> In the struggle of the courts with numerous valuation issues, this problem of the weight to be accorded to changes in the level of prices came to occupy a central position, with an undoubted tendency toward the judicial recognition of the cost of reproduction doctrine.<sup>56</sup> But the judicial determinations, and particularly those of the Supreme Court, have by no means been decisive in character. Upon a proper differentiation between the decisions as such and the mere dicta contained in the opinions, there has appeared to be much wavering between the requirement that reproduction costs be taken into consideration among the various relevant facts constituting evidence of value, that they actually be accorded some weight in the findings of value, and that they be recognized as the controlling standard or substantial equivalent of value in the establishment of the rate base.<sup>57</sup> While much of what has been said

<sup>55</sup> *Excess Income of St. Louis & O'Fallon Ry. Co.*, 124 I.C.C. 3, 28 (1927).

<sup>56</sup> See Edwin C. Goddard, "The Evolution of Cost of Reproduction as the Rate Base," *Harvard Law Review*, vol. 41 (March, 1928), pp. 564-592.

<sup>57</sup> The question as to the legal status of the reproduction cost theory was brought to a head during the post-war period of high prices in the *Southwestern Bell*, *Bluefield*, *Georgia Power*, *McCardle*, and *O'Fallon* cases. In the *Southwestern Bell* case the Supreme Court held the telephone rates at issue to be invalid. The apparent ground of the decision was the failure of the Missouri commission to give actual weight to the greatly enhanced prices of labor, material, and supplies over those prevailing in the

by the courts, on this and other issues, has been either irrelevant or indefinite and confusing, the judicial determinations, largely in the field of local utilities, have been of such volume and of such origin that they could not well be overlooked or thrust aside. Court decisions and judicial opinions have necessarily exerted a substantial influence upon the Commission's valuation processes.

It must not be inferred, however, that the Commission has bowed meekly to every positive direction or negative limitation imposed upon it by statutory requirements and judicial determinations. On the basis of the broad discretionary authority which inheres in an admin-

pre-war years. The requirement seems to have been established that reproduction costs must not only be considered but that some actual allowance for enhanced prices must be made in the findings of value. It is noteworthy, however, that Justice Brandeis, with whom Justice Holmes joined, concurred in the result, although, in a separate expression, he presented the now classical case for the adoption of "prudent investment" as the rate base. In the *Bluefield* case the water rates involved were likewise declared to be confiscatory, on substantially the same grounds as those that had been controlling, with the majority of the Court, in the earlier proceeding. But it is noteworthy, once more, that Justice Brandeis and Justice Holmes were again able to concur in the result, referring to the separate opinion in the *Southwestern Bell* case by way of explanation. In the *Georgia Power* case, which was decided the same day as the *Bluefield* case, the gas rates under attack were upheld by the Supreme Court. The opinion was delivered by Justice Brandeis. He noted that the Georgia commission had given careful consideration to cost of reproduction but had refused to adopt it as the measure of value, and he concluded unequivocally that this refusal was "clearly correct." Justice McKenna dissented, however, on the ground that the majority view contradicted the principles laid down in the *Southwestern Bell* case, holding that "the contrariety of decision cannot be reconciled." Much doubt was created as to the meaning and significance of these three decisions, and numerous conflicting interpretations were placed upon them. See, for example, John Bauer, "Recent Decisions by the Supreme Court of the United States on Valuation and Rate Making," *American Economic Review*, vol. 14 (June, 1924), pp. 254-282, including comments by Robert L. Hale, Donald R. Richberg, and William L. Ransom; Frederic G. Dorety, "The Function of Reproduction Cost in Public Utility Valuation and Rate Making," *Harvard Law Review*, vol. 37 (December, 1923), pp. 173-200; Donald R. Richberg, "The Supreme Court Discusses Value," *ibid.* (January, 1924), pp. 287-300; Nathan Matthews, "The Effect of the Recent Decisions of the Supreme Court on Reproduction Cost as a Test of Value," *ibid.* (February, 1924), pp. 431-463. Perhaps the following is the most clearly justified negative interpretation of these decisions: "If these three cases settled that there must be not only consideration of, but also actual allowance for, cost of reproduction at present prices, they certainly did not decide that cost of reproduction was value, nor did they determine how much weight must be given to that element." Edwin C. Goddard, *op. cit.* (note 56), at p. 569. Under these circumstances, the decision in the *McCardle* case but added further confusion to the situation. In affirming the decree of the lower court holding the water rates involved to be confiscatory, the Supreme Court appeared to have accepted reproduction cost at spot prices as the equivalent of value. Justice Butler, who delivered the opinion of the Court, said (272 U.S., at p. 411): "Undoubtedly, the reasonable cost of a system of waterworks, well-planned and efficient for the public



istrative tribunal, it has asserted a considerable measure of independence in both respects. We have already seen that in its decision to report single-sum values, and to report them for purposes of rate making, the Commission journeyed beyond the precise letter of the Valuation Act. In the pages following we shall see the same tendency manifesting itself with reference to other features of the project—and accompanied by a tendency moving in the opposite direction: an occasional refusal to make and report findings explicitly or implicitly called for by the wording of the statute. Thus, for example, we shall

service, is good evidence of its value at the time of construction. And such actual cost will continue fairly well to measure the amount to be attributed to the physical elements of the property so long as there is no change in the level of applicable prices. And, as indicated by the report of the commission, it is true that, if the tendency or trend of prices is not definitely upward or downward and it does not appear probable that there will be a substantial change of prices, then the present value of lands plus the present cost of constructing the plant, less depreciation, if any, is a fair measure of the value of the physical elements of the property." The issue, it must be noted, was not as to the relative merits of "fair value" or "prudent investment" as the measure of the rate base; it was solely a question as to what constitutes a lawful measure of "fair value." In his dissent, with which Justice Stone joined, Justice Brandeis disclosed concretely the nature of the issue (*ibid.*, at pp. 421-422): "The Commission and the lower court likewise agreed that reproduction cost was evidence as to value. The primary questions on which they differed are these. Is a finding of reproduction cost tantamount to a finding of value? Is the reproduction cost which should be ascertained by the tribunal, the 'spot' reproduction cost—that is, cost at prices prevailing at the time of the hearing? The District Court . . . answered both of these questions in the affirmative. The learned judge assumed that spot reproduction cost is the legal equivalent of value. He found that \$19,000,000 was, on the evidence, the lowest conceivable spot reproduction cost. He assumed that, since the utility was willing to accept this minimum as reproduction cost, no amount less than that could be found by him to be the value, or rate base. He believed that recent decisions of this Court required him so to hold. In this belief he was clearly in error." If this analysis is correct, then the affirmance of the lower court's decree was not only a marked extension of the Supreme Court's acceptance of the reproduction cost doctrine, but constituted a virtual repudiation of the doctrine of *Smyth v. Ames* and the numerous cases following it. If reproduction cost is conclusive evidence of value, the consideration of all relevant facts, and the exercise of reasonable judgment thereon, become meaningless. But since the Court evidenced no apparent intent to reverse its position, and since Justice Holmes, although generally in agreement with the views of Justice Brandeis in valuation controversies, was able to concur in the result, there was much speculation as to the general significance of the decision, and particularly as to its relationship to the principles and practices employed by the Interstate Commerce Commission in its federal valuation of railroads. That the Commission might not meet the requirements of the law by the simple expedient of "considering" reproduction cost, without according it substantial weight, was indicated by the Court in the *O'Fallon* case; but that reproduction cost need not be accepted as the invariable equivalent of value was also clearly stated. What weight it should receive, or even whether that weight should ordinarily be the dominant factor, the Court refrained from determining.

note the Commission's decision, in the face of protest, to report the "restated investment" of the carriers, for consideration as evidence of fair value, without the support of an express statutory mandate; its refusal to report original cost to date, except in those cases where such cost could be exactly determined from authentic and accurate records; its failure to report separately on "other values and elements of value"; its noncompliance with the command of the statute to find and report as to carrier lands the "present cost of acquisition and damages, or of purchase, in excess of present value."<sup>58</sup> Similarly, the Commission has never assumed that its sole function is to promulgate and apply valuation pronouncements made by the courts. While it has felt constrained to follow the courts in certain important directions—notably, for example, in the adoption of the "judgment" method for ascertaining single-sum values<sup>59</sup> and of the "market value" test for the valuation of lands<sup>60</sup>—many of the instances in

<sup>58</sup> Here the Commission felt constrained to choose between the positive requirement of the Valuation Act and the ruling of the Supreme Court in the *Minnesota Rate Cases*, 230 U.S. 352, 452 (1913), condemning the use of multipliers in land valuations, which it construed to be contrary to the purport of the statute. In deciding to act in conformity with what it deemed to be the Court's position, then, the Commission was displaying at once an attitude of independence and of subservience, although it is perhaps only fair to interpret its action as one of reaching an independent conclusion and then using the Court's decision by way of support. Unfortunately, however, at least as far as immediate results were concerned, the Commission's construction of the ruling in the *Minnesota Rate Cases* was held by the Supreme Court to be erroneous, and the Commission was ordered to make the findings which it had declared impossible to make. *Kansas City So. Ry. v. I.C.C.*, 252 U.S. 178 (1920). By the Act of June 7, 1922 (42 Stat. 624), the Commission was relieved of this task.

<sup>59</sup> In emphasizing, throughout, that its final valuations are not the result of "rule" or "formula," the Commission has been clearly leaning, not only upon the injunction of *Smyth v. Ames* as reflected in the omission of positive guidance in the Valuation Act, but upon the famous pronouncement of Justice Hughes in the *Minnesota Rate Cases*, 230 U.S. 352 (1913), at p. 434: "The ascertainment of that value is not controlled by artificial rules. It is not a matter of formulas, but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts."

<sup>60</sup> In accepting "market value" as the proper basis for the valuation of carrier lands, the Commission has been expressly applying the following dictum of Justice Hughes in the *Minnesota Rate Cases*, 230 U.S., at p. 455: "Assuming that the company is entitled to a reasonable share in the general prosperity of the communities which it serves, and thus to attribute to its property an increase in value, still the increase so allowed, apart from any improvements it may make, cannot properly extend beyond the fair average of the normal market value of land in the vicinity having a similar character. . . . The company would certainly have no ground of complaint if it were allowed a value for these lands equal to the fair average market value of similar land in the vicinity, without additions by the use of multipliers, or otherwise, to cover

which judicial opinions have been quoted by the Commission prove, on examination, to be matters upon which there is little or no difference of view, or upon which the Commission has reached independent conclusions and has then fortified them by the citation of authority.

Moreover, with reference to the most outstanding of the valuation issues—as to the weight to be accorded to reproduction costs in the ascertainment of single-sum values—the Commission initially asserted a measure of independence from judicial control fully in keeping with its position as an expert administrative body dealing with a matter peculiarly within its own sphere. In the *O'Fallon* case,<sup>61</sup> involving a valuation for recapture purposes, the Commission not only declined to recognize cost of reproduction at current prices as the controlling element of value, but it applied instead a modified investment standard—combining a basic valuation at 1914 unit prices of the elements of the property then in existence, with substantially the actual net cost of capital additions made thereafter. In bringing the 1914 valuation down to date for each of the recapture periods no allowance was made for enhanced prices, and this procedure appeared on its face to constitute a departure from the principles to which the Supreme Court had given approval in its most recent decisions. In any event, the Commission found it necessary to reconcile its findings with judicial precedents. Four of the commissioners dissented, and they were agreed that the Commission had exceeded its authority under the law.<sup>62</sup> The majority of the Commission, on the other hand, proceeded on the assumption that the issue, as applied to the railroads

hypothetical outlays." It should be noted that this pronouncement was only a dictum, and that even as a dictum it was merely hypothetical. What the Court did was to condemn the use of multipliers; it did not set up any positive principles of land valuation.

<sup>61</sup> *Excess Income of St. Louis & O'Fallon Ry. Co.*, 124 I.C.C. 3 (1927).

<sup>62</sup> Commissioner Hall, in an opinion in which Commissioners Aitchison, Woodlock, and Taylor joined, stated the dissenting view on purely legal grounds: "At the risk of appearing to lack vision," he began, "we venture the reminder that the function of this commission is not to act as an arbiter in economics, but as an agency of Congress, to apply the law of the land to facts developed of record in matters committed by Congress to our jurisdiction. We may, indeed, in our annual reports to that body recommend needed changes in legislation, but we may not make those changes ourselves. This dissent is from the refusal of the majority to apply that law to the *O'Fallon*" (*ibid.*, pp. 59-60). The substantive reasons for this conclusion were summarized as follows: "From first to last, from *Smyth v. Ames* . . . decided in 1898, to *McCardle v. Indianapolis Water Co.* . . . decided November 22, 1926, 'the present as compared

as a whole, was a novel one, and that "in important aspects" it had "never before been presented to either a commission or a court."<sup>63</sup> Speaking for the majority, Commissioner Meyer said: "Commissions and courts, including the Supreme Court of the United States, have had to deal with a multitude of valuation cases, relating for the most part to local utilities—water, gas, electric and power properties. From a composite of all these cases various principles of valuation, frequently standing in striking contrast to one another, have been evolved by interested parties according as their interest lies. . . . Our problem in the administration of the valuation and recapture provisions is national in its scope and in its consequences, and is affected by a vast variety of considerations that either do not enter into, or are less easily perceived in, problems incident to the regulation of local public utilities. Limitations of issues, facts, or viewpoint impair many of the precedents which we are asked to follow by routes as divergent as the interests of those who make the requests."<sup>64</sup> Commissioner Eastman, in a special concurring opinion in which he was joined by Commissioner McManamy, went much further. He not only denied that the Commission was disregarding established prin-

with the original cost of construction' has been named, continuously and consistently, in various forms of expression, as among the relevant facts to all of which proper consideration must be given and to each of which such weight is to be given as may be just and right in each case. The more recent decisions of the Supreme Court seem to require that, as to previously constructed property devoted to public service, the enhanced-cost basis should be given an effectual weight. . . . It follows that, under the law of the land, in determining the value of the O'Fallon for any of the purposes contemplated by either section 19a or section 15a . . . we must accord weight in the legal sense to the greatly enhanced costs of material, labor, and supplies during the periods of inquiry, here the recapture years, over those prevailing in the pricing period. The majority in according no weight to such evidence disregard highly relevant facts, established by competent testimony and undisputed" (p. 62). Commissioner Aitchison, in a separate expression, explicitly confined his agreement with this dissent to legal grounds. He said (p. 64): "In much that is stated by the majority as to the effect of the valuation rule contended for by the carriers, I unreservedly concur. . . . But this is not the appropriate place to discuss the economic and political results of the enforcement of a rule laid down by the Supreme Court. Our present duty is to ascertain the rule of law and to enforce it. If we anticipate grave results will follow, our responsibility will be fully met if we suggest to the Congress, under our statutory powers to recommend new legislation to that body, the enactment of a rule for rate making under the commerce clause which will have no such unfavorable effects." Commissioners Woodlock and Taylor also expressed separate dissents on economic grounds (*ibid.*, pp. 64-66, 66-69).

<sup>63</sup> *Ibid.*, pp. 26-27.

<sup>64</sup> *Ibid.*, p. 27.

principles of law,<sup>65</sup> but he contended that even if the Supreme Court had already expressed itself with apparent finality, the Commission was not thereby estopped from throwing the weight of its influence against the claims of the carriers, when deemed to be fraught with grave consequences to the public welfare, in an effort to induce the Court to alter its position.<sup>66</sup> The fundamental problem was conceived as one in public policy, on which conclusions might properly shift with the passage of time, changes in conditions, and the growth of enlightenment. "Where public policy is the issue, law is not a matter of dogmas nor should reasoning be confined to deductions from past judicial utterances."<sup>67</sup> Knowledge and experience are indispensable under such circumstances. The Commission is presumed to possess such knowledge and experience. It is its function, therefore,

<sup>65</sup> "The court, as I read its decisions, has very wisely avoided a crystallization of the law with respect to the limits set by the Constitution to the public regulation of undertakings affected with a public interest. There is no controlling decision under the statute which here governs our action, nor any other decision which can fairly be regarded as conclusive of the vital issue in this case." *Ibid.*, pp. 49-50.

<sup>66</sup> The Supreme Court had reversed itself in the past in this very field of railroad regulation, notably by the establishment of the doctrine of judicial review, after it had previously declared rate making to be a matter solely of legislative discretion. Compare *Munn v. Illinois*, 94 U.S. 113 (1876) and *Peik v. Chicago & Northwestern Ry. Co.*, 94 U.S. 164 (1876), with *Stone v. Farmers' Loan & Trust Co.*, 116 U.S. 307 (1886) and *Chicago, Milwaukee & St. Paul Ry. Co. v. Minnesota*, 134 U.S. 418 (1890). For numerous other illustrations of an unwillingness on the part of the railroads and utilities to submit to established doctrines, see Edwin C. Goddard, *op. cit.* (note 56), at pp. 575-579. Moreover, the contentions of the railroads in the *O'Fallon* case involved a virtual repudiation of *Smyth v. Ames*, in that they argued "that 'original cost of construction,' the first matter enumerated in *Smyth v. Ames* for consideration in determining 'fair value,' should be wholly ignored." "Should a public body be less zealous in defense of the public interest," queried Commissioner Eastman, "than private bodies in defense of private interests?" His own position was clear: "I cannot avoid the conclusion that the commission would be derelict in its duty in this case if it should confine its attention, so far as the fundamental law is concerned, to past utterances of the court in more or less analogous cases and should neglect the illumination which is thrown upon the law by its own intimate knowledge of transportation affairs and problems." 124 I.C.C., at p. 51.

<sup>67</sup> *Ibid.*, p. 50. His amplification of this view is in accord with a forward-looking conception of judicial process: "It is here our duty to ascertain fair value for rate-making purposes. Such fair value is a concept which originated in an effort of the court to set limits to public regulation which would protect private property against confiscation. The constitutional necessity for such limits has its basis, so far as the States are concerned, in the 'due-process' clause of the fourteenth amendment and, so far as the Federal Government is concerned, in the similar provisions of the fifth amendment. Every candid person who has studied the 'due-process' clause and the many cases where it has been successfully or unsuccessfully invoked will concede that it offers wide scope for judicial interpretation, that in the process of interpretation the court is, and of

which must not be abdicated, to reach independent conclusions as a body of experts occupying with respect to these matters "a daily front seat upon the stage," and to impart these conclusions to the Court, which "of necessity is only an occasional visitor in the balcony."<sup>68</sup> Without considering, at this point, the substantive merits of the conflicting principles of "value-determination" involved in this proceeding, one cannot escape the conclusion that the majority view, as expressed by both Commissioner Meyer and Commissioner Eastman, was in accord with the best tradition of independent administrative tribunals and held out the most fertile promise of significant achievement.

On the whole, then, as will appear more fully in subsequent pages, the Commission was called upon to steer a very difficult course through a network of mandates, restrictions, and suggestions, interspersed with spaces left clear for the unhampered exercise of discretion. It is against a background which embodies all of these factors that the Commission's valuation work must be thrown if anything approaching a reasonable appraisal of the project is to be had.

#### §4. THE ASCERTAINMENT OF THE UNDERLYING FIGURES

The Commission's valuation work involves two logically separable tasks: the ascertainment of the underlying figures, and the determi-

necessity must be, guided largely by its conception of what is inherently just and consistent with a sound public policy, and that such conception is not a constant but a variable quantity dependent upon the political and economic views, habits of thought, extent of knowledge, and degree of enlightenment prevailing not only in the court but in the community generally."

<sup>68</sup> "In determining such questions," said Commissioner Eastman, "knowledge of pertinent facts and an experience which makes it possible to visualize the probable results of a particular public policy are quite as important as familiarity with the law books. It is an instance in which the law is influenced if not governed by the facts. When, therefore, the question relates to the constitutional limits of the public regulation of railroads, an intimate knowledge of railroads, of their relations with and their importance to the shipping and investing classes and to the public generally, and of their past history and future prospects becomes of the highest consequence. Such knowledge it is the peculiar duty of this commission to acquire." *Ibid.*, pp. 50-51. In its review of the case, however, a majority of the Supreme Court regretted that "proper heed was denied the timely admonition" of Commissioner Hall "that the function of this commission is not to act as an arbiter in economics but as an agency of Congress." "The Commission," said the Court, "disregarded the approved rule and has thereby failed to discharge the definite duty imposed by Congress." *St. L. & O'Fallon R. Co. v. U.S.*, 279 U.S. 461, 487 (1929).

nation and revision of single-sum values. The underlying figures provide the evidences of value out of which its ultimate findings are fashioned. The single-sum values, which constitute these ultimate findings, provide the operative basis for regulatory purposes. We shall first examine the processes employed by the Commission in the ascertainment of the several underlying cost and value figures which it was specifically required to report. The most significant of these figures include original cost to date, cost of reproduction new, and cost of reproduction less depreciation of the structural elements of the property, original cost and present value of lands, and such other values or elements of value as the Commission may find. These underlying figures will be treated in the order named.

#### *Original Cost*

On its face, the legislative requirement for the ascertainment and report of "the original cost to date" appeared to place no extraordinary burden upon the Commission and promised much by way of relevant data for the ultimate determination of value for rate-making purposes. As a matter of fact, however, this requirement came to involve the Commission in a welter of difficulties of interpretation and detail, and it eventuated, until very recently, in the reporting of figures which, however interesting for the economic historian, were of practically no utility in connection with the primary valuations. During the Congressional hearings and debates preceding the passage of the Valuation Act, much was said concerning the impossibility, because of inadequacy of carrier records, of securing complete, accurate, and usable data on original cost. The correctness of this prediction (in so far as original cost is interpreted exclusively in terms of the actual recorded experience of the roads) was quickly borne out by the Commission's investigations; and this confirmation led to conclusions with respect to the requirement which, if not entirely unsound, are at least open to question.

Original cost to date, said the Commission in its first report, "is a fact of prime importance. Every effort is being made to secure this information." But, the Commission continued, "the experience of the bureau indicates that in most cases it will be impossible to report

original cost to date from accounting records alone."<sup>69</sup> The withholding of the original books and records in connection with consolidations and mergers, and their destruction, inaccuracy, incompleteness, or lack of uniformity have been cited as reasons for the unsatisfactory character of the original cost figures. Where carrier records were missing or deficient, search for the best evidence of cost was made in the available records of contractors, syndicates and reorganization committees, commissions and courts, and in authentic publications dealing with the early history of the properties.<sup>70</sup> But large gaps still remained in the information needed for complete findings of original cost. When thus confronted with the alternative of reporting only such cost figures as the records actually and accurately disclosed, or of reporting "original cost to date" on the basis of estimates as well as facts, the Commission chose the former and more conservative course. It undertook to report only such figures as could be "exactly" determined. Its position was made clear in the following pronouncement: "As the act is interpreted by the Commission original cost is a fact, to be determined from the best evidence available in each case. The cost of reproduction new is of necessity an estimate, for the property never will be reproduced in fact and the exact expense of reproducing it cannot, therefore, be known. Depreciation is necessarily an estimate, for there is no way in which the exact amount of deterioration can be known. But these properties have been actually produced in the past and their production has cost a given amount of money. Original cost can, where the records suffice therefor, be exactly known, and it is in that sense that these words are understood by the Commission."<sup>71</sup> Accordingly, where, as in the vast majority of the properties, original cost as a fact could not be determined "within

<sup>69</sup> *Texas Midland R. R.*, 75 I.C.C. 1, 8 (1918). See, also, *ibid.*, pp. 10-11; *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463, 466-467 (1923); *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645, 649-650 (1923); *Florida East Coast Ry. Co.*, 84 I.C.C. 25, 34, 86 (1924); *Delaware & Hudson Co.*, 116 I.C.C. 611, 615 (1926).

<sup>70</sup> *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at pp. 9-10, 177.

<sup>71</sup> *Ibid.*, p. 176. Compare also the following from the testimony of Commissioner Prouty when he was Director of Valuation: "The Bureau of Valuation . . . attach more importance to original cost when original cost can be known than we do to any other thing that can be known in this valuation. But . . . we want to know that it is original cost. Now original cost is a fact; it is not a guess." Hearings, *Texas Midland case*, December, 1917, p. 142.



reasonable limits of accuracy, from evidence which carries with it a fair degree of certitude,<sup>772</sup> the Commission merely reported its inability to find such cost.<sup>78</sup>

The Commission's decision to limit its reports on original cost to exactly determinable facts, and thus virtually to destroy the significance of the resulting figures in the determination of final single-sum values, was not reached without protest from its own membership. The most illuminating expressions of this adverse sentiment, which appears to constitute a sound critique of the Commission's procedure, are to be found in connection with the Petition of the National Conference on Valuation of American Railroads.<sup>74</sup> The petition requested, *inter alia*, that all pending proceedings be recommended to the Bureau of Valuation with directions to ascertain and report "original cost to date of each piece of property owned or used by a common carrier for common-carrier purposes."<sup>75</sup> The Commission declined to alter its conclusions as previously announced, but a

<sup>72</sup> *Texas Midland R. R.*, *supra*, p. 177.

<sup>73</sup> The Commission's practice was thus described in the first of its valuation reports: "Original cost to date will be reported as fully as it can be ascertained from the best evidence which is practically available in each particular case, and which seems to us to carry weight as establishing the fact called for by Congress. If it is not possible to show original cost to date for all of the carrier property, but it can be ascertained for a portion of the property, that fact will be reported. In the event that it is impossible to identify the cost of any portion of the property, the total amount on the books of the carrier property assigned to the road and equipment account will be shown, with an explanation that the authenticity of the amount can not be verified. Whenever the original cost of the greater portion of the property can be ascertained, and as to minor parts can not be ascertained from records, we shall within comparatively narrow limits estimate the original cost of such minor portions so as to show original cost of the whole property as closely as may be, and the maximum limit, stating fully the method pursued. . . . Our findings as to original cost will be supplemented by a full statement of the financial history of the road, including the issuance of securities. These facts, it is believed, will show the maximum amount of money which could have been put into the property, and there will thus be a reasonable and substantial compliance with the act." *Ibid.*, pp. 8, 9. See, also, *Kansas City Southern Ry. Co.*, 75 I.C.C. 223, 251-252 (1919); *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463, 466-467 (1923); *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645, 649-650 (1923); *Florida East Coast Ry. Co.*, 84 I.C.C. 25, 34 (1924); *New York, Philadelphia & Norfolk R. R. Co.*, 97 I.C.C. 273, 274-277 (1925); *Laurinburg & Southern R. R. Co.*, 108 I.C.C. 358, 359 (1926); *Cape Charles R. R. Co.*, 114 I.C.C. 274, 275 (1926); *Delaware & Hudson Co.*, 116 I.C.C. 611, 615-616 (1926); *Chicago & North Western Ry. Co.*, 137 I.C.C. 1, 14 (1928); *Pittsburgh, C. C. & St. L. Ry. Co.*, 24 Val. Rep. 1, 17-21 (1929).

<sup>74</sup> 84 I.C.C. 9 (1923).

<sup>75</sup> *Ibid.*, p. 10.

number of the commissioners insisted that the ascertainment of original cost was both necessary and feasible. Where recorded data were deficient, resort to estimate was the obvious expedient. Commissioner Potter, concurring with modifications, argued that the Commission's final valuations were invalid to the extent that they failed to include findings of original cost, and that there were no insurmountable obstacles to the making of such findings. "There is, in my judgment," he said, "no serious difficulty in making the findings which petitioner suggests. The majority assumes that there is difficulty and takes far too seriously the burden of finding original cost. Like most impossible tasks, it can be done. We are not directed to report book entries. We are to investigate and report a conclusion, and we are not relieved from that task if some one has made it more difficult by destroying records. We arrive at our conclusion the same way we arrive at other conclusions—by using the best competent evidence that is available. Where cost is the question and records are not available, evidence as to what the cost should have been is always competent. An estimate may, in fact, be much more reliable than a book entry of actual payment."<sup>76</sup> Similarly, Commissioner McManamy, dissenting in part, not only declared that a finding of original cost, on the basis of the best evidence available in each particular case, was specifically required by the statute, but that "such a finding can be made without resorting to estimates to an extent that will materially impair its value."<sup>77</sup> And Commissioner Eastman, likewise dissenting in part, argued further that not only may the statutory mandate be construed as requiring findings of *reasonable costs* at the time the properties were produced rather than *actual costs* to the carriers, but that, whatever the meaning of "original cost to date," the ascertainment of what the properties should have cost is essential

<sup>76</sup> *Ibid.*, p. 14.

<sup>77</sup> *Ibid.*, p. 22. Note, also, the following from the dissenting opinion of Commissioner Campbell in *Florida East Coast Ry. Co.*, 84 I.C.C. 25 (1924), at p. 50: "The law specifically requires the commission to ascertain and report in detail the original cost to date of each piece of property owned or used for common-carrier purposes. The majority have found the original cost of the Florida East Coast Railway only with respect to the Key West extension. Had the law been complied with and the original cost of the property as a whole been ascertained, the figure at which the final value has been placed might have been different. For this reason I withhold my assent to the findings of the majority."

to the determination of final value and hence should not be excluded from the Commission's findings.<sup>78</sup> His emphasis, it will be noted, was not merely upon the need of executing the legislative requirement, but upon the necessity, regardless of the stipulation of the statute, of ascertaining figures that might approximate prudent investment.<sup>79</sup> Nor was he beset by doubts as to the possibility of securing the required information with substantial accuracy. "So far as the reasonable cost of the railroad properties is concerned, such records as are available will be a great help, and so far as they are lacking or misleading the deficiencies can be supplied by estimates. It is, perhaps, somewhat more difficult to estimate cost of production at the time the property was produced than to estimate cost of reproduction as of any given date, but essentially the two processes are

<sup>78</sup> *Petition of National Conference on Valuation*, 84 I.C.C. 9 (1923), at pp. 20-21.

<sup>79</sup> Primarily, Commissioner Eastman's view was a necessary corollary of his conclusion "that value for rate-making purposes should be based on the amount invested honestly and with a reasonable degree of providence in the property." From this, the rest logically followed: "To determine such investment it is necessary to know, as nearly as may be, what the property should have cost. From my point of view, therefore, it makes little difference what the meaning of the words 'original cost to date' may be. The fact which petitioners want reported is necessary to the determination of so-called 'final value'; we have full authority to ascertain all necessary facts, and we should exercise that authority." *Ibid.*, p. 21. But he was so fully convinced that such data would throw light upon the evolution of the regulatory process that he urged their ascertainment and report even if his views as to what should constitute value for rate-making purposes should prove to be incorrect. "I know of nothing more important in this connection," he said, "than that the people of the country should have full information indicating: 1. What the railroad properties should reasonably have cost. 2. The extent to which their construction was aided by public or private gifts, grants, and donations. 3. The extent to which funds for their construction have been provided by surplus earnings after the payment of liberal profits to investors. The people should have this information so that they may fairly appraise the persistent claim that railroad owners have been oppressed; so that they may fairly weigh the meaning and possible consequences of any theory of valuation which may finally be adopted by the courts; and so that they may fairly and intelligently determine their future policy with respect to railroads in the light of experience in the past." *Ibid.* In thus urging the ascertainment and report of what the properties should reasonably have cost, Commissioner Eastman was not only protesting against the Commission's usual statement of inability to find original cost, but against having the findings restricted to actual cost, regardless of the circumstances surrounding the capital expenditures, when the recorded evidence was sufficient for such findings. On this point the Commission's view had been expressed as follows in *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at pp. 176-177: "Investigation shows that original cost is frequently, indeed almost invariably, more or less than a fair average cost. Many causes contribute to this result. Poor judgment may have been used in the planning and executing of the project; accidents may have intervened; an unusually wet season may very much increase the cost of certain construction work; there may have been extravagance or even dishonesty; and all this

the same. Surely the public can not fairly be penalized because the railroads have failed to keep proper records."<sup>80</sup>

It is difficult to avoid the conclusion that Commissioner Eastman and his minority colleagues were on essentially sounder ground in this matter than the majority of the Commission. Original cost, interpreted either as actual cost to the carriers or as what the properties should reasonably have cost, was not only called for by the statute, but is clearly necessary to the proper determination of final single-sum values. No mere formality was involved; without data as to original cost one of the most significant of the "relevant facts" would be lacking. Yet the Commission disposed of the matter by an interpretation of its statutory duty which rested largely on grounds of expediency. It shrank from going beyond the actual records, despite the yawning gap in the underlying figures which resulted from this procedure. The difficulty of the task and the fear of an unreliable outcome appear to have been primarily responsible for this refusal to supplement the results derived from the records by resort to estimate; but in view of the fact that its major task—the cost of reproduction appraisal—was entirely a question of hypothesis and estimate, it would seem that the Commission was altogether over-timid in this aspect of the valuation project. Indeed, it is hard to rationalize its position, or to reconcile it with its usual attitude on such issues. There was, in this disposal of the problem, little kinship to the Commission's usual will to transcend technical interpretations of its powers and duties, and to look upon its program of activities as an opportunity rather than as a task. Its general approach, in valuation matters as well as in connection with its other functions, is that of a powerful administrative tribunal, ready and able to substitute realities for superficial facts and to promulgate expert judgments on controversial issues. In this case the question of principle was largely ignored.<sup>81</sup>

would increase the expense above normal. Upon the other hand, all conditions may have been extremely favorable, and in consequence the work may have cost less than a fair average. The Commission in its report does not inquire what the work ought to have cost." But, for apparent departures from this policy, see *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), at pp. 468-473; and *New York, Philadelphia & Norfolk R. R. Co.*, 97 I.C.C. 273 (1925), at p. 275.

<sup>80</sup> *Petition of National Conference on Valuation*, 84 I.C.C. 9 (1923), at p. 21.

<sup>81</sup> Compare H. B. Vanderblue, *Railroad Valuation by the Interstate Commerce Commission* (1920), pp. 72-83.

The attempt to pursue the task of ascertaining final values without the aid of original costs or of figures reasonably representative of prudent investment, chiefly because of a narrow interpretation of the statutory mandate and despite the obvious Congressional intent that the Commission bring all relevant considerations to bear upon its ultimate findings, appears to have been ill-conceived; nor should the "unreliability" of estimates of original cost have received controlling emphasis from a body familiar with the vagaries of the cost of reproduction method.<sup>82</sup>

Because of its inability to ascertain original cost to date, the Commission has reconstructed the accounts of the carriers and has re-

<sup>82</sup> The above strictures are applicable to the Commission's specific treatment of the "original cost to date" item. As a matter of fact, as will appear subsequently, the Commission's cost of reproduction appraisal at 1914 prices was utilized, in the determination of final values, as an approximation of the original cost of the properties then in existence. It should be noted, furthermore, that the Commission's position with respect to estimates of original cost has recently undergone a material change. In *Excess Income of Richmond, F. & P. R. Co.*, 170 I.C.C. 451 (1931), original cost figures, based partly on records and partly on estimates, were submitted by the Bureau of Valuation, and the carrier's protest against the use of these estimates was expressly overruled: "For the purpose of comparing the original with the present cost of construction, as required by *Smyth v. Ames*, . . . we find that reasonable estimates of original cost may be considered when no such comparison could otherwise be made. The exception to the use of estimates in the determination of original cost is overruled" (p. 465). The carrier directed attention to the Commission's finding in *Richmond, F. & P. R. Co.*, 31 Val. Rep. 227 (1930), that the original cost of the property, as of primary valuation date, "was unknown and could not be ascertained owing to the absence of the necessary accounting records"; and also to the long-established views of the Commission, as expressed in *Texas Midland R. R.*, 75 I.C.C. 1 (1918) and in *Petition of National Conference on Valuation*, 84 I.C.C. 9 (1923). But the Commission found ample grounds for its new procedure: "It is true that we stated in the *Texas Midland* case, that the original cost called for by section 19a is a fact and not a matter of estimate like cost of reproduction. But we also stated that where the original cost of the greater portion of the property could be ascertained but as to minor portions could not be ascertained from the records, we would within comparatively narrow limits estimate the cost of the minor portions so as to show original cost of the whole property as closely as may be. If authority is present for estimates within narrow limits there is no reason for supposing that it does not likewise extend to the making of estimates covering a wider range of property." In the case of the respondent, estimates covered more than 50 per cent of the property other than land, but "the extent of the necessity for recourse to estimates is a constantly narrowing one due to the continuing increase of the proportion of property the actual cost of which is known." For the railroads of the country as a whole, "nearly 45 per cent, in terms of cost of reproduction at . . . [primary valuation dates] has now been retired and replaced with new units installed mostly at a higher price level. For all of this increasing proportion of new property there are . . . complete records of cost." The amount to be estimated, for the railroads in the aggregate, "is now about 35 per cent of the whole." Furthermore: "The estimated portion will yearly decrease to a limit fixed by grading, tunnels,

ported the maximum amount of money that could have been invested in the properties, together with a statement of the sources from which this money was derived.<sup>83</sup> This restated investment has been reported in the absence of any statutory requirement therefor, and despite carrier protests.<sup>84</sup> It is designed to provide additional evidence of value, but it is admittedly not the exact equivalent of original cost to date. In the first place, it was not always possible to make

and other relatively unchanging structures, which at the present time represent not much over 10 per cent of the total original cost except land, of the carriers as a whole. With the constant reconstruction and replacement of old property and additions of new property, this proportion will continually decrease until a time when the record of actual cost of property in service will be but little short of completeness and any possible margin of error arising out of the presence in part of estimates will be negligible. Moreover, the property to be covered by estimates is old and has depreciated to a considerably further extent since the original inventory whereby any amount representing the original cost of the unexpired service units of the existing property or, in other words, the cost less depreciation, reflects a still smaller proportion of estimates." *Excess Income of Richmond, F. & P. R. Co.*, 170 I.C.C. 451 (1931), at pp. 464-465. It should be noted, however, that the Commission has continued to maintain its original position in the primary valuations. See, for example, *Southern Ry. Co.*, 37 Val. Rep. 1, 6 (1931).

<sup>83</sup> In *Texas Midland R. R.*, 75 I.C.C. 1 (1918), the Commission described as follows the character of "this kind of original cost" (pp. 179-180): "It is possible to approach this problem from a different angle. Instead of inquiring what particular pieces of property cost, the Commission may state what has been the total investment in the property now in being. The Commission's accountants have usually approached the problem from this angle in case of older properties, with more satisfactory results. In showing this kind of original cost the accountant endeavors to determine the source from which the money is derived. It may have been paid in for the issue of securities or upon some other consideration; it may have come from the earnings of the property by appropriating income which might otherwise have been divided as dividends; additions and betterments have often been paid for out of revenues. Whenever the records of the carriers clearly show that a given amount has actually gone into the purchase of property and the source from which this was derived, our report indicates both the amount and the source."

<sup>84</sup> In *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), the Commission disposed as follows of the carrier's protest against the restatement of its investment account (p. 467): "While the act does not specifically require us to ascertain and report the carrier's investment in road and equipment, we ascertain and report it, because in many cases we find it impossible to determine the original cost to date from the records, and because, when properly stated, it constitutes evidence of value to which consideration must be given. It is not to be inferred that we regard it as fully equivalent to an ascertainment of original cost to date." But note the following from the dissenting opinion of Commissioner Daniels (at p. 522): "It is . . . remarkable that when the report omits certain things called for in explicit terms by section 19a of the interstate commerce act, it devotes such ample discussion to ascertaining, reporting, and restating the investment figures. The word investment is nowhere found in section 19a. The oft-quoted rule in *Smyth v. Ames*, with its encyclopaedic enumeration of items properly to be considered, fails to mention investment."

proper deductions for retirements, and hence the investment figures sometimes represent more than the units of the property actually remaining in place. In the words of the Commission: "Generally it is possible to know with reasonable accuracy the total amount which has been invested in the development of the enterprise. This, however, may have been expended for property which is not now in existence and does not, therefore, represent the original cost of the property in being. To obtain this result proper deduction must be made on account of retirements. Whenever the fact of the retirement can be located from the records of the carrier and the cost can be determined it is deducted, but in many cases this can not be done. It will be seen, therefore, that this figure will represent before retirements have been written out the total investment in the enterprise; that is, the amount of money which has gone in and no part of which has been taken out as money. When the proper retirements have been made, the result is the original cost of the property in existence, assuming those retirements to have been all identified and the original cost properly determined. It is believed that this figure is of great value, but it must not be understood that it precisely represents original cost, for it does not."<sup>85</sup> Secondly, the accounting records were frequently so confused that difficulty was encountered in determining whether expenditures which a carrier had charged to operating expense, income, and other accounts should properly be included in the findings of maximum investment. This difficulty was typically illustrated by the investigation covering the Texas Midland Railroad, where the accounts were reconstructed on the basis of an examination of every voucher which had been issued by the carrier for the payment of money from the beginning of its operation. The accounting improprieties were so numerous as to render precise determinations impossible.<sup>86</sup> In subsequent proceedings similar situations were

<sup>85</sup> *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at p. 180.

<sup>86</sup> *Ibid.*, p. 10. "For instance," said the Commission, "on vouchers which had been indorsed 'construction' the word 'construction' had been crossed out and the words 'operating expenses' substituted, and the amount charged to operating expenses. Other vouchers marked 'construction' were charged directly to operating expenses. In still other instances apparent property costs were charged into the reserve account. Vouchers for materials entering into bridges were found, but nothing to indicate the bridge into which the material was placed. With reference to road and equipment account an amount aggregating \$185,000 was found in operating expenses; an amount aggregating

met, although it was not practicable to examine all of the vouchers in minute detail.<sup>87</sup> Finally, certain of the Commission's accounting rules took no cognizance of additional investment resulting from the replacement of units of property by more expensive units of the same kind. The difference, under such circumstances, was deemed to have been charged to the costs of operation. This procedure was followed with regard to original cost, in so far as ascertained, as well as in the reports of maximum investment.<sup>88</sup> "If the purpose is to show what the existing article has cost the stockholders of the company," said the Commission, "then the method observed is correct, since the difference between the price originally paid and the present price has been charged to operating expenses."<sup>89</sup> This reasoning is not alto-

\$450,000 in income account; an amount aggregating \$27,000 in suspense account; an amount of approximately \$500 in miscellaneous income account; and a credit of approximately \$100 in miscellaneous revenues account. Instances of this character could be multiplied, but the above sufficiently show why it is impossible to determine precisely the amount of money which has been spent in the production of the carrier's property, and which is a proper charge to road and equipment."

<sup>87</sup> *Elgin, Joliet & Eastern Ry. Co.*, 84 I.C.C. 587, 592, 594 (1924). The burden of proof in these matters was thrown upon the carriers, but because of deficiencies in accounting records, no means was available for assuring accurate results. See, also, *New York, Philadelphia & Norfolk R. R. Co.*, 97 I.C.C. 273, 278-280 (1925); *Cape Charles R. R. Co.*, 114 I.C.C. 274, 275 (1926); *Chicago, Burlington & Quincy R. R. Co.*, 134 I.C.C. 1, 19-20 (1927); *Minneapolis, St. Paul & Sault Ste. Marie Ry. Co.*, 143 I.C.C. 547, 556-557 (1928); *Pittsburgh, C. C. & St. L. Ry. Co.*, 24 Val. Rep. 1, 4-17 (1929); *Northern P. Ry. Co.*, 25 Val. Rep. 397, 408 (1929); *Denver & R. G. R. Co.*, 26 Val. Rep. 733, 737-739 (1929); *Hocking Valley R. Co.*, 29 Val. Rep. 321, 324-325 (1929); *Duluth & Iron Range R. Co.*, 31 Val. Rep. 159, 165 (1930).

<sup>88</sup> The nature of the practice has been concretely described as follows: "It should be noted that the original cost to date reported by the Commission is not always the actual cost of the unit now in existence. The accounting rules of the Commission with respect to certain primary accounts in case of replacement take no account of differences in cost between the thing when replaced and the thing which is replaced. Consider the tie as an illustration. Let it be assumed that the tie now in place is exactly similar in every respect to the tie which was originally installed 25 years ago. That tie cost 50 cents; the present tie cost \$1; nevertheless, the original cost of the present tie as carried upon the books of the carrier and in its investment account is 50 cents, which is reported as the original cost. The cost of placing the tie is carried in Account 12, tracklaying and surfacing, which is entirely a labor account. Evidently if the cost of labor has increased the expense of placing the present tie exceeds the expense of placing the original tie, but this difference in expense is not reflected in Account 12, and it does not therefore appear in our report of original cost. Other of the primary accounts are affected in the same way to a greater or less extent." *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at pp. 178-179.

<sup>89</sup> *Ibid.*, p. 179. "The question thus resolves itself," commented one critic, "into the question of whether we are now interested in what the existing plant cost, or what the original plant cost five, ten, fifty years ago. Which constitutes original cost to date,



gether convincing. It appears to assume the validity of the operating accounts, although the property accounts are deemed unreliable. There is scarcely adequate ground for this differentiation. Furthermore, the unsupported assumption underlies this practice that past earnings had in fact sufficiently reimbursed stockholders for this added expense, or at least that conscious efforts had been made so to adjust rates of charge that such reimbursement might be effected. Under all these circumstances, the restated investment does not constitute an accurate reflection of the original cost of the properties, or of the actual or reasonable sacrifice of the investors.<sup>90</sup> The records alone proved equally inadequate for both purposes.

It appears, then, that although the Valuation Act expressly required the ascertainment and report of original cost to date of carrier property, the Commission reported that figure only in part, and sup-

which constitutes investment?" H. B. Vanderblue, *Railroad Valuation by the Interstate Commerce Commission* (1920), pp. 75-76 *et seq.* Without qualification, this statement of the distinction is somewhat misleading. For mere replacements, the Commission's method would give costs as of time of origin of the units; but additions and betterments, however recent, would also appear. The issue is as between two different methods of costing the existing plant. Where the replacements differ substantially from the original units, the original items are retired and the new ones are charged at cost. Compare the following from *Excess Income of Richmond, F. & P. R. Co.*, 170 I.C.C. 451 (1931), at p. 484: "In accounting for the replacement of ties, rails, ballast, and other track materials, the investment account is charged with the excess cost, if any, of the heavier or improved types of material over the cost to replace in kind the material removed, the cost of replacing in kind the material removed, less salvage, being charged to operating expenses. In accounting for the retirement of practically all other property the original cost of the property removed, less the value of salvage, is charged to operating expenses and the investment account is adjusted to reflect the cost of the new property."

<sup>90</sup> That little, if any, weight was given to the degree of providence with which properties were constructed or investments made is evidenced by the treatment accorded to acquisitions from other companies and to units of the plant no longer in existence. The investment reports of carriers which had acquired property by purchase from predecessor companies were limited to the amounts actually expended in these purchase transactions. The amounts carried in the investment accounts of their predecessors were held to be of significance only in connection with efforts to ascertain the original cost of the properties, and to have no place in the investment statement of the carriers being valued. This policy was carried out without regard to the amount of the predecessors' investment accounts as compared with the costs of acquisition to the present carriers. *Bangor & Aroostook R. R. Co.*, 97 I.C.C. 153, 157 (1925); *Georgia Southern & Florida Ry. Co.*, 106 I.C.C. 155, 156-158 (1925); *Mobile & Ohio R. R. Co.*, 143 I.C.C. 459, 462 (1928); and see *Winston-Salem Southbound Ry. Co.*, 75 I.C.C. 187, 189-190 (1918). For the application of a like procedure to carrier consolidations, see *Pittsburgh, C. C. & St. L. Ry. Co.*, 24 Val. Rep. 1, 5-9 (1929), and *New York Central R. Co.*, 27 Val. Rep. 1, 6, 74-75 (1929). The carriers' investment

plemented this finding with other data and figures designed to serve somewhat similar purposes. Authentic records of original cost proved not to be available, and the Commission declined, for the most part, to resort to estimates: it sought to find original cost as an exactly ascertainable fact, rather than as a conclusion as to what the properties should have cost. But the orders and appendices at the end of the valuation reports regularly contain, besides such statements as "the original cost to date of the existing property of the carrier is not obtainable from the records," a finding of the maximum investment, a restatement of the investment accounts, and a summary of the financial history of the carrier. None of these elements is of very direct moment; combined, they stand as a mass of interesting material, serving as a check upon other elements of value, though possessing scant intrinsic probative force. No provision was made in the Act for the presentation of figures representative of original cost less depreciation, and no such reports have generally been included in the Commission's findings.<sup>91</sup> It is clear that even with respect to

accounts were carefully checked to eliminate amounts representing property which had been abandoned or which for other reasons was no longer in existence. While no criticism of the carriers' original construction plans was implied by the practice, no account was taken of the causes of the abandonment, and deduction therefor was made from the investment figure. In *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), the Commission deducted the sum of \$2,160,331.71 from the carrier's investment account because of the abandonment of roadbed resulting from "a flood of unusual volume and violence." In supporting its procedure, the Commission virtually acknowledged the substantive merit of the carrier's claim (p. 473): "There is no ground for criticism of the carrier because it originally located the line in such manner that floods later destroyed it. At least the usual care and prudence appear to have been exercised in determining where it should be built in the first instance. It is probable that any other carrier would have constructed its roadbed at about the elevation the carrier selected. The disaster that came later was unforeseen and probably impossible to foresee when the matter of location was first being considered. There can be no doubt that substantially \$2,160,331.71 was expended for property that was for a period of almost five years devoted by the carrier to the service of the public. But the fact remains that such property was not in existence on the date of valuation. If the cost of the lost property were, under such circumstances, to remain in the investment account, that account would not reflect accurately investment charges attributable to the property devoted to the public service." Commissioner Eastman, on the other hand, in a dissenting opinion, deemed the abandonment of the property to have been made under such circumstances as to justify the inclusion of the expenditures therefor in the "reasonable investment" (p. 566). See, also, *Kansas City Southern Ry. Co.*, 75 I.C.C. 223, 230, 242-244 (1919).

<sup>91</sup> But in *Excess Income of Richmond, F. & P. R. Co.*, 170 I.C.C. 451 (1931), the Commission not only resorted to estimates for the ascertainment of original cost, but made a finding of original cost less depreciation. The nature of the issue and its dis-

such figures as the Commission decided to report it was torn between an apparent urge to ascertain the actual cost of the units in place and a desire to measure the effective sacrifice incurred by investors. Manifestly, neither aim was adequately realized.

### *Cost of Reproduction*

The cost of reproduction appraisal has constituted the Commission's major and most significant task in the ascertainment of the underlying figures. The act required specific findings of the cost of reproduction new and the cost of reproduction less depreciation of each piece of property owned or used by each carrier for carrier pur-

position may best be stated in the words of the Commission (pp. 468-469): "The above estimate of original cost represents the approximate cost of the property when new. Estimates were also presented by the bureau of the cost diminished by the depreciation in the property since its installation or placing in service. The respondent objects that there is no justification for depreciating original cost because it measures the investment in the property, which can not possibly become less because of depreciation, and the question before us is whether a statement of original cost less depreciation should likewise be set forth as one of the evidential factors for consideration in the determination of value, or, on the other hand, whether it should be entirely suppressed and removed from consideration. . . . An article when new contains a certain number of units of service and as those units are exhausted the article depreciates. In order to make any figure, whether of original cost or cost of reproduction, representative of the condition of the property at the time of the inquiry it would seem on principle to be necessary to make due allowance for the expired units of service life. . . . The respondent argues, however, that in *Smyth v. Ames* . . . the court in stating a basis for calculation as to the reasonableness of rates mentioned 'the original cost of construction' and 'the present as compared with the original cost of construction,' but said nothing about depreciation. This is undoubtedly true, but if the same line of reasoning were valid it would not be permissible to depreciate cost of reproduction new and the result would be to invalidate any statement of cost of reproduction less depreciation, which is one of the elements of value called for by section 19a and generally recognized in judicial decisions. It is next said that original cost less depreciation should not be reported because it is not required to be found by section 19a. This contention would be valid if the intention of Congress had been to restrict us in our valuation work to the ascertainment and reporting of only those evidential facts or elements of value called for in express terms by the statute. But the opposite is plainly true, the wording of the law itself, as well as its legislative history, making it completely evident that Congress intended to authorize us in the course of our investigations to assemble all facts with relevancy on the question of value." On this basis, and after a brief survey of judicial decisions bearing on the issue, the Commission concluded (p. 470): "The respondent's contention that there is no justification for deducting from original cost the depreciation found to exist in the property must be overruled." If the practice adopted in this recent proceeding had been generally followed in the primary valuations, the original cost data might have constituted a much more influential factor in the determination of single-sum values as of primary valuation dates.

poses.<sup>92</sup> Ostensibly, the execution of this mandate involved an immense amount of detailed work, by way of inventory and pricing, but left little room for the exercise of judgment or discretion; in fact, numerous far-reaching decisions on matters of policy were inevitable. The determination of reproduction cost, "at best an estimate,"<sup>93</sup> is no mere objective fact-finding task. At every turn assumption and opinion play controlling rôles. An analysis of the Commission's hypotheses, and of its conclusions on controversial issues, will disclose the character of its functioning processes.

Reproduction cost, in valuation terminology, has come to mean the cost of duplicating the existing plant at the current level of prices, under either present or original conditions. Since the purpose of the reproduction theory is to determine the capital costs which would be incurred by a like plant built on valuation date, rather than merely to compensate or penalize common stockholders for possible changes in the value of the monetary unit resulting from the ups and downs of the price level, the hypothesis of reproduction under present rather than original conditions is unquestionably involved.<sup>94</sup> This hypothesis

<sup>92</sup> A detailed inventory of each piece of carrier property was required by the statute. As a "practical" construction of this requirement, the Commission interpreted the phrase "each piece of property" as defining units "which are current in the purchase and sale of the property under consideration or are commonly used in construction contracts and settlements." Since ties, for example, are bought and sold by the piece, the single tie was taken as the unit; in the case of rails, on the other hand, which are bought and sold by the gross ton, the gross ton was used as the unit. With regard to equipment, the single car or engine was taken as the unit, but these units were grouped when of the same series. Bridges of over 12-foot span were reported separately, while those under that were grouped. Separate reports were generally made of the superstructure and substructure of individual bridges. Buildings of considerable cost were reported individually, with specification of the cost of the major parts of the structure. The act further required that, as far as practicable, the physical property be classified in conformity with the classification of expenditures for road and equipment prescribed by the Commission. Hence, on the basis of the units as previously determined, the property was grouped in accordance with the Commission's 62 primary investment accounts. *Texas Midland R. R.*, 75 I.C.C. 1, 113-114 (1918).

<sup>93</sup> *Ibid.*, p. 16.

<sup>94</sup> Strictly speaking, of course, such validity as the cost of reproduction theory may possess, largely in terms of competitive reasoning, involves a duplication, under present conditions and at current prices, of the *service* furnished by the existing plant rather than of the *plant* itself. In other words, the cost of producing a new plant capable of rendering a substantially identical service, rather than of reproducing the substantially identical plant, would measure "value." Since, however, the determination of the cost of replacing the service, without the anchorage of an existing and operating plant, would involve a highly speculative if not entirely impracticable procedure, the

was adopted by the Commission at the very outset, and, in the main, it has been acted upon consistently in all subsequent proceedings.<sup>95</sup> The road under valuation was deemed to have been obliterated, but all other conditions were assumed to remain the same as on valuation date. Topographical conditions prevailing at the time of the original construction of the property were entirely disregarded.<sup>96</sup> The character of the right of way, for example, was determined by the character of the land adjoining it at the time of valuation. If tillage land was to be found on either side of the right of way, the right of way was "treated as similarly devoid of trees and brush"; if, on the other hand, a forest adjoined, it was assumed that there was a corresponding growth upon the right of way. These assumptions were made

proponents of the reproduction cost theory urge the acceptance of the cost of reproducing the existing plant as the nearest feasible approach to the cost of replacing the service. Because cost of replacement is virtually impossible of ascertainment without unlimited play of imagination and conjecture, reproduction cost is advanced as a not too dissimilar practical makeshift. But both interpretations must necessarily be governed by present conditions rather than by those prevailing at the time the plant under valuation was constructed. See H. G. Brown, "Railroad Valuation and Rate Regulation," *Journal of Political Economy*, vol. 33 (October, 1925), pp. 505-530, "Economic Basis and Limits of Public Utility Regulation," *Reports of American Bar Association*, vol. 53 (1928), pp. 717-737; Frederic G. Dorety, "The Function of Reproduction Cost in Public Utility Valuation and Rate Making," *Harvard Law Review*, vol. 37 (December, 1923), pp. 173-200; James C. Bonbright, "Railroad Valuation with Special Reference to the O'Fallon Decision," *American Economic Review*, vol. 18 (March, 1928, Supplement), pp. 181-205.

<sup>95</sup> The Commission was also influenced by practical considerations in making its estimates of reproduction cost under present rather than original conditions: "If original conditions were to govern, data concerning the work done many years ago could not be obtained in many instances. Data concerning original conditions could probably be secured in the case of recently constructed railroads. The amount reported in the first case would be the result of speculation while in the latter it would be the statement of a fact. Cost of reproduction new is at best an estimate, but as now reported by us is derived under the same general rules, and the estimates regarding different properties are comparable in all cases." *Texas Midland R. R.*, 75 I.C.C. 1, 16 (1918).

<sup>96</sup> Note the following, for example: "The carrier asserts that in determining cost of reproduction new, conditions with respect to population, business capacity, productiveness, and property values in the territory served by the railroad shall be taken as they exist on valuation date, but that the historical construction of the property must be taken into consideration whenever a rational engineering program for reproduction would so warrant or require. In the case of clearing and grubbing an allowance for the work which was done in order to clear the right of way is contended for. . . . As previously stated, we interpret the term 'cost of reproduction new' literally, i.e., the cost of reproducing under present conditions the existing property of the carrier without computing depreciation. The amount of clearing and grubbing which was necessary in the original construction is reported in 'original cost to date' when it can be obtained." *Ibid.*, pp. 15, 16.

without respect to the actual topography at the time the road was constructed; the method was approved "as involving the minimum of conjecture," and allowances for clearing and grubbing were estimated in accordance therewith.<sup>97</sup> Again, since the reproduction hypothesis involves the assumption that the entire territory is fully developed into countryside and urban communities, with industries operating and markets in full swing, but that down through the center, along an exactly determined line, a narrow strip of land, bordered by factories and warehouses but itself devoid of all construction, lies in readiness to serve as the roadbed of the plant to be theoretically reproduced, the Commission has deemed improper the inclusion of any allowance for "location engineering."<sup>98</sup> The exact location of the road being known, such an allowance for recon-

<sup>97</sup> *Ibid.*, p. 15. The Commission appears to have been swayed, also, by the fact that the value of carrier lands was determined by the present value of adjoining lands. "The value of lands," said the Commission, "is determined, not upon the basis of its original condition, but with reference to its present condition, and there seems to be no reason why it should be assumed for the purpose of fixing value that a field is in tillage and for the purpose of clearing and grubbing that it is covered with stumps which must be removed and which would render it untillable." *Ibid.*, p. 117. Moreover, as a logical corollary of this method of estimating the cost of clearing and grubbing, the Commission provided that proceeds from the sale of products that might theoretically be removed from the right of way be set off against such cost: "It will undoubtedly happen that in a theoretical reproduction of a railroad the right of way at present runs through valuable standing timber. If the assumption that the right of way is covered with the same growth in the same density is correct for the purpose of ascertaining the cost of reproduction of clearing and grubbing, it follows that an estimate should also be made of the amount of saleable products which could be derived from such growth and the proceeds thereof at prices prevailing in the locality credited against the estimated cost of clearing and grubbing. No such offset is allowed in this case for the reason that the facts do not warrant it." *Ibid.*, p. 16. See, also, *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645, 651-652 (1923); *Kansas City Southern Ry. Co.*, 75 I.C.C. 223, 245-246 (1919); *Elgin, Joliet & Eastern Ry. Co.*, 84 I.C.C. 587, 601-603 (1924); *New York, Philadelphia & Norfolk R. R. Co.*, 97 I.C.C. 273, 300 (1925); *Union Point & White Plains R. R. Co.*, 103 I.C.C. 147, 148 (1925); *Alabama Northern Railway Co.*, 108 I.C.C. 564, 565 (1926); *St. Louis & Hannibal R. R. Co.*, 114 I.C.C. 317, 318 (1926); *Cumberland & Manchester R. R. Co.*, 116 I.C.C. 407, 410 (1926); *Minneapolis, St. Paul & Sault Ste. Marie Ry. Co.*, 143 I.C.C. 547, 564-565 (1928); *Pennsylvania R. Co.*, 22 Val. Rep. 1, 13, 50 (1929); *Boston & M. R.*, 30 Val. Rep. 515, 517-518 (1930).

<sup>98</sup> "In the construction of a new railroad," said the Commission, "it is necessary to reconnoiter, lay out lines, and engage in considerable preliminary work in order to secure the most advantageous route. Such a program is not necessary in a theoretical reproduction of a property under valuation. The inclusion of an amount to cover expenses of this character is incorrect." *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at p. 28.

naissance would be "an obvious conjectural expense incurred in supposititious groping through the country for locations which are not used."<sup>99</sup> Similar applications of the hypothesis of present conditions—with regard to the inventory, the program of construction, and the level of prices—will be noted in due course. Before attempting, however, to provide any further illustrations of the Commission's practice, its general procedure in arriving at "cost of reproduction new" will be stated in its own words, as summarized in the first of the valuation reports, by way of comprehensive background for the subsequent detailed discussion: "The engineer making the estimate assumed that the road was not in existence. All other conditions in the territory through which the road runs were taken as they existed on valuation date. The engineer then prepared what he conceived to be the most

<sup>99</sup> *Ibid.* Similarly, since in the theoretical reproduction of a property all the essential facts are presumed to be known, the Commission has declined to make any separate allowance for "contingencies." In the original construction of a railroad, such allowances are generally and properly made. "When the construction of a railroad is under consideration it is customary for an engineer to estimate the amount of money it will be necessary to expend in building the property. Experience has shown that it is practically impossible, no matter how carefully such an estimate may have been made, to include all the items of expense which will be incurred in the work of construction. Additional expense is caused by omissions and unforeseen difficulties in the work of construction. . . . In order to provide for expenses of this kind the practice of including a certain sum for contingencies in estimates of the prospective cost of construction has been quite generally adopted." *Ibid.*, p. 25. But the Commission found that in a reproduction cost estimate this reasoning is applicable to neither of the two classes of items. As to "omissions" the Commission said: "The road has been constructed. Every item which enters into the property is present and can be inventoried. Those things which are omitted in the estimate of original construction are all here in case of the completed property." In like manner, subsequently, the Commission disposed of "unforeseen difficulties": "What is true of omissions in the estimate of original cost is equally true of those unforeseen happenings and conditions which in preliminary estimates must be taken care of by an allowance for contingencies. The engineer in the making of his original estimate may overlook many of the difficulties to be encountered; the engineer in estimating cost of reproduction has before him every one of those difficulties. If the sounding rod struck what appeared to be solid rock but was in fact a boulder, and if for that reason the pier must be sunk 20 feet deeper, this is known today." Moreover, the Commission directed attention to the fact that due allowance is in reality made for many contingencies in connection with specific items of the appraisal, particularly through the medium of the prices used. Further allowance would constitute duplication. Hence the following conclusion: "After careful consideration the Commission has felt that much more reliable results would be obtained by giving due weight to this element of doubt at the specific points where it occurs rather than by making some general addition applicable to the entire inventory. No general allowance has therefore been made for contingencies under that name." *Ibid.*, pp. 143, 144, 147.

practicable and economical program for the construction of the road. The items which make up the physical property were then inventoried and cost prices fairly representative of conditions on valuation date were applied. To the figures thus obtained was added the estimated cost of placing the items in position as of valuation date, including certain overhead charges. The result thus arrived at is the cost of reproduction new.<sup>100</sup> In examining this procedure, it will be necessary to analyze the Commission's policies with respect to inventories, construction programs, and unit prices.

The inventory contained only property used for common-carrier purposes,<sup>101</sup> and it embraced nothing not in existence on valuation date.<sup>102</sup> If in improving the alignment of a roadway, for example, a portion of the original embankment had been abandoned, the abandoned part was not inventoried. The gradual processes by which the railroad had been developed to its present condition were disregarded; it was assumed that the existing property would be reproduced "by a single continuous impulse."<sup>103</sup> Accordingly, no account was taken of grading which might have gone into embankments unless found there at the time of inventory.<sup>104</sup> Nor was the repro-

<sup>100</sup> *Ibid.*, p. 11.

<sup>101</sup> In *Kansas City Southern Ry. Co.*, 75 I.C.C. 223 (1919), for example, certain grading and bridges in place on valuation date were not inventoried, since the tracks were not then laid and the section or "cut-off" was not opened for several months following that date. The Commission's inventory "does not permit of the inclusion of property which is owned by a carrier but not used by it on valuation date for common-carrier purposes" (p. 242).

<sup>102</sup> *Texas Midland R. R.*, 75 I.C.C. 1, 115 (1918).

<sup>103</sup> "The estimate of reproduction cost arrived at in this manner does not correspond with the original cost of producing the property as it was in fact produced. The present railroads of this country are the product of a process of gradual development. The narrow-gauge road has passed into the standard gauge, the low class into the high class, the single track into the double track. Grades have been improved, curves eliminated. In the estimate of reproduction, all this is disregarded, and it is assumed that the existing property is reproduced by a single continuous impulse." *Ibid.*

<sup>104</sup> *Ibid.* As a further application of the principle involved, note the following from *Missouri & Illinois Bridge & Belt R. R. Co.*, 125 I.C.C. 424 (1927), at pp. 429-430: "Due to requirements of the War Department when the carrier's bridge was constructed, and to the then necessity of changing the channel of the Mississippi River, it was necessary to construct and use a temporary pontoon draw to avoid obstructing navigation. This pontoon was later removed and dismantled and was not in existence on valuation date. The evidence is not persuasive that any pontoon draw would be required if the carrier's bridge were being reproduced as of June 30, 1919. In our estimate of cost of reproduction new of this account we included the cost of only those items



duction estimate permitted to include costs which might originally have been incurred in changing the location of a public highway; allowance was made "for whatever structure has been provided by the carrier for the crossing of the highway, whether that structure is on or off the right of way, but it is assumed that the location of the highway would be as it now exists."<sup>106</sup> Similarly, no claim was recog-

and elements of property actually in existence on date of valuation, or those required as a part of the process or mechanics of reproduction. The pontoon draw in question being non-existent on that date, and not necessary on the theoretical reproduction of the carrier's property, it was properly excluded from our inventory and estimates."

<sup>106</sup> *Texas Midland R. R.*, 75 I.C.C. 1, 116 (1918). For allowances for the cost of viaducts and of "riprap protection against streams" not located on the carrier's right of way, see *Kansas City Southern Ry. Co.*, 75 I.C.C. 223, 239-240, 245 (1919). Where states or municipalities have contributed to the elimination of grade crossings, it was assumed "that the present undergrade or overgrade crossing would be reproduced as it was produced, and when those portions of the work which were involved in the elimination of the crossing can be clearly distinguished from the rest of the railroad, there is shown in our reproduction cost estimate . . . the amount paid by the carrier." *Texas Midland R. R.*, *supra*, at p. 116. See, also, *Lessees, Buffalo Creek R. R.*, 141 I.C.C. 1, 4-5 (1928); *Pennsylvania R. Co.*, 22 Val. Rep. 1, 52-53 (1929); *Pittsburgh, C. C. & St. L. Ry. Co.*, 24 Val. Rep. 1, 28-29 (1929); *Boston & M. R.*, 30 Val. Rep. 515, 548-551 (1930). In *New York Central R. Co.*, 27 Val. Rep. 1 (1929), in considering the cost of eliminating grade crossings, the Commission recognized that public contributions must be deducted from reproduction cost, and that "any rule which would include in the reproduction estimate property neither owned nor used by the carrier and which it would not be necessary to reconstruct in the reproduction of the property under conditions existing on valuation date would be a step in the wrong direction," but it found it reasonable, before deducting public contributions, to diminish the figure for such deductions by an amount covering the cost of "the construction of approaches, public and private sewer and pipe-line changes, street railway, sidewalk, and curbing changes, underpinning of buildings, etc., even beyond the crossing and its approaches, where the carrier has actually borne such costs" (p. 27). But assessments for public improvements not located on the carrier's right of way were disallowed as part of the reproduction cost estimates. "The amount expended is reported in original cost to date when such a figure can be ascertained. The principle announced concerning the treatment of 'topographical conditions' in cost of reproduction new applies with equal force to this item; and, since the property of the carrier is presumed to be reproduced under present topographical and other present conditions, it will be seen that no assessments for public improvements would be incurred, and this item would therefore be improper. As assessments for public improvements can only be levied in proportion to benefits received by the lands assessed, the present value of the lands adjacent, taken as the basis for the ascertainment of the value of railroad lands, reflects the public improvement assessments in question. It should be stated, however, that if a public improvement for which an assessment against a carrier has been made in the past is located on the right of way of the carrier, or so closely connected therewith that it would be wiped out if the railroad were removed, the estimated cost of reproducing it would be included in the valuation under the heading of cost of reproduction new." *Texas Midland R. R.*, *supra*, p. 20. See, also, *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645, 655 (1923); *Pennsylvania R. Co.*, 22 Val. Rep. 1, 93-94 (1929). On the Commission's refusal to include in the

nized for the cost of removing buildings (an expense which would unquestionably be incurred in constructing a new railroad through any extensive section of a great city), since the land in question, under the reproduction hypothesis, would necessarily be unoccupied on valuation date.<sup>106</sup>

In the treatment of railroad crossings, however, the Commission permitted itself a departure from strict adherence to the reproduction cost hypothesis, as a means of avoiding duplication and minimizing conjecture. Wherever the line of one carrier intersects that of another, it is customary for the expense of constructing the crossing to be borne by the junior carrier. In applying the reproduction hypothesis to this situation, the road under valuation would always occupy the position of junior carrier, since all property in the territory on valuation date, regardless of when constructed, is assumed to be in existence, with the sole exception of the property being valued. Under these circumstances the full cost of providing for a crossing of two intersecting lines might logically find its way into the reproduction cost estimates of both roads, either as property owned or used, or as simple expense of construction. But the logical compulsion of this

reproduction cost estimate the costs incurred in relocating and rearranging carrier tracks, as well as the costs incurred in paving city streets in connection with the enlargement of carrier yards, see *Elgin, Joliet & Eastern Ry. Co.*, 84 I.C.C. 587, 601-602, 603 (1924). See, also, *Augusta Union Station Co.*, 97 I.C.C. 586 (1925), at p. 589.

<sup>106</sup> "It is said with truth that items of the two kinds last mentioned [the changing of highways and the moving of buildings] do almost invariably occur in the building of a roadbed, and it is urged that if they be omitted from the estimate of reproduction cost that estimate does not fairly represent the cost of reproducing the property. The Commission is required to show the cost of reproduction new. This is not the cost of reproducing the property as it was produced, and no attempt is made to show that cost except as it appears in original cost. What expense the carrier may have incurred for the moving of buildings and the changing of highways are always matters of more or less doubt. Assuming for the moment that these items should be added to reproduction cost for any purpose, it has seemed the better course to allow the carrier to present its claim for such items and to substantiate that claim by proper reference to its records or by such other evidence as may be available. Engineers in the field can not properly deal with such evidence; it is their function to observe and report upon what is now in existence." *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at pp. 116-117. But where a sewer had had to be moved in the original construction, but would not have to be removed under reproduction, the Commission held that "the cost of the sewer should be reflected in the valuation of the property, not, however, as a part of the cost of reproduction of property owned or used, since it is not owned or used, nor does the carrier have any inventoriable interest therein, but as a part of the costs of rights in public domain." *New York Central R. Co.*, 27 Val. Rep. 1, 20-21 (1929).

analysis did not impress the Commission, and in handling the problem it commended "as involving the minimum of conjecture, and as the only plan which in all its aspects is feasible and certain in practical application," a practice of apportionment according to ownership and use worked out by the Bureau of Valuation.<sup>107</sup> Complete

<sup>107</sup> In *Winston-Salem Southbound Ry. Co.*, 75 I.C.C. 187 (1918), the accepted practice was described as follows (p. 193): "It has been the practice of the bureau of valuation to apportion the estimated costs of reproduction in accordance with any agreement as to ownership of property of this character which the interested carriers may make. Failing such agreement, the cost of reproduction estimates of the junior carrier omit, in the case of under-crossings, anything for the assumed reproduction of structures used entirely for the passage of the trains of the senior companies; but the cost of reproduction estimate of every junior carrier includes the estimated cost of reproducing the property exclusively used by it. One-half of the estimated cost of reproducing property commonly used by both carriers, such as crossing frogs, is carried into the tentative valuation of the Southbound." In reply to the carrier's contention "that if it be assumed for purposes of determining the cost of reproduction that other railroads exist as of valuation date, then as a matter of theory it must be assumed that the identical structures which the Southbound company as the junior carrier was obliged to construct would likewise have to be constructed in reproduction," the Commission said (p. 194): "The method followed in the tentative valuation does in fact contemplate the assumed existence of the railroads as crossed, and gives full credit in the cost of reproduction estimates for whatever is shown to be owned by a carrier, or occupied and used by it, while showing, as a historical fact for whatever it may be worth, the expenditures in fact made by the carrier in original construction." It was this practice, thus explained, which commended itself to the Commission as indicated above. See, also, *Atlanta, Birmingham & Atlantic R. R.*, 75 I.C.C. 645 (1923), at pp. 654-655, for an application of the rule to undergrade and overhead crossings. The same principle was also applied to joint interlocking-switch plants. Such a plant protected the movement of trains of the principal carrier, the Southern, and the Western & Atlantic. The bureau found that nine per cent of the use of the plant was for the benefit of the Atlanta, Birmingham & Atlantic, and although as junior carrier it had in fact constructed and paid for most of the plant, it was allowed only nine per cent of the reproduction cost. *Ibid.*, pp. 656-657. See, also, *Elgin, Joliet & Eastern Ry. Co.*, 84 I.C.C. 587, 599-600 (1924); *Norfolk Southern R. R. Co.*, 84 I.C.C. 693, 699-700 (1925); *Gulf, Texas & Western Ry. Co.*, 97 I.C.C. 29, 31 (1925); *Chicago, Terre Haute & Southeastern Ry. Co.*, 97 I.C.C. 535, 537 (1925); *Augusta Belt Ry. Co.*, 103 I.C.C. 523, 527 (1925); *Toledo, St. Louis & Western R. R. Co.*, 141 I.C.C. 287, 297 (1928); *New York Central R. Co.*, 27 Val. Rep. 1, 22 (1929); *Texas & Pac. Ry. Co.*, 29 Val. Rep. 483, 501 (1929); *Richmond, F. & P. R. Co.*, 31 Val. Rep. 227, 236-237 (1930). The Commission's views with respect to inclusion in the reproduction cost inventory of the present day equivalent of costs incurred in the construction of telegraph wires along the carrier's right of way are interesting in this connection, and they are also illustrative of the Commission's willingness, after mature deliberation, to admit mistakes in its own prior decisions. In *Texas Midland R. R.*, 75 I.C.C. 1 (1918), where of a number of wires along its right of way the carrier had the exclusive use of only one, while the Western Union had exclusive use of the rest, the Commission reasoned as follows (p. 45): "A telegraph line is necessary in the conduct of the business of the carrier and for the purposes of estimating cost of reproduction new of its property it is assumed that it would equip itself with this facility in the same manner

and thoroughgoing application of the reproduction doctrine was sacrificed, but duplication was avoided.<sup>108</sup> With respect to duplication of items in the inventory of a single carrier the Commission was correspondingly cautious.<sup>109</sup> Furthermore, carriers were re-

that it did originally [the carrier had performed the labor of constructing all of the lines]. Therefore the carrier would be obliged to perform the same amount of work in a theoretical reproduction of the property as it did in original construction. Such work estimated at prices prevailing on valuation date would amount to \$8,715. This amount will be added to the cost of reproduction new as stated in the tentative valuation." See, also, *Kansas City Southern Ry. Co.*, 75 I.C.C. 223 (1919), at p. 240, for the inclusion of \$88,925 for such labor. But in *Inventories of Telegraph Property*, 84 I.C.C. 1 (1923), the Commission, after a careful reconsideration of the pertinent facts and a realization that its prior ruling was "not in harmony with the method of procedure . . . in inventorying railroad property owned by one carrier and used by it jointly with another carrier," concluded that the ruling was "erroneous and should be changed." The Commission continued: "Treating the contract as an entirety—and apparently this is the manner in which it must as a matter of law be treated—we conclude that the expenditures incurred by the Texas Midland in connection with the construction of the telegraph line simply constituted a partial payment in advance on account of services to be performed and facilities to be furnished under the contract to the Texas Midland by the Western Union during the life of the contract" (pp. 5-6). The necessary changes in the inventories were made subsequently in *Kansas City Southern Ry. Co.*, 84 I.C.C. 113, 120 (1924), and in *Texas Midland R. R.*, 84 I.C.C. 150, 152-153 (1924). In case of disagreement between a railroad and a telegraph company as to the ownership of a telegraph line, the Commission has held the line to be "jointly and equally owned," and has inventoried it accordingly. *East Tennessee & Western North Carolina R. R. Co.*, 119 I.C.C. 552, 553-557 (1926); *Grand Trunk Ry. Co. of Canada*, 143 I.C.C. 1, 9-10 (1928).

<sup>108</sup> That this practice is quite in line with the Commission's general approach is indicated by the following passage from its first reported case: "When the valuation work has been completed for all the railroads in the United States, the Commission, the Congress, and the public will be informed with respect to every piece of property used in serving the public, with the single exception of that insignificant portion which is privately owned and partially used by common carriers. The inventories of the individual carriers will contain the cost values in detail with respect to property owned; the cost values in detail for property exclusively used by them but owned by a non-carrier; total cost values for property exclusively used by them but owned by a common carrier; a description of the terms and use of jointly used property of others with a reference to the report of the owning carrier for details in regard thereto; and a description of the terms and use of jointly used property owned by them with a reference to the reports of the using carrier or carriers for details in regard thereto. All the property used in serving the public will be inventoried and valued, and will be inventoried and valued once and only once. There will be and should be no duplications." *Texas Midland R. R.*, 75 I.C.C. 1, 24 (1918). For further explanation as "to whom carrier property is inventoried," see *ibid.*, pp. 122-125. See, also, *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645, 655-656 (1923); *Elgin, Joliet & Eastern Ry. Co.*, 84 I.C.C. 587, 601-602 (1924); *Augusta Union Station Co.*, 97 I.C.C. 586, 590 (1925); *Augusta Belt Ry. Co.*, 103 I.C.C. 523, 525 (1925); *Kentwood & Eastern Ry. Co.*, 110 I.C.C. 366, 369-370 (1926).

<sup>109</sup> Thus, for example, in *Kansas City Southern Ry. Co.*, 75 I.C.C. 223 (1919),

stricted to their rightful interest in railroad property not altogether owned or used. Industrial tracks—those which the carrier “has not an unrestricted right to use in serving the general public, but which it has obligated itself to use instead exclusively, or preferentially, in serving a particular industry or certain industries”—were carried into the reproduction cost inventory only in such portions as the carrier would have a right to remove if it should discontinue the service, except that there was always included the “estimated cost of reproducing any item of property in the industrial track which was in fact paid for by the carrier in original construction.”<sup>110</sup>

where the carrier had excavated drainage ditches in cuts along its right of way, and the ditches were partially filled on valuation date, only the open portions were inventoried. In answer to the carrier's demand that the total amount actually excavated be inventoried, the Commission said (pp. 244-245): “To do as the carrier suggests would result in duplication for the reason that the cut as it is found on valuation date is measured and credit given therefor. Whatever soil or other loose material has been carried into the ditches comes from the sides of the excavation. If the measurements of the ditches were assumed to be the same as if the ditches were empty a double allowance would be made to the extent of all the material in the ditches.” Hence the action of the bureau, which excluded 259,524 cubic yards of excavation, was approved. Compare also the following from *Texas Midland R. R.*, 75 I.C.C. 1, 43 (1918): “The sand which was used by the carrier was obtained from sand pits along its right of way. In the theoretical reproduction of the property it has been assumed that the same pits would be available. Nothing has been allowed for the sand itself. This is fair when it is borne in mind that our land report includes the value of the sand pit before the sand is removed.”

<sup>110</sup> *Ibid.*, p. 17. By way of concrete application of this principle, the Commission continued: “In determining the portions of the track which the carrier would have a right to remove in case of reproduction if the service were discontinued, we assume that reproduction would take place under a contract identical with that covering original construction. Where the carrier has procured the right of way and constructed the track at its own expense, both are inventoried to it. If the industry constructed the track at its expense and owns it, nothing is allowed to the carrier in cost of reproduction new. Where the carrier and the industry have both contributed, which is the usual case, the carrier is credited with an amount covering the estimated cost of reproducing that which it did produce. If the industry has paid for the items of property making up the track, but has given the carrier the right by contract to remove the track, etc., credit is given to the carrier for the reproduction cost of such property. . . . In other words, the carrier is limited to its interest in the industrial track.” In answer to the carrier's contention that the act requires a report of cost of reproduction new of “all property owned or used,” that the carrier “unquestionably uses these industrial tracks,” and that therefore they should be included in the carrier's cost of reproduction inventory, regardless of where title lies, the Commission said (pp. 18, 19): “Certainly such a figure would not be accepted by the carrier as an element to be considered in arriving at a value for taxation purposes, since the amount would embrace property which it did not own. The use of such a figure would be equally without justification for purchase purposes, for the reason that a carrier could not convey title to property which it used but did not own. The same objection would apply to the use of

Since the Commission's aim, in all aspects of the appraisal, was to determine the cost of duplicating the existing property owned or used by the carrier in the same condition as when originally constructed, the hypothetical reproduction was ordinarily assumed to be "in kind." When this proved to be impossible or theoretically not feasible, the property was reproduced "by the substitution of the best known available and practicable materials."<sup>111</sup> As put by the Commission: "It may sometimes happen that an abutment was originally constructed of stone which was brought from a long distance. Today concrete would be provided at a very much less price than stone.

the figure for capitalization purposes. While for rate-making purposes it may be proper to consider the value of the property used, a figure reported in the manner contended for might include more property than was being used by the carrier whose rates were being adjusted, for the reason that the carrier might not be operating all of the property which it owned. . . . To hold that a carrier is entitled to the full amount of the value of industrial tracks, when a part of the expense of original construction has, in fact, been borne by the industry, would be manifestly unfair. Under these circumstances it can not be that the lawmaking power intended by the words 'used by said carrier for its purposes as a common carrier' to include property not owned by the carrier where the use by it is only incidental and at the request and for the peculiar benefit of the owner. The mere movement of a locomotive of the carrier over the track of a private individual for the benefit of that individual at his request is not a use under the act. The industry track is *sui generis* and the act must be interpreted with reference to practical conditions in each case." See, also, *Winston-Salem Southbound Ry. Co.*, 75 I.C.C. 187, 194 (1918). In *New York Central R. Co.*, 27 Val. Rep. 1 (1929), it appeared that an industrial extension was maintained and operated by the carrier, and that the carrier paid taxes thereon, as well as 6 per cent on the cost of construction to the industry. It was agreed that the carrier shall have the right to purchase the extension at any time, and to maintain team tracks in connection therewith for the delivery of freight to the public, provided that "such use for others shall not interfere with the reasonable use for the business of the industry." This extension was omitted from the inventory, and the carrier contended that it should be included as property used for common carrier purposes but not owned. In denying the request of the carrier, the Commission said (pp. 32-33): "The circumstance that the carrier has an option to purchase is immaterial. The use, if any, of this extension in the service of the general public is not shown, and we are not justified in assuming that it is any more than an incident to the operation for the benefit of the industry served. The most influential factor in favor of its inclusion is the carrier's payment to the industry of a return on the cost of construction, a return which the carrier states is necessarily charged to income and not to operating expenses under the prevailing classification of accounts. But in our opinion this is not of sufficient force to warrant the inclusion in a railroad inventory of a track owned by an industry and used preferentially in its service. The classification of the track as used for transportation purposes would ordinarily carry with it a similar classification of the land upon which it rests and which is also owned by the industry. The carrier pays nothing, with the possible exception of taxes, on account of its limited use of this land, and there is no good reason why it should have a return upon it."

<sup>111</sup> *Texas Midland R. R.*, 75 I.C.C. 1, 41-42 (1918).

Ordinarily the reproduction is in kind, and the cost of the stone is used even though concrete might today be somewhat more economical, but this rule would not necessarily be followed in extreme cases."<sup>112</sup> Where, subsequent to the original construction, sources of supply had been developed from which materials of substantially the same kind, though not identical, might be obtained at a much smaller outlay, the inventory would enumerate material of the general kind actually in place, but the price would contemplate obtaining the material from the less expensive source.<sup>113</sup> Nothing was included in the ballast account for cinders in the roadbed which were produced by the carrier in the course of its operation, the assumption being that the reproduced carrier would obtain cinders in the same manner.<sup>114</sup> Where second-hand materials were originally installed and were found in existence on valuation date, the Commission accepted the bureau's interpretation of cost of reproduction new as "the cost of reproducing the materials in the same condition in which they were installed."<sup>115</sup> Similarly, in keeping with the assumption that the prop-

<sup>112</sup> *Ibid.*, p. 118. For a discussion of the substitution in the reproduction cost inventory of treated pine in place of the bois d'arc used in the original construction, see *ibid.*, pp. 41-42; for examples of assumed substitution of open-hearth for Bessemer steel, see *Birmingham & Southeastern Ry. Co.*, 135 I.C.C. 34, 42 (1927), and *Vicksburg, S. & P. Ry. Co.*, 26 Val. Rep. 481, 490 (1929).

<sup>113</sup> *Texas Midland R. R.*, 75 I.C.C. 1 (1918), p. 117.

<sup>114</sup> *Ibid.*, p. 43.

<sup>115</sup> *Ibid.*, p. 34. "A typical illustration of secondhand materials is the logging road. In many cases such roads have been built entirely with materials which have seen previous service. The rail and equipment, for instance, may be larger and more expensive than the road would have been justified in buying if it had bought them new. Because, however, such materials would serve the purposes for which the road was built and could be secured at prices considerably below the market prices for new material of the same kind they were secured. A strict interpretation of the word 'new' in estimating the cost of reproduction new of a property of that kind would require the substitution of new materials for materials which are known to have been secondhand when the road was 'new' or first built. We do not think that the act requires or contemplates this. The property to be reproduced is the existing property as it was when it was put into its present service. When the records of the carrier clearly show that secondhand materials were used the cost of reproduction new will be estimated for the same kind of materials in the same condition as when installed." *Ibid.*, p. 35. In conformity with these views, for example, a \$7,500 locomotive crane which prior to its purchase by the carrier had been in use for only four or five days, but which the carrier had been able to secure for \$5,000, was included in the reproduction cost new estimate at its secondhand price of \$5,000. *Ibid.*, pp. 46-47. See, also, *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463, 476, 477, 482, 483, 484 (1923); *New York, Philadelphia & Norfolk R. R. Co.*, 97 I.C.C. 273, 303-304 (1925); *West Virginia Northern R. R. Co.*, 110 I.C.C. 385, 387 (1926); *Clinton &*

erty to be reproduced is the property "as it was when put into its present place," rails which had been purchased new by the carrier, but which after use in main tracks had been placed in passing or side tracks, were inventoried as "relay," although other rails of the same age and type whose location had not been changed were inventoried as "new."<sup>116</sup>

Numerous other illustrations might be given of the troublesome problems and resulting practices which bear upon the inventory, but no useful purpose would be served by such extended enumeration. Enough has been said in this connection to indicate the general atmosphere surrounding the reproduction appraisal, the inevitable artificiality of many of its assumptions and the necessarily conjectural character of many of the findings, the complicated nature of the burden imposed thereby upon the Commission and the care and intelligence with which, on the whole, the tasks involved were performed. But "the result," it has been said, "has none the less been to pile estimate on average."<sup>117</sup> Although it is conceded that "the semi-cooperative method of making the inventory has substantially estopped challenge of quantities,"<sup>118</sup> the following bill of particulars has been submitted: "But the quantity reported by the Commission for each inventory unit is at best only an estimate, a more accurate estimate than those upon which the state appraisals have been predicated, perhaps, but none the less an estimate. The degree of error necessarily differs with the unit of plant measured or counted, depending upon the extent to which human judgment and not mechanical counting is

*Oklahoma Western Ry. Co.*, 116 I.C.C. 247, 250 (1926); *Dansville & Mount Morris R. R.*, 116 I.C.C. 274, 275 (1926); *Great Northern Ry. Co.*, 133 I.C.C. 1, 76 (1927); *Pennsylvania R. Co.*, 22 Val. Rep. 1, 99 (1929); *Norfolk & W. Ry. Co.*, 26 Val. Rep. 255, 272-273 (1929). But where the materials, when purchased, were new, the payment of exceptionally low prices as a result of unusual conditions may not measure the "normal prices" sought by the Commission. See, for example, corrections in unit prices in *Lake Superior & Ishpeming Ry. Co.*, 116 I.C.C. 1, 4-5 (1926).

<sup>116</sup> *Kansas City Southern Ry. Co.*, 75 I.C.C. 233, 238-239 (1919); *Elgin, Joliet & Eastern Ry. Co.*, 84 I.C.C. 587, 603-604 (1924); *Atchison, Topeka & Santa Fe Ry. Co.*, 127 I.C.C. 1, 32-33 (1927). But items of machinery purchased second-hand and rebuilt by the carrier prior to valuation date were included in reproduction cost new at not less than their cost as rebuilt. *Roscoe, Snyder & Pacific Ry. Co.*, 97 I.C.C. 1, 8-9 (1925).

<sup>117</sup> H. B. Vanderblue, *Railroad Valuation by the Interstate Commerce Commission* (1920), p. 23.

<sup>118</sup> *Ibid.*, p. 30.



significant. How great this error may be can only be determined by a qualified engineer. To point out the existence of the source of error is sufficient for the economist. The conspicuous case is, of course, the definition of standards and the classification of materials, doubly important, too, because of the necessary correlation with unit prices. But the problem of estimating is by no means limited to grading. The Commission's engineers have inventoried the ties (by classes) by counting the ties in two 600-foot sections in each mile; the weight, kind of material, brand and standard length of rail, whether new or relay, have been noted at least once in each mile; the 'probable dimensions' of the accessible portions of bridges and the 'probable penetration' of piles have been reported. Buildings have been inventoried on the basis of cubic contents, or the square feet in side wall or floor. And locomotives have been inventoried by the pound. . . ."<sup>119</sup>

All this is true, and it reinforces the evidence available on all sides of the inherent defects of the cost of reproduction method (indeed, of the "fair value" rule as such); even as seemingly objective a task as the making of the physical inventory cannot be divorced from an extensive use of judgment and estimate. But there is little ground for belief that the inventories reflect substantial inaccuracies which can be traced to the Commission's shortcomings in performance. As in all aspects of the reproduction appraisal, the results suggest a false and unfounded exactitude. But there was ample basis for the Commission's dictum that the requirement of "an inventory in detail of each piece of property . . . would be impossible of performance, if construed narrowly."<sup>120</sup> It would have been a forbidding task, for all practical purposes, to count every tie, to determine the precise weight and character of every rail, to measure the dimensions and consider the constituents of all parts of every structure, to treat each item of equipment in accordance with its distinctive detailed specifications; and it would have been literally impossible to inventory much of the materials involved without classification and estimate. The determination to do "a common sense job" was quite in accord with the Commission's generally pragmatic processes. In terms of any absolute standard of accuracy, there was doubtless error; but such

<sup>119</sup> *Ibid.*, pp. 26-27. Footnote references in this passage have been omitted.

<sup>120</sup> *Texas Midland R. R.*, 75 I.C.C. 1, 113 (1918).

error was not grounded in arbitrary procedure, nor did it issue in flagrant departure from fact. In order that the results might be rendered as reliable as possible, as well as for reasons of economy, the Commission made independent inventories, but not without the active cooperation and participation of the carriers.<sup>121</sup> The coöperative methods pursued justify the Commission's conclusions: first, "that this inventory is really the joint product of the carrier and the bureau, or, at all events, that the Commission's valuation forces have fully considered everything which the carrier desires to point out or to say in the completion of the inventory"; and second, "that . . . all unnecessary duplication of effort has been avoided and that a more accurate inventory is produced than would otherwise be obtained."<sup>122</sup> Under these circumstances, the fact that "there has been almost no complaint of omission upon the part of the carrier and comparatively little dispute as to quantities" is significant.<sup>123</sup>

<sup>121</sup> "An inventory of this character," said the Commission,<sup>4</sup> "can only be prepared after an inspection of the property. Some representative of the Commission must either see the property which is included or must ascertain such facts as demonstrate the existence of that property to a reasonable certainty. If an inventory is filed by the carrier, it must be checked by the Commission to this degree of certainty, and this would mean that the work of filing the inventory would be duplicated by the work of subsequently checking the same inventory. It was felt that the total expense of preparing the inventory would be less if made by the Commission in the first instance with such assistance from the carrier as could properly be called for and granted. This method avoids the duplication of effort and secures an inventory which can be vouched for by the Commission and which also reflects the claims of the carrier itself, at the least total outlay by which a result of that character could be obtained." *Ibid.*, p. 110.

<sup>122</sup> *Ibid.*, p. 112.

<sup>123</sup> *Ibid.* Compare the following, at p. 143: "It may be said, although that claim has not been very clearly urged by the carriers, that it is impossible to enumerate all the items of property which enter into the construction of a railroad, and that some sum must be included to take care of inevitable omissions. While this might be so in case of an inventory hastily taken, it is not true of the inventories made by the Commission pursuant to the valuation act. To an extent the Commission's inventory is made in the first instance by the carrier and checked by the Commission. This is true of equipment. The carrier furnishes a list of its rolling stock of all kinds, and that list is verified by the representatives of the Commission. It is significant as bearing upon the accuracy of the work that up to the present time in no case has there been any dispute between the carriers and the Commission as to the units of equipment which the carrier owns. Further investigation by the Commission's engineers has shown that many such units which appeared upon the records of the carrier as in existence were no longer in service, and in some instances equipment has been identified which did not appear upon the records of the carrier; but in the end there has been a complete agreement between the carrier, the engineer, and the accountant, all approaching this subject from different points of view." Examination of the long series of subsequent valuation reports reveals that differences respecting inventories have been infrequent and

The artificial character of the reproduction cost theory which the Commission, as required by the Valuation Act, was pressing into service, and the inherently speculative nature of the task of arriving at exact dollar and cents judgments on the innumerable items inevitably in dispute, are further illustrated by the problems involved in fixing upon a "program of construction" and in determining the "unit prices" to be applied to the inventories. The program of theoretical reproduction for each carrier was prepared on the basis of practicableness and economy under conditions existing on valuation date.<sup>124</sup> Not only were the uncertainties of original construction presumed to be absent, but the historical actualities of such construction were freely disregarded when deemed inconsistent with necessary or approved practice at the time of valuation. For example: "It often happens that the track was at first supported upon a timber trestle which later was filled. The existing structure is an embankment, which contains upon the inside the original trestle. In the inventorying of the property this is measured, computed, and priced as though it was simply an embankment, no reference whatever being made to the trestle. In applying the price the engineer inquires whether approved construction would require the erection of a temporary trestle from which the embankment would be built, or whether the embankment should be constructed without the expense of such trestle, or so much of it as has not decayed. If good construction would require a temporary trestle, then proper allowance is made for the same; otherwise the price is determined as though no trestle had

unimportant, involving, in general, such conjectural matters as the probable normal waste of material during construction and the reasonable allowance for ballast shrinkage. See, for example, *Lehigh Valley R. Co.*, 34 Val. Rep. 1, 12-13 (1930), and *Bessemer & L. E. R. Co.*, 34 Val. Rep. 745, 763 (1930).

<sup>124</sup> *Texas Midland R. R.*, *supra*, at p. 11. After considering in some detail the objections raised by the Minnesota Railroad & Warehouse Commission against a too literal construction of "cost of reproduction new"—the contention being that the Commission should confine itself to ascertaining "the cost of the railroad property as it stands on valuation date without taking into consideration any expense which would be incurred by reason of the fact that it would have to be built" (p. 12)—the Commission concluded (p. 14): "Cost of reproduction new, as applied to the items embraced in the engineering report, must be assumed to mean exactly what the words themselves imply, namely, that a railroad actually being operated is conceived of as nonexistent and then theoretically brought into existence by a succession of steps well known to competent engineers."

ever existed."<sup>126</sup> Similarly, where the carrier protested the exclusion by the bureau of 106,522 cubic yards of excavated material, the Commission answered: "An economical reproduction of the property of the carrier would render unnecessary the excavation of this material in the same manner as it was excavated in original construction and for this reason it has no place in cost of reproduction new."<sup>126</sup> The fact, then, that a program worked out by the bureau varied from the program of actual construction served in no way to invalidate the estimates based thereon. But marked departures from historical fact also sprang from the reproduction hypothesis as such. All existing means of transportation, aside from the carrier being valued, were assumed to be present, regardless of when they came into existence, and intersecting roads were used, theoretically, to bring men and materials to junction points, enabling hypothetical reproduction to proceed simultaneously at several different places.<sup>127</sup> "This assumption," the Com-

<sup>126</sup> *Ibid.*, pp. 117-118. "The same rule would apply," said the Commission, "where, owing to climatic or other changes, a water course which existed when the road was constructed had dried up and disappeared. Originally that stream was crossed by a trestle or possibly a bridge, but when the necessity for this no longer existed the bridge or trestle was filled, presenting today a continuous embankment. In this case present topographical conditions are assumed, and nothing is included for the bridge necessary in the first building of the road." *Ibid.*, p. 118.

<sup>126</sup> *Kansas City Southern Ry. Co.*, 75 I.C.C. 223 (1919), at p. 244. The following, involving the question of classification of material, likewise illustrates the Commission's independence in formulating a program of construction: "The carrier objects to the classification of 3,000,000 yards of grading material as teamwork excavation. It asserts that this yardage should be classified as steam-shovel work and priced accordingly. In its last analysis the claim of the carrier is an attack upon the program adopted by the bureau for the reproduction of the property of the carrier. What the carrier is contending for is that the property should be reproduced in the particular way it was originally built. In the instant case, after careful consideration, we are convinced that the method adopted will lead to more accurate results than the one suggested by the carrier. It follows that the classification of the 3,000,000 cubic yards in controversy is approved." *Ibid.*, p. 245.

<sup>127</sup> *Texas Midland R. R.*, 75 I.C.C. 1, 32 (1918). In *Kansas City Southern Ry. Co.*, *supra*, the Commission pointed out that "the estimates of the bureau contemplate the reproduction of the separately owned properties by themselves. . . . A compliance with the statute to our minds contemplates the reporting of physical facts with respect to each common carrier separately rather than by systems where, through stock ownership, convenience, or otherwise, the properties of two or more common carriers are welded into one system for the purposes of operation" (pp. 256-257). Under these circumstances, both "the accident of ownership" and the status of railroad development in a particular region become significant. The following comment is altogether pertinent, although it constitutes a stricture upon the reproduction hypothesis, rather

mission remarked, "often reduces the period allowed for reproduction materially below that which was required for the building of the property, but since the circumstances and conditions surrounding

than upon the Commission's performance: "Had the Texas Midland been absorbed, say by the St. Louis Southwestern, the latter road would not, as now, be available to haul men and materials. Conceivably a different construction program, and a different cost of reproduction would result. Likewise if the Pacific coast extension of the St. Paul had not been built, a different construction program for the Northern Pacific would be necessary, from the program now available. That line, extended as a pioneer, carried materials over its completed portion to the end of track. Now that the St. Paul is built, it can receive men and materials at many points along the line." H. B. Vanderblue, *Railroad Valuation by the Interstate Commerce Commission* (1920), pp. 13-14. (Footnote references in this passage have been omitted.) Compare, also, the following: "It was necessary in the building of the Central Pacific to construct expensive wagon roads for the purpose of hauling the necessary materials. Today those are highways maintained at the public expense and are available." *Texas Midland R. R., supra*, p. 139. In *Atchison, Topeka & Santa Fe Ry. Co.*, 127 I.C.C. 1, 24-32 (1927), it appeared that the Bureau of Valuation had included in its tentative report figures for freight on ties, piling, and bridge and culvert lumber which involved a rejection of the single-impulse theory of reproduction, and which assumed, instead, that the carrier being valued was available for transportation. In defense of this procedure, the bureau argued that "if the strict theory of reproduction of a non-existent property were followed it would be impossible to reproduce except at a prohibitive cost the exact kinds of items in the track on valuation date. Because they have their own lines to haul over, carriers use material in replacements under operation that they would not use in original construction, and competent engineers would not build a railroad by using materials not available except at a prohibitive cost" (pp. 26-27). This departure from earlier policy was justified by the bureau on the ground "that when the *Texas Midland case* was decided the effect of the nonexistent theory was not considered with reference to longer lines and systems of railroads, inasmuch as the Texas Midland was only 110 miles long and was intersected by a number of foreign lines, and whether it was considered in existence or not, did not affect the question of haul" (p. 27). But the Commission found no controlling reason for abandoning its established position: "We are unable to approve the methods used in preparing the tentative reports in so far as they are based upon the theory of the existence of the whole line during the entire course of the construction period and its complete availability for the transportation of construction material. . . . So far as we are advised, the almost universal practice in valuation proceedings has been to accord to the words 'reproduction' and 'cost of reproduction' their ordinary significance, which . . . implies in the case of an operating railroad or other property the assumption of its nonexistence and its theoretical reconstruction under methods customarily employed in actual practice. This interpretation is necessary to avoid the contradiction of assuming the existence of the railroad under valuation for the transportation of construction material while at the same time assuming the progress of construction activities in the reproduction of the very same property. . . . We must choose between two irreconcilable theories, and our choice is simplified by the circumstance that we are by law required to ascertain, not cost of replacement under maintenance, but cost of reproduction" (pp. 28, 29). In conformity with the bureau's contentions, however, no sanction was given to any plan that would involve prohibitive or excessive outlays: "If the identical kind of ties or lumber in the roadway can not be reproduced with proper regard for economical practice, a substitute must be found equal, as nearly as may be, in quality and serviceability, just as it would

reproduction are entirely different from original construction, this method is believed to be fair."<sup>128</sup> In a very real sense the program of construction cannot be separated from the other elements involved in the hypothetical restoration of the properties. It is bound up in all aspects of the reproduction method, and it manifested itself, as has already appeared, in matters of inventory, classification, overhead allowances, additions for contingencies, duration of the building period, and numerous items of allied character.<sup>129</sup>

In view of the technical nature of the entire process, and of the numerous opportunities for diversity of judgment, the Commission necessarily displayed a large measure of confidence in the work of the Bureau of Valuation when assumptions and practices adopted by that body were called into question by protesting carriers. The following is typical: "We have carefully examined the testimony relating

be availed of by a prudent management in charge of a program of construction" (p. 29). As a result of the Commission's ruling, which meant "that commercial hauls must be substituted to a considerable extent for the company hauls used in the preparation of the tentative report" (p. 30), \$2,621,565 was added to the figure for cost of reproduction new, and \$1,805,607 was added to the figure for cost of reproduction less depreciation (p. 32). See, also, *Great Northern Ry. Co.*, 133 I.C.C. 1, 9-13 (1927); *New York Central R. Co.*, 27 Val. Rep. 1, 16-17 (1929); *Boston & M. R.*, 30 Val. Rep. 515, 522 (1930).

<sup>128</sup> *Texas Midland R. R.*, 75 I.C.C. 1 (1918), p. 32.

<sup>129</sup> As suggestive of the type of problem with which the Commission was compelled constantly to deal in this connection, mention may be made of the claim of the carrier in *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), relative to allowances for transportation charges on locomotives and freight cars. This equipment was assumed to move on the commercial freight rate, and in the tentative valuation the freight allowance was computed on the theory that all of the cars and locomotives would be delivered at Salt Lake City, the nearest point on the carrier's line from the point of manufacture. The carrier protested "that charges computed upon this basis make no allowance for cost of distribution over the carrier's line," and urged that computation be made upon the theory that half of the equipment would be delivered at Salt Lake City and half at Los Angeles. After due consideration the Commission denied the carrier's claim, pointing out that "some of this class of equipment would be put into service soon after leaving the point of manufacture and would move under load most or all of the way to point of connection with the carrier's line"; that "a considerable proportion of that equipment would move under load to various destinations after reaching the carrier's line and immediately upon the beginning of operations"; and that "in connection with such movement under load the carrier would not only be obliged to pay no freight charges but would receive revenues which would to that extent offset any possible understatement of freight charges in the figure reported." *Ibid.*, pp. 483-484, 484. And see, at pp. 475-476 and 480, illustrations of the Commission's handling of more or less minute details of similar character. See, also, *Atchison, Topeka & Santa Fe Ry. Co.*, 127 I.C.C. 1, 59-60 (1927); *Great Northern Ry. Co.*, 133 I.C.C. 1, 106-107, 108 (1927).

to the practicability of the program of reconstruction that our engineers have adhered to. Whether or not it was the best possible program that could have been adopted we need not decide. For the purpose of estimating the cost of reproduction of the carrier's property in this case we approve it."<sup>180</sup> In principle, the Commission was probably sound both in rejecting many claims based on the construction programs originally followed, and in its general disposition to support the conclusions of the bureau. With respect to the first of these matters, it might be argued that the Commission was thinking in terms of duplicating the service rather than of strict reproduction cost, but it was in fact merely according controlling weight to present conditions, without relinquishing the definite anchorage of the plant actually in existence. As to the Commission's acceptance of the bureau's findings, it was based in all instances upon a full consideration of all the facts, after granting every reasonable opportunity to the carriers for the assertion and support of their claims. None the less, the critic would be hardy indeed who would venture dogmatic approval of the Commission's judgment in the numerous matters of detail on which, in this connection, it was forced to pass. It is sufficient to assert that there is no ground for questioning the substantial soundness

<sup>180</sup> *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), at pp. 474-475. When, however, sufficient grounds appeared for overruling the assumptions of the Bureau of Valuation, the Commission did not hesitate to do so. In *Pennsylvania R. Co.*, 22 Val. Rep. 1, 95-99 (1929), for example, an interesting problem arose in connection with the treatment of company-built locomotives. Should such locomotives be figured at cost to the company or at commercial prices? Of 3,737 locomotives owned and used by the Pennsylvania Railroad, 2,068 were built in its Altoona shops, as were also 781 locomotives owned by other carriers in the Pennsylvania system. The bureau applied unit prices based on Pennsylvania construction costs; the carrier contended for an addition of \$5,607,539 to the cost of reproduction new, on the basis of commercial prices, arguing, *inter alia*, "that the assumption that the Altoona shops would reproduce the locomotive is unreasonable and wholly irreconcilable with the major premise of the reproduction theory, namely the obliteration of the railroad plant and its reconstruction at a single impulse under a practical program" (p. 96). This departure from "the customary assumptions" did not approve itself to the Commission. In sustaining the carrier, the Commission said (p. 97): "The method of acquisition of the property to be reproduced or its original cost should not be the controlling factors in estimating cost of reproduction. Under the assumptions made by the bureau to obtain the reproduction cost of the locomotives, we have the peculiar situation wherein two locomotives, identical with respect to type, age, service, and condition, are given different estimated costs because of the fact that originally one was purchased from the builder and the other was made in the shops of the carrier. If our reproduction estimate is to mean anything, the same estimated costs should be applied universally to all similar units of equipment owned by the same carrier."

of the results as a whole. A like conclusion appears to be justified in the matter of "unit prices."

The completion of the inventory and the formulation of the construction program must be further supplemented by a determination of unit prices. Cost of reproduction can be ascertained only upon the application of prices to the various quantities listed; and since the prices cover the entire cost of each unit in place, they must embrace costs of transportation, handling, storing, and installation. The Commission's task, as a necessary fundamental, was to establish some reasonable basis for the ascertainment of such prices. The method adopted was essentially one of reliance upon judgment grounded in specific data. In general conformity with the reproduction hypothesis, data gathered from the experience of the individual carrier whose property was being valued played a relatively minor rôle.<sup>181</sup> Such experience, as of valuation date, seldom embraced any substantial portion of the numerous items involved, and when available for a long enough period in the past it would measure original rather than reproduction cost. Nor, on the other hand, was reliance placed upon evidence of the extreme opposite sort, expert opinion, which the Commission took occasion to condemn in unusually positive terms.<sup>182</sup>

<sup>181</sup> Note the following, for example, from *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), at p. 477: "The carrier's exception to the cost prices at point of purchase which we have applied to tie plates, rail braces, manganese crossings, and other items is based upon prices which it paid for such materials at the time when it constructed 84 miles of its line in Meadow and Clover Valleys. The prices, on the other hand, that we have used for these items have been determined by consideration of the large amount of data furnished by carriers throughout the country. . . . The proper price to apply under a theoretical reproduction of the property is an average or a normal price determined after considering a large number of construction projects rather than the price determined from a particular carrier's experience on a single project." In a number of cases the Minnesota Railroad and Warehouse Commission contended that tentative valuations were excessive, basing its protests on alleged original cost figures for the roads in question, corrected by the application of a conversion factor derived from the Department of Labor wholesale commodity price index. Such figures, the Commission has held, are inferior to its unit prices as of valuation date. See *Duluth & Northeastern R. R. Co.*, 119 I.C.C. 750, 752 (1926); *Chicago & North Western Ry. Co.*, 137 I.C.C. 1, 16 (1928). For a discussion of price proposals for the determination of the reproduction cost of locomotives, see *Great Northern Ry. Co.*, 133 I.C.C. 1, 105-106 (1927); *Toledo, St. Louis & Western R. R. Co.*, 141 I.C.C. 287, 309 (1928).

<sup>182</sup> "The carriers contend," said the Commission, "that the only proper evidence of these prices is the opinion of an expert. If the price of engineering be in question, then an engineer must be called and his opinion taken. If the inquiry is upon the fair cost of grading, then a contractor must be produced, who should give his opinion



Instead of proceeding along either of these lines, the Commission resorted to the past price experience of the carriers as a whole as interpreted by its own engineers.

Regardless of the dates of the various inventories, unit prices were applied in all cases as of June 30, 1914; but the figures computed and accepted for this purpose were designed to represent "normal prices," rather than to reflect the prices which were actually paid or chanced to be listed at that time. "The attempt," said the Commission, "is not to determine the exact price of a particular article on that date, for that price may have been abnormally high or low, but rather to ascertain what may be termed a normal price."<sup>183</sup> As a basis for the ascertainment of these prices, the Commission required the carriers to provide from their records sworn information concerning the prices actually paid by them for materials, supplies, and labor of all kinds entering into railroad construction and operation for the period of five years, and in some instances ten years, immediately preceding June 30, 1914.<sup>184</sup> From these returns a compilation was made showing

upon this point. The unreliability of mere opinion evidence is well understood by all those who have ever had experience with it. An opinion is personal to the man who gives it. It depends upon his education, his mental habit, his present mental state. It is influenced by his environment and often controlled by the objective point which he desires to reach. The same man may hold different opinions upon the same subject at different times. Perhaps the most serious infirmity of opinion evidence is that the witness may be selected at the will of the one producing him. A fact must be established by those who have knowledge of it, who were present and saw it, for example, but an expert can be brought from the ends of the earth, and a dozen may be rejected till the right one is found. Given time and the money, almost any opinion can be had within certain limits. After careful consideration it was felt by the Commission that it would be unwise and unsafe to depend chiefly upon the opinion of experts; that the only certain foundation upon which to rest was the experience of the past." *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at pp. 135-136.

<sup>183</sup> *Ibid.*, p. 136. In like manner, with regard to the labor costs involved in installation, the Commission concluded that "the general average furnishes a basis upon which the Commission may rest with confidence. The best measure of the cost of doing a piece of work on June 30, 1914, is what that work did in fact cost during the years immediately preceding that date." *Ibid.*, p. 137.

<sup>184</sup> *Ibid.*, p. 136. The following is a more detailed statement of the methods pursued by the Commission in securing cost data for the support of its unit prices: "Under date of February 9, 1915, the Commission issued its Valuation Order No. 14, known as 'Order, instructions, and forms pertaining to purchases of materials, prices paid, and rates of compensation paid for labor.' With respect to materials, this order required every carrier whose property was to be valued to file with us a statement of the two largest purchases of each class of material for each calendar year from 1910 to 1914, inclusive, together with net prices paid. In the event that two purchases per

"the average price paid by the principal carriers of the entire country for a given article at a given point."<sup>185</sup> These averages constituted the basic data, but they were not accepted, without more, as the prices to be applied to the inventory.<sup>186</sup> In the light of the totality of

year had not been made, a statement of such purchases as might have been made was required. Information with respect to certain materials for the period from 1905 to 1914, inclusive, and as many as four purchases per year were in some instances required. The statement required, among other things, information as to the purpose for which the material was used, the name of the maker, the maker's catalogue number or reference, name of the party from whom purchased, and the amount of freight charges actually paid. With respect to labor, the carrier was required to report the rates of compensation paid on each of its separate divisions for each calendar year, 1910 to 1914, to all classes of employees. The rate of compensation was defined to be the usual and ordinary rate paid for the particular occupation, and required the rate for each year to be obtained by taking the governing rate on the first day of January, April, July, and October of each year and dividing the aggregate by four." *Ibid.*, pp. 35-36.

<sup>185</sup> *Ibid.*, p. 137. The carriers' returns were sometimes verified by the Commission's accountants, and in addition statements were obtained from manufacturers "showing the prices at which standard goods had been sold to railroads during the same period." *Ibid.* By way of supplementing the labor data, the carriers also filed with the bureau "completion reports" of various construction projects recently undertaken. "We are required to report to the Congress the cost values with respect to completed properties, and the cost of assembling must be shown in addition to the cost of materials and labor. In order to ascertain what had been expended in the past, the carriers were required to file a statement of all completed projects for which information could be furnished. After these statements were received, certain of the projects therein contained were selected and completion reports were required to be filed. In addition to this information, an accountant has been detailed in each district to bring together cost data under the direction of the district engineer." *Ibid.*, p. 36. Transportation costs, with occasional exceptions, were taken to equal the commercial freight rate as of June 30, 1914, from the point of shipment of the materials to some point upon the line of the carrier being "constructed." By way of concrete application of this rule, note the following from *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), at p. 477: "In determining the cost of transporting other track material we have applied rates on material to be delivered at Daggett which were in effect on June 30, 1914. The carrier has shown that a somewhat higher rate was in effect before that time when, under the assumed program of reconstruction, some of the material might have moved. In making determinations as to prices of materials, it is a practical impossibility to observe all refinements such as varying freight charges from day to day or as transportation charges may have fluctuated throughout the theoretical construction period. We deem it proper as a general rule to determine transportation costs to the most economical delivery points on the line of the carrier or the carrier system upon the basis of rates in effect on June 30, 1914, excepting from this rule instances where the published rate is deemed to be unreasonably high, due to the absence of commodity rates or other reasons. In such cases we adopt what may be termed reasonable rates to be applied for reproduction purposes." See, also, *ibid.*, p. 486.

<sup>186</sup> "The price so applied is mainly dependent upon past experience, but it is not a mere mechanical average. Both the engineers who supervise the compilation and those who apply the price are familiar with the subject and property under consideration.

the information thus gathered, reinforced by special knowledge and experience, unit prices were finally fixed by the Commission's engineers.<sup>187</sup> The Commission placed confident reliance upon these engineers because of the large mass of specific data at their disposal, because of their general competence in this field, and because of their disinterested approach. "It will be seen," the Commission announced, "that when the engineers of a particular district are called upon to price an installation they have before them the record of what it has cost to do similar work in numbers of cases. They are themselves men of experience and of judgment who have built, bought, and installed the kind of material or apparatus under consideration. They are practical men who bring to the question before them judgment ripened by experience. They are actuated by the sole desire of applying a proper price."<sup>188</sup> Hence, on the whole, the prices thus fixed were accepted. "The Commission, after having worked out prices by this method and listened to the criticism of the carriers made upon the same, has no doubt of their substantial accuracy. While individual carriers have paid and would have paid, had they been constructing their properties during the five years preceding June 30, 1914, prices somewhat varying from those applied to our inventories, considered as a whole the prices employed are believed to be fair."<sup>189</sup> In some in-

While the price depends upon the cost data and can be relied upon in proportion as it is supported by such cost data, it must be such as commends itself to the judgment of one qualified to judge." *Texas Midland R. R.*, 75 I.C.C. 1, 138 (1918).

<sup>187</sup> "The complement of each valuation district has, in addition to the district engineer, a corps of experienced engineers. These men have had practical experience in railroad construction in the past and are conversant with every phase of the problem. The sole purpose of these men is to apply prices to the units of property set forth in the inventory which will do justice to all concerned. These men study the cost data which have been received from carriers and exercise their judgment as to the prices to be allowed in a theoretical reproduction of the property under valuation. The cost data which are before the engineers are not controlling, but are applied with reference to the particular property the details with respect to which are well known by observation to the engineers." *Ibid.*, p. 36.

<sup>188</sup> *Ibid.*, p. 138.

<sup>189</sup> *Ibid.*, p. 137. By way of further support of its general conclusions, the Commission said: "Costs arrived at in this manner will not exactly coincide with the original prices paid; some will be higher and some lower than those which obtained on original construction. A stroke of hard luck may inflate the price; there are wet seasons and dry seasons; organization and coordination profoundly influence cost. Labor conditions may be entirely different. All this may affect individual prices, but it is believed that the general price arrived at by the foregoing method can be used with confidence in reaching a reproduction estimate for railroads as a whole. This method

stances the prices applied were the result of agreement between the bureau and the carriers, but in all cases the Commission proceeded with a presumption in favor of the correctness of the bureau's determinations.<sup>140</sup>

How far is this aspect of the Commission's processes entitled to approval? The decision to determine unit prices on the basis of a vast array of cost data rather than to depend upon the distinctive price experience of the individual carrier being valued was clearly in accord with the reproduction hypothesis. The decision to use "normal" prices was equally sound, since the prices prevailing on a given date are subject to all sorts of accidental influences and can possess no special significance in the time-consuming task of reconstructing an extensive plant. Whether the norm was properly determined depends upon whether the period over which the prices were taken corresponds roughly to the probable time required for reproducing the property. At this point the Commission, by utilizing a uniform period of five to ten years in the computation of unit prices, appears to have tempered strict logic with reasonableness. Since it was engaged upon a comprehensive valuation task, it accorded uniform treatment to all the carriers; and because of "the hazards which attend all prophesies in respect to prices," it adopted a longer experience than that measured by the probable period of reconstruction. Even if, from the standpoint of strict reproduction doctrine, the Commission may be

is better than mere expert opinion, for the opinion of the expert is valuable in proportion as his experience has been broad and universal, while here we have the experience not of one but of hundreds of experts." *Ibid.*, p. 139.

<sup>140</sup> For a detailed account of the methods and considerations governing the determination of unit prices, see *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at pp. 35-48 and 135-140. For brief discussions of the application of these methods and considerations to particular prices, see *Kansas City Southern Ry. Co.*, 75 I.C.C. 223, 246-248, 253-256 (1919); *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463, 477-480 (1923); *Akron Union Passenger Depot Co.*, 106 I.C.C. 305, 307-308 (1925). See, also, *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645, 651-652 (1923); *Bangor & Aroostook R. R. Co.*, 97 I.C.C. 153, 168 (1925); *New York, Philadelphia & Norfolk R. R. Co.*, 97 I.C.C. 273, 289-298 (1925); *Wyoming Ry. Co.*, 114 I.C.C. 194, 195 (1926); *Gulf & Northern Ry. Co.*, 114 I.C.C. 506, 507 (1926); *Lake Superior & Ishpeming Ry. Co.*, 116 I.C.C. 1, 8 (1926); *Cumberland & Manchester R. R. Co.*, 116 I.C.C. 407, 408 (1926); *Achison, Topeka & Santa Fe Ry. Co.*, 127 I.C.C. 1, 34-43 (1927); *Great Northern Ry. Co.*, 133 I.C.C. 1, 88-95 (1927); *Chesapeake & O. Ry. Co.*, 24 Val. Rep. 451, 465-469 (1929); *Chicago, R. I. & P. Ry. Co.*, 24 Val. Rep. 709, 747-753 (1929); *Duluth, M. & N. Ry. Co.*, 26 Val. Rep. 387, 408-410 (1929); *Boston & M. R.*, 30 Val. Rep. 515, 523-528 (1930).

said to have erred somewhat in so doing,<sup>141</sup> its position none the less appears more defensible than the apparent acceptance by the Supreme Court of "spot" prices as of valuation date.<sup>142</sup> The artificiality of the reproduction theory was not to be further accentuated by results possessing but a momentary significance. The hypothetical figures, in so far as they are dependent upon unit prices, were made to bear some realistic relationship to normal reproduction costs. Nor can any valid

<sup>141</sup> The Commission's results with regard to unit prices approximated the original cost of most of the property in existence in 1914. In the first of its valuation reports the Commission said: "While the Commission is not as well informed today as it hopes to be before the end of its work, we are prepared to state with considerable confidence that the cost of producing and equipping a railroad in most parts of this country on June 30, 1914, was a fair average for at least the 20 years preceding. There had been many changes during that period. Some prices had advanced while others had declined. The cost of labor had somewhat increased, but improved methods tended to offset this increase. On the whole, the 1914 cost was just about an average for those previous years during which the great bulk of the railroad property then in use had come into existence." *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at p. 140. This interpretation of the results was confirmed almost nine years later in *Excess Income of St. Louis & O'Fallon Ry. Co.*, 124 I.C.C. 3 (1927). The Commission said (p. 42): "The line of railroad of the O'Fallon . . . was constructed in the years from 1896 to 1900, both inclusive. While a satisfactory statement of the carrier's actual investment, or of the original cost of its property, is not available, much thought and effort have been devoted by us in our valuation work to determine the costs of building railroads during the years immediately following the period when this carrier's property was being built. The results of that study are reflected in the unit prices, which are herein termed 1914 unit prices, used in making the reproduction cost estimates of this property." The Commission then quoted with approval the statement from the *Texas Midland* case set forth above, "with regard to the reliability of these unit prices for use in approximating the probable, reasonable, and necessary costs of constructing railroad properties built prior to June 30, 1914." In so far as actual cost or approximate investment is accepted as the controlling determinant of final value, these results provided a useful approximation to original costs, in the absence of original costs derived from authentic records; but in so far as these results are designed to represent reproduction cost, the question may pertinently be raised whether their approximation to original costs did not spring from the use of an unduly extended experience in the establishment of normal unit prices.

<sup>142</sup> See note 57, *supra*, with special reference to the *McCardle* case. In his dissenting opinion in that case, Justice Brandeis expressed views on this issue in substantial conformity with the practice of the Commission: "Nor do I find in the decisions of this Court any support for the view that a peculiar sanction attaches to 'spot' reproduction cost, as distinguished from the amount that it would actually cost to reproduce the plant if that task were undertaken at the date of the hearing. 'Spot' reproduction would be impossible of accomplishment without the aid of Aladdin's lamp. The actual cost of a plant may conceivably indicate its actual value at the time of completion or at some time thereafter. Estimates of cost may conceivably approximate what the cost of reproduction would be at a given time. But where a plant would require years for completion, the estimate would be necessarily delusive if it were based on 'spot' prices of labor, materials and money. The estimate, to be in any way worthy of trust, must

ground of protest be found in the Commission's determination to apply normal prices as of June 30, 1914, to all inventories, regardless of their date.<sup>148</sup> "At the beginning of the valuation work," said the Commission in the first of its important final valuation reports, "we deemed it advisable, for purposes of comparison, and also for the purposes of securing a base for future use in fixing values as of later dates, to price all common-carrier structures as of a common date."<sup>144</sup> It is obvious that a value derived by applying 1914 prices to a 1914 inventory is not comparable with a value resulting from the application of 1914 prices to a 1918 inventory. Revision would clearly be necessary if such results were to be utilized for regulatory purposes. At this point, however, the Commission was seeking reproduction cost rather than a rate base, and it was merely obtaining information rather than reaching any final conclusion. Since all of the figures were later to be brought up to date, the method by which this revision was to be ef-

be based on a consideration of the varying costs of labor, materials, and money for a period at least as long as would be required to construct the plant and put it into operation. Moreover, the estimate must be made in the light of a longer experience and with due allowances for the hazards which attend all prophesies in respect to prices. The search for value can hardly be aided by a hypothetical estimate of the cost of replacing the plant at a particular moment, when actual reproduction would require a period that must be measured by years." *McCardle v. Indianapolis Co.*, 272 U. S. 400, 423-424 (1926).

<sup>148</sup> The Commission's decision to apply prices, in the first instance, as of a common date, regardless of the date of each particular inventory, was reached only after careful consideration, in the interests of uniformity and as a means of providing a readily comparable basis for subsequent revision. The rationale of this decision was initially set forth as follows: "Our inventories are taken as of different dates, but all prices are applied as of June 30, 1914. The first thought was to apply prices as of the date of the inventory in each case, but subsequent reflection led to the conclusion that this course could not properly be pursued. The railroads of this country are competitive. If the costs which are being produced by the application of these prices are to be influential in the fixing of rates, they ought to be upon some common basis. Without attempting to indicate how far changes in prices should affect changes in value, it is manifest that all carriers ought to be, if possible, measured by the same standard. The fluctuations in price which have occurred since June 30, 1914, illustrate and confirm this view. Many prices, especially of equipment, are today double those of 1914. It would, in our view, be manifestly absurd to apply to the Pennsylvania lines between Washington and Philadelphia, of which the date of valuation is 1914, prices as of that date, while applying to the Baltimore & Ohio, a parallel line constructed at substantially the same time and developed under the same conditions, the prices of June 30, 1918, which happens to be the date of its valuation. If a uniform price be applied that price can be varied by appropriate factors or otherwise as justice may require." *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at pp. 139-140.

<sup>144</sup> *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), at p. 474.

fects constituted the crucial issue; the fact that unit prices were applied to the basic inventories as of a common date was largely a matter of practical convenience. The attack upon the unit prices, then, presented itself largely in terms of differences of judgment as between the Commission's engineers and those of the carriers. Despite its repudiation of expert opinion, the Commission could not escape reliance, in considerable measure, upon the judgment of experts. While an extensive mass of cost data was laboriously collected, these data were translated into unit prices on the basis of the special knowledge and observation and experience of the bureau's engineering personnel. The resulting figures, therefore, were necessarily estimates, and they possessed only a pseudo-accuracy. But although, in the last analysis, resort to the exercise of judgment could not be avoided, the accepted presumption in favor of the Commission's own experts was not without foundation. The fact that the past price experience of the carriers as a whole, collated into specific data of representative character, constituted the dominant source of their judgments together with the fact that the approach of the Commission's engineers was in the very nature of the case a disinterested one, provided ample justification for the confidence reposed in their findings. Such judgments differ essentially from expert opinion produced by the carriers in support of particular *ex parte* claims. While it is impossible to assume that truth lay with the findings of the bureau in all instances, the processes pursued, once the guiding principles promulgated by the Commission are accepted, do not disclose any seriously vitiating sources of error.<sup>145</sup> The claims of the carriers, when

<sup>145</sup> It is interesting to note that the general reliability of the bureau's subsidiary findings was expressly recognized even by those members of the Commission who could not agree with the majority in matters of principle. Commissioner Daniels, for example, although dissenting from the majority in the first of the final valuation reports, explicitly relieved the bureau of all responsibility for what he deemed to be defects in the Commission's report, and he took occasion to commend the high quality of its labors. "It should be stated at the outset that in whatever respects the report may be defective, the Bureau of Valuation is not chargeable. The able, detailed, painstaking, and efficient work of the bureau has resulted in an enormous inventory of the railway plant of the United States that constitutes a notable monument of achievement. The defect in the result, based upon the bureau's careful investigation, arises from what has long seemed to me certain erroneous instructions approved by us, under which the bureau has been operating. In the ascertainment of a figure to be placed upon the aggregate of carrier property devoted to public service, it is inevitable, in the nature of the case, that we must heavily lean and largely rely upon the bureau's

presented in specific terms, were accorded full consideration, but the Commission rightly declined to abdicate its primary responsibility in the premises.<sup>146</sup>

There remains for brief consideration the Commission's treatment of "overheads." These were generally recognized as constituting legitimate charges to the cost of reproducing the physical property, since they represent expenditures that would unquestionably be incurred in "reconstruction," emerging as separate items only because they cannot be allocated to specific units of the inventory.<sup>147</sup> A few such charges were deemed inherently inconsistent with the reproduc-

inventory. Particular items embodied in the bureau's tentative valuation evoke protest, and to these items our attention is specifically called. But in the main we must rely, and no doubt we may do so with safety, upon the propriety and fairness of the bureau's itemized assembly of items." *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 L.C.C. 463, 514-515 (1923).

<sup>146</sup> But compare the following critical comment from H. B. Vanderblue, *Railroad Valuation by the Interstate Commerce Commission* (1920), at pp. 31-33: "Experts were also introduced by the railroads, who fixed upon higher unit prices. In answer to these claims, Mr. Prouty insisted: 'The presumption should be that the work is right, and it should be incumbent upon the carrier to show error with reasonable certainty.' The theory would seem to be that the testimony of even the most eminent expert witness hardly makes that show of scientific procedure which is created by arrays of cost figures, however incomparable and however irrelevant. Nor does the respectability attach to opinions of railroad employees that attaches to the 'judgment' of 'practical men,' government employees instructed to be fair, who, having considered all the cost data and examined the work to be done 'theoretically,' 'finally reach a price which in their judgment is right.' But whether unit prices fixed in one way or fixed in the other are more truly a measure of what it would cost to reproduce a railroad 'theoretically,' who can say? The Commission has been content to accept the Bureau's figures, the figures of the tentative valuation being made final except where the Bureau has later agreed that increases would be 'fair.' But from the nature of the case the ultimate determinant is judgment, and the figures reported are only estimates. Any accuracy professed for them is largely specious." Footnote references in the above passage have been omitted.

<sup>147</sup> From the very beginning the Commission expressly recognized both the need and the propriety of including "overhead charges" in the reproduction cost appraisal: "When an inventory has been prepared, including every item of physical property which enters into the construction of a railroad, and when a proper price has been applied to every item in that inventory covering both the expense of acquiring the property and of putting it in place as a part of the railroad, the result does not express the entire cost of the physical railroad itself for the reason that certain expenses connected with the production of this property have not been taken into account. Before the building of the railroad or even the preliminary steps looking toward its building can be undertaken, a corporation is organized. There must be some entity to hire men and disburse money. The creation of this corporation entails the procuring of legal services and generally the payment of certain fees and other expenses. Engineers must be employed to locate the line, prepare contracts, supervise the construction, etc. There must be a general organization with the necessary employees for the



tion hypothesis. As already noted, for example, no separate allowance for "contingencies" was countenanced. In view of the assumption that all items of property and conditions of construction are exactly known, no special provision was made for the omissions and unforeseen difficulties which inevitably arise in new projects.<sup>148</sup> The principal overhead allowances were for "engineering," "general expenditures," and "interest during construction." The methods employed in ascertaining the amount of these allowances followed the usual practice in railroad appraisals—that is, blanket percentages of total cost were added for engineering and general expenses, and interest during construction was computed on the basis of an assumed rate of interest applied to an assumed construction period. An effort was made, however, to reduce conjecture and personal opinion to a minimum. A broad basis of past experience was looked to as the starting-point for the exercise of judgment. "Seemingly in the past," said the Commission, "the amount of these charges has depended rather upon the impression of the engineer who applied them than upon any well ascertained basis of fact. It has been the attempt of the Commission to reach a conclusion grounded, not upon impression or inclination, but

purpose of conducting the work and making record of the details. Money must be provided for the payment of expenses as the work progresses and the interest on this money is in addition to the capital invested. It is evident that these items and others of a similar character call for the outlay of money, and that they are not represented in the inventory which has been prepared and priced. These items are ordinarily denominated 'overhead charges' for the reason that they attach, not to any particular structure or part of the work, but to the work as a whole or at least to a certain class of that work. It must be conceded that a railroad could not be built without expenditure for some or all of these items, and that if the cost of reproduction is to be indicative of the cost of production at present some inclusion must be made on this account." *Texas Midland R. R.*, 75 I.C.C. 1, 141 (1918).

<sup>148</sup> In so far as allowances for contingencies were deemed necessary, they were included in connection with the price treatment of specific items. "Since reproduction new is at best an estimate," said the Commission, "it is apparent that an estimate arrived at upon a basis as outlined above is as liable to be too high as too low and that therefore there is no warrant for the addition of a definite amount to cover contingencies, but that any allowance of that kind which ought to be made should be and is taken care of in connection with particular items of property." *Texas Midland R. R.*, 75 I.C.C. 1, 26 (1918). See, also, *Winston-Salem Southbound Ry. Co.*, 75 I.C.C. 187, 194-195 (1918); *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645, 653 (1923); *Bangor & Aroostook R. R. Co.*, 97 I.C.C. 153, 160 (1925); *Augusta Belt Ry. Co.*, 103 I.C.C. 523, 525 (1925); *Gulf & Ship Island R. R. Co.*, 106 I.C.C. 111, 112 (1925); *Milledgeville Ry. Co.*, 110 I.C.C. 262, 265 (1926); *Missouri Southern R. R. Co.*, 114 I.C.C. 795, 797 (1926); *Lehigh & Hudson River Ry. Co.*, 137 I.C.C. 698, 706 (1928); *Chicago, R. I. & P. Ry. Co.*, 24 Val. Rep. 709, 764-766 (1929).

upon a substantial foundation. The attempt has been made to bring these charges under the same test which has been applied in the development of prices, namely, the actual experience of the past.<sup>149</sup> Accordingly, on the basis of a study of 121 construction projects of varying types in different parts of the country, the Commission instructed its staff to allow for "engineering," save in exceptional circumstances, from two to five per cent of the investment in road, exclusive of land and engineering.<sup>150</sup> On the basis of a study of the same projects, and especially in reliance upon an examination of a few individual properties "where the circumstances of construction were fully known" and "which were believed to be fairly typical of what might be expected under normal conditions," the Commission has usually permitted the addition of one and one-half per cent of the road accounts, exclusive of land, to cover "general expenditures."<sup>151</sup>

<sup>149</sup> *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at pp. 141-142.

<sup>150</sup> *Ibid.*, pp. 26-28. The exact percentage in each case was fixed by the Commission's engineer, in furtherance of the following considerations: "He must consider the nature of the property with which he is dealing. If the railroad runs through a comparatively level country, crossing few streams, and therefore with few bridges, slight cuts, and no tunnels, the percentage of engineering would be comparatively low even though the cost were also small, but as the difficulties increase the percentage would rise. It must be noted, however, that the percentage may be comparatively low, although the engineering difficulties are many, for the reason that the total cost of the work is large and the percentage of engineering therefore small, although the gross amount of engineering is itself large. In fixing this percentage the engineer also frequently derives great assistance from what he can ascertain as to the original cost. This is by no means conclusive, but it is always instructive and when ascertainable is carefully considered." *Ibid.*, pp. 150-151. See, also, *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645, 652-653 (1923); *Raritan River R. R. Co.*, 84 I.C.C. 463, 465-466 (1924); *Roscoe, Snyder & Pacific R. R. Co.*, 97 I.C.C. 1, 9 (1925); *Cement, Tolenas & Tidewater R. R. Co.*, 108 I.C.C. 555 (1926); *Pittsburgh & Susquehanna R. R. Co.*, 110 I.C.C. 787 (1926); *Chicago, Milwaukee & Gary Ry. Co.*, 114 I.C.C. 16, 18 (1926); *Cumberland & Manchester R. R. Co.*, 116 I.C.C. 407, 408-409 (1926); *Atchison, Topeka & Santa Fe Ry. Co.*, 127 I.C.C. 1, 13-18 (1927); *Great Northern Ry. Co.*, 133 I.C.C. 1, 15-19 (1927); *Chicago, Burlington & Quincy R. R. Co.*, 134 I.C.C. 1, 20-23 (1927); *Chicago & North Western Ry. Co.*, 137 I.C.C. 1, 17 (1928); *Chesapeake & O. Ry. Co.*, 24 Val. Rep. 451, 461-463 (1929); *Chicago, R. I. & P. Ry. Co.*, 24 Val. Rep. 709, 714-720 (1929).

<sup>151</sup> The category of "general expenditures" embraced the accounts involving organization expenses, general officers and clerks, law, stationery and printing, taxes, and other expenditures of a miscellaneous character. When the normal allowance of one and one-half per cent for "general expenditures" fixed by the Commission was attacked as unduly low, the protest was disposed of as follows: "The carrier contends that this percentage is too small, and that the particular group of roads selected by the accountants is not representative. It calls attention to six other roads which might have been selected, for which the average would have been between 4 and 7 per cent.

The treatment of "interest during construction" was, on the whole, similarly orthodox. Efforts made to ascertain the credit status of each

In answer to this it is sufficient to state that no one knew, when the properties included in the study were selected, what the figures would show, and no attempt was made to support any preconceived theory, the sole desire being to ascertain the fact, and it is believed that the results obtained are fairly representative." *Texas Midland R. R.*, 75 I.C.C. 1, 29-31, 151-153, 30 (1918). See, also, *Kansas City Southern Ry. Co.*, 75 I.C.C. 223, 257 (1919); *Manchester & Oneida Ry. Co.*, 103 I.C.C. 1, 3 (1925); *Sewell Valley R. R. Co.*, 106 I.C.C. 236, 237 (1925); *Angelina & Neches River R. R. Co.*, 108 I.C.C. 539, 540 (1926); *Lufkin, Hemphill & Gulf Ry. Co.*, 110 I.C.C. 220, 221 (1926); *Missouri Southern R. R. Co.*, 114 I.C.C. 795, 796-797 (1926); *Atchison, Topeka & Santa Fe Ry. Co.*, 127 I.C.C. 1, 61-65 (1927); *Great Northern Ry. Co.*, 133 I.C.C. 1, 110-111 (1927); *Chicago & North Western Ry. Co.*, 137 I.C.C. 1, 23-24 (1928); *Virginia Ry. Co.*, 141 I.C.C. 595, 627-629 (1928); *Chicago, R. I. & P. Ry. Co.*, 24 Val. Rep. 709, 759-761 (1929); *Western Pacific Ry. Co.*, 29 Val. Rep. 239, 267 (1929). But the one and one-half per cent allowance was not made as an invariable rule. In *Pennsylvania R. Co.*, 22 Val. Rep. 1 (1929), for example, in which one per cent was allowed, the Commission said (p. 105): "We formerly computed general expenditures by the practically uniform application of a percentage of 1.5. . . . After further consideration of the matter we concluded that a sliding scale should be used." Again, in *New York Central R. Co.*, 27 Val. Rep. 1 (1929), in which the allowance was likewise reduced to one per cent, the Commission declared that "because of their magnitude and the opportunities for effecting economies, the percentage necessary for the larger systems has been found to be relatively lower than that for the smaller lines" (p. 39). In many instances, on the other hand, the allowance found to be justified exceeded one and one-half per cent. See, for example, *Great Western Ry. Co.*, 125 I.C.C. 674, 678-683 (1927); *Norfolk & Portsmouth Belt Line R. R. Co.*, 133 I.C.C. 771, 776-777 (1927); *Unity Rys. Co.*, 143 I.C.C. 833, 835 (1928); *Minnesota, D. & W. Ry. Co.*, 25 Val. Rep. 1, 5 (1929); *Kansas City T. Ry. Co.*, 25 Val. Rep. 82, 92 (1929); *Massena T. R. Co.*, 25 Val. Rep. 181, 184 (1929); *Franklin & A. Ry. Co.*, 26 Val. Rep. 197, 208 (1929); *Pullman R. Co.*, 26 Val. Rep. 227, 236 (1929); *Manufacturers' Junction Ry. Co.*, 26 Val. Rep. 607, 609 (1929); *Chicago & W. I. R. Co.*, 29 Val. Rep. 1, 10 (1929); *Fort Worth Bels Ry. Co.*, 29 Val. Rep. 457, 465 (1929); *Union Stock Yards Co. of Omaha*, 31 Val. Rep. 136, 140 (1930). Incorporation fees, unless nominal in amount, were added to the percentage allowance for general expenditures. In the *Texas Midland* case the Commission declared (p. 30): "Where . . . more than a nominal charter fee has been required, the engineers have been instructed to ascertain the amount of such fee and add it to the 1.5 per cent." But only fees actually paid were thus recognized; no allowance was made for hypothetical expenses that might be incurred for this purpose on reproduction. In *Toledo, St. Louis & Western R. R. Co.*, 141 I.C.C. 287 (1928), the Commission said: "Incorporation or charter fees represent moneys paid to the State for the privilege of corporate existence. They are analogous to the cost of franchises and should be treated in the same way. It is well settled that franchises have no place in a valuation for rate-making purposes, except to the extent of outlays made in the acquisition. . . . We are not unmindful that a strict application of the reproduction theory would require a different treatment and cause the ascertainment of what would be paid for incorporation fees on reproduction rather than the original cost. But the reproduction theory must be reasonably applied . . . and the Supreme Court has held that the logical implications of the theory need not be pushed to an extreme inconsistent with equity and justice . . ." (p. 313). See, also, *New York Central R. Co.*, 27 Val. Rep. 1, 39 (1929).

company and the distinctive circumstances which would surround its financing were early abandoned, "because it was found to be an almost impossible task, and the result was misleading."<sup>152</sup> The assumption was made, instead, "that the reconstruction would be done by a company the credit of which was good and which could purchase supplies at advantageous prices."<sup>153</sup> Under these circumstances a rate of six per cent was fixed upon as ample to cover not only interest but all items of expense, such as brokerage, connected with the hypothetical borrowing of money for construction;<sup>154</sup> and the interest was computed for one-half the construction period plus three months upon the total amount of the road accounts, with the exception of land, and the general expense accounts, with the exception of interest during construction.<sup>155</sup> As for the length of the period of construc-

<sup>152</sup> *Texas Midland R. R.*, 75 I.C.C. 1, 31 (1918).

<sup>153</sup> *Ibid.* "Upon no other theory," added the Commission, "would the cost of reproducing the different properties be fairly comparable." *Ibid.*, p. 154.

<sup>154</sup> "Since a railroad with good credit has no difficulty during normal times in borrowing money at  $4\frac{1}{2}$  per cent, it was felt that the rate of 6 per cent would be ample to cover all incidental items of expense in connection therewith." *Ibid.*, p. 31. This conclusion was largely based upon an examination of the sale of bonds of various kinds during the five-year period ending June 30, 1914. Furthermore, the Commission directed attention to the fact that the assumption of equally good credit and the use of the same rate of interest in all cases need not vitiate the findings of final value, since the figures as to reproduction cost are supplemented by financial data, of a historical character, which might justify according special weight to the distinctive experience of the particular carrier: "It should be further borne in mind that engineering reports do not attempt to place a final value upon properties. There may be facts in the financial history of a corporation which would make it just to consider the cost to that road of obtaining money in the determination of its final value. The financial history of every corporation is fully dealt with in the accounting report. The engineering report deals merely with the physical property of the carrier, and in estimating the cost of reproducing that property new it is assumed that the money can be had for 6 per cent without additional cost and without inquiring how it is to be obtained." *Ibid.*, pp. 154-155.

<sup>155</sup> A study of various construction projects disclosed that when once construction is begun and is continued without interruption, the monthly expenditures are distributed with reasonable uniformity over the entire building period. Hence, according to the general rule followed in public utility valuations, interest would have to be computed for one-half the period of construction. But since, under the Commission's practice, no account was taken of work performed preliminary to actual construction, and since, too, funds must be available for a reasonable period—say, six months—in advance of their actual expenditure, the Commission added three months to the period for which computations were made. In the case of equipment, which is normally not acquired until the road is practically completed, a differentiation was made from other items of construction, and an allowance of interest for three months on the equipment accounts was in usual circumstances deemed to be equitable. Expenditures

tion, upon which the application of the foregoing methods depends, mention has already been made that it was determined by the Commission's engineers, as part of their formulation of the construction program. They were not bound by the actualities of the historical development of the properties, nor did they seek to establish the shortest possible construction period. Taking into account "the usual delays which occur in normal times, due to labor and market conditions," but eliminating "unusual delays, due to financial troubles and other causes peculiar to individual properties," they fixed upon "that period within which the work might be economically done."<sup>156</sup> As in the matter of unit prices, it is obvious, in connection with these "overheads," that actual experience constituted a general background, rather than a precise determinant, of the Commission's findings—that informed judgment was the controlling factor, and that, despite the apparent certainty and exactness of the results, estimate and approximation were the utmost possible under the reproduction hypothesis.

for land were excluded from the base, first, because land valuation was not embraced in the reproduction cost appraisal, and, second, on the merits, because "the present value of adjacent land" test was regarded as precluding any separate allowance for interest. Interest during construction was excluded from the base on which interest was computed—that is, compounding of interest was not permitted—because it was believed "that the interest which the carrier should obtain upon its cash balances in the bank ought to be sufficient on the whole to offset this item." *Ibid.*, pp. 32-33, 155-158, 158 (1918). See, also, *Kansas City Southern Ry. Co.*, 75 I.C.C. 223, 257 (1919); *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463, 485 (1923); *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645, 659 (1923); *Raritan River R. R. Co.*, 84 I.C.C. 463, 466-467 (1924); *West Virginia Northern R. R. Co.*, 110 I.C.C. 385, 390 (1926); *Pittsburgh & Susquehanna R. R. Co.*, 110 I.C.C. 787, 790 (1926); *Chicago, Milwaukee & Gary Ry. Co.*, 114 I.C.C. 16, 20-21 (1926); *East Jersey R. R. & T. Co.*, 114 I.C.C. 441, 443 (1926); *Western Pacific Ry. Co.*, 29 Val. Rep. 239, 269-270 (1929).

<sup>156</sup> *Texas Midland R. R.*, 75 I.C.C. 1, 32 (1918). See, also, *Winston-Salem Southbound Ry. Co.*, 75 I.C.C. 187, 196 (1918); *Kansas City Southern Ry. Co.*, 75 I.C.C. 223, 256-257 (1919); *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645, 658-659 (1923); *Fort Street Union Depot Co.*, 97 I.C.C. 663, 665 (1925); *Mobile & Ohio R. R. Co.*, 143 I.C.C. 459, 476 (1928); *Pennsylvania R. Co.*, 22 Val. Rep. 1, 106-115 (1929); *Chicago, R. I. & P. Ry. Co.*, 24 Val. Rep. 709, 762-763 (1929). A reasonable plan of reproduction, the Commission has held, requires that a road be built in sections, and that each section be opened to commercial use upon completion. At this point the interest period terminates; nor is there warrant for further allowance of interest because of subsequent use of a completed section in the transportation of materials for sections still under construction. *Norfolk Southern R. R. Co.*, 84 I.C.C. 693, 702 (1925); *Atchison, Topeka & Santa Fe Ry. Co.*, 127 I.C.C. 1, 30 (1927); *Great Northern Ry. Co.*, 133 I.C.C. 1, 113 (1927).

Turning, by way of conclusion, to the reproduction cost appraisal as a whole, what significance does it possess and what light does it throw upon the Commission as a functioning tribunal? In what sense, for example, may it be said that the \$42,844,150 which the Commission found, as of valuation date, to be the reproduction cost new of the wholly owned and used property, other than land, of the San Pedro, Los Angeles & Salt Lake Railroad Company,<sup>187</sup> or the \$58,432,710 of the Delaware & Hudson Company,<sup>188</sup> or the \$490,007,919 of the Chicago, Burlington & Quincy Railroad Company,<sup>189</sup> really represent the cost which would be incurred in a duplication of these properties? It must be evident from the foregoing analysis that it would be the simplest of tasks to point out numerous sources of possible error and miscalculation; there are scores of items concerning which equally competent judgments might produce widely divergent results. Final figures so painfully precise, and yet built upon an hypothesis so markedly unreal, are almost ludicrous in their exactness. Even with conjecture reduced to a minimum, the results are still too conjectural to be altogether acceptable as objective findings. There can be no question, however, as to the high quality of the Commission's performance of this aspect of the valuation project. The colossal task which in its initial stages was characterized by some as "an attempt to achieve the impossible" was not only accomplished, but in decidedly creditable fashion. The shortcomings of the results spring from the inherent nature of the reproduction cost method, rather than from any want of skill or reasonableness in its practical application. It must be borne in mind, too, that the Commission had no alternative in the matter of ascertaining and reporting reproduction costs—this task was specifically imposed upon it by the terms of the Valuation Act. When the appraisal is regarded from these angles, one is repeatedly impressed by the soundness of the Commission's approach, the thoroughness of its labors, the balanced character of its judgment, the measured restraint of its policies, the general consistency of its findings. If reproduction cost figures are to be utilized in the processes of valuation, it can hardly be doubted that those re-

<sup>187</sup> 75 I.C.C. 463, 606 (1923).

<sup>188</sup> 116 I.C.C. 611, 626 (1926).

<sup>189</sup> 134 I.C.C. 1, 59 (1927).

ported by the Commission will be found more legitimately supportable from the standpoint of equitable adjustment of private rights and public interests than any that are likely to be made available by less experienced if not less disinterested agencies.<sup>100</sup>

### *Cost of Reproduction Less Depreciation*

The Commission was also required to ascertain, as the third of the underlying cost figures applicable to the physical properties other than land, cost of reproduction less depreciation. The manifest objective was to obtain reproduction cost estimates that would reflect the actual condition of the properties at the time of valuation. The initial reproduction cost findings, therefore, were to be diminished by such sums as would measure the differences in condition, because of age, wear, or loss of adaptability, between the properties when new and in their existing state on valuation date. This difference constitutes depreciation, and the resulting figures reflect the cost of reproducing the depreciated properties. The ascertainment of depreciation, under these circumstances, was but an extension of the original hypothetical process: the theoretical reproduction of the properties new was immediately followed by their theoretical reduction to actual condition. Reproduction cost new was assumed to measure the full hypothetical outlay for duplicating the properties in new condition; reproduction cost less depreciation was assumed to measure that portion of the hypothetical outlay which remained after the properties had been reduced to their existing condition. And the mandate to ascertain and report depreciation for this purpose was independent of prevailing accounting practices. Depreciation was to be deducted as the monetary measurement of physical and functional influences affecting the integrity of the hypothetical outlay, regardless of the provision made therefor in the carriers' accounts, as a means of establishing one of the underlying cost figures. With these considerations in mind, it appears that, despite a failure to sound the depths of the depreciation problem and perhaps an undue willingness to sacrifice principle to practicability, the Commission has been substantially sound in its

<sup>100</sup> A discussion of the use made by the Commission of the reproduction cost figures so derived must necessarily be postponed to our subsequent analysis of the determination of single-sum values.

conclusions. But whatever its merits, the Commission's depreciation policy, to be presently analyzed, has been consistently applied in the face of carrier protests.<sup>161</sup>

The principal controversy centered about the basic conception of depreciation that should prevail. In general terms, the Commission found depreciation to accrue as a result of mere age and use, regardless of the observable effects upon the service rendered by the property. The carriers, on the other hand, insisted that depreciation arises only to the extent of such loss in operating efficiency as may result from deferred maintenance. According to the first conception, depreciation is an inevitable accompaniment of the lapse of time—all properties not new are depreciated properties, and the only problem is to measure the amount of depreciation. According to the other view, the very existence of depreciation is an open question—assuming adequate repairs and replacements and the resulting maintenance of full service efficiency, no deduction for depreciation need be made from reproduction cost new in order to reflect the condition of the existing property. The nature and significance of this conflict as to fundamental definition will be clarified by a more detailed consideration of these divergent contentions.

The Commission has treated depreciation "as the exhaustion of capacity for service."<sup>162</sup> In translating into monetary terms, with regard to any element of the property, this decrease in the number of units of capacity for service as compared with the number of units of such capacity existing when the particular element was first installed, the Commission has defined depreciation as "the lessening of worth of physical property due to use or other causes,"<sup>163</sup> or as "the lessening in cost value due to the smaller number of service units in the property as found, than in the same property new."<sup>164</sup> "An article when

<sup>161</sup> See, for example, *Florida East Coast Ry. Co.*, 84 I.C.C. 25, 26-27 (1924); *Durham & South Carolina R. R. Co.*, 84 I.C.C. 313, 316 (1924); *Atchison, Topeka & Santa Fe Ry. Co.*, 127 I.C.C. 1, 97-98 (1927); *New York Central R. Co.*, 27 Val. Rep. 1, 40 (1929).

<sup>162</sup> *Texas Midland R. R.* 75 I.C.C. 1, 48 (1918). This conception was misconstrued by the carriers as necessarily involving a reduction in operating efficiency. The Commission, however, was using the phrase in terms of loss of service units, in view of the limited life of the property, rather than as a loss of capacity for service at any one time.

<sup>163</sup> *Ibid.*, p. 183.

<sup>164</sup> *Ibid.*, p. 125.



new," explained the Commission, "contains, so to speak, a certain number of units of service; as those units are exhausted the article depreciates. When they are all used up the service life ends. . . . The extent of depreciation is expressed in condition per cent stated as a fraction, of which the denominator expresses the total service units while the numerator gives those remaining."<sup>165</sup> The fraction thus obtained was then applied to the reproduction cost new of the depreciable property, and the resulting figure was accepted as cost of reproduction less depreciation, due consideration being given to the salvage or scrap value of the depreciated unit.<sup>166</sup> In formulating and applying this conception of depreciation, the Commission unqualifiedly rejected the contention of the carriers that depreciation should be treated as deferred maintenance—that there can be no depreciation so long as the property is maintained at 100 per cent efficiency.<sup>167</sup> It recognized from the first that the outstanding conflict with regard to depreciation was this one of fundamental theory—"that the question presented . . . for determination touching depreciation is whether

<sup>165</sup> *Ibid.* See, also, *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645, 660 (1923); *Florida East Coast Ry. Co.*, 84 I.C.C. 25, 27 (1924); *Ann Arbor R. R. Co.*, 84 I.C.C. 159, 166 (1924); *Danville & Western Ry. Co.*, 84 I.C.C. 227, 230 (1924); *Southern Ry. Co. in Mississippi*, 84 I.C.C. 253, 254 (1924); *Winston-Salem Southbound Ry. Co.*, 84 I.C.C. 581, 583 (1924); *Gulf, Texas & Western Ry. Co.*, 97 I.C.C. 29, 31 (1925); *Bangor & Aroostook R. R. Co.*, 97 I.C.C. 153, 162 (1925); *Boston Terminal Co.*, 103 I.C.C. 707, 718 (1925); *Oncida & Western R. R. Co.*, 106 I.C.C. 479 (1926); *Lawrinburg & Southern R. R. Co.*, 108 I.C.C. 358, 359 (1926); *DeKalb & Western R. R. Co.*, 110 I.C.C. 724, 726 (1926); *Flint River & Northeastern R. R. Co.*, 114 I.C.C. 142, 143 (1926); *Dansville & Mount Morris R. R.*, 116 I.C.C. 274, 275 (1926); *Great Northern Ry. Co.*, 133 I.C.C. 1, 116 (1927); *Chesapeake & O. Ry. Co.*, 24 Val. Rep. 451, 481-482 (1929); *Hocking Valley Ry. Co.*, 29 Val. Rep. 321, 336-337 (1929); *Excess Income of Richmond, F. & P. R. Co.*, 170 I.C.C. 451, 484-486 (1931).

<sup>166</sup> In Engineering Board Memorandum No. 226, which is attached as *Note to Appendix 3* of the *Texas Midland* report, the general principles and methods to be applied in "depreciation of road and equipment property" are briefly set forth. In addition, there is given, with respect to many of the primary accounts, the normal service life of the property involved and other details peculiar to each such account. *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at pp. 183-186.

<sup>167</sup> "The carrier insists that this [the bureau's] conception of depreciation is wrong, that the inquiry should be whether the property is in 100 per cent efficiency. So long as it is maintained at 100 per cent efficiency, or what comes to the same thing, so long as there is no deferred maintenance, there can be no depreciation." *Ibid.*, p. 48. Similarly: "It [the carrier] asserts that so long as the various units are adequate to perform the service in which they are operated and are maintained in proper physical condition their service life will be indefinite." *New York, Philadelphia & Norfolk R. R. Co.*, 97 I.C.C. 273, 306 (1925).

the theory of the bureau or that of the carrier is correct."<sup>168</sup> But the Commission did not present any extensive or convincing discussion on the merits. It appeared to be content to rely upon "legislative and judicial authority."<sup>169</sup> "When the act was passed," said the Commission, "the phrases 'cost of reproduction new' and 'cost of reproduction less depreciation' had come to have a clearly defined and well understood meaning. The conception of depreciation as used in this connection was the equivalent of that put upon it by the bureau. There were differences of opinion as to the part which physical deterioration and functional depreciation should play and all persons were not agreed whether depreciation and life were essentially identical; that is, whether an article might not depreciate more rapidly in the first years of its existence than in the last, or vice versa, but all were agreed upon the fundamental concept that depreciation means decline in value due to loss of capacity for service. An article was assumed to have incorporated in it a certain amount of use when new; a certain part of that use had gone; and so much remained. Reference might be made to hundreds of instances in which this idea of depreciation when the act was passed had been used in valuation proceedings by individuals, by commissions, and by courts. It is doubtful if any case can be found where it had been deliberately assumed that depreciation and deferred maintenance were synonymous."<sup>170</sup> There then followed, by way of support, a brief résumé of the rulings of the Supreme Court in the *Knoxville*,<sup>171</sup> *Cedar Rapids*,<sup>172</sup> *Des Moines*,<sup>173</sup> and *Minnesota*<sup>174</sup> cases, with the conclusion that Congress must be assumed to have used the word "depreciation" in its gener-

<sup>168</sup> *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at p. 48. By way of focussing attention upon this central issue, the Commission quoted the following from the brief of the carrier: "It is apparent, from the testimony received on the subject of depreciation and from the questions and statements of the Director during the introduction of the same, that the principal difference is one of definition of depreciation. The witnesses called by the carriers—men of candor, ability and experience—while fully recognizing deterioration from age and use and the necessity of repairs and replacements of perishable elements, state that in the absence of deferred maintenance there is no depreciation."

<sup>169</sup> *Florida East Coast Ry. Co.*, 84 I.C.C. 25, 27 (1924).

<sup>170</sup> *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at p. 48.

<sup>171</sup> *Knoxville v. Water Co.*, 212 U.S. 1, 9-10, 13-14 (1909).

<sup>172</sup> *Cedar Rapids Gas Co. v. Cedar Rapids*, 223 U.S. 655, 670 (1912).

<sup>173</sup> *Des Moines Gas Co. v. Des Moines*, 238 U.S. 153, 161-162 (1915).

<sup>174</sup> *Minnesota Rate Cases*, 230 U.S. 352, 456-457 (1913).

ally accepted sense, and the consequent approval of the depreciation concept which had been formulated and applied by the bureau. Despite sustained attacks by the carriers,<sup>175</sup> as well as vigorous opposition by a dissenting minority of the Commission,<sup>176</sup> this approval has never been withdrawn.

<sup>175</sup> See *Kansas City Southern Ry. Co.*, 75 I.C.C. 223, 258 (1919); *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463, 487-488 (1923); and the citations in note 165, *supra*. In *Elgin, Joliet & Eastern Ry. Co.*, 84 I.C.C. 587 (1924), the Commission, in order to prevent delay in the determination of final value, allowed the tentative valuation to stand, although the cost of reproduction less depreciation of ballast was reported in the same amount as cost of reproduction new. It took care to stipulate, however, that this was not to be regarded as "a purposeful departure from our usual practice" (p. 597). See, also, *Chicago, Terre Haute & Southeastern Ry. Co.*, 97 I.C.C. 535 (1925), at p. 536.

<sup>176</sup> Among the minority opinions relative to depreciation, those of Commissioners Daniels, Potter, and Eastman may be noted. Commissioner Daniels' dissenting expressions dealt with the majority's failure to give explicit cognizance to appreciation, either as an offset to depreciation or otherwise, and with the impropriety, as a matter of equity, of deducting accrued depreciation from the rate base under all circumstances, particularly where past earnings had been insufficient to build up a reserve against depreciation and where there had been no improvidence in the distribution of earnings. These problems will be considered in subsequent pages. At this point it is important to note that his protest did not extend to the controversy as between theoretical or accrued depreciation and deferred maintenance. *Kansas City Southern Ry. Co.*, 75 I.C.C. 223 (1919), at pp. 266-269, and *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), at pp. 518-521. Commissioner Potter, on the other hand, took direct issue with the majority as to its basic concept of depreciation. In the *San Pedro* case, *supra*, he said (p. 573): "I am not in accord with the method which has been applied in charging depreciation. It is my view that no appreciable depreciation takes place so long as a property is properly maintained and kept in condition for efficient operation. It is well known that in actual practice few carriers make any charge for depreciation to physical property other than equipment. The practice with respect to depreciation upon equipment arises out of the convenience to the carrier of setting up a reserve account against which large retirements in any particular year may be charged instead of charging the necessary replacements or retirements to current income. Depreciation is in its essence merely a bookkeeping entry designed to accomplish maintenance, and its purpose is to maintain an annual equality with respect to charges for maintenance. The testimony shows that the policy of this carrier with respect to maintenance has been liberal and that the property has been kept in excellent condition. There is, therefore, no basis for the reported depreciation except at most with respect to equipment." He expressed similar views in connection with the final value reports in *Florida East Coast Ry. Co.*, 84 I.C.C. 25 (1924), and in *Kansas City Southern Ry. Co.*, 84 I.C.C. 113 (1924). While his protest was directed against the deduction of depreciation from the rate base, the rationale of his protest was largely based upon the conception of depreciation as deferred maintenance. In the first of these proceedings he said (pp. 48-49): "It appears obvious that the figure of final value has been made less than it otherwise would be by the deduction of \$4,945,496, being the amount by which the property is said to have depreciated. The amount would be required to reproduce the property, and should be considered as in the original investment. The property has been well maintained and as a going entity has not

In calculating depreciation, the so-called "straight-line" method was adopted—that is, it was assumed that the loss of units of service is evenly distributed throughout the life of the property item involved. The Commission argued that while some elements of the property may depreciate more rapidly during the earlier years of service and others in later years, "the practical way is to assume that the loss is uniform, and it is believed that this as applied generally will produce a fair result."<sup>177</sup> The method thus adopted necessitated the determination of the total life, and of the future or remaining life, of the property. For these purposes the Commission resorted to experience, observation, and opinion.<sup>178</sup> Moreover, in order that due weight might be given to the distinctive conditions prevailing in any given case, as

depreciated. It is not conceivable that a sane person would ever build a railway if he knew that a substantial part of his investment would be considered lost through depreciation and that he would not be permitted to have a return upon it. The law has no such unconscionable purpose. The report praises the carrier as essential and efficient. To deduct depreciation where such depreciation has not been taken care of out of income from the value which other figures suggest, is arbitrary, inequitable, and illegal confiscation of property. . . . Nor can I agree that the mandate under which we act required us to report depreciation when as here there is no depreciation in fact which affects value." And in the second of the above proceedings he explicitly denied the existence of depreciation because of a policy of adequate maintenance (p. 133): "It [the carrier] has been well maintained and has suffered no depreciation that affects value or that is not taken care of in the usual course as an operating expense." Commissioner Eastman recognized depreciation as an impairment of investment, and hence as a proper deduction from the rate base, but he was inclined to regard the depreciation so deducted by the majority as too great in amount: "The decisions of the court clearly indicate that depreciation should be deducted in estimating 'value for rate-making purposes.' . . . There are no Supreme Court decisions to the contrary. It is the investment still remaining in the property upon which the company is entitled to earn a return. The carriers, however, claim, in effect, that there is no depreciation in a railroad property so long as it is well maintained. . . . In my judgment depreciation should be deducted from 'value for rate-making purposes,' where a property has been well maintained, to the extent that it is necessary in successful operation to create a reserve fund for protection against depreciation. Viewed in this light, I am led to the conclusion that the deduction which the majority have made for depreciation in estimating cost of reproduction less depreciation may be too large. If, for example, ties have been properly maintained, a deduction of 50 per cent for depreciation impresses me as theoretical rather than real." *San Pedro, Los Angeles & Sals Lake R. R. Co.*, *supra*, at p. 558.

<sup>177</sup> *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at p. 125, which has been followed in all of the Commission's proceedings. See, for example, *Great Northern Ry. Co.*, 133 I.C.C. 1, 115-116 (1927).

<sup>178</sup> The Commission has described its processes as follows: "In applying the above principles it is necessary to determine total life and future life. The date of installation or of the beginning of the use is usually known, and if total life can also be fixed, future life may be obtained by subtracting the one from the other. Ordinarily, there-

affected by maintenance and service factors, the normal or standard life figures were subject to modification as a result of actual inspection.<sup>170</sup> The Commission recognized that its estimates frequently would be shown by later experience to be wide of the mark in indi-

fore, the problem is to determine total life. This may be done by reference to the experience of the past. Where sufficient time has elapsed so that articles of the kind under investigation have in fact been worn out and displaced, the period for which they have been in service is known and life tables can be prepared. In determining total life, observation is of value. The amount of wear which has taken place in a given number of years can be noted and from this the total life can be calculated. The opinion of those who are qualified by their training and experience to form such opinion is also of service. From all sources an estimate of total life must be formed, and a great amount of study has been devoted to this, mainly in the way of collecting statistics from the experience of the past." *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at p. 126. Similarly, in determining with respect to each piece of property the number of service units which remained in that property, as compared with new, for the purposes for which it was being used, "an inspection of the property is made and the experience of the past, both as developed by the records of the carrier under valuation and from that of other carriers as well, is considered in the light of present knowledge and conditions." *Ibid.*, p. 130.

<sup>170</sup> Although 70 years was adopted as the average life of steel bridges, for example, "it must not be understood . . . that this life is used in case of all bridges irrespective of what an inspection may show, but simply that it is taken as such life unless inspection demonstrates that some other period should be used." The part played by inspection in the determination of total life has been explained in concrete fashion by the Commission. First, under normal conditions: "The engineer examines a bridge which has been in service for five years. He finds it to have been well maintained and to be entirely adequate to the traffic. So far as observation reveals, this structure is as good as it ever was, and if the engineer were required to point out the particular in which the bridge has depreciated he would be unable to do so. Nevertheless, it is certain that those causes which will finally put an end to the useful life of this structure have been at work, and it is considered that they have reduced the life 5 of the 70 years of its probable existence. The condition of this structure would therefore be 65/70. In reaching this conclusion the only part played by the inspection is to establish that observation of the property indicates nothing as to the extent of depreciation. In other words, the condition of the property is normal." But inspection may reveal grounds for reducing the normal estimate of total life and hence of the condition per cent: "Let it now be assumed that the same kind of a structure which has been in place for 30 years is under inspection. Observation shows that this structure, either through lack of proper maintenance or due to its location or from some accident of its use, is badly corroded and otherwise worn. If the same rate of depreciation continues for another 10 years the structure must be replaced. In this case the engineer would reduce the probable life from 70 years to 40 years; the bridge would be three-fourths worn out and its condition per cent would be 25/100." Similarly, the total life and the condition per cent might be increased as a result of inspection: "Upon the other hand, an observation of this structure might show that it had been perfectly maintained and at the end of 30 years was apparently as good as at the beginning. The engineer might feel that this bridge was likely to continue in service for more than another 40 years, and in that event he might increase the total life as a result of his inspection from 70 to 80 years. The condition in this event would be not 40/70 but 50/80." *Ibid.*, pp. 128-129.

vidual instances, but it concluded that they might still be "substantially accurate for all the property of a given class."<sup>180</sup> Not only was "physical depreciation," resulting from age and wear, taken into account, but also "functional depreciation," resulting from obsolescence or want of adaptation. The problem of functional depreciation was a difficult one with which to deal. Obsolescence had played a very significant rôle in the past development of the railroad properties,<sup>181</sup> but there was doubt as to whether the future would bring similarly sweeping displacements of plant or equipment because of lack of adaptability.<sup>182</sup> In any event, since functional depreciation is dependent, in large measure, upon unpredictable industrial changes, it becomes an extremely elusive and uncertain factor, inviting almost uncharted speculation. Under these circumstances the Commission recognized the need for restrained and conservative policy, in the interest both of realistic performance and of equity to the carriers. Accordingly, it instructed its engineers to consider only functional depreciation which had already accrued<sup>183</sup> or which was imminent.<sup>184</sup>

<sup>180</sup> *Bangor & Aroostook R. R. Co.*, 97 I.C.C. 153, 163 (1925).

<sup>181</sup> "The station has been replaced because it was too small and not because it had worn out. The steel bridge has been removed because it could no longer carry the heavier rolling stock which modern methods of operation have rendered imperative. Cars and engines have been discarded, not for the reason that further repairs could not be made, but rather because the type had become obsolete. It will be seen, therefore, that if a mortality table be constructed entirely or mainly from the experience of the past, functional depreciation will perhaps exercise a more dominating influence than physical depreciation." *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at p. 127.

<sup>182</sup> "But it is by no means certain that what has occurred in the past will be true of the future. It generally happens that in the earlier and formative stages of any industry changes take place rapidly, whereas when time has indicated the best methods and types greater permanency occurs. It is hardly probable that functional depreciation will play the same part with the same articles in the future as in the past. The railroad builder of today will be more likely to supply in original construction or in reconstruction a bridge of sufficient capacity; the size of the locomotive will not so much increase, thereby rendering everything else too small, and even the type is likely to be more permanent. Upon the other hand, functional depreciation may be even more pronounced in some other direction. Electricity may supplant steam as a motive power, or some discovery may do away with both steam and electricity." *Ibid.*

<sup>183</sup> For example: "If the bridge is too light for the equipment being used and should be removed as soon as possible, that fact must be taken into account. If the station is too small to accommodate the traffic now flowing through it, that must be a controlling item in its depreciation. So of all other pieces of property. The depreciation has already taken place; the thing is no longer fit for its use and must be discarded. This being so, it makes no difference whether the cause be physical or functional." *Ibid.*, pp. 127-128.

<sup>184</sup> "This word," said the Commission, "admits of no exact definition. If in the

"Generally speaking," said the Commission, "in so far as functional depreciation can be accurately forecast, it must be considered, but speculation must not be resorted to."<sup>185</sup> Even under this policy, however, there was ample room for the exercise of discretion. Indeed, throughout the depreciation inquiry, as in the appraisal of cost of reproduction new, judgment and estimate were the ultimate determinants of results, despite the exactitude of the mathematical formulae employed.<sup>186</sup>

What of the general soundness and propriety of the Commission's depreciation policy? The Commission's recognition, by way of basic definition, that depreciation may accrue despite the full maintenance of operating efficiency appears to be entirely well grounded. The problem with which it was faced was one of measuring the unimpaired hypothetical capital investment rather than of ascertaining the condition of the plant for rendering service. The maintenance of operating efficiency does not necessarily involve the maintenance of

near future such depreciation is certain to occur, or reasonably certain to occur, it must be considered by the engineer. If, for example, the railroad has already begun to remove bridges of a similar type because they are too light, this fact must be considered. If, while the station may do for a few years to come, plans are already being considered for its replacement, the architect must not close his eyes to this circumstance and look only to the physical condition of the property." *Ibid.*, p. 128.

<sup>185</sup> *Ibid.*

<sup>186</sup> A single illustration will disclose the broad limits of the discretion exercised by the Commission. The normal life of steel bridges, it will be recalled, was set at 70 years. By what process was this precise figure reached? The Commission's own explanation indicates the dominance of mere opinion, unsupported by conclusive objective evidence: "It has been said that the average life of steel bridges in this country has not exceeded 30 years. This may be true; our studies would indicate that some comparatively short period would represent the active service life of that structure; but it is also perfectly evident that this has been due, not to the actual wearing out of the bridge, but to its inadequacy. It is further not apparent that the same cause will be operative to the same extent in the future. Thirty years is not, therefore, used as the total life by which steel bridges are to be depreciated." This negative conclusion appears to be entirely well founded. But what of the figure that shall be used in its place? Here the argument is less convincing; at any rate, it provides only the most general support for the particular conclusion. "There is no way," continued the Commission, "in which a satisfactory total life can be fixed for a structure of this character, but the engineers have decided that, taking all things into account, 70 years will probably fairly represent that period; certainly it is sufficiently long for an average life, and this figure for total life is used in the depreciation of steel bridges." *Ibid.*, p. 128. The same latitude is discernible in connection with other items of property. In case of the Texas Midland Railroad, for example, 25 years was originally fixed as the normal life of rails in the main track. This figure was used in the tentative valuation, in face of the carrier's claim of 80 years. The figure was subsequently increased

this investment in the property. Service life rather than service condition is the controlling factor. The consumption of capital, through age or wear or loss of adaptation to function, cannot be avoided, however efficient the service which may be rendered at any given time. Under such circumstances the interval at the end of which replacements must of necessity be made is inevitably shortened. In so far as units of service have thus been exhausted, the investment, as measured by the assumed first cost of the property in being, has been impaired. If, therefore, cost of reproduction measures the hypothetical outlay for the plant when new, then accrued depreciation must be deducted in order to measure the hypothetical outlay for the plant in its existing condition. In the ascertainment of the underlying figures, that was the Commission's only appropriate task. It was seeking to estimate not only what the property would cost new, but what it would cost in its depreciated condition. The use to be made of the various cost figures in their relation to the rate base was left for subsequent settlement in the determination of single-sum values.

None the less, since the Commission, in finding reproduction cost less depreciation, was reporting one of the significant evidences of value, and since much of the conflict of opinion has been concerned with the propriety of deducting depreciation from cost of reproduction new in the determination of the rate base, it is pertinent to inquire whether its depreciation policy was sound in terms of its utilization in the valuation process.<sup>187</sup> Moreover, the Commission has itself used value terms in its treatment of depreciation. While it found the fact and extent of depreciation to be grounded in the exhaustion of capacity for service—that is, in the loss of service units—it defined and treated depreciation, not as a measure of the capital consumed in past operations, but as a reduction in the value of the property. Its

to 40 years, however, and the computation of accrued depreciation was made final on that basis. "After conference between the carrier and the bureau," said the Commission, "the bureau recommended that this item be increased to 40 years, which appears to be sufficient, although no definite figure can be named with absolute certainty." *Ibid.*, p. 52.

<sup>187</sup> Indeed, it has been asserted that it is impossible "to discuss intelligently the proper treatment of depreciation except by reference to the underlying theory of valuation to which the depreciation policy is meant to apply." James C. Bonbright, "Depreciation and Valuation for Rate Control," *Quarterly Journal of Economics*, vol. 41 (February, 1927), at p. 211.



governing definition of depreciation, it will be recalled, was "the lessening of worth of physical property due to use or other causes." Depreciation does bring about a decline in *value*: a depreciated property, as will appear, is *worth less* than the same property new. But while the conclusion is sound, the Commission nowhere discloses, outside the simple statement of terms, that here it is seeking value rather than cost, and that the propriety of the deduction is bound up with the conception of reproduction cost less depreciation as the measure of the rate base.

The Commission was content, for the most part, to rely upon authority. But while the opinions of the Supreme Court appeared to supply precedent for the deduction of depreciation,<sup>188</sup> it is by no means certain that the Court was entirely clear in its own mind as to exactly what is involved in the depreciation controversy or in the theory to which it seemed to give support.<sup>189</sup> At any rate, there has arisen a substantial body of critical opinion adverse to the Commission's doctrine.<sup>190</sup> More satisfactory results would have been achieved,

<sup>188</sup> In the *Knoxville* case, for example (note 171), the Supreme Court said: "The cost of reproduction is one way of ascertaining the present value of a plant like that of a water company, but that test would lead to obviously incorrect results if the cost of reproduction is not diminished by the depreciation which has come from age and use"; and in the *Minnesota Rate Cases* (note 174), the Court stated that "when an estimate of value is made on the basis of reproduction new, the extent of existing depreciation should be shown and deducted."

<sup>189</sup> See, for example, *McCardle v. Indianapolis Co.*, 272 U.S. 400 (1926), in which the majority of the Court sanctioned the deduction of depreciation, "if any." Compare also the following from James C. Bonbright, *op. cit.* (note 187): "On at least one occasion the United States Supreme Court has declared that, in fixing rate-making values, commissions should reduce the 'value new' by the amount of the depreciation. But just what is meant by the ambiguous word, 'depreciation,' and just how it should be computed, has never been made clear by the highest tribunal. It is therefore open to argument, at least, that what the Court refers to is merely a figure representing loss of operating efficiency rather than a figure representing loss of life-expectancy." In the *Baltimore Street Railways* case, which involved depreciation, not as a deduction from the rate base but as an annual charge to operating expenses, the Court, in holding that the allowance should be computed on "present value," rather than on "cost," of plant, appeared to confuse the need of maintaining "the same level of efficiency" with that of preserving "the original investment." In an elaborate dissenting opinion, Justice Brandeis directed attention to the marked departure from accepted and sound business practice which this ruling involved. *United Railways v. West*, 280 U.S. 234, 238-240, 259-288 (1930). See, also, George O. May, "Further Thoughts on Depreciation and the Rate Base," *Quarterly Journal of Economics*, vol. 44 (August, 1930), pp. 687-697.

<sup>190</sup> See, for example, James E. Allison, *Reports to St. Louis Public Service Commission*, "Should Public Service Properties be Depreciated to Obtain Fair Value in Rate or Regulation Cases" (1912), and "In Re Theoretical Depreciation," Brief presented to

therefore, if the Commission had resorted to a defense of its depreciation policy on the merits rather than on authority. This could readily have been done. With reproduction cost as the accepted valuation standard, the deduction of "accrued depreciation"—the type required by the Commission as distinct from the "deferred maintenance" contended for by the carriers—necessarily follows. Regardless of the grounds upon which the adoption of reproduction cost is urged—whether because it will serve as the most accurate feasible measure of the present value of the property, or because it will provide a base likely to result in rates of charge most closely approximating those which would prevail in a freely competitive situation—it must be modified by the deduction of accrued depreciation before it can be shown to satisfy these grounds. The burden of renewals and replacements is obviously heavier in an old plant than in a new one: hence the "value" of a depreciated plant is less than that of a new one, since the necessary "costs" of operation, to be reflected in the rates charged, are greater than those that would be incurred by a substitute plant in new condition. "It is nonsense to say that a dynamo of an obsolete type is *worth as much* as a dynamo of the most modern design. It is equally fallacious to claim that a plant which has undergone accrued depreciation is worth as much as a new plant. For the presence of this accrued depreciation means that the property has fully or partly outlived that early period when renewal costs are abnormally low, and that it has reached or approached the stage of 'normal condition' where it is doomed, forever after, to incur relatively heavy (and relatively stable) annual outlays for replacements. It is only by disregarding this difference between the renewal burdens of a new and an old property that public utility counsel are able to make accrued depreciation appear to be merely 'theoretical' and of no influence on the 'real value' of the property."<sup>191</sup> Unless deduction

New York Public Service Commission, First District, on behalf of Consolidated Gas Co. of New York (1923); Allyn A. Young, "Depreciation and Rate Control," *Quarterly Journal of Economics*, vol. 28 (August, 1914), pp. 630-663, and discussion by J. S. Davis, John Bauer, and James C. Bonbright, *ibid.*, vol. 29 (February, 1915), pp. 362-400, vol. 29 (May, 1915), pp. 651-659, vol. 30 (May, 1916), pp. 546-558; H. E. Riggs, *Depreciation of Public Utility Properties* (1922). For an excellent summary of the controversy, see James C. Bonbright, "Depreciation and Valuation for Rate Control," *Quarterly Journal of Economics*, vol. 41 (February, 1927), pp. 185-211.

<sup>191</sup> James C. Bonbright, *op. cit.* (note 190), p. 200.

for deterioration and obsolescence is made "from the estimated cost of reproducing the present property, the resulting rate base would sanction rates of charge in excess of the cost of reproducing the service."<sup>102</sup> In accord with the Commission's practice, then, cost of reproduction new must clearly be diminished by the amount of accrued depreciation.<sup>103</sup>

From the standpoint of carrying its depreciation policy into effect, the Commission's work is deserving of high commendation. As in case of the appraisal of reproduction cost new, the ever prominent

<sup>102</sup> *Ibid.*, p. 204. "Accrued depreciation must be deducted because it represents the disadvantage that the older plant suffers from the necessity of charging to its operating expenses the full 'normal' renewal costs of a developed property instead of the light renewal costs of the unmatured plant. It is simply a capitalization of the temporary advantage enjoyed by the new property in the form of low displacement charges. Obsolescence is a similar deduction to offset the advantages of the modern types of machinery and structure—advantages that may take the form of lower operating costs or of lower capital costs per unit of plant capacity."

<sup>103</sup> Two further questions are deserving of brief consideration at this point. First, should deduction of depreciation be made, regardless of whether adequate reserves for this purpose are included in the carrier's accounts? Such deduction, irrespective of whether past earnings had been sufficient for a depreciation reserve, was the primary basis of Commissioner Daniels' dissent in *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923): "If it appeared that prior to June 30, 1914, the net earnings had been ample to cover a fair return for distribution to the security owners and also to provide a reserve for making good the expired service life in parts of the plant, and if it had been the case that the entire earnings had been improvidently distributed as interest or dividends, there might be plausible warrant for basing future returns on the cost less depreciation. But the facts in this case are all to the contrary. The return paid to security holders had been moderate, not to say meager. The carrier had not been able to carry to a reserve against depreciation more than a small fraction of the accrued depreciation. In whose interest and service had the wasted service life or parts of the plant been spent? Manifestly not in the interest of the carrier, which would have been better off had there been no lessening in the service life of its physical plant and no accrued depreciation. To base return upon cost less depreciation would be tantamount to saying that the \$7,409,000 used up in the service of the public and to the disadvantage of the carrier should be a loss imposed for all time on the investor. . . . In practical effect . . . to make cost less depreciation the rate base is to tell the investor to bid good-bye forever to the amount lost in the depreciated plant while serving the public. This would not be exactly an incentive to the investment of private capital in future railroad securities" (pp. 520-521). This problem raises considerations of equity, and under certain circumstances a modification of policy may well be justified on the basis of the facts disclosed by the financial history of the particular carrier. In general, however, the Commission's practice appears to be well grounded. In the absence of special circumstances, it is as reasonable to assume that the failure to provide for depreciation is the result of improvident distribution of earnings as that it is the outcome of inadequate revenues. Moreover, since all of the property in being, regardless of the source of the funds utilized for its acquisition, is included in the reproduction cost appraisal, and hence may comprehend units acquired through excessive

theorizing and hypothesizing, and the ultimate dominance of judgment and discretion, are inherent in the task; all that can be demanded is reasonableness and care and consistency in application, together with a steady emphasis upon the realities of the situation. These, as evidenced by its insistence upon actual experience checked by competent observation and inspection, and by the limitations it imposed upon resort to speculative findings, the Commission has furnished in good measure. The primary defect in this aspect of its performance lay in an inadequate analysis of the problem of depreciation, particularly with reference to other elements of value, such as appreciation, and in its relationship to the determination of final value. Generally sound in its conclusions and effective in its practice, the Commission unfortunately did not prepare explanatory opinions of very convincing character. The source of the difficulty is probably to be found in the general acceptance, until comparatively recent years, of the depreciation doctrine it sought to apply. Under these circumstances chief reliance was placed upon the support of authority.

earnings, it is only reasonable that such property be appraised in its existing condition and not new. Such equities as may exist in a particular situation can usually be met much more satisfactorily through adjustment of the rate of return than through modification of the rate base. In the words of Commissioner Eastman: "If earnings in the past have been insufficient to enable the company to make proper provision against depreciation, this fact . . . may well be considered, as in the case of losses during the development period, in determining the 'fair return' necessary to attract further investment of capital." *Ibid.*, p. 558. More recently the Commission has declared: "The valuation act requires us to ascertain and report the cost of reproduction less depreciation of the properties of carriers subject to the act, and no provision is made therein which would relieve us of this requirement on carriers which have not earned a sufficient amount to pay a fair return on their investment and set aside a depreciation reserve." *Pittsburg & Shawmut R. Co.*, 31 Val. Rep. 667, 676 (1931). The second question concerns the propriety of deducting depreciation when, as appears to have been the case in the Commission's determination of final value in *Excess Income of St. Louis & O'Fallon Ry. Co.*, 124 I.C.C. 3 (1927), reproduction cost is used as a means of approximating investment or original cost, rather than as a measure of present value. Here, too, an affirmative answer, in approval of the Commission's practice, seems to be justified. If strict investment, as measured by the funds actually contributed by the security owners, were accepted as the rate base, the matter of depreciation would become irrelevant. The pecuniary sacrifice of the investors would constitute the measure of their right to return, without reference to the condition of the property to which their funds had been applied. But so long as a physical valuation is resorted to—that is, so long as the existing property, however acquired, is looked to as the measure of the rate base—the deduction of depreciation is necessary, even if the objective is to approximate investment, rather than to reflect present value. Only a depreciated reproduction cost would measure that part of the assumed investment which has been kept intact.

Bent upon the practical discharge of the tremendous valuation task immediately confronting it, the Commission did not deem it necessary, in this instance, to pursue the method of independent and incisive analysis.

Had the Commission been more thorough in its analysis of *depreciation*, that fact might have led to the emergence of a more satisfactory policy with respect to *appreciation*. The carriers regularly introduced testimony to show that an old roadbed, because of solidification and adaptation, is of more value than a new one, and they urged that this value be stated in some form in the reports of the Commission. The Commission readily admitted the fact of appreciation. "While most items of property entering into the construction of a railroad depreciate from the first, the cut and embankment appreciate."<sup>194</sup> The real difficulty, which the Commission found itself unable to overcome, was "to express in dollars or otherwise the extent of this appreciation and to determine just what report upon this item can be made to Congress."<sup>195</sup> The Valuation Act nowhere specifically required the ascertainment of appreciation, but the Commission willingly conceded "that it was the intent of Congress to require a statement of all those costs, values, and other circumstances which might bear upon the value of the property, for rate-making purposes at least, and possibly for other purposes"; and it further granted, unequivocally: "Appreciation is a fact which may affect the final value of the property."<sup>196</sup> Such a statement of appreciation as was thus admittedly required might have found a place either in the report of "reproduction cost less depreciation," or in that of "other values and elements of value"; clearly, of course, appreciation could not properly be reported as an item under "reproduction cost new."<sup>197</sup> Despite these

<sup>194</sup> *Texas Midland R. R.*, 75 I.C.C. 1, 65-66 (1918). By way of explanation the Commission continued (p. 66): "The soft sides assume a natural slope, the earth becomes solidified and less susceptible to the action of the elements, vegetation frequently springs up which serves to hold in place the soil. The soft spots which at first develop in the embankment disappear. The texture of the embankment and the bottom of the cut become firmer owing to the gradual settling together of the earth and the pounding of the trains. All this tends to improve the quality of this part of the railroad. It is generally understood that in some respects the cost of maintaining the old railroad is less than the new and that trains can be operated over it with greater safety and economy."

<sup>195</sup> *Ibid.*, p. 66.

<sup>196</sup> *Ibid.*

<sup>197</sup> *Winston-Salem Southbound Ry. Co.*, 75 I.C.C. 187, 195 (1918); *San Pedro, Los*

circumstances, the Commission, over the active protest of the carriers and the dissent of a minority of its own members, steadfastly declined to make any separate finding and report of appreciation—choosing only to “consider” this element in its determination of final single-sum values. The Commission struggled with the problem, but could find no definite and altogether consistent way out. Although it recognized the existence of a certain relationship between appreciation and depreciation, it was unable to fit the acknowledged facts of appreciation into the basic categories of the depreciation concept. “Appreciation is the antithesis of depreciation,” said the Commission, “and it would be natural to show the two in the same connection, but depreciation is stated with reference to the life of an article while appreciation can not be so estimated.”<sup>198</sup> At times, moreover, the contention was advanced that in the failure to depreciate the roadbed due recognition had already been accorded to the element of appreciation.<sup>199</sup> But perhaps the chief ground for the Commission’s attitude lay in its inability to develop or approve a reliable method of computing appreciation. Figures introduced by witnesses for the carrier tending to show the annual amount by which the cost of maintaining a new road exceeded the cost of maintaining an old road—appreciation to be computed by a capitalization of this amount—served only to elicit this response: “We have carefully examined the figures given by the carriers and have reached the conclusion that they do not war-

*Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463, 487 (1923). In the latter proceeding the Commission said: “Appreciation is never an element of value in a new roadbed, and where it exists it is found only in a roadbed that has been in use for some time and is in a seasoned and solidified condition. No amount for cost of appreciation, even if the money value thereof could be determined, should be included in a cost of reproduction new estimate.”

<sup>198</sup> *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at p. 66.

<sup>199</sup> In *Winston-Salem Southbound Ry. Co.*, 75 I.C.C. 187 (1918), for example, the Commission said (p. 195): “The character of appreciation in roadbed claimed by the carrier . . . is the equivalent of an overcoming of depreciation in roadbed items. We have reported the various items of roadbed substantially without depreciation, although, by the processes for which the carrier claims an allowance, the original or ideal form of the roadbed has been considerably altered. In not depreciating roadbed we have, in fact, taken into consideration the effects of these processes of operation, the lapse of time, and the elements, which the carrier terms appreciation.” See, also, *New York, Philadelphia & Norfolk R. R. Co.*, 97 I.C.C. 273, 298-300 (1925). It is questionable whether a roadbed can be said to depreciate, as distinct from being subject to under-maintenance. If, therefore, effect had in reality been given to appreciation, the value of the roadbed would be in excess of its cost of reproduction new.

rant any definite finding. . . . Any finding based on the testimony in this record would be only a guess."<sup>200</sup> The Commission noted that allowances for solidification and adaptation—"off-hand estimates"—had often been approved by engineers and commissions, but it preferred to follow the recommendation of its own engineers that no attempt be made to state this item in exact figures; it concluded, therefore, that "no separate value can be placed upon appreciation," but with the following saving clause: "When it definitely appears that it exists it must be taken into account in determining the value of the property."<sup>201</sup>

Perhaps the most that can be said for this treatment of appreciation is that it involved a minimum of speculation in so far as the underlying figures are concerned; but this in itself, it seems clear, scarcely provides adequate justification. The Commission's policy is subject to legitimate attack on at least two basic grounds: first, the uncertainty and vacillating character of its reasoning, coupled with an unwillingness to assume affirmative responsibility in the premises; and second, its failure to recognize the substantive relationship between the element of appreciation and the valuation process. In both directions,

<sup>200</sup> *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at p. 67. Compare the following typical statement from *New York, Philadelphia & Norfolk R. R. Co.*, 97 I.C.C. 273 (1925), where the carrier presented elaborate estimates of appreciation based on alleged excess of cost of maintenance in early years of operation over cost of maintenance following the period of seasoning, together with a chart by the use of which it was asserted that the total seasoning cost could be determined for any railroad provided the rates of speed and the length of track were known: "We adhere to the views formerly expressed that no separate value can be placed upon appreciation. In the case of this carrier, we have given consideration to it in our reproduction estimates by failing to apply depreciation to roadbed, by increasing pay quantities in embankments and the measured volume of ballast 10 per cent for shrinkage, and by computing the quantity of material taken from cuts without deduction for the weathering that has taken place. Moreover, to the extent that we have found appreciation to exist in the condition of the property, we have recognized and taken it into account in determining the single-sum value of the property" (p. 300). See, also, *Florida East Coast Ry. Co.*, 84 I.C.C. 25, 35 (1924); *Elgin, Joliet & Eastern Ry. Co.*, 84 I.C.C. 587, 604-605 (1924); *Bangor & Aroostook R. R. Co.*, 97 I.C.C. 153, 169 (1925); *Manchester & Oneida Ry. Co.*, 103 I.C.C. 1, 5 (1925); *Gulf & Ship Island R. R. Co.*, 106 I.C.C. 111, 117 (1925); *Lake Superior & Ishpeming Ry. Co.*, 116 I.C.C. 1, 6 (1926); *Atchison, Topeka & Santa Fe Ry. Co.*, 127 I.C.C. 1, 89-91 (1927); *Great Northern Ry. Co.*, 133 I.C.C. 1, 131-132 (1927); *Denver & R. G. R. Co.*, 26 Val. Rep. 733, 759-760 (1929); *New York Central R. Co.*, 27 Val. Rep. 1, 68-69 (1929); *New York, N. H. & H. R. Co.*, 30 Val. Rep. 1, 39 (1929); *Duluth & Iron Range R. Co.*, 31 Val. Rep. 159, 195-196 (1930).

<sup>201</sup> *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at p. 68.

perhaps the most trenchant criticisms have come from the Commission's own ranks. Commissioner Daniels, for example, directed attention in pointed fashion to inconsistencies of approach and to the need of positive policy in the matter of appreciation. "To admit its existence in one case," he said, "to affirm that an old and solidified roadbed is of more value than a new one . . . and to intimate that it may enter into and affect final value . . . ; to disallow it in a second on the ground that we have given credit to appreciation by not depreciating roadbed . . . ; and to indicate in a third that appreciation is due mainly to the action of the elements and time, and that we have been unable to find any acceptable basis by which to measure appreciation, discloses a lack of uniformity, to say the least. It is apparently admitted in the instant case that future argument on the single-sum value may indicate reasons not now apparent for making an allowance for appreciation of roadbed. But to reject the carriers' methods of attempting to prove the money measure of this item and to devise no method on our own account to gauge or to estimate approximately its money measure is not . . . a proper acquittal of our duties under the act. . . . I realize some of the difficulties which encompass the subject; but I do not admit that these difficulties excuse us from treating the item with uniformity in different valuation reports or exempt us from making a well-reasoned finding or at least an estimate in relation thereto which may serve as a guide to the carriers and to all other parties in interest. Such finding ought to determine whether it is to be allowed for; if so, in what parts of tentative valuations; and thereafter in what amounts in each specific case; or, if it is to be universally excluded both from cost inventories and from inventories of intangibles, exactly upon what grounds."<sup>202</sup> The contention is unquestionably sound that the Commission's wavering conclusions, even in their negative aspect, are far from convincing. But there ap-

<sup>202</sup> *Kansas City Southern Ry. Co.*, 75 I.C.C. 223 (1919), at pp. 268-269. In his dissenting opinion in *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), Commissioner Daniels returned to the attack and stressed once more the Commission's failure to substitute its own findings for the carriers' claims which it deemed inadequate: "It is said that the figures submitted by the carriers do not satisfy us as to the approximate allowance for appreciation. Let this be granted. Are we not able for ourselves to make an appropriate estimate of appreciation? I am satisfied that our Bureau of Valuation could do so, as it has done in the similar problem of depreciation, a much larger and an equally complex problem, or as it has done in the mat-



pears to be ample positive ground for reporting appreciation as an element of value. We are not concerned, of course, with the question of its ultimate inclusion in the rate base; that issue would necessarily depend upon what basic principle of valuation should prevail as the controlling standard. In the ascertainment of the underlying figures, however, all elements of cost and of value must be disclosed. Since the Commission rightly recognized appreciation to constitute such an element of value, the only problem was to find an appropriate place for its disclosure.<sup>203</sup> The possibility of its treatment as an item of "original cost" has not generally received approval and need not be dwelt upon here.<sup>204</sup> But certainly any "reproduction cost less depre-

ter of working capital. I think it not an unfair statement of the fact that the bureau has not been encouraged to proceed along the lines of an independent ascertainment of the figures to be attached to the item of appreciation. Our attitude has been to tell the carriers to show us the method and the resulting amount. This, I believe, is not the discharge of our obligations in the premises" (p. 519).

<sup>203</sup> The difficulties of ascertainment, while doubtless great, could probably have been met by the bureau as successfully as in other complicated matters, if once the Commission had determined to report appreciation and to measure its extent independently of the carriers.

<sup>204</sup> Despite the fact that this method of treating appreciation is seldom mentioned, the suggestion is not altogether without merit. Professor Vanderblue's careful argument is worthy of statement: "Any legitimate claim for 'appreciation' is based upon an analysis of maintenance as investment, altho the concept, as discussed by the carrier counsel, is by no means clean cut. Too frequently the evidence (expert testimony) has sought to show that the old roadbed is more 'valuable' than the new roadbed, because maintenance expenses are less, or a purchaser would be willing to pay more, etc. But the essential point is that 'a railroad is not a finished product when the construction forces have put its parts together and turned it over to the operating department.' There is still much work to be done 'in resurfacing, in opening up clogged waterways, and in bringing about an improved condition of roadbed, right of way, and station grounds.' And to the extent that this work represents a net addition to investment it may be said that an 'appreciation' has occurred which is quite independent of earnings or 'value,' regardless of the method of handling the extraordinary expenses upon the books. When the Commission falls back on its accounting categories, the real underlying problem is passed over. That under the prescribed rules of accounting the carrier cannot carry any part of this expense into its investment account proves nothing conclusively, except that, when tested by a refinement of economic theory, the accounting rules are inadequate. Thus there is no 'transmutation of past operating expenses into property.' The property (plant) already exists as part of the machinery of production. Nor from the point of view of principle is it important that an extremely difficult task of measurement is proposed. It is perhaps significant that the Commission in the Winston-Salem Southbound opinion falls back on the cost of reproduction hypothesis: 'Appreciation cannot be produced merely by the expenditure of money and therefore cannot be reproduced new. We have already pointed out that the valuation amendment contemplates the ascertainment of cost of reproduction new, and not the cost of reproduction in the present condition.' The cost of appreciation has not been recognized as

ciation" estimate, if it is to be supported either as a measure of present value or as a base for the charging of competitive rates, must take definite account of appreciation, if only as an offset to gross depreciation.<sup>205</sup> The controlling factor for the addition of appreciation is identical with that for the deduction of depreciation—namely, the influence exerted upon operating costs. In the one case, these costs are increased; in the other, they are decreased. Depreciation must be deducted under such circumstances, but appreciation must be added. The fact that consumers may have paid for the item through the medium of operating charges is no more germane to a discussion of *reproduction* cost than that certain elements of the inventory may have been acquired out of surplus earnings. Once appreciation is thus recognized as an item of value, it must find its way into the underlying figures—if not in connection with depreciation, then among the "other values and elements of value."<sup>206</sup> Neither the practice of not depreciating items of the inventory which in fact should not be de-

possibly constituting a part of the real original cost. And this is the fundamental error in the Commission reasoning." H. B. Vanderblue, *Railroad Valuation by the Interstate Commerce Commission* (1920), pp. 78-80. The footnote references in the above passage have been omitted.

<sup>205</sup> Compare the following from James C. Bonbright, "Depreciation and Valuation for Rate Control," *Quarterly Journal of Economics*, vol. 41 (February, 1927), at p. 201: "Public Utility representatives quite rightly insist that there are some respects in which an established plant, with a history of several years of operation, is worth more, rather than less, than a new plant. Solidification is an example of this kind, especially important with railway roadbed. In addition there are the advantages of having passed the experimental stage in the operation of the running mechanisms. All these advantages of maturity are necessary and proper factors for consideration in any rate base which involves a measure of the *value* of the physical property. They should either be included as a separate factor of 'appreciation,' or else they should be offset against the gross depreciation to show the net depreciation."

<sup>206</sup> Such a disposition of appreciation was advocated by Commissioner Daniels. In his dissenting opinion in *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), he set forth his proposal as follows: "There is no specific mention of appreciation in the valuation act. This may be a tenable reason for not treating the item among the three costs which we are ordered to report. But, if so, surely among 'other values or elements of value' we ought to list and estimate appreciation. My personal view is that the estimate for appreciation might appropriately be largely identified with the cost of developing, not the business but the physical plant of the carrier. There is no dispute that the cost of operation over a green roadbed is greater than over the same roadbed when it has been pounded into a compact whole. This excess cost of initial operation is *de facto* a cost of construction spread over the early years of the carrier's activity. It makes no difference how the charges for perfecting the roadway were booked, so far as the object of our quest is concerned, which is to find the present value of property put at the service of the public" (pp. 519-520).

preciated, nor the promise to "consider" appreciation along with a host of other elements in arriving at a single-sum value, afforded an acceptable substitute for outright recognition and measurement of this element of value.

### *Original Cost and Present Value of Lands*

The ascertainment of the three underlying cost figures thus far covered in this analysis concerned property other than land. To complete the inventory of the physical elements of the property, a land appraisal was necessary. By the terms of the Valuation Act the Commission was required to report both "original cost" and "present value" of all lands, rights of way, and terminals owned or used for common-carrier purposes. It is now essential that the distinctive problems and processes involved in this land appraisal be noted, although the Commission's experience in its investigations of original and reproduction cost of carrier structures was substantially duplicated in this aspect of the valuation project. As may have been anticipated, "original cost" proved to be impossible of ascertainment; and "present value," although sharply distinguishable from "reproduction cost," came to involve much the same dependence upon hypothesis and estimate as characterized the cost of reproduction appraisal. The Commission's treatment of land is all the more important, however, since this "present value," despite the highly speculative features which accompanied its determination and the marked departure which it involved from any investment standard of valuation, was accorded controlling recognition, not only in the establishment of basic single-sum values, but in their subsequent revision.<sup>207</sup>

<sup>207</sup> The relationship to the land appraisal of lands not used for carrier purposes may be briefly noted at this point. The Commission was directed to "show separately the property held for purposes other than those of a common carrier, and the original cost and present value of the same." It was necessary at the very outset, therefore, to establish a standard of distinction between carrier and noncarrier lands. See *Texas Midland R. R.*, 75 I.C.C. 1, 161 (1918); *Petition of National Conference on Valuation*, 84 I.C.C. 9, 11 (1923). This matter, which was merely introductory to the principal task, was fraught with considerable difficulty. A nice balancing was involved between the public interest in enabling the railroads to exercise proper foresight in the purchase of lands for future development, and the public interest in preventing the imposition, through rates and charges, of a heavier burden than the land reasonably required for the provision of railroad service would justify. In general the Commission followed the rules employed by the courts in permitting the condemnation of lands for carrier purposes.

Efforts were made by the Commission to comply with the statutory provision for the ascertainment of original cost of land, but, as in the case of property other than land, the requirement was interpreted as embracing only such original cost as could be exactly determined from authentic records. Carriers were required to make returns showing such cost in detail wherever possible, and these returns were carefully examined and verified by the Commission's accountants. Not only the records of the carriers, but county and municipal records, court records, and any and every source of information tending to

The carriers were requested to state their position in every case, with a presumption in favor of their own judgment when exercised in good faith. Lands not in fact devoted to the public service were none the less classified as carrier lands when their use for carrier purposes was shown to be "imminent"—that is, that the possible use was at least capable of definition. Similarly, although the amount of land devoted to a particular use appeared to be excessive, the judgment of the carrier was none the less generally accepted—the limits fixed by the carrier being changed only in very plain cases. *Texas Midland R. R.*, *supra*, at pp. 161-163. See, also, *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463, 497-499 (1923); *Columbia Union Station Co.*, 114 I.C.C. 387, 390 (1926); and note the following from *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645 (1923), at p. 662: "We are not impressed with the carrier's evidence as to its plans for terminal developments, although we do not question the existence of the plans. The whole plan for its road was too expensive for the traffic which the territory served reasonably could be expected to afford. We are convinced that its terminal facilities as then developed were fully adequate to meet the needs of its traffic existing on date of valuation and reasonably prospective at that time, and that any plans for further terminal developments which it may have had were not within the class of plans discussed in *Texas Midland Railroad*, *supra*, commencing at page 161. We wish to emphasize that the plans there referred to were for reasonable prospective development, and that the plans for the carrier here do not fall in that category. Under the circumstances of this case, we question the right of the carrier to hold these large areas of high-priced city lands for transportation purposes at the expense of the public. The carrier can not be heard to complain of unfair treatment if they are apportioned to its noncarrier assets until such time as their inclusion in common-carrier lands seems justified." In one instance, where the Commission's attention was directed to the fact that within a short time following valuation date a tract originally classified as noncarrier land was converted to actual common-carrier use, the original classification made by the appraisers in the tentative valuation was changed. *San Pedro, Los Angeles & Salt Lake R. R. Co.*, *supra*, at pp. 498-499. But the Commission has held that land used for industrial sites or held for sale to manufacturing plants, even though the carrier's business was developed thereby, "serves no public purpose, and is properly classified as noncarrier." *Lake Erie & Fort Wayne R. R. Co.*, 114 I.C.C. 1, 3-4 (1926). For later specific applications of these doctrines, see *Chicago, Burlington & Quincy R. R. Co.*, 134 I.C.C. 1, 39 (1927); *Minneapolis, St. Paul & Sault Ste. Marie Ry. Co.*, 143 I.C.C. 547, 575-577 (1928); *St. Louis Southwestern Ry. Co.*, 149 I.C.C. 371, 381-382 (1928); *Pittsburgh, C. C. & St. L. Ry. Co.*, 24 Val. Rep. 1, 54 (1929); *Northern P. Ry. Co.*, 25 Val. Rep. 397, 430-433 (1929); *Denver & R. G. R. Co.*, 26 Val. Rep. 733, 757 (1929); *New York Central R. Co.*, 27 Val. Rep. 1, 43 (1929).

show the amounts actually paid for rights of way were consulted.<sup>208</sup> When, however, as was usually the case, it proved to be impossible to show the exact amount paid for lands at the time of their original acquisition, no attempt was made to estimate original cost. "In some of the earlier valuations," the Commission reported, "such an attempt was made, but the result was clearly valueless, and a moment's thought will show that this must inevitably be true."<sup>209</sup> The doubtful accuracy of sources of information, the fact that lands may have been donated, purchased, or condemned, and, in the absence of records, with nothing to indicate the relative proportions acquired under these varying methods, and the further consideration that no clue as to the actual price paid by the carriers could be obtained from the market acreage price prevailing at a given time—all these factors operated to make any effort to estimate original cost involve "not the exercise of good judgment but rather of pure speculation. The Commission has not felt justified in expending time and money in an attempt to make these estimates when they would be not only valueless but absolutely misleading when made."<sup>210</sup> It is doubtless true, for the reasons suggested as well as for others of similar character,<sup>211</sup> that the difficulties

<sup>208</sup> *Texas Midland R. R.*, 75 I.C.C. 1, 164 (1918).

<sup>209</sup> *Ibid.*

<sup>210</sup> *Ibid.*, p. 165.

<sup>211</sup> Several questions of a peculiarly perplexing type arose in connection with the reports on original cost. Where the carrier had purchased an entire tract of land, used a certain portion for carrier purposes, and either sold or retained the balance, what amount was to be reported as the original cost of the carrier portion? The Commission's answer, where the noncarrier portion had been sold previous to the date of inventory, was to add interest, taxes, and other expenditures shown to have been made, to the original cost of the entire parcel, and to subtract from this sum whatever the carrier had received for the portion sold. "This result is not accurate," admitted the Commission, "and in some cases the increase in value of the noncarrier portion between the date of acquisition and of sale has been such that the original cost of the carrier part is nothing, but the figure so reached does represent the money cost to the carrier as the result of the entire transaction." Where the noncarrier portion was still retained, on the other hand, no attempt was made to distribute the original cost as between the two classes of land, the entire cost being treated as that of a single parcel. "This method has the advantage of reporting the exact fact, so that the figures given are exactly what they purport to be"; but it necessarily rendered the original cost figures for carrier lands defective. *Ibid.*, pp. 165-166. Again, difficulties arose because of discrepancies between the nominal and actual consideration involved in the purchase of lands. The consideration named in the deed did not always represent the amount actually paid. Accordingly, the consideration named in the deed was disregarded, and the actual consideration was reported, whenever the amount in fact paid could be accurately ascertained; but in the absence of evidence that the actual consideration dif-

involved in estimating original cost of carrier lands were greater and more likely to bring "misleading" results than those surrounding attempts to estimate the original cost of the structural elements of the property. None the less, it is by no means clear that the ascertainment of original cost data, even under such handicaps, would not have provided a desirable check upon the use of land figures for rate-making purposes based entirely upon estimates of "present value."<sup>212</sup>

When we turn to a consideration of the requirement as to "present value," it is first necessary to note its relationship to the reproduction cost theory and to the determination of final value. Present value of land, it must be borne in mind, is not analogous to reproduction cost of physical property other than land. Reproduction cost, as applied to land, would be measured by the price which the carrier would pay for its lands at time of valuation, and it would consist of their market value plus any excess costs incident to their acquisition. But this conception of present value of land has received no acceptance. Consistently from the first, the Commission has interpreted "present value" as "nearly synonymous with market value," and it has adopted as its measure the market value of similar land adjacent to or adjoining that of the carrier.<sup>213</sup> Yet "market value" appears to have no

ferred from the recital, the amount named in the deed was accepted as the amount in fact paid. The inclusion of presumptions as well as facts was thus unavoidable. In keeping with its usual policy, however, the Commission made clear the exact basis upon which its specific findings were determined: "The Commission's accountants in their reports distinguish . . . between those cases in which the actual consideration is known and those in which it is presumed from the recital of the deed. The tentative valuation shows as donations all lands conveyed for a nominal consideration . . . but by looking into the report of the accountants it can be determined just what portion of the donations were so conveyed. It has been felt that it was highly important in all matters of original cost to report facts and not presumptions or estimates. Where it has been necessary to include a presumption in the final summary, it has been the endeavor to show at some previous stage to what extent the presumption has been made." *Ibid.*, pp. 166-167.

<sup>212</sup> As illustrative of the Commission's usual inability to report original cost of lands, see the following: *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645, 682, 687 (1923); *Durham & South Carolina R. R. Co.*, 84 I.C.C. 313, 321 (1924); *New York, Philadelphia & Norfolk R. R. Co.*, 97 I.C.C. 273, 320 (1925); *Tennessee & North Carolina R. R. Co.*, 106 I.C.C. 265, 269 (1925); *Texas, Oklahoma & Eastern R. R. Co.*, 108 I.C.C. 47, 49 (1926); *Tennessee, Alabama & Georgia R. R. Co.*, 110 I.C.C. 595, 597 (1926); *Chicago, Milwaukee & Gary Ry. Co.*, 114 I.C.C. 16, 27 (1926); *Delaware & Hudson Co.*, 116 I.C.C. 611, 627 (1926); *Gulf, Mobile & Northern R. R. Co.*, 125 I.C.C. 765, 770 (1927); *Chicago, Burlington & Quincy R. R. Co.*, 134 I.C.C. 1, 61 (1927); *Duluth & Iron Range R. Co.*, 31 Val. Rep. 159, 164 (1930).

<sup>213</sup> *Texas Midland R. R.*, 75 I.C.C. 1, 167 (1918).

standing, in terms of any sound principle of valuation, as a measure of the value of land for rate purposes. It represents neither what has actually been paid nor what would have to be paid for the property in question, for railroad use, on valuation date. Whether economic grounds or equitable considerations are relied upon, it fails to qualify as the proper standard of the amount on which investors should be allowed to earn their fair return. Its sole significant support was found in a bit of judicial dictum by Justice Hughes, the full nature of which is disclosed by the following: "Assuming that the company is entitled to a reasonable share in the general prosperity of the communities which it serves, and thus to attribute to its property an increase in value, still the increase so allowed, apart from any improvements it may make, cannot properly extend beyond the fair average of the normal market value of land in the vicinity having a similar character. . . . The company would certainly have no ground of complaint if it were allowed a value for these lands equal to the fair average market value of similar land in the vicinity, without additions by the use of multipliers, or otherwise, to cover hypothetical outlays."<sup>214</sup> It seems obvious that there was merely condemnation of the use of multipliers, as a measure of the special costs that would be incurred, under the facts disclosed; that the conclusion as to "market value" was based upon a mere *assumption*, with regard to the propriety of which no stand was taken; that these judicial dicta provided no binding precedent for the doctrine that carriers are entitled, as of right, to the so-called market value of their lands.<sup>215</sup> But the Commission was re-

<sup>214</sup> *Minnesota Rate Cases*, 230 U.S. 352, 455 (1913).

<sup>215</sup> See dissenting opinion of Commissioner Eastman in *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), at pp. 535-537. He not only called attention to "the careful phrasing of the language of Justice Hughes," but he concluded as follows with regard to the significance of the pronouncement: "This is far from a finding that the company is *entitled* to values so determined. A conclusion upon this point was unnecessary, for even if such values were allowed, the rates fixed by the State of Minnesota could be sustained." Compare, also, the following from H. B. Vanderblue, *Railroad Valuation by the Interstate Commerce Commission* (1920), at pp. 53-54: "Justice Hughes really decided nothing when he used these words, for the conclusion is qualified by an assumption neither approved nor disapproved. This fact Mr. Prouty, and the Commission, following Mr. Prouty, have ignored. Where Mr. Prouty found authority for his assertion that 'the decision explicitly holds . . . that either an increase or a decline in the value of land must be taken into account,' or for his assertion that 'in the opinion of the court the carrier was entitled to the increase in the value of its lands like any other individual,' is not indicated in his Memorandum. If there is one thing that the opinion did not do, it was to reach any decision explicitly

quired to ascertain the "present value" of carrier lands; and this requirement is understandable only in the light of the further requirement that the Commission ascertain and report separately "the original and present cost of condemnation and damages, or of purchase," in excess of original cost and present value. In so far as this latter requirement related to the original costs of condemnation or acquisition, it amounted merely to an order to distribute the actual original costs of land into two accounts—original market values, and original costs in excess thereof; but in so far as it dealt with current estimates, it provided for the ascertainment of the costs in excess of "present value" which would be incurred by a carrier seeking to duplicate its lands.<sup>216</sup> In other words, "present value" was recognized as but part of the story; only when coupled with present costs of condemnation or acquisition would it attain such validity as attaches to a reproduction cost estimate as a measure of final value. It becomes necessary, therefore, to examine the Commission's attitude toward this complementary requirement. As a background for our discussion of the Commission's processes in connection with the ascertainment of the "present value" of lands, we must trace the character of the developments which resulted ultimately in the elimination of the "excess cost" requirement—an elimination which, taken with the impossibility in most instances of ascertaining original cost of land, largely explains, although it does not justify, the Commission's recognition of "present value" as the controlling factor in land valuation.

about land. It condemned what had been done; but it proposed no substitute program except that qualified by an assumption neither approved, disapproved, nor even discussed. In terms of the assumption Justice Hughes set a maximum, which the Division of Valuation has reported as present value without analysis of the underlying problem."

<sup>216</sup> It seems clear that "original cost of land" and "present value of land" are not comparable concepts, since the former contains condemnation or acquisition costs while the latter does not. It would seem that the requirement of the Act to ascertain and report the original excess costs of acquisition or condemnation really amounted to a requirement to allocate the total cost originally paid for land into "original market value" and "original cost of acquisition or condemnation," whereas the provision requiring that present costs of acquisition or condemnation be ascertained involved the ascertainment of such costs in excess of the "present value" of land. Under these circumstances, it would appear that the statutory provision directing the Commission to ascertain and report "original . . . cost of condemnation and damages, or of purchase, in excess of such original cost . . .," although sufficiently clear in general intent, was poorly drawn, since the costs of acquisition would be part of, rather than in excess of, the original cost of land.



In its first published report the Commission professed inability to comply with the provision of the act calling for the ascertainment and report of original and present costs of land condemnation or acquisition. The nature of the reasoning which led to this conclusion can be set forth very briefly, and largely in its own words. Recognizing that the requirement necessitated, in effect, a finding as to the cost of reproduction of carrier lands, the Commission asked, "Must this be done, and can this be done?" "It seems elementary," it continued, "that the cost of reproduction can be estimated only by assuming that the thing in question is to be produced again, and that if it is to be produced again, it is to be taken as not existent. It seems sophistry to contend that lands of the railroad can be produced again at a cost to the railroad without first making the assumption that they are no longer lands of the railroad; and this necessary assumption carries with it the mental obliteration of the railroad itself."<sup>217</sup> The uncertainties, under such an assumption, as to "what would be the conditions of ownership, of improvement, and of value of near-by property, and of general industrial development" were elaborated, and it was further pointed out that "there can be no certainty as to what land would have to be acquired at a cost to the carriers upon reproduction or a present acquisition."<sup>218</sup> In other words, not only would the ascertainment of such reproduction cost involve resort to uncharted speculation, because of the totally undefined character of the surrounding circumstances and conditions that would prevail in the event of the non-existence of the railroad,<sup>219</sup> but the extent of the property to be reproduced at a price would be open to question, be-

<sup>217</sup> *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at p. 54.

<sup>218</sup> *Ibid.*, p. 61.

<sup>219</sup> The Commission quoted with approval, for example, the following excerpt from the opinion of Justice Hughes in the *Minnesota Rate Cases*, 230 U.S. 352 (1913), at p. 452, which pointed out "what must be assumed in an attempt to estimate the cost of reproduction of lands": "Moreover, it is manifest that an attempt to estimate what would be the actual cost of acquiring the right-of-way, if the railroad were not there, is to indulge in mere speculation. The railroad has long been established; to it have been linked the activities of agriculture, industry and trade. Communities have long been dependent upon its service, and their growth and development have been conditioned upon the facilities it has provided. The uses of property in the communities which it serves are to a large degree determined by it. The values of property along its line largely depend upon its existence. It is an integral part of the communal life. The assumption of its nonexistence, and at the same time that the values that rest upon it remain unchanged, is impossible and can not be entertained. The conditions of owner-

cause of the problematical character of the public attitude which might manifest itself in aids, gifts, grants, or donations.<sup>220</sup> To proceed on the assumption that the railroads would be obliterated without any change in surrounding conditions, or that all lands would have to be *purchased* on reacquisition, was to proceed on an impossible assumption; on the other hand, a decision as to what circumstances would actually prevail, or as to what influence they would exercise upon the cost of "reproducing" the lands, once the non-existence of the roads was assumed, was beyond the processes of rational determination. "The real question," said the Commission, "is as to the cost to a particular railroad of procuring its right of way at the present time if it were obliterated and were obliged to reacquire its operative lands. The answer to this question depends upon considerations and elements which the Commission can by no possibility determine with accuracy, and for this reason the question itself can not be answered."<sup>221</sup> Under these circumstances, the Commission's conclusion was inevitable: "Because of the impossibility of making the self-contradictory assumptions which the theory requires when applied to the carrier's lands, we are unable to report the reproduction cost of such lands or its equivalent, the present cost of acquisition and damages, or of purchase in excess of present value."<sup>222</sup> It

ship of the property and the amounts which would have to be paid in acquiring the right-of-way, supposing the railroad to be removed, are wholly beyond reach of any process of rational determination." *Ibid.*, p. 58.

<sup>220</sup> "The carrier," said the Commission, "has been constructed within comparatively a recent period of time; nothing in the record shows us that the reproduction of the road would be regarded in any less friendly spirit by the community as a whole and individual owners in particular, than when the right of way and terminals in question were acquired but a few years back. . . . Of the total original cost of the carrier lands, approximately 40 per cent was donated by citizens of various communities along the line. That all such donated lands would necessarily have to be bought or condemned and paid for at the full amount which a jury would award on condemnation is an assumption we do not feel warranted in making from the record before us." *Ibid.*, pp. 61-62.

<sup>221</sup> *Ibid.*, p. 169.

<sup>222</sup> *Ibid.*, p. 62. It should be noted, further, that in declining to apply the reproduction cost method to carrier lands, the Commission was influenced not only by the self-contradictory nature of the assumptions involved and by the speculative character of the findings it might make, but by practical administrative considerations, such as the burden of time and expense which would be imposed by the task of ascertaining excess costs of condemnation or acquisition. The reality of this burden was made manifest by an analysis of the task: "As interpreted by the carriers, the Commission is required to take every individual parcel which the carrier must acquire if its road were obliterated

must be noted, however, that the Commission conceded "that frequently the cost to a railroad of acquiring its right of way with respect to parcels which must be purchased materially exceeds the acreage value of the land taken";<sup>228</sup> it simply argued, and reasonably enough, that as a practical matter anything approaching an accurate

and the right of way were to be repurchased, and to determine the cost of acquiring the right of way across that parcel in addition to the base or acreage value of the land used. This would be equivalent to what is done by a railroad in originally procuring its right of way and would involve a consideration of all those elements which determine the amount of the damages. The use of the parcel, the extent to which that use would be interfered with, its value before and after that railroad has been constructed, and the almost numberless considerations which enter into the determination of that question must be considered. An inspection and a study of each individual parcel must be made which of necessity would be more minute and exhaustive than the study which is made in determining the acreage value." *Ibid.*, pp. 168-169. Nor did the method used by the carriers, by way of indicating that this enormous task was entirely manageable from the standpoint of time and expense, approve itself to the Commission; indeed, it characterized this method as "too fantastic for serious discussion." The Commission's brief statement of the procedure which was adopted fully justified this characterization: "In answer to the objection that this kind of an appraisal would be in the matter of time and expense prohibitive, the presidents' conference committee, representing all the principal carriers in the United States, attempted to show the Commission how it should be done. The road selected was the Texas Midland, about 112 miles in length. Two men were selected who had no special knowledge of lands along this railroad, who were stationed upon the rear end of a passenger coach and provided with a map showing the parcels as they were originally acquired. The train proceeded at its ordinary rate over the length of the line. From this inspection these gentlemen undertook to state parcel by parcel the excess cost of acquisition and the damages. A computation showed that less than one minute could have been devoted by them to the inspection and determination of these excess costs and damages as to each parcel. The proposition that the Commission could make a report under any such method as this is too fantastic for serious discussion." *Ibid.*, p. 169.

<sup>228</sup> *Ibid.*, p. 170. Indeed, the concession went further, but without modification of the ultimate result: "It would be possible for the Commission . . . to report something in the nature of an average percentage [of excess cost over acreage value], but such a figure would be of little or no significance as applied to individual railroads, and would be tantamount only to a general statement that there is such additional element of cost which usually falls within certain limits. The Commission has not felt that this would satisfy the requirement of the statute, and has believed, as already stated, that it was practically impossible to report the fact called for." *Ibid.*, pp. 170-171. The Commission likewise determined not to ascertain the excess of original cost over market value at the time of original acquisition. Here, again, the Commission urged practical impossibility of performance of the statutory mandate: "There are many instances where the amount paid the land owner for the parcel is known, but there are certain general costs considerable in amount incident upon procuring the right of way which can not be allocated to individual parcels. It is difficult, therefore, to give the exact original cost of any one parcel, although such cost of the entire right of way can be stated with accuracy. To show excess of original cost over market value it would therefore be necessary to take each individual parcel and show with respect to it the fair market value of the land, combining the results into an aggregate and

and reliable ascertainment of the excess costs which would be incurred by a carrier in the reacquisition of its lands was impossible.

It will be recalled, however, that in the Commission's reproduction cost appraisal of property other than land the fantastic character of the hypotheses and assumptions was not always deemed to constitute a controlling barrier to the ascertainment of facts considered worth reporting. It seems not at all unlikely that the artificiality of the doctrine would not have been so regarded in this instance, had not the Supreme Court handed down its famous decision in the *Minnesota Rate Cases* just three months after the passage of the Valuation Act. In considering the estimated value of the railroad property in question, as a necessary factor in determining whether the prescribed rates at issue were confiscatory, the Court was called upon to review the validity of land values calculated by adding percentages to the normal appraised value for "cost of acquisition and consequential damages." The problem was subjected to elaborate analysis, and the opinion of Justice Hughes condemning such conjectural allowances, by the use of multipliers or otherwise, in determining land values for rate-making purposes (at least in so far as the facts and methods there involved were concerned), has become a classic in the literature of valuation.<sup>224</sup> The Commission's policy was largely influenced by this determina-

comparing this with original cost as shown by the records. This was actually attempted in one or two instances and it was made evident from that experience that the result could not be relied upon. To do that with respect to every parcel would involve an enormous amount of work without any beneficial result so far as we could see. The Commission has therefore felt justified in treating as practically impossible a compliance with this requirement of the statute." *Ibid.*, p. 168.

<sup>224</sup> *Minnesota Rate Cases*, 230 U.S. 352 (1913), especially at pp. 450-456. The crucial issue was stated as follows: "The question is whether, in determining the fair present value of the property of the railroad company as a basis of its charges to the public, it is entitled to a valuation of its right-of-way not only in excess of the amount invested in it, but also in excess of the market value of contiguous and similarly situated property. For the purpose of making rates, is its land devoted to the public use to be treated (irrespective of improvements) not only as increasing in value by reason of the activities and general prosperity of the community, but as constantly out-stripping in this increase, all neighboring lands of like character, devoted to other uses? If rates laid by competent authority, state or National, are otherwise just and reasonable, are they to be held to be unconstitutional and void because they do not permit a return upon an increment so calculated?" (pp. 453-454). The Court's answer to these questions was unqualifiedly in the negative: "The increase sought for 'railway value' in these cases is an increment over all outlays of the carrier and over the values of similar land in the vicinity. It is an increment which can not be referred to any known criterion, but must rest on a mere expression of judgment which finds no proper test or

tion. Independently impressed by the difficulties of ascertaining the excess costs of condemnation or acquisition, the Commission none the less leaned heavily upon the Court's findings<sup>225</sup>—particularly since it was convinced, in view of the Court's decision, that such "excess costs," even if ascertained, could be given no valid consideration in the determination of final single-sum values. But the Commission did not long remain undisturbed in its refusal to execute the "excess cost" provision of the Act. On December 5, 1918, the Kansas City Southern filed a petition for a writ of mandamus to compel the Commission to comply with the statute in this regard; and on March 8, 1920, the Supreme Court ordered the issuance of the writ requested by the petitioner.<sup>226</sup> The issue before the Court was not concerned

standard in the transactions of the business world. It is an increment which in the last analysis must rest on an estimate of the value of the railroad use as compared with other business uses; it involves an appreciation of the returns from rates (when rates themselves are in dispute) and a sweeping generalization embracing substantially all the activities of the community. For an allowance of this character there is no warrant. . . . We therefore hold that it was error to base the estimates of value of the right-of-way, yards, and terminals upon the so-called 'railway value' of the property. The company would certainly have no ground of complaint if it were allowed a value for these lands equal to the fair average market value of similar land in the vicinity, without additions by the use of multipliers, or otherwise, to cover hypothetical outlays. The allowances made below for a conjectural cost of acquisition and consequential damages must be disapproved. . . ." (p. 455).

<sup>225</sup> The carriers attempted to show that the rule of the *Minnesota Rate Cases* was inapplicable to the task explicitly imposed by the statute and to the particular methods suggested for its performance, but the Commission was unable to find any essential distinction between the practice condemned by the Court and that which it was urged to follow: "We are unable to distinguish between what is suggested by the carrier in this record and nominally required by the act and what was condemned by the court as beyond the possibility of rational determination; nor is there any essential difference in the actual methods there employed and those now urged upon us. Before we can report figures as ascertained, we must have a reasonable foundation for our estimate, and when, as here, if the estimate can be made only upon inadmissible assumptions, and upon impossible hypotheses, such as those pointed out by the Supreme Court in the opinion quoted, our duty to abstain from reporting as an ascertained fact that which is incapable of rational ascertainment, is clear." *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at p. 60. See, also, *Winston-Salem Southbound Ry. Co.*, 75 I.C.C. 187, 199-200 (1918); *Kansas City Southern Ry. Co.*, 75 I.C.C. 223, 262 (1919). Compare, also, the following from *Annual Report*, 1920, p. 52, in which the Commission, referring to the Kansas City Southern proceeding, said: "In estimating the present value of lands included in the right of way, yards, and terminals of the carrier, we have used as a measure the 'fair average market value of land in the vicinity,' and relying upon the action taken by the court in the *Minnesota Rate Cases*, we declined to receive evidence relating to the cost of condemnation."

<sup>226</sup> *Kansas City So. Ry. v. I.C.C.*, 252 U.S. 178 (1920). The carrier's position was that the Commission's refusal to make the report in question would result in "a finding

with the substantive merit of recognizing costs of condemnation or acquisition as proper elements in the value of land; it related solely to the "alleged refusal to discharge duties which the statute exacts," and the Court found that this issue "brings out in bold contrast the direct and express command of the statute to the Commission, to act concerning the subject in hand, and the Commission's unequivocal refusal to obey such command." Although the Court recognized the relationship between the Commission's action and its own decision in the *Minnesota Rate Cases*, it held the Commission's conclusion not to comply with the Congressional mandate to be erroneous.<sup>227</sup> The service of tentative valuations had been suspended pending the decision of the Supreme Court; but immediately thereafter studies were made, information was collected, and "excess cost" figures were calculated and embodied in the tentative valuation reports. Separate tentative reports covering this aspect of the land valuation were issued by way of supplement to 55 tentative reports served prior to the decision.<sup>228</sup> But this task was brought to a summary close before the issuance of any of the Commission's final valuation reports. Congress stepped

by respondent of a value of but \$60,000 with respect to parcels of land acquired by relator by judicial award in condemnation proceedings during four years immediately preceding such valuation at an actual cost to relator of \$180,000; and in the aggregate will result in a finding with respect to said lands at least \$5,000,000 less than the value so directed by the Act of Congress above mentioned to be found." *Ibid.*, p. 186.

<sup>227</sup> "It is true," said the Court, speaking through Chief Justice White, "that the Commission held that its nonaction was caused by the fact that the command of the statute involved a consideration by it of matters 'beyond the possibility of rational determination,' and called for 'inadmissible assumptions,' and the indulging in 'impossible hypotheses' as to subjects 'incapable of rational ascertainment,' and that such conclusions were the necessary consequence of the *Minnesota Rate Cases*. . . . We are of opinion, however, that, considering the face of the statute and the reasoning of the Commission, it results that the conclusion of the Commission was erroneous, an error which was exclusively caused by a mistaken conception by the Commission of its relation to the subject, resulting in an unconscious disregard on its part of the power of Congress and an unwitting assumption by the Commission of authority which it did not possess. And the significance which the Commission attributed to the ruling in the *Minnesota Rate Cases*, even upon the assumption that its view of the ruling in those cases was not a mistaken one, but illustrates in a different form the disregard of the power of Congress which we have just pointed out, since, as Congress indisputably had the authority to impose upon the Commission the duty in question, it is impossible to conceive how the *Minnesota Rate* ruling could furnish ground for refusing to carry out the commands of Congress, the cogency of which consideration is none the less manifest though it be borne in mind that the *Minnesota Rate Cases* were decided after the passage of the act in question." *Ibid.*, pp. 187-188.

<sup>228</sup> See *Annual Reports*: 1920, p. 70; 1921, p. 55.

into the breach and eliminated the "excess cost" requirement.<sup>229</sup> The first of the final single-sum value reports contains the following brief passage as the only reminder of the memorable battle: "The claim of the carrier to have the present cost of condemnation and damages or of purchase of lands in excess of such original cost or present value ascertained, is disallowed. Congress has . . . repealed the clause . . . which requires such finding to be made. The supplemental tentative valuation is modified accordingly."<sup>230</sup>

The Commission's decision not to report or consider condemnation or acquisition costs was made, of course, solely on its own responsibility. While Congress eliminated this report as an express require-

<sup>229</sup> By the Act of June 7, 1922 (42 Stat. 624). See, also, *Annual Report, 1922*, p. 73.

<sup>230</sup> *Evansville & Indianapolis R. R. Co.*, 75 I.C.C. 443, 444 (1922). Similarly, in *Florida East Coast Ry. Co.*, 84 I.C.C. 25, 27-28 (1924), the Commission, in arriving at final single-sum value, disregarded figures of \$2,607,264 and \$548,158 which, following the Supreme Court's decision in the *Kansas City Southern* case, it had found to be the excess costs of acquisition of carrier lands. See, also, *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463, 488 (1923); *Durham & South Carolina R. R. Co.*, 84 I.C.C. 313, 314 (1924); and *Elgin, Joliet & Eastern Ry. Co.*, 84 I.C.C. 587, 615-616 (1924). In the following final reports, among numerous others, attention is directed to the elimination of the "excess cost" findings made in the respective tentative reports: *Danville & Western Ry. Co.*, 84 I.C.C. 227, 231 (1924); *Raritan River R. R. Co.*, 84 I.C.C. 463, 467 (1924); *Roscoe, Snyder & Pacific Ry. Co.*, 97 I.C.C. 1, 14 (1925); *New York, Philadelphia & Norfolk R. R. Co.*, 97 I.C.C. 273, 309 (1925); *Augusta Belt Ry. Co.*, 103 I.C.C. 523, 526 (1925); *Fernwood & Gulf R. R. Co.*, 108 I.C.C. 62, 65 (1926); *Lufkin, Hemphill & Gulf Ry. Co.*, 110 I.C.C. 220, 222 (1926); *Chicago, Milwaukee & Gary Ry. Co.*, 114 I.C.C. 16, 17 (1926); *Lake Superior & Ishpeming Ry. Co.*, 116 I.C.C. 1, 6 (1926); *Great Northern Ry. Co.*, 133 I.C.C. 1, 117 (1927). In *Excess Income of Richmond, F. & P. R. Co.*, 170 I.C.C. 451, 486-488 (1931), a claim for costs of acquisition which would practically have doubled the bureau's land valuation was presented in somewhat novel form. "What it claims, the respondent insists, is not present costs of acquisition in excess of the actual value of the lands but merely the fair value of such lands taking into account their special adaptability for railway use and rights appurtenant to construct, maintain, and operate the railway, tantamount to easements in the adjacent lands. This value in turn can only be measured, it is argued, by the present costs of acquisition" (p. 487). On the basis of the doctrines approved by the Supreme Court in the *Minnesota Rate Cases*, and of the rules uniformly followed by the Commission in its valuation proceedings, the claim of the carrier was rejected. Again, in *Toledo, St. Louis & Western R. R. Co.*, 141 I.C.C. 287, 318-319 (1928), the carrier offered as evidence of the value of its land the prices paid for comparable land by two other carriers during 1916, 1917, and 1918, contending that prices actually paid for similar land for the same purpose "are the best index of the value of its own right of way." The Commission disposed of the contention summarily: "We have heretofore discussed and passed upon the only principle here involved, namely, the propriety of valuing carrier lands upon the basis of the theoretical cost to acquire or reproduce, and have decided contrary to the contention of this carrier" (p. 318). See, also, *Detroit & T. S. L. R. Co.*, 25 Val. Rep. 355, 364-365 (1929).

ment, there was nothing in the Valuation Act forbidding the Commission to ascertain such costs if it chose to do so, or even to employ the figures in the determination of final values.<sup>281</sup> But its decision appears to have been entirely sound. The fact that during the brief period intervening between the court decree and the legislative elimination of the excess cost requirement the Commission actually found it possible to ascertain and report these costs did not alter the substantive merits of the controversy. The Commission never contended that it could not report figures which might be termed representative of present condemnation or acquisition costs; it argued, rather, that it is impossible to report figures which can with any degree of reasonable assurance be said to represent such costs in genuine fashion. Its activity under the pressure of the judicial mandate was in no significant sense a refutation of this position, nor did it involve a relinquishment of its conviction that the use of such figures is improper. Because of the self-contradictory nature of the hypotheses involved, and because of the highly conjectural character of the findings to which these hypotheses must lead, the excess costs of condemnation or acquisition are beyond the processes of rational determination and have no legitimate place even in a reproduction cost appraisal.<sup>282</sup>

We return, then, to a consideration of "present value" of carrier lands—the only land figure which the Commission, in its final deliberations, has regarded as of real significance. It has been indicated earlier that present value, as reported by the Commission, was "nearly synonymous with market value." Present value, as thus conceived, was determined by ascertaining the market value per acre of similar land adjoining that of the carrier or in the immediate vicinity and by applying the price so ascertained to the acreage of carrier lands. The processes whereby this adjacent land test was derived have been

<sup>281</sup> In his separate opinion, concurring in part, in *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), Commissioner Potter said (pp. 575-576): "The fact of cost exists as when our tentative report was made. If, under the present law, it be not required that the item be set up separately, it is nevertheless our duty to include it as an element of present value or of cost of reproduction new."

<sup>282</sup> In the words of the Supreme Court: "The cost-of-reproduction method is of service in ascertaining the present value of the plant, when it is reasonably applied and when the cost of reproducing the property may be ascertained with a proper degree of certainty. But it does not justify the acceptance of results which depend upon mere conjecture." *Minnesota Rate Cases*, 230 U.S. 352 (1913), at p. 452.



described briefly as follows: "For the purpose of determining this present value the Commission sends into the field its land appraisers, who make a personal inspection of the property and ascertain certain facts which bear upon the value. The right of way is first divided into zones, and each zone contains lands of substantially similar character and value. Every zone is continuous from one end to the other. The appraiser having laid out his zone next proceeds to determine the market value of adjoining and adjacent lands. For this purpose he collects all recent sales which he can find of similar lands in the immediate vicinity. He also ascertains the assessed value of such lands and finally takes the opinion of different classes of well-informed persons as to such value. From a consideration of all these sources of information he determines the unit or market value."<sup>283</sup> Although, as appears from the above, all available sources of reliable information were drawn upon, the Commission was inclined to accept current records of land sales as the best criteria of prevailing market value. The following is typical of the Commission's attitude: "Actual sales as a rule afford the best evidence of value and in our opinion the sales enumerated in the field notes of our appraisers fully support the values set out in the tentative report."<sup>284</sup> Of like import: "Neither options nor opinions need be considered further, as in this case the sales made in the vicinity are better evidence and sufficient to deter-

<sup>283</sup> *Texas Midland R. R.*, 75 I.C.C. 1 (1918), at p. 167. See, also, *Florida East Coast Ry. Co.*, 84 I.C.C. 25, 27-28 (1924); *Elgin, Joliet & Eastern Ry. Co.*, 84 I.C.C. 587, 609-610 (1924); *New York, Philadelphia & Norfolk R. R. Co.*, 97 I.C.C. 273, 309 (1925); *Augusta Belt Ry. Co.*, 103 I.C.C. 523, 527 (1925); *DeQueen & Eastern Ry. Co.*, 106 I.C.C. 714, 716 (1926); *West Virginia Northern R. R. Co.*, 110 I.C.C. 385, 392 (1926); *Elberton & Eastern R. R. Co.*, 114 I.C.C. 759, 760 (1926); *Lake Superior & Ishpeming Ry. Co.*, 116 I.C.C. 1, 8 (1926). For an elaborate discussion of the application of the Commission's rule to the facts of a particular case, see *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), at pp. 488-501, 574-575. In *Denver & R. G. R. Co.*, 26 Val. Rep. 733, 753-756 (1929), the Commission overruled carrier claims for an increase of \$3,173,209 in the value of land in canyons "on account of special adaptability to railroad use," and in doing so followed the principle enunciated in *Minnesota Rate Cases*, 230 U.S. 352, 451 (1913), that "the inquiry would be as to the fair market value of the property; as to what the owner had lost, and not what the taker had gained." As stated in the *Texas Midland* case, "due allowance is made for any peculiar value which may attach by reason of the peculiar adaptability of the land to railroad use"; but such special adaptability "is merely an element in the determination of market value, so that the extent to which it enters into consideration is necessarily limited to such effect as it may appear to have upon the market value."

<sup>284</sup> *Birmingham & Northwestern Ry. Co.*, 84 I.C.C. 675, 678 (1925).

mine the value of the carrier lands.<sup>285</sup> These methods were consistently applied by the Commission. It refused to modify its rule, for example, upon protest of a carrier that throughout its territory it was customary for landowners when making conveyances to carriers to require the latter to change the location of their rails, at their own expense, whenever the owners wished to mine the underlying ore, and that this carrier had in fact been subject to large expenditures because of the exercise of this right. Noting that "the reservation of mineral rights is not confined to sales of right of way only, but is characteristic of all land transactions," the Commission found no error in following its "approved principles and methods in ascertaining land values in this proceeding";<sup>286</sup> and it pointed out, further, that the present value of land may frequently be less than the cost to its owner: "This may be due to a number of reasons, and the fact that our appraisal has developed such a difference for the carrier's lands is no proof that it is wrong."<sup>287</sup> Aside from the inventory,<sup>288</sup> the Commission's land appraisal was chiefly concerned with seeking an accurate

<sup>285</sup> *Norfolk Southern R. R. Co.*, 84 I.C.C. 693, 703-704 (1925).

<sup>286</sup> *Lake Superior & Ishpeming Ry. Co.*, 116 I.C.C. 1, 6-7 (1926). See, also, *Rarian River R. R. Co.*, 84 I.C.C. 463, 467-468 (1924).

<sup>287</sup> *Lake Superior & Ishpeming Ry. Co.*, *supra*, p. 7. See, also, to the same effect, *Knoxville, Sevierville & Eastern Ry. Co.*, 84 I.C.C. 329, 329-330 (1924); *Norfolk Southern R. R. Co.*, 84 I.C.C. 693, 706 (1925); *Fort Street Union Depot Co.*, 97 I.C.C. 663, 668 (1925); *Sewell Valley R. R. Co.*, 106 I.C.C. 236, 238 (1925); *Great Northern Ry. Co.*, 133 I.C.C. 1, 129 (1927). With respect to rights in land of which the carrier has neither ownership nor exclusive use, the Commission based its treatment on a distinction between private lands and public domain. Rights in private lands, including government lands which could be acquired by private persons, were appraised at present value, irrespective of the cost to the carrier; rights in the public domain, on the other hand—that is, rights in lands which could not be reduced to private ownership—were valued at the price paid for the privilege, on the theory that "the privilege of use accorded by the superior authority is analogous to a franchise and should be treated in the same manner." *Texas Midland R. R.*, 75 I.C.C. 1, 175-176 (1918); *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463, 500-501 (1923); *Pittsburgh & Susquehanna R. R. Co.*, 110 I.C.C. 787, 792 (1926); *Grand Trunk Ry. of Canada*, 143 I.C.C. 1, 19-20 (1928); *Central R. Co. of N. J.*, 149 I.C.C. 659, 697-699, 700-701 (1929); *Pittsburgh, C. C. & St. L. Ry. Co.*, 24 Val. Rep. 1, 49-51, 54-55 (1929); *Chesapeake & O. Ry. Co.*, 24 Val. Rep. 451, 489 (1929); *Northern P. Ry. Co.*, 25 Val. Rep. 397, 428-429 (1929); *New York Central R. Co.*, 27 Val. Rep. 1, 56-68 (1929); *Boston & M. R.*, 30 Val. Rep. 515, 543-548 (1930).

<sup>288</sup> One of the difficult problems encountered in connection with the land inventory concerned the treatment to be accorded to land occupied by the carriers in streets and highways. Many intricate questions were involved, particularly with respect to the ultimate ownership of the fee; and after extended consideration the Commission adopted a policy, based largely on rebuttable presumptions as to ownership under

measure of the market value of adjoining and adjacent lands. Factual data, especially by way of records of sales and assessments, constituted the objective background of the Commission's findings; but the acceptance of opinion evidence and the exercise of coordinating judgment could not, in most instances, be avoided. The very classification of lands, as well as the determination of the reliability of the evidentiary data and the dissolution of conflicts in result, necessitated the assertion of authoritative control, in the first instance by employees

varying defined circumstances, which was to be applied, in more or less arbitrary fashion, in all subsequent proceedings. *Texas Midland R. R.*, *supra*, pp. 62-63, 172-175; *San Pedro, Los Angeles & Salt Lake R. R. Co.*, *supra*, pp. 500, 576; *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645, 663-664 (1923). The Commission showed a willingness, however, when confronted by justifying circumstances, frankly to reverse itself. In *Georgia Southern & Florida Ry. Co.*, 106 I.C.C. 155 (1925), complaint was made by the carrier "that parts of 28 areas embracing street intersections and used by it for its right of way and by the public for street purposes" had been omitted from the inventory. Under the Commission's original rule, these areas should have been inventoried to the carrier. The contentions were "that the evidence shows that the fee-simple titles are in the carrier; that the titles were acquired, and the railroad constructed, prior to the opening of the several streets; and that the carrier has never conveyed the fee thereto nor received any compensation for the use thereof as streets by the public" (p. 160). But the Commission held, contrary to its previous policy, that ownership of title was not the controlling consideration: "It is not our function to determine questions of title to lands. For the purposes of this report we may assume, without deciding, that it affirmatively appears upon this record that the fee title to the 28 areas above referred to is in the carrier. But the carrier's use of the lands is wholly independent of its ownership, and depends upon a right that is inferior and subordinate to the right of the public to use and control the use of such lands as parts of public streets. The carrier's right to use these streets is a right in the nature of a franchise, the cost of acquiring which we should report as the value of that right if there were evidence of that cost in the record before us. We shall not include the areas in question in our inventory of property owned or used by the carriers. The right of way of the carrier has been valued by pricing the units at the values of adjacent land areas. The enhancement of value of adjacent lands because of the fact that streets have been laid out across the right of way of the carrier is already reflected in the findings of present value of the carrier's lands. *Texas Midland case* . . . and *Atlanta, Birmingham & Atlantic case* . . . we overrule" (pp. 160-161). See dissenting opinion of Commissioner Hall, with whom Commissioner McChord joined, *ibid.*, pp. 162-163; and see, also, *Georgia R. R.*, 125 I.C.C. 551, 565-566 (1927). One more matter of inventory may be mentioned. In instances where the tracks of a carrier were located upon the rights of way of other carriers, either at grade or overhead, the Commission inventoried the entire land occupied to the senior carrier if it were the owner, and nothing to the junior carrier, although any expense incurred by the junior carrier in securing the right to cross the tracks of the senior carrier was set forth in its land report in the schedule showing rights in private lands. *Kansas City Southern Ry. Co.*, 75 I.C.C. 223, 251 (1919); reaffirmed in *Norfolk Southern R. R. Co.*, 84 I.C.C. 693, 706 (1925). Nothing was allowed the carrier for land used to reach industries off its right of way if the land was in fact owned by the industry. *Texas Midland R. R.*, *supra*, p. 17; *Kansas City Southern Ry. Co.*, *supra*, p. 251.

of the bureau, and ultimately by the Commission. Present value of lands, therefore, like reproduction cost of structures, represented, in the last analysis, the results of judgment and discretion, rather than a body of objectively ascertained facts.<sup>289</sup>

Despite these circumstances, a major portion of the criticism, from both within and without the Commission, which has been aimed at the principles and processes employed in the execution of the "present value" mandate appears to be beside the point. Such criticism should properly be directed, for the most part, against the statutory provision itself, or against the employment of the ascertained figures in the determination of final single-sum values. As in other phases of the valuation project, care must be taken to distinguish between the

<sup>289</sup> The estimated present value of lands was not increased by any allowance for the financial burden of carrying these lands. In *Texas Midland R. R.*, *supra*, at p. 155, the Commission ruled that "interest during construction" should not be calculated on land, because no attempt was being made "to show the cost of reproducing the operative lands of a carrier." This position was elaborated in *Kansas City Southern Ry. Co.*, *supra*, at pp. 262-263. The carrier stated that the sum it would be necessary to expend for lands would be considerable in a reproduction of its property, and that the amount reported as interest was insufficient to show the cost which would actually be incurred for this purpose. The Commission answered by an appeal to authority: "The commission reports as the present value of lands owned and used by common carriers for common-carrier purposes an amount equal to the fair average value of similar lands in the vicinity. An increase in this amount because of interest during construction would be in conflict with the views of the Supreme Court of the United States in the *Minnesota Rate cases*, *supra*, as follows, appearing at page 455: "The allowances made below for a conjectural cost of acquisition and consequential damages must be disapproved; and, in this view, we also think it was error to add to the amount taken as the present value of the lands the further sums, calculated on that value, which were embraced in the items of "engineering, superintendence, legal expenses," "contingencies" and "interest during construction." " For a reaffirmation of this position, see the following: *Ann Arbor R. R. Co.*, 84 I.C.C. 159, 167 (1924); *Elgin, Joliet & Eastern Ry. Co.*, 84 I.C.C. 587, 614 (1924); *Fort Street Union Depos Co.*, 97 I.C.C. 663, 668 (1925); *Augusta Bels Ry. Co.*, 103 I.C.C. 523, 526 (1925); *Cape Charles R. R. Co.*, 114 I.C.C. 274, 276 (1926); *Dansville & Mount Morris R. R.*, 116 I.C.C. 274, 277 (1926); *Alton & S. R.*, 149 I.C.C. 22, 29 (1928); *Western Pacific Ry. Co.*, 29 Val. Rep. 239, 269 (1929); *Boston & M. R.*, 30 Val. Rep. 515, 543 (1930). Reasonable objection may be taken to the Commission's stand on this matter. In the first place, it may be questioned whether the ruling of the Supreme Court in the *Minnesota Rate Cases* was binding upon the Commission. A valid distinction may be made between the function of the Court in deciding whether a given item *must* be included in "fair value," in order to render that value non-confiscatory, and the function of the Commission in determining whether the same item *should* be included in "fair value," in order to serve some desirable end. Furthermore, on the merits, it may well be argued that "interest during construction" is not a *land* item, even though it be computed partly on the land figure. In other words, to say that the item has no place as part of the present value of land is not necessarily to establish that it has no place, though

ascertainment of particular items and the use to which these items are put when once determined. It is true that in the performance of a statutory requirement the Commission should, wherever possible, adjust its administrative principles and technique to the ultimate purposes of the task in hand; but the legislative mandate must be carried out in any event: even where there is fundamental incompatibility between a particular provision and ultimate purposes, the Commission is not by this fact relieved of the obligation to execute the requirement in question. Such, it will be recalled, was the import of the *Kansas City Southern* decision. This consideration is forgotten by those who argue that the Commission erred in measuring present value of carrier lands by the market value of adjacent lands, on the ground that the latter is not a proper determinant of value for rate-making purposes—because the “adjacent land test” is essentially subject to the same infirmities as the “excess cost” proposal, in that it virtually capitalizes, for the purposes of fixing rates, the very existence of the railroad, the flow of earnings which it has enjoyed, and all the surrounding commercial and industrial conditions molded thereby. While the contention is sound from the standpoint of final value, it is irrelevant to the performance of the immediate task. It is difficult to see how present value of carrier lands can be determined otherwise than by direct reference to the present market value of similar lands in the vicinity; whether, of course, the Act should have required the determination of present value, and whether the Commission should embody figures so calculated in any rate base which it promulgates, are different matters. It may readily be conceded, further, that the present value figures, as ascertained by the Commission, are essentially “opinion figures.”<sup>240</sup> But how else, than by the exercise of

partly computed on land, as an overhead to be taken into account in the determination of “fair value.” The Commission and the Court are entirely correct and consistent in their application of the present value theory if the item of “interest during construction” is considered as a *land* item; but their position might be deemed questionable from the broader viewpoint of “fair value.”

<sup>240</sup> Note, for example, the following from the Commission's report in *Chicago, R. I. & P. Ry. Co.*, 24 Val. Rep. 709 (1929), at pp. 784-785: “From our discussion of the evidence of record it is apparent that the appraisal of the carrier's lands in this area was a very difficult matter and that among men equally well informed a reasonable diversity of opinion would exist. The values for which the carrier contends on the three valuation sections at Chicago are approximately 17 per cent, 5.5 per cent, and 10.5 per cent, respectively, in excess of those stated in the tentative valuation. . . .

"judgment," are *value* figures ever to be determined? Cost actually incurred can ordinarily be exactly and objectively ascertained; but value, in the absence of a *bona fide* transaction involving the property in question and occurring under ideal conditions, is inherently a matter of opinion. And in so far as the basic data used by the Commission were defective—showing forced sales, fictitious transactions, assessment figures relating to taxation of non-residents, opinions colored by apprehension of the tax assessor, and similar vitiating circumstances—it may well be argued that this is a condition which one may hope to mitigate but which can never be entirely eliminated from proceedings of this character. The Commission, rather than the subordinate employees of the bureau, was the final arbiter of conflicting claims; and in passing upon them it weighed the relative merits and

We have given careful consideration to the testimony and exhibits submitted by witnesses called by the carrier, by the State commissions, and by the bureau. In our opinion, the difference between the values contended for by the carrier and our tentative valuation is a difference in judgment and is within the realm of a reasonable difference of opinion as to values between men equally well informed. Land values are not susceptible of exact proof, and especially is this true where values are extremely high and elements affecting the results are many, varied, and complicated. Therefore . . . no change will be made in the tentative valuation." For a detailed critical discussion of the claims of the carriers and the reasoning of the Commission, see H. B. Vanderblue, *Railroad Valuation by the Interstate Commerce Commission* (1920), pp. 52-72. On the point at issue he comments as follows (pp. 54-55): "The methods used in the federal appraisal have been adapted from the expedients developed in the previous state investigations. Mr. Prouty, who 'really organized the system,' simply took over the sales method, the sales assessment method, and the opinion method, and provided a coordinating and determining factor—the independent judgment of a civil service appointee (salary \$2400-\$3000 per year). Thus the actual figures assigned as value are opinion figures, just as the unit prices in Cost of Reproduction are opinion figures. The parallel in the problem is very real: just as the engineer must correlate specifications and prices, the land appraiser must correlate the quality of land and the values assigned. This has been done by dividing the railroad line into zones, the length of the zone depending upon the substantial similarity of the railroad right of way and the adjacent and adjoining land, and upon the assumed uniformity of the value of that adjacent and adjoining land. But the actual figure of value reported has been an opinion figure, altho the fact that more often than not, perhaps, the appraiser has been a stranger in the community (he may even be a city real estate expert suddenly required to appraise farm lands), would seem to enforce great dependence upon the sales, sales assessment, and opinion investigation." If the foregoing statement, essentially accurate as to fact, is designed to argue against the propriety of using figures so determined in arriving at final value, because market value of carrier lands is inherently a hypothetical and speculative figure, it possesses decided merit; but if it is to be understood as suggesting that the Commission might have proceeded by a radically different route in executing the "present value" requirement, or that the situation demanded the employment of "experts" at high salaries, the validity of its implications is decidedly open to question.

defects of counter-proposals as well as those of its own findings. On the whole the present value figures as such proved to be reasonably satisfactory to all concerned. The chief objections urged against the land appraisal consisted, essentially, of dissatisfaction with the use of these figures as a constituent of the rate base, rather than with the Commission's performance of the statutory mandate.<sup>241</sup>

<sup>241</sup> Commissioner Daniels, for example, dissenting in *Kansas City Southern Ry. Co.*, 75 I.C.C. 223 (1919), argued against "what appears to be too rigid and mechanical an observance of the rule laid down for the ascertainment of the present value of carriers' lands" (p. 269). But a study of the burden of his objections, apart from the point very properly made with reference to the danger of placing too great dependence upon a single naked formula, suggests that he was critical of the Commission's determinations of "present value" because of their failure to correspond to his conception of "fair value." Apparently he favored some recognition of "excess costs" of acquisition or of special "railroad value." Note the following: "For example, a carrier's line may run through a barren country, through deserts or across long stretches of sand where the market value of adjacent lands may be a very unreliable index of the present value of the carrier's land. Or again, the right of way through an industrial district of a city may have involved certain structural readjustments on the part of property owners, resulting in heavy damages, and the price paid may have been out of all proportion to the land values adjacent. Here to hold the present value of the railroad's land is governed exclusively by adjacent land values seems to me to be erroneous" (pp. 269-270). Even more revealing of his position is the following: "Evidence before us shows clearly that where a railway is first projected through a new region, the land is often acquired at a nominal cost, whereas when a carrier is well established and a region is fairly populous, the costs to the carrier of the later-acquired lands whether through purchase or condemnation are likely to exceed the normal value of lands adjacent" (p. 270). He was virtually arguing for the application of the reproduction cost method to carrier lands, despite the ruling of the Supreme Court in the *Minnesota Rate Cases* and the Commission's adherence thereto. His position was not unlike that of the carriers who urged that present value itself should be measured by hypothetical costs of acquisition. But he took no issue with the Commission's findings as such: "In what is said above in criticism of what appears to me an unduly inflexible method of estimating land values, I am not to be understood as challenging the propriety of the Commission's specific land estimates in the present case and still less as subscribing to the exaggerated figures sought by the carrier for its Kansas City lands" (p. 270). Similarly, Commissioner Eastman, in his dissenting opinion in *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), was solely concerned with the propriety of using "present value," as found by the Commission, as a measure of the rate base. "The theory is," he said, "to base the value of railroad right of way and terminal lands upon the market value of adjacent real estate. The ordinary assumption is that here at least we have a reality which can not be challenged. But have we? Is it meant that these railroad lands would have an exchange value of, or in other words could be sold for, such an amount so determined, if, by any chance, the carrier were able to sell them?" (p. 535). And after citing both concrete evidence and general considerations in support of a negative answer to the above questions, he continued: "But if there is little reason to believe that 'present value' of land, as we estimate it, has much if any relation to exchange value, upon what other theory can it be argued that it should be the basis for a fair return? So far as I know, only two other theories have been suggested. One is the theory of cost of reproduction, which was so effectively punctured in the

*Other Values and Elements of Value*

Turning from the Commission's execution of the statutory provisions relating to the "physical" items of the property, consideration must now be given to the treatment of "intangibles"—the last of the major underlying figures specified in the Act.<sup>242</sup> In requiring the

*Minnesota Rate Cases* by Justice Hughes, and the other is a theory which he merely suggested but which was thereafter enthusiastically adopted by the carriers. I refer to his suggestion that a railroad 'is entitled to a reasonable share in the general prosperity of the communities which it serves.' But what is the 'general prosperity' of a community? Is it the prosperity of favored landholders? Because certain owners of real estate reap profits which have universally come to be known by the designation 'unearned increment,' is that a reason why railroads should have such an increment also? Are there not communities where such profits have been realized but where no 'general prosperity' has visited the bulk of the inhabitants? And if a railroad is entitled to share in general prosperity, ought it not to be inflicted with a share in general lack of prosperity when that falls to the lot of a community? This is indeed what the farmers of the West have been claiming since 1920, but it is a conception which is quite inconsistent with section 15a of the interstate commerce act and is vigorously repudiated by the carriers" (pp. 536-537).

<sup>242</sup> The Commission's disposition of the item of "working capital," although it differed strikingly from its treatment of "intangibles," in that a specific figure was always included in the single-sum value to represent this item, may be indicated briefly at this point. Information respecting materials and cash on hand was contained in the accounting reports, and the final allowance was regularly kept separate from the original cost and reproduction cost findings. In the first case in which a final single-sum value was named, *Evansville & Indianapolis R. R. Co.*, 75 I.C.C. 443 (1922), the Commission merely announced (p. 451): "The carrier does not maintain any stock of materials and supplies." In the following case, *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), where the carrier owned and held cash on hand and materials and supplies in the amount of \$2,221,093, the Commission allowed \$1,000,000 for working capital, treating the remainder as noncarrier property (pp. 608, 609). In a rehearing of this case, 103 I.C.C. 398 (1925), the Commission increased this allowance by \$200,000 (pp. 401-403). In *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645 (1923), in which the sum of \$617,090 allowed for working capital in the tentative report was reduced to \$410,000, will be found a brief statement of controlling considerations (p. 670); and in *Florida East Coast Ry. Co.*, 84 I.C.C. 25 (1924), this statement is amplified. In the latter case, in which the sum of \$1,431,947 allowed for working capital in the tentative valuation was reduced to \$700,000, the Commission said (pp. 32-33): "This sum [that is, the original allowance] is 35 per cent of the carrier's operating expenses for the year ended on valuation date and 40 per cent of the average operating expenses for the five years preceding that date, and is, in our opinion, substantially in excess of the carrier's normal requirements. Our experience with the actual operating needs of individual carriers has thus far indicated that as a rule the requisite amount of working capital for carrier purposes is substantially less than 20 per cent of annual operating expenses, and in some cases is as low as 6 per cent." The rationale of this experience is amply convincing. By way of explanation the Commission continued: "That the amount of cash and materials on hand on a particular date does not necessarily afford an accurate measure of the sum needed for working capital must be readily apparent. . . . A large cash balance may have been



Commission to ascertain and report separately "other values, and elements of value, if any," Congress virtually authorized the Commission to present estimates based on whatever hypotheses it deemed worthy of acceptance. There were no directions or restrictions, either as to inventory of items or as to measurement of results. This undefined legislative mandate might well have served, therefore, as a

accumulated for payment of dividends, for interest on funded debt, or for construction chargeable to capital account. It may represent surplus. Where a large amount of cash is on hand it is ordinarily held on deposit in banks, drawing a small rate of return; to include it in full in a valuation would mean that the rate-paying public would also be required in a measure to duplicate that return. Also, the materials and supplies and stock on valuation date may or may not represent normal requirements. Large purchases may have been made for additions or betterments, whereas on the other hand the stock may have been depleted by unusual demands for maintenance and repairs." Concretely, if this particular carrier had been valued as of one year earlier, the cash and materials and supplies then on hand would have amounted to approximately one-half the allowance made in the tentative valuation. Hence the Commission concluded: "Taking into account the foregoing considerations, and in addition, the extent of the carrier's property, the average cash balance and value of materials and supplies over a period of years preceding valuation date, the fact that construction was in progress during the larger part of this period and materials and supplies were used in connection with both construction and operation, and the average operating revenues and expenses during the same period, we are of opinion that the sum of \$700,000, which is equal to 17.5 per cent of the operating expense for the year ending on valuation date would suffice to meet all ordinary requirements for working capital. . . . The excess of \$731,947 of the cash and materials and supplies on hand on valuation date over the amount here found necessary for working capital is considered for purposes of this valuation as noncarrier property." The principles here enunciated, which necessarily involve the exercise of judgment and resort to estimate, have been repeatedly reaffirmed; and the Commission has generally kept within the percentage of operating expenses for the year ending on valuation date indicated above. Note, for example, the following cases: *Danville & Western Ry. Co.*, 84 I.C.C. 227 (1924), at pp. 231-232 (14 per cent); *Tallulah Falls Ry. Co.*, 84 I.C.C. 537 (1924), at pp. 538-539 (15 per cent); *Norfolk Southern R. R. Co.*, 84 I.C.C. 693 (1925), at p. 707 (13.7 per cent); *Bangor & Aroostook R. R. Co.*, 97 I.C.C. 153 (1925), at p. 167 (14 per cent); *Memphis Union Station Co.*, 97 I.C.C. 418 (1925), at p. 421 (15.1 per cent). But in *Louisville & Wadley R. R.*, 103 I.C.C. 252, 253 (1925), 31 per cent of average operating expenses for the five years preceding valuation date was allowed; and in *Boston Terminal Co.*, 103 I.C.C. 707, 718 (1925), 29 per cent of the operating expenses for the year ending on valuation date was allowed. Moreover, as a check upon unwarranted conjecture, the Commission has generally not permitted its allowance for working capital to exceed the amount of such working capital actually possessed or used by the carrier. Although this amount may fall short of normal requirements, the excess, being non-existent, is not property subject to valuation. In *Artesian Belt R. R.*, 84 I.C.C. 481 (1924), the Commission said (p. 486): "We believe that in no case should the amount stated as working capital be in excess of the actual cash and material and supplies on hand on date of valuation, since we are making a valuation of property. Therefore, no working capital should be valued that is not represented by cash and material and supplies which the carrier owns or in fact uses." This position was amplified by the Commission in

means of adding generous allowances, based largely on the record of current earnings, which would more than offset any cost elements previously in dispute in the appraisal of the physical property. The carriers, from the very beginning, placed emphasis, as elements of value, upon "the factors which make for larger gross earnings, or lower operating costs, and which, therefore, govern net earnings."<sup>248</sup>

*Christie & Eastern Ry. Co.*, 114 I.C.C. 116 (1926), at pp. 118-119: "It is apparent from the testimony of the carrier's witness and also from the contentions urged in his brief that the carrier considers working capital as an element and component part of the theoretical cost of reproduction new of its property as of date of valuation. Working capital, however, is not a matter of cost but is a thing of value actually in the property of a carrier on valuation date, an amount of capital actually invested in the business in necessary materials and supplies, and in cash required to meet proper operating maintenance expenses where the current income of the business is not sufficient for the purpose, and to provide a reasonable buffer fund. It is not an element of the estimated cost of reproduction, nor is it an estimate of future requirements; it is a matter of actual investment for the purpose. The valuation act requires us to find the value of the carrier's property, which includes the value of the invested working capital. If there is no such investment, though one might be needed, we can only report the fact; but we can not capitalize the carrier's present or future needs for working capital beyond the amount actually found invested for the purpose on the date of valuation." But see the dissenting expressions of Commissioner Lewis, who held that "the inventory method applied in the ascertainment of working capital is impracticable and unfair": *Artesian Belt R. R.*, *supra*, at p. 487; *West Virginia Northern R. R. Co.*, 110 I.C.C. 385 (1926), at p. 393; *Flint River & Northeastern R. R. Co.*, 114 I.C.C. 142 (1925), at pp. 144-150. See, also, *Great Western Ry. Co.*, 125 I.C.C. 674, 685-686 (1927); and compare R. H. Whitten, *Valuation of Public Service Corporations* (second edition, 1928, revised by D. F. Wilcox), vol. II, secs. 780, 781, 791. Particular theories advanced by the carriers for the determination of working capital were rejected in *Durham & South Carolina R. R. Co.*, 84 I.C.C. 313, 317 (1924); *Georgia Northern Ry. Co.*, 110 I.C.C. 742, 744 (1926); *Dansville & Moun's Morris R. R.*, 116 I.C.C. 274, 276 (1926). In *Nevada Northern Ry. Co.*, 84 I.C.C. 523 (1924), there appears as Appendix 3 (pp. 534-535), an "Analysis of Methods for Determining Working Capital." This analysis, which formulates the principles developed above, has been repeated, intermittently, in subsequent valuation reports. See, for example: *Hartwell Ry. Co.*, 103 I.C.C. 380, 395 (1925); *Central Indiana Ry. Co.*, 106 I.C.C. 75, 96 (1925); *Manistee & North-Eastern R. R. Co.*, 114 I.C.C. 339, 367 (1926); *Fredericksburg & Northern Ry. Co.*, 116 I.C.C. 458, 472 (1926); *Detroit, Toledo & Ironton R. R. Co.*, 141 I.C.C. 115, 189-190 (1928). A somewhat expanded form of this "Analysis," with a detailed application to the facts of the particular proceeding, appears in the following cases, among others: *Iowa Transfer Ry. Co.*, 106 I.C.C. 699, 709-713 (1926); *Brownstone & Middleton R. R. Co.*, 110 I.C.C. 520, 527-531 (1926); *Youngstown & Northern R. R. Co.*, 116 I.C.C. 475, 486-490 (1926); *Benwood & Wheeling Connecting Ry. Co.*, 125 I.C.C. 531, 543-550 (1927); *Northampton & B. R. Co.*, 149 I.C.C. 244, 263-272 (1928).

<sup>248</sup> H. B. Vanderblue, *Railroad Valuation by the Interstate Commerce Commission* (1920), p. 85. Among the considerations of this character urged in support of "intangible values," and concerning which data are found in the Commission's reports, are the nature and density of the population served, the nature and density of the

But the Commission, although wholly free, exercised singular restraint in its handling of the intangibles as separate value figures. For the most part the efforts of the carriers to secure specific allowances under the provision for the ascertainment of "other values and elements of value" ultimately took the form of persistent claims for the recognition of "going value," conceived predominantly as a development cost.<sup>244</sup> The Commission's treatment of going value reflects its treatment of the intangibles as a whole. It assigned no specific sums to this element; but effective weight was accorded to it as a relevant fact in the determination of single-sum values. The Commission conceded that "consideration" must be given to going value in its final deliberations; and, as will appear subsequently, the "consideration" actually given to this element has been something more

traffic carried, the facilities available for rendering service, the physical conditions governing operation. In *Texas Midland R. R.*, 75 I.C.C. 1 (1918), for example, the Commission reported that "claim was made on account of (1) going-concern value; (2) connection with other lines; (3) good station facilities; and (4) gradients" (p. 69). Similarly, in *Atlanta, Birmingham and Atlantic R. R. Co.*, 75 I.C.C. 645 (1923), the Commission reported the claim of the carrier "that among other values and elements of value to be considered are going concern, franchises, location and gradients, favorable contracts, the right to use properties not owned, facilities used by it provided by non-carriers and other carriers, continuity of land making a complete right of way and terminals, a completely organized and equipped property ready for business and doing business, and other costs of construction and development than those reported" (p. 660). Such claims, in so far as they rested directly upon the earning capacity of the carrier, were summarily disallowed. Even Commissioner Daniels, who found himself in disagreement with the Commission's treatment of "other values and elements of value," recognized the impropriety of allowances on such a basis. In his dissenting opinion in *Kansas City Southern Ry. Co.*, 75 I.C.C. 223 (1919), he said (p. 270): "To preclude, if possible, misunderstanding in this matter, it will be well at the outset to disclaim agreement with various contentions urged by the carrier in the instant case, whose effect, if admitted, would be substantially to bridge the large gap between the par of the carrier's securities and the figures reasonably attaching to its physical property. The commission can not, in my judgment, adopt the view of the carrier that other values and elements of value are to be measured by the difference between the capitalized profitableness of its operations and the figure properly attaching to its physical property." Under such a procedure value would be determined by the capitalization of earning capacity, and the assignment of specific sums to intangibles would but constitute an allocation of the result as between physical and non-physical items of the property.

<sup>244</sup> A separate allowance for "strategic location" was held to have no proper place in valuations for rate-making purposes. See *Fort Street Union Depot Co.*, 97 I.C.C. 663, 669 (1925); *West Virginia Northern R. R. Co.*, 110 I.C.C. 385, 392 (1926). For a discussion of the valuation of water rights, see *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463, 501-504 (1923), and, upon rehearing, 103 I.C.C. 398, 399-401 (1925).

than nominal.<sup>245</sup> But as far as the specific claims of the carriers are concerned, in connection with the ascertainment of the underlying figures, the Commission has uniformly reported that "no other values or elements of value to which specific sums can now be ascribed are found to exist."<sup>246</sup>

The Commission's denial of any specific allowances for other values and elements of value, and particularly for going value, was based upon two primary considerations: first, that the physical appraisal had already valued the property on a "going" basis, since the various items were conceived and treated as parts of an operating business rather than of a dead plant, and the prices assigned to these items were not scrap prices; and second, that the deficits short of a fair return which had been incurred and which were pressed for recognition in the valuation process, though perhaps constituting development costs which might be given consideration in its ultimate findings, could not properly be treated as specific elements of value. This position was clearly stated by the Commission in the first of its valuation reports,<sup>247</sup> and the reasoning involved has continued to serve as the

<sup>245</sup> The statement that going value has been given "consideration" appears in the "order" in all of the Commission's reports. In addition, the Commission frequently states that in the determination of final values full consideration has been given to all the factors which going value is presumed to cover. See, for example: *Bangor & Aroostook R. R. Co.*, 97 I.C.C. 153, 164-167 (1925); *Memphis Union Station Co.*, 97 I.C.C. 418, 422 (1925); *Augusta Belt Ry. Co.*, 103 I.C.C. 523, 526 (1925); *Delray Connecting Ry. Co.*, 106 I.C.C. 192, 194 (1925); *DeKalb & Western R. R. Co.*, 110 I.C.C. 724, 726-727 (1926); *Texas Mexican Ry. Co.*, 114 I.C.C. 677, 679 (1926); *Delaware & Hudson Co.*, 116 I.C.C. 611, 616 (1926); *Atchison, Topeka & Santa Fe Ry. Co.*, 127 I.C.C. 1, 93-96 (1927); *Chicago, Burlington & Quincy R. R. Co.*, 134 I.C.C. 1, 49-52 (1927); *New York, N. H. & H. R. Co.*, 30 Val. Rep. 1, 39-40 (1929); *Nashville, C. & St. L. Ry.*, 31 Val. Rep. 567, 581-582 (1930).

<sup>246</sup> The conclusion was first stated in this form in *Kansas City Southern Ry. Co.*, 75 I.C.C. 223 (1919), at p. 292. In *Texas Midland R. R.*, 75 I.C.C. 1 (1918), the Commission merely reported that "no other values or elements of value were found to exist" (p. 79), and it further declared that "the requirements of the act in this regard have been fully complied with" (p. 71).

<sup>247</sup> In *Texas Midland R. R.*, *supra*, the Commission said, at pp. 68-71: "In the tentative valuation under consideration we have stated that 'no other values or elements of value were found to exist.' The carrier asserts that since no figure has been reported under this heading, the act has not been complied with. . . . In this connection it should be stated that in the instant case going-concern value has been given consideration in the cost of reproduction new and cost of reproduction less depreciation figures. . . . Going-concern value has been described as the value of an assembled and established plant doing business over one not thus advanced. In making up the inventory we apply prices to the different parts of the property in the light of the fact that

mainstay of its policy in subsequent cases.<sup>248</sup> The Commission was doubtless influenced, in considerable measure, by the fact that the carriers sought to establish the existence of such elements of value, but frequently without the submission of pertinent evidence or the proposal of methods for the reduction of the alleged intangible values to concrete figures;<sup>249</sup> for the most part, however, it supported its conclusions, as independently arrived at, by reference to the deci-

it is a railroad and doing business; otherwise the prices which would be applied would be scrap prices. . . . However, there has been urged upon us a going value which is said to exist in addition to that here referred to, which apparently runs into sums of great magnitude, but which, in spite of its magnitude, is incapable of more than the most metaphysical and conjectural description on the part of those who advocate its inclusion as an element of value. It has been urged upon us on many successive occasions, but from the beginning it has been nothing but a vague claim. However, the owners of the Texas Midland have not received a fair return on their investment in this property. The operation of the road . . . has resulted in frequent deficits. These deficits are not elements of value, but they are pertinent facts to be given consideration in a proper proceeding."

<sup>248</sup> With reference to the treatment of the accumulated annual deficits below a fair return as development costs, in *Winston-Salem Southbound Ry. Co.*, 75 I.C.C. 187, 197-198 (1918), for example, the Commission not only declined to recognize the company's claim for \$853,591 on this account, but reiterated its determination to "consider" this factor in connection with its ultimate findings of value. The Commission concluded (p. 198): "Whether, in fixing a value for purposes under the act to regulate commerce, we should increase the cost of reproduction by the amount of deficit which the carrier may have incurred during the early years of the enterprise, will be a proper consideration when we come to state a single sum as value of the common-carrier property for such purposes. That question we leave intact. As stated, in the final valuation herein made we have the basic facts. The record herein shows no other values or elements of value." For a recent case, see *Excess Income of Richmond, F. & P. R. Co.*, 170 I.C.C. 451, 499-500 (1931).

<sup>249</sup> In *Texas Midland R. R.*, 75 I.C.C. 1 (1918), for example, the Commission said (p. 69): "We have diligently searched for and inventoried the property of the carrier and have reported everything we have found in the tentative valuation already served. The carrier has asserted that there are other values and elements of value in connection with its property, but although repeatedly asked to do so has failed to name a figure which it believes should be found by us." In his dissenting opinion in *Kansas City Southern Ry. Co.*, 75 I.C.C. 223 (1919), Commissioner Daniels took sharp issue with the Commission's negative findings in the matter of intangibles in so far as they were based upon the carriers' failure to make precise claims or propose practicable methods: "I do not concur in the intimation in previous valuation reports that the carrier's failure to show us the method to employ in estimating other values or elements of value or the carrier's failure to demonstrate to us the appropriate figure to be attached to other values or elements of value, constitutes the fulfillment of our affirmative duty in the premises. The searching out and finding and reporting separately with a description of the methods used the other values or elements of value, if they exist, is a duty resting primarily upon the commission. In my judgment we do not satisfy the requirements of the statute by reciting that we have not been shown by the carriers appropriate figures to attach to these items or appropriate methods by which

sions of the Supreme Court, particularly in the *Des Moines* and *Galveston* cases.<sup>250</sup> The Commission offered the *Des Moines* case as "authority for the view that allowance may be made for going-concern value in the method of valuation employed, and that it is not necessary if the method does make such an allowance to state a separate sum to represent going value";<sup>251</sup> and by way of application of this doctrine to the particular state of facts involved, the Commission declared: "Not only have we appraised the physical plant as a going concern, but we have reported in the cost of reproduction new and cost of reproduction less depreciation figures those general expenditures which would be incurred in a reproduction of the property, in-

to gauge or estimate them. We have not waited for them to show us the proper cost figures to attach to many parts of the physical property. The search for and the appraisal and reporting of these items for intangibles, if they exist, is an obligation imposed on the commission" (p. 273). These contentions possess undoubted merit; but the Commission emphasized the carriers' failure in these directions as evidence of the non-existence of these elements of value rather than as controlling ground for its own negative conclusions.

<sup>250</sup> *Des Moines Gas Co., v. Des Moines*, 238 U.S. 153 (1915); *Galveston Elec. Co. v. Galveston*, 258 U.S. 388 (1922).

<sup>251</sup> *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), at p. 510. The Commission was but reaffirming the view it had taken of the *Des Moines* case in the first of its valuation reports. In *Texas Midland R. R.*, 75 I.C.C. 1 (1918), the Commission had said (p. 69): "In the cost of reproduction new and cost of reproduction less depreciation figures the values assigned to the property are not those of a dead plant but of a going concern, and to the extent indicated in the *Des Moines Gas Case* cited below, this element has been covered in the figures." The Commission then quoted with approval pronouncements from the Supreme Court's decision bearing upon the nature of the issue involved and the character of its disposition in the particular controversy. On the issue as to going value, the Court had said (238 U.S., at p. 165): "That there is an element of value in an assembled and established plant, doing business and earning money, over one not thus advanced, is self-evident. This element of value is a property right, and should be considered in determining the value of the property, upon which the owner has a right to make a fair return when the same is privately owned although dedicated to public use. Each case must be controlled by its own circumstances, and the actual question here is: In view of the facts found, and the method of valuation used by him, did the Master sufficiently include this element in determining the value of the property of this Company for rate-making purposes?" And the Court's answer to this question was as follows (p. 171): "When, as here, a long established and successful plant of this character is valued for rate-making purposes, and the value of the property fixed as the Master certifies upon the basis of a plant in successful operation, and overhead charges have been allowed for the items and in the sums already stated, it can not be said, in view of the facts in this case, that the element of going value has not been given the consideration it deserves and the appellant's contention in this behalf is not sustained." Both in the *Texas Midland* case and in the *San Pedro* case, the Commission concluded that its own methods corresponded to those approved by the Supreme Court.

cluding organization expenses, general officers and clerks, law, stationery and printing, taxes, other general expenditures, and interest during construction, the total of which approximates 11.5 per cent of the costs assigned to the physical items represented in the road and equipment accounts."<sup>252</sup> Similarly, in declining to recognize past losses as specific elements of value, the Commission drew much of its support from the decision in the *Galveston* case. "Since our original report," said the Commission in one proceeding, "the Supreme Court of the United States . . . has decided that past losses are not an element to be considered in deciding what the base value should be for rate-making purposes."<sup>253</sup> The declaration of the Supreme Court which was thus deemed to be controlling, made through Justice Brandeis, was as follows: "The fact that a utility may reach financial success only in time or not at all, is a reason for allowing a liberal return on the money invested in the enterprise; but it does not make past losses an element to be considered in deciding what the base value is and whether the rate is confiscatory. A company which has failed to secure from year to year sufficient earnings to keep the investment unimpaired and to pay a fair return, whether its failure was the result of imprudence in engaging in the enterprise, or of errors in management, or of omission to exact proper prices for its output, cannot erect out of past deficits a legal basis for holding confiscatory for the future, rates which would, on the basis of present reproduction value, otherwise be compensatory."<sup>254</sup> In conformity with this pronouncement the Commission has refused to include early losses or development costs in the rate base, although it recognized that even a carrier which was ill-conceived and greatly over-built "must be given a value on the basis of a going concern rather than that of a financial failure."<sup>255</sup> It flatly rejected the contention that its method of valuation "only repro-

<sup>252</sup> *San Pedro, Los Angeles & Salt Lake R. R. Co.*, *supra*, at p. 512. Furthermore, the Commission again emphasized the fact that its failure to report a separate figure was not tantamount to a disregard of intangibles: "To the extent that we have found or the courts have said that there is a value or an element of value in any intangible right, privilege, or advantage which the carrier asserts that it enjoys, we have endeavored to give weight thereto, even though we could not assign a separate, definite money value to it."

<sup>253</sup> *Winston-Salem Southbound Ry. Co.*, 84 I.C.C. 581, 582 (1924).

<sup>254</sup> *Galveston Elec. Co. v. Galveston*, 258 U.S. 388 (1922), at p. 395.

<sup>255</sup> *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645, 669 (1923).

duces the property to the point where the physical plant is ready to begin operations and makes no allowance for the cost of vitalizing it; of finding men to compose the personnel of the organization; of finding and bringing to it the traffic which it is capable of transporting; and of developing it into the active, successful, and efficient plant that existed on valuation date.<sup>256</sup> All in all, no allowance for going value has been recognized which is measured in whole or in part by earning power, skill of management, efficiency of employees, readiness to serve, amount of attached business, or past deficits.<sup>257</sup> The

<sup>256</sup> *Florida East Coast Ry. Co.*, 84 I.C.C. 25, 28 (1924). Figures showing the actual cost of bringing about this condition of successful and efficient operation were not available, and the carrier's claim was based upon an elaborate reproduction hypothesis, going-concern value being used by the carrier "synonymously with cost of development." The Commission replied: "Not only are we unable to include development cost in the valuation but we are also unable to ascertain a separate amount to be allowed for going value" (p. 30); and, in the terms of the carrier's contention: "Our tentative valuation of the carrier took into consideration the fact that it was on valuation date a vitalized, organized, going railroad" (p. 35). See, also, *Ann Arbor R. R. Co.*, 84 I.C.C. 159, 164-165 (1924); *Raritan River R. R. Co.*, 84 I.C.C. 463, 468 (1924); *Elgin, Joliet & Eastern Ry. Co.*, 84 I.C.C. 587, 615-617 (1924); *Augusta Northern Ry.*, 125 I.C.C. 14, 17 (1927); *Middletown & Unionville R. R. Co.*, 125 I.C.C. 143, 151 (1927). And for specific rejections of separate going value allowances, see, in addition to the above: *Roscoe, Snyder & Pacific Ry. Co.*, 97 I.C.C. 1, 11-13 (1925); *Georgia Northern Ry. Co.*, 110 I.C.C. 742, 743 (1926); *Wyoming Ry. Co.*, 114 I.C.C. 194, 197-198 (1926); *East Jersey R. R. & T. Co.*, 114 I.C.C. 441, 444 (1926); *Lake Superior & Ishpeming Ry. Co.*, 116 I.C.C. 1, 6 (1926); *Great Northern Ry. Co.*, 133 I.C.C. 1, 132-133 (1927).

<sup>257</sup> *Atchison, Topeka & Santa Fe Ry. Co.*, 127 I.C.C. 1, 93-96 (1927); *Minneapolis, St. Paul & Sault Ste. Marie Ry. Co.*, 143 I.C.C. 547, 591-592 (1928); *Excess Income of Richmond, F. & P. R. Co.*, 170 I.C.C. 451, 501-504 (1931). In *Virginian Ry. Co.*, 141 I.C.C. 595, 648-652 (1928), counsel for the carriers, in a brief characterized by the Commission as "exceptionally able and closely reasoned," sought to have the subject of development cost considered *de novo*. The basis of the carrier position was that the Commission had "misapprehended the holding in the *Galveston case*, which, it is urged, deals with a third-rate public utility, where the circumstances are entirely different from those involved in the consideration of the great railroad properties of the country, which have justified their existence through all the struggle of competitive conditions and which are interdicted by law from recouping their expenditures in the way suggested in that case" (p. 649). The facts of the instant proceeding, it was alleged, would "negative the hypotheses under which the court held that there should be no recoupment of deficiencies"; proof was offered that "the construction of the carrier was justified," that "its operation has been conducted with economy and efficiency," that "the rate structure is adequate," that "the period of development was reasonable," that "the process of development has occasioned costs—a sacrifice usually foreseen in advance on the part of the owners of the property," and that "development is now assured" (pp. 649-650). But in face of these claims, the Commission, without examining the evidence, declared: "It is manifest, we think, that development cost, under these limitations, can be proved only as an original-cost item. To



following expression summarizes succinctly the Commission's attitude, as uniformly applied, in relation to "other values and elements of value":

Paragraph (b) of section 19a requires that "The Commission shall in like manner ascertain and report separately other values, and elements of value, if any, of the property of such common carrier." The final-value clause in each of the tentative valuations served as above contains this language: "A careful consideration of all facts herein contained, including appreciation, depreciation, going-concern value, working capital, and all other matters," and this is followed by the statement that "No other values or elements of value to which specific sums can now be ascribed are found." Thus we have made plain that careful consideration has been given to every element that diligent investigation discloses. If there are elements of value appropriate to be reported under paragraph (b) and which were not discovered by us it was within the power of protestants to have made disclosure of same. This they made no attempt to do, and no

attempt to estimate it by resort to the reproduction theory would involve a welter of speculations and assumptions susceptible of test by no reliable criteria, unless indeed there was a resort to historical conditions. But the latter would involve a wholly untenable confusion of concepts. . . . [Moreover] it would, in the majority of cases, be practically impossible to secure reasonably accurate information with respect to cost of development" (p. 650). It was further contended by the carrier that early deficiencies of income can be recouped, as contemplated by the Supreme Court, only through amortization or capitalization, and that for a railroad, unlike a monopolistic local utility, amortization is out of the question, both on economic and on legal grounds. To the economic contention that early losses cannot be amortized through increased revenues because of the competition to which railroads are subject, the Commission gave the obvious answer that, for the same reason, an acceptable rate of return cannot be earned on an augmented capitalization; and to the legal argument that under the group system of rate making rates cannot be fixed with reference to early revenue deficiencies of individual carriers, the Commission replied, similarly, that modification of the rate base would not remove the difficulty. Accordingly, the claim of the carrier for \$8,000,000 as development cost—comprising the approximate amount by which its earnings fell short of a fair return on investment during the first seven years of its operation—was denied. By way of summarizing its position on the general problem, in light of the carrier's contentions, the Commission said: "We conclude that there is no better basis or reason for finding development cost in a railroad than in a utility valuation case. Moreover, we believe that it is entirely improper to capitalize past railroad deficits of any nature. The possibility of failure to earn a reasonable return upon invested capital, either during an early period of development or thereafter, is a risk faced in all business enterprises whether regulated or unregulated. Risks of this nature are generally reflected in the rate of return at which capital can be induced into the venture. We do not believe that the railroad field affords an exception to the general rule. When the rate of return is fixed by governmental action, the risks of the business enter into consideration. In our opinion, losses in operation are essentially related, not to property value, but to the rate of return" (p. 652).

figures have been submitted to us by the carrier as proper to be set opposite "other values or elements of value." Our tentative valuation of the properties of these carriers, each considered as a whole, includes all elements of value of the properties as they existed on valuation date so far as we could ascertain them.<sup>258</sup>

The Commission's conclusions on specific allowances for going value are undoubtedly sound. In so far as claims for going value are based upon actual or prospective earnings, they obviously merit no consideration. Market value can not be utilized, in whole or in part, as a direct or indirect measure of the rate base, without encountering circularity of reasoning and confusing cause and effect. Going value, in this sense, is the outcome of earning power, rather than an element

<sup>258</sup> *Delaware & Hudson Co.*, 116 I.C.C. 611 (1926), at p. 616. Not all of the commissioners agreed with this disposition of intangibles. In *Kansas City Southern Ry. Co.*, 75 I.C.C. 223 (1919), for example, Commissioner Daniels dissented from the finding that "no other values or elements of value to which specific sums can now be ascribed are found to exist" (pp. 270-273). Again, in his dissenting opinion in *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), he protested vigorously against the Commission's failure to report other values and elements of value "separately." He said, among other things: "I do not understand how it is permissible to treat this injunction of the statute so cavalierly as we have done. . . . I find it impossible to find in the report anywhere that we have even attempted, after reporting the three cost values, to 'ascertain and report separately other values and elements of value, if any.' . . . Let there be no mistake about the point here urged. It is not the amount or figure to be attached to 'other values and elements of value.' It is not that we should give credence to certain exaggerated claims made as to the magnitude of such alleged values. The point made is that in the face of a simple, direct, and specific behest of the statute, enjoining in unmistakable terms a certain procedure of *separately* reporting these items, the report squarely neglects to obey the express injunction of the statute." Nor was he content with the Commission's claim that the physical property had already been valued as that of a going concern. "Whether this element has been 'covered' in the figures or not, the method followed in the report is palpably not the method prescribed by the statute. We are not told to report values of physical property multiplied by a judgment coefficient which takes care of 'values of an intangible nature which inhere in the property of the carrier as a going concern, etc.' We are plainly directed to ascertain and to report such values separately" (pp. 515, 516, 517). In the same proceeding, Commissioner Potter, concurring in part, not only supported Commissioner Daniels' claim that a separate finding should have been made for going value, but he urged that "development costs reflected by deficits below a fair return should be adopted as the measure." "Deficits, of course," he explained, "are not elements of value. Where, however, they are natural incidents to a development process which must take place before a carrier can be deemed to be really established, they are measures of the development service that built up and created the going value and can be accepted as the measure of that value" (pp. 578-579). For what appears to be an adequate reply to the contentions of Commissioner Daniels and Commissioner Potter, see the concurring opinion of Chairman Meyer in the same case, at pp. 591-592, 598-599.

to be considered in determining the propriety of present or future income. Any legitimate claim for going value, then, must be approached, as it generally has been, in terms of *cost*. This approach has assumed many forms, but without providing convincing grounds for the inclusion of specific allowances in addition to those comprehended in the physical valuation. The reproduction cost appraisal obviously contemplates an assembled plant, rather than the bare bones of the enterprise. Not only is there no resort to mere scrap prices in such an appraisal, but overheads are expressly added as necessary costs of placing the "plant" on a going basis. Nor is there sounder ground for recognizing going value in terms of the costs incurred in establishing the "business"—in so vitalizing the organization, through the development of operating personnel and the acquisition of traffic, that it is earning money. Once the plant begins to serve the public, these costs, like other current costs, become chargeable to operating expenses. They have no place in the capital account, nor can they be made a proper constituent of the rate base. The claim for going value, therefore, resolved itself largely into a claim for the inclusion in the rate base of a sum sufficient to offset foregone income or uncompensated losses below a fair return—to cover development cost, as measured, usually, by the Wisconsin early deficit rule.<sup>269</sup> The acceptance of such early losses as a cost item analogous to direct investment in physical plant proceeds upon many unsupportable assumptions as to fact and policy: it assumes early deficits to inhere in the enterprise,

<sup>269</sup> This rule has been briefly characterized as follows: "The Wisconsin rule calls for the cumulative addition to the capital-base of the amounts by which earnings during a reasonable development period fail to cover all costs, including depreciation and a fair return to investors. Subsequent surplus earnings are customarily recognized under the rule as offsets to early losses, though only rarely are they considered as repayment of investment in physical property. Students of the problem . . . have pointed out that few public service companies have found it possible from the moment construction is completed to earn an income sufficient to provide for the cost of operating the property as well as for fixed charges and the current rate of return on the investment. There is a formative period, it is said, in the life of every corporation, extending from the time income begins to accrue until the payment of normal dividends is realized. Income foregone during this interval constitutes the cost of establishing the going business, and, for rate purposes, should be embodied in the earning-base. Failure so to include it will result in a grave injustice to investors, and, consequently, will deter the later flow of capital into the field. Thus, the argument runs, expediency as well as equity dictates the capitalization of early deficits." Ben W. Lewis, "Going Value—Comments on its Nature and Legal Status," *American Economic Review*, vol. 17 (December, 1927), at pp. 658-659. For an analysis and critique of the application of

regardless of the special responsibility of the management therefor; it necessitates, without controlling principle, a sharp differentiation between early losses and later deficiencies in revenue; contrary to usual practice, it generally involves the premise that "investment," in this sense, may be recouped through subsequent earnings; it contemplates something in the nature of a guarantee of capital commitments in an industry subject to private ownership and administration; it fails to recognize that the risk inseparable from all enterprise constitutes the basic justification for the profit element included in the rate of return. Operating deficits, whatever their cause and in whatever stage of the carrier's life history they may arise, are appropriate elements for consideration in the adjustment of the rate of return—so that the flow of income, by affording adequate compensation for all the risks involved, may effectively attract the necessary capital; but such deficits are not investments—the alleged capital costs incurred are measured "not in terms of saving, of effort, of sacrifice, but by results"<sup>260</sup>—and whether they be characterized as items of cost or as elements of value, there is no legitimate warrant, from the standpoint of the regulative process, for their capitalization and use, as part of the base, for rate-making purposes. In declining, then, to report separate allowances for "other values and elements of value," urged primarily in terms of going value and development cost, the Commission appears unquestionably to have reached a sound conclusion.<sup>261</sup>

the early deficit rule by the Wisconsin Railroad Commission, see Robert L. Hale, *Valuation and Rate-Making* (1918), at pp. 101-131. For testimony bearing upon the relationship of the Wisconsin rule to the provision of the Valuation Act requiring the Commission to ascertain and report "other values and elements of value," see 62d Cong., 3d Sess., Sen. Rep. No. 1290, pp. 94-99, 225-228.

<sup>260</sup> H. B. Vanderblue, *op. cit.*, p. 88.

<sup>261</sup> For an excellent discussion of the entire problem of going value, see Ben W. Lewis, "Going Value and Rate Valuation," *Michigan Law Review*, vol. 26 (May, 1928), pp. 713-746. With regard to the Wisconsin rule, no justification for its acceptance is found in logic or expediency or equity (pp. 725-733). With regard to allowances for going value in general, regardless of the theory upon which the allowance is based or the method by which it is measured, the following conclusion is reached (p. 738): "The various methods proposed for the determination of going value for rate making purposes have been considered, and each in turn rejected. Whether in principle or in detail, all have proved to be unacceptable. They are inherently defective in that they are rules for the performance of a task which cannot itself be fundamentally justified. We cannot measure for rate making purposes an element which for those purposes does not exist. . . . The cost methods are the result of an attempt to lend some content to an empty but persistent concept by filling it with

But while most of the foregoing considerations are implicit in the Commission's results, its reasoning has not been wholly adequate. In connection with early losses, for example, the Commission merely declared, in the first published proceeding, that "these deficits are not elements of value," without analysis of the factors supporting its conclusion.<sup>262</sup> In most of the subsequent reports, in rejecting the early deficit method, it was largely content to rely upon the authority of the Supreme Court in the *Galveston* case, which had been decided in the interim.<sup>263</sup> Yet the issue before the Commission was by no means identical with that before the Court. An item may be a proper constituent of "fair value" from the standpoint of policy, and yet its omission from the rate base may afford no grounds for condemnation from the standpoint of law. The Court merely decided that it was unnecessary to add early losses to the rate base in order to render that base non-confiscatory;<sup>264</sup> it was not concerned with the question of the wisdom or propriety of providing for early losses in this manner, and any comments it may have offered on this phase of the controversy have the force only of dicta.<sup>265</sup> The inclusion of early deficits was open to the Commission, and their rejection should have been grounded in independent considerations of principle and policy.<sup>266</sup>

elements whose true habitats are to be found either in the rate of return or in the operating accounts. The others depend for their validity upon at least a tacit acceptance of a market value theory of rate valuation; this consideration alone is decisive of their unfitness for the purpose at hand. Going value for rate making purposes should be flatly—openly—denied."

<sup>262</sup> *Texas Midland R. R.*, 75 I.C.C. 1, 71 (1918).

<sup>263</sup> *Galveston Elec. Co. v. Galveston*, 258 U.S. 388 (1922).

<sup>264</sup> Justice Brandeis had said (258 U.S., at pp. 396-397): "Going concern value and development cost, in the sense in which the master used these terms [that is, as a capitalization of net deficiencies in past earnings] are not to be included in the base value for the purpose of determining whether a rate is confiscatory." Such compulsory inclusion of past deficits in the rate base he characterized as involving "substantially a guarantee by the community that the investor will net on his investment ultimately a return of 8% yearly, with interest compounded on deferred payments; provided only that the traffic will, in the course of time, bear a rate high enough to produce that amount" (pp. 394-395).

<sup>265</sup> Indeed, the Court had said that "the good will and earning power due to effective organization, . . . like past losses, should be considered in determining whether a rate charged by a public utility is reasonable." *Ibid.*, at p. 396. Compare, also, *S. W. Tel. Co. v. Pub. Serv. Comm.*, 262 U.S. 276 (1923), in which a substantial allowance for going value, against the inclusion of which no protest was made, was left undisturbed.

<sup>266</sup> Compare, for example, the following characterization of the *Galveston* case:

Nor was it altogether valid for the Commission to attack this method of measuring going value by urging, as many have done, the alleged anomaly of "the value of a prosperous road being decreased because it had a good business and the value of a less prosperous road increased because it has a poor business."<sup>267</sup> The apparent anomaly becomes real only when one is thinking in terms of *market value* as distinct from *rate value*. If early losses are recognized as costs, and costs constitute the stuff of which the rate base should be fashioned, there is nothing anomalous in according a higher value to the carrier which has experienced the greater cost. The impropriety of recognizing past deficits as capital costs, rather than the resultant relative effect of such recognition upon particular carriers, constitutes the basic defect of the method. The Commission's reasoning appears to be questionable, further, in connection with its contention that going value is adequately recognized in the physical valuation because the reproduction cost appraisal is designed by its very nature to ascertain the value of the property as a going concern rather than its junk or scrap value—apparently regarding the difference between reproduction costs and scrap values as a measure of the going value element. This contention is sound only if a rather restricted and quite unorthodox meaning is attached to going value. Such a physical appraisal, including due allowance for overheads, doubtless covers the costs of assembling and establishing the *plant*; it does not embrace the costs of developing the *business*, which constitute the distinctive characteristic of the going value concept as generally proposed. The conception of going value implied in the Commission's reasoning involves an acceptance of the

"This decision denies the assumption . . . that early losses not made up by later gains should be taken into consideration by the Court in a confiscation case, though deserving consideration by a commission in considering the reasonableness of a rate." Edward W. Bemis, "Going Value in Rate Cases in the Supreme Court," *Columbia Law Review*, vol. 27 (May, 1927), at p. 540. To the same effect: "Note that the court did not reject going value *per se*, nor did it reject going value based upon early losses as a factor to be considered in determining *reasonable* rates; it was not called upon to do so. It simply held that going value, so determined, need not be injected into a rate-base in order to render the base *non-confiscatory*. . . . The decisions of the Supreme Court seem, then, to stand for the proposition that any type of going value *may* be included in a rate-base; but that none, with the exception of such as is inherently embodied in the 'physical value,' is absolutely required in order to forestall reversal on the ground of confiscation." Ben W. Lewis, *op. cit.* (note 259), pp. 667-668.

<sup>267</sup> *Georgia R. R.*, 125 I.C.C. 551, 562 (1927).

name without a recognition of the substance. It is true that the alleged elements of value which arise from the established business have no proper place in the rate base, and should be rejected, as the Commission has rejected them: either they are functions of earnings, or, as costs, they receive recognition in the operating accounts and in the rate of return. But nothing is gained, and much confusion results, from appearing to accept the going value principle and yet stripping it of its essential content.<sup>268</sup>

<sup>268</sup> The above strictures, it should be emphasized, are directed against the reasons for denying specific going value allowances, rather than against the denial itself. The following, though not expressly applicable to the Interstate Commerce Commission, is an illuminating statement of this point of view: "The situation amounts virtually to this: in an effort to make effective the proposition that for rate purposes a public utility can properly be allowed no value in excess of the actual or reproduction cost of its physical structure, and to temper what otherwise might appear to be a harsh and inconsiderate decision—and incidentally, perhaps, to avoid reversal by a higher tribunal—a new and harmless substance has been prepared for the shell of going value. An actual 'no allowance' is made to masquerade in the guise of a nominal 'complete acceptance of the going value principle.' If going value is to mean 'the element of value arising from the established business'—certainly a representative definition of the term—we must question seriously this disposition of the problem. Going value as the difference between scrap value and the actual or reproduction cost of the property is an increment which arises, not from the established business, but, rather, out of the fact that the property is being used in a public calling and is being given a particular value in view of the peculiar purpose for which the valuation is being conducted. 'Established business' is an attribute, not only of a marginal concern earning the current gross profit on the investment, but is also a characteristic (in a lesser degree) of a plant which is developing more slowly, and (in a greater degree) of a plant which is returning surplus profit to its owners. All three are organized, keeping records, selling services, and earning incomes, and, assuming their physical structures to be the same, they will be accorded under the above theory the same rate-bases, including identical going values. But, by the terms of our definition, there should have arisen wholly different going values, corresponding to the varying degrees of established business. To recognize the principle of going value, and then to evidence the act by rejecting all of the elements which have ever been associated with the term and substituting in their stead an increment which, in another capacity, has been universally accepted from the first as a matter of course, savors of a disinclination to meet the issue. We shall not quarrel with the proposition that when courts and commissions appraise public service corporations on the basis of actual or reproduction cost they are in reality valuing them as going concerns in the same sense in which the accountant, for instance, assumes the continuity of the business enterprise. But the assumption is, here, wholly irrelevant. If going value is to mean only the difference between scrap and cost values, it should, beyond question, be included in the rate-base; but it should not be characterized as the increment of value arising out of the established business, and it should not be termed going value. The more completely we banish 'going value' from our valuation vocabulary the more probable it is that existing confusion will be allayed. Going value *per se* is a vestigial concept, a hangover from earlier days of regulation; for rate making purposes it should be flatly denied." Ben W. Lewis, *op. cit.* (note 259), pp. 663-664.

On the merits, it would seem, the Commission should frankly and decisively have rejected the carriers' claims for these intangibles: there should have been neither the appearance of recognition of these elements in the physical valuation, as indicated above, nor the granting of effective consideration to them, as will appear in due course, in the determination of final single-sum values. If it is true that "going value for rate purposes cannot be supported on any positive basis, there seems to be little justification either for throwing in an indefinite amount merely for good measure, or for continuing to do lip service to an outworn formula by appearing to approve of going value while in reality rejecting the claims made in its behalf."<sup>269</sup> The Commission's approach was influenced, to a considerable extent, by the confused legal status of valuation doctrine—not only in the matter of going value, but with respect to the entire range of administrative discretion in this sphere. Though the Commission uniformly rejected claims for specific allowances, it treated going value in terms analogous to those used by the courts and accorded consideration to it as a relevant fact in the determination of final value, in a desire to satisfy the inconclusive standards of judicial censorship which are bound up with the "fair value" rule.<sup>270</sup> In light of these circumstances, and in view of the fact that an *ex post facto* situation may warrant if not demand resort to equitable adjustments and the utilization of indirect methods,<sup>271</sup> the Commission's policy was probably as drastic as could

<sup>269</sup> Ben W. Lewis, "Going Value and Rate Valuation," *Michigan Law Review*, vol. 26 (May, 1928), p. 736.

<sup>270</sup> Whether the Commission's treatment of going value will be upheld on judicial review depends upon whether the Supreme Court comes finally to agree with its own decisions, as developed over many years, or with some rather startling dicta. The Commission's conclusions are quite in line with the Court's decision in the leading *Des Moines* case and those following it; they are decidedly out of harmony with the dicta of the Court, speaking through Justice Butler, in *McCardle v. Indianapolis Co.*, 272 U.S. 400 (1926). In the latter proceeding the Court appears to have misconstrued the decision in the *Des Moines* case, and to have accorded acceptance to an indefensible "market value" concept of going value. Since, however, in view of the Court's general disposition of the case, the holding on going value was unnecessary to the decision, the pronouncements of Justice Butler may be taken as mere *obiter dicta*. In any event, no evidence is available that the Court intended a deliberate reversal of its previous position, particularly as developed in the carefully considered *Des Moines* and *Galveston* cases. For an analysis and interpretation of the course of judicial decision, see Edward W. Bemis, "Going Value in Rate Cases in the Supreme Court," *Columbia Law Review*, vol. 27 (May, 1927), pp. 530-546.

<sup>271</sup> Compare, for example, the following contentions: "In this country we are



fairly have been expected. None the less, the Commission's "consideration" of intangibles, and more specifically of going value, appears to have resulted, as will be developed presently, in very material allowances—allowances so substantial, in fact, as to suggest the query

building up a policy of regulation which was an unknown quantity twenty years ago. Certainly twenty-five and thirty-five years ago public utility managers were given a freer hand in the development of the earning capacity of their properties. The scope and rules of public utility regulation are in a state of flux. The entire valuation problem bristles with difficulties in which *ex post facto* considerations are being applied to finding current solutions. . . . Do not these modifications suggest the need for recognizing going-value so that reasonable expectations will not be disappointed? If the rules of the game are thus to be revised by means of an all but omnipotent police power, ought not a wise public policy give discretion to an administrative commission with the responsibility for future service, so that it may round off the edges of these changes by means of a 'going-value' concept which recognizes an equitable claim on account of past losses? Justice Brandeis' decision points the way by eliminating 'going value' as a judicial concept which legislatures disregard at their peril. According to this view the definition and measurement of going value in each case are concerns of legislatures, and of commissions acting under legislative authority, not under the authority of judicial opinion. This will enable administrative commissions, in dealing with particular facts in special cases, to build that bridge from rate-control in an inchoate state, when the rule of *Smyth v. Ames* must be applied, to one in which the elements of rate-regulation stand clearly revealed, and when, consequently, a new rule of rate-making becomes feasible." Martin G. Gleaser, *Outlines of Public Utility Economics* (1927), pp. 500-501. Note, however, the following very persuasive reply: "This line of reasoning, reflecting the distinction frequently drawn between retrospective valuation and valuation for the future and founded on equitable considerations growing out of a situation for which the public appears to be primarily responsible, is extremely persuasive. Yet, just what measure of equity is really involved? To be sure, commission regulation of the present type is a development of the last twenty years; but for centuries the law has been familiar with the distinction—however hazily drawn—between public and private callings, and has permitted the distinction to serve as a basis for differential treatment. While prediction as to the exact details of forth-coming regulation is always impossible, it certainly is not unreasonable to presume that at least since *Munn v. Illinois* in this country investors in public utility securities have committed their capital with full knowledge (or with opportunity for full knowledge) of the possibility that additional regulatory measures would be imposed upon their industries. Nor, indeed, have these regulatory restrictions been unattended by very substantial benefits to utility owners. As to the equitable claim of present owners for past deficits, Dr. Bauer reminds us [John Bauer, *Effective Regulation of Public Utilities* (1925), pp. 210-212] that through the normal gradual transfer of stock, as well as through reorganizations resulting from insolvencies occasioned, perhaps, by early deficits, ownership in many instances has now passed into the hands of persons who, never having experienced such losses, have no claim, as of equity, to their capitalization. It might be added that in view of the very tenuous hold which the Wisconsin rule has secured, even in those jurisdictions most favorable to it, it is extremely unlikely that present owners have paid more for their holdings because of the probability that the earning-base would presently be expanded by the amount of past losses. Finally, granting that some adjustment is necessary, that the situation calls for some allowance with which to calk the seams inevitably left by the trial-and-error

as to whether the Commission failed to convince itself by its own reasoning. On principle, of course, this reasoning, if sound, is as damaging to the validity of allowances under cover as it is to the recognition of the same elements under specific labels.<sup>272</sup>

development of the regulatory system, it does not follow that going value should be selected as the vehicle for carrying out the program. 'Going value' . . . can be shown in any of its common interpretations to have no proper place in the base upon which the utility is to be allowed to earn. Nothing is to be gained by injecting these allowances under the caption 'going value'—a name which not only fails to reflect the nature of the allowance, but which, in fact, is generally understood to mean something of quite a different sort. These 'equitable adjustments' will lose nothing of their effectiveness through being termed 'equitable adjustments'; they certainly gain nothing by being termed 'going value.' The latter practice tends to obscure the real purpose in permitting the allowance, and, more important, tends to give a wholly false respectability to an otherwise discredited item." Ben W. Lewis, *op. cit.* (note 269), pp. 732-733.

<sup>272</sup> Before turning to the discussion of single-sum values, brief reference should be made to two further requirements of the Act: first, that the Commission ascertain and report the amount and value of aids, gifts, grants, and donations made to each carrier; and second, that the Commission's valuation reports show the value of the property of each carrier not only as a whole, but separately by states. The matter of aids and donated property was handled by the accounting section of the bureau. Returns made by the carriers were verified by accountants, and the books and records of the carriers were examined for such further information as they might disclose. In this connection the coöperation of the state commissions was also relied upon in some measure. "By these various means," said the Commission, "many, perhaps most, of the donations by public authority and private individuals are ascertained and reported, but considerable still remains. To discover this would involve investigation of outside sources of information attended by much expense if made at all exhaustive and it has been felt that this would not be justified. Land grants are treated as a separate proposition, the report covering the total grant, the amount received from lands already sold, and the value of those remaining unsold. This last value is necessarily an estimate." *Texas Midland R. R.*, 75 I.C.C. 1, 180-181, 181 (1918). See, also, *Petition of National Conference on Valuation*, 84 I.C.C. 9, 10-11 (1923). In the matter of reporting valuations separately by states, the Commission was compelled to place a practical construction upon the requirement. It was held to refer "to the cost and other facts with respect to the property" rather than to "the value proper." The fixed property, such as roadbed and buildings, and certain movable property whose use is generally confined to one place, such as roadway small tools and shop tools, were thus assigned to particular states. But property which has no situs, such as locomotives and other equipment, was held not to fall within the requirement—because "the Commission is not required to create, nor would it be justified in attempting to create by any arbitrary rule, a location which does not in fact exist. It has been determined, therefore, not to attempt to allocate by states property embraced in the equipment accounts, but to report that in one item as nonassignable." *Texas Midland R. R.*, *supra*, at pp. 158-160, 159. The nature of the Commission's report, under this interpretation of the requirement, has been described as follows: "In the tentative valuation we have shown and in the final order entered herein we show by States the mileage of main-line and branch tracks, the area and present value of lands and of rights in lands, and the cost of reproduction new and cost of reproduction less depreciation of all classes of property, except land wholly

## §5. THE DETERMINATION OF SINGLE-SUM VALUES

The first of the valuation reports, issued in 1918, embodied the Commission's conclusions, supported by full data and elaborate discussion, with respect to the various underlying cost and value figures attributable to the property of the Texas Midland Railroad; and it included the announcement that in due course a supplementary finding would be issued naming a final single-sum value for the carrier.<sup>273</sup> The preceding section has considered at length the subject-matter of this report and of subsequent reports of similar character. Obviously, however, these were "valuations" within valuations—in reality, property appraisals rather than valuations for regulatory purposes. They are of interest primarily as illustrative of the capacity of the Commission to execute a series of positive and intrinsically difficult legislative requirements; they are ultimately significant only in so far as they have contributed to the sound and effective determination of final single-sum values. The establishment of a single-sum value for the property of each carrier was the real goal of the valuation project. Short of such an end, the valuation inquiry could have served no purposes commensurate with the great burden, direct and indirect, which it placed upon the Commission and the carriers; anything less by way of result could have been of no avail for carrying out the various regulatory tasks imposed upon the Commission toward the execution of which the federal valuation was deemed indispensable. Despite the failure of the statute specifically to require a finding of single-sum values, therefore, it was not only natural but imperative that such values should be ascertained and announced as soon as the requisite data were gathered and analyzed. The first of the single-sum value orders, which made its appearance about the middle of 1922, was of summary character;<sup>274</sup> it was followed about a year later by the sec-

and partly owned and used by the carrier, the cost of which is reflected in road and general expenditures accounts. Owing to the obvious difficulty of apportioning the value of equipment to the several states in which the carrier operates and to the fact that any apportionment of the elements of value, such as original cost and reproduction cost of property of this character to states, could be made only upon arbitrary bases, we do not now report it by states, but report it in a single amount for all states in which the carrier operates." *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463, 513 (1923). See, also, *Delaware & Hudson Co.*, 116 I.C.C. 611, 617-618 (1926).

<sup>273</sup> *Texas Midland R. R.*, 75 I.C.C. 1 (1918).

<sup>274</sup> *Evansville & Indianapolis R. R. Co.*, 75 I.C.C. 443 (1922).

ond of these orders, which was accompanied by a full report setting forth the processes which had been pursued in building from the underlying figures a single sum representing the value of the property of the San Pedro, Los Angeles & Salt Lake Railroad Company for rate-making purposes.<sup>275</sup>

It is in this phase of its valuation work that the Commission has had the greatest opportunity to display those qualities of flexibility and to utilize that reservoir of discretion which are presumed to be distinctive of administrative bodies. Since it proceeded under no legislative requirements in finding single-sum values—at most the statute only afforded authorization—the Commission was bound by no express limitations. So far as Congress was concerned, the Commission, as an expert administrative agency, was implicitly charged with the task not only of ascertaining but of weighing the vast mass of varied data relevant to the problem ultimately to be faced, and, in the exercise of its independent judgment, of computing, extracting, or determining single-sum values from these underlying data in the light of the total situation. No restrictions or directions or suggestions were furnished by the legislature. None the less, as was indicated earlier, it would be a wholly artificial view to regard the Commission, in the matter of single-sum value determination, as an entirely independent agency attacking an original problem, unhampered by limitations or entanglements of any sort. In fact, the Commission was virtually catapulted into a situation the almost overwhelming difficulties of which were the product not only of the inherent uncertainty of the valuation process but of the vagaries of several decades of makeshift regulation. The cry of vested interests has an unattractive sound in a young democracy, yet some heed must be given to it. Rights and expectations which have been permitted to emerge, even if not definitively recognized or affirmatively encouraged by governmental practice, must at least be accorded consideration when proposals for change or modification in the regulatory scheme are in process of development. Railroad valuation for rate-making purposes in the second and third decades of the twentieth century possessed vastly different implications from those which would have characterized the same task undertaken at the very beginning of regulatory activity. In

<sup>275</sup> *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923).

addition, the pressure of judicial pronouncements in matters of valuation itself could not be ignored; and the complications were intensified by the confusing and inconclusive character of these pronouncements. The judicial determinations proved confusing and inconclusive because the courts were apparently not clear in their own minds either as to the essential nature of the valuation problem or as to the proper scope of their relation to it. This situation rendered it increasingly difficult, among other things, to distinguish between judicial holdings which the courts themselves would ultimately construe as mere dicta and those to which they would accord the binding force of decision. To speak of the Commission as "free" and "independent" in such circumstances is to attach to these terms a relative rather than an absolute meaning: the Commission may be so characterized in this connection only by way of contrast with the express and affirmative guidance of other governmental agencies or with its own position, in these respects, relative to some of its other activities. That it was subject to external pressure from various directions there can be no question.

Just as the *Texas Midland* case may be said to have set the pattern in all leading respects for subsequent findings on the underlying figures, so the *San Pedro* case may be said to have provided the guiding principles so far as the basic single-sum values are concerned. Two determinations made effective in this case are of far-reaching significance in the valuation process: first, the decision, not discussed in the majority report, to distinguish in some measure between *retrospective* valuations and valuations *for the future*; and second, the decision to adopt the *judgment* as distinct from the *formula* method of arriving at single-sum values. The import of each of these determinations must be carefully noted.

The report in the *San Pedro* case was issued June 7, 1923; it announced a basic single-sum value for the property of the carrier as of June 30, 1914. Clearly, to be of any service in facilitating current processes of regulation, the 1914 figure would require revision to take account of subsequent property and value changes. Nothing was said as to the method by which this necessary revision was to be effected; to all appearances—and possibly in fact—the emphasis upon basic valuations, as of 1914 or other designated dates, was a matter merely

of administrative convenience. But this is significant: the way was left open, should the Commission so decide when time for revision finally came, to bring these basic figures up to date in a manner quite different from that employed in their original determination. One cannot be dogmatic as to exactly what was in the mind of the Commission, or of individual commissioners, at this time. It will be recalled that in its reproduction cost appraisals the Commission began by applying 1914 prices to 1914 inventories. In later appraisals the same prices were applied to inventories as of dates ranging up to June 30, 1921, the Commission declaring that this practice "will permit consideration of the carriers upon a uniform basis as to time, so that as the normal trend of prices of material and labor may go upward or downward correction factors can readily be applied, from time to time, as by law required, to the end that all appraisals may be kept to date upon a comparable basis."<sup>276</sup> The tenor of this pronouncement was scarcely such as to suggest that the Commission was then committed to a policy of adopting a method for revision essentially different from that used in determining the primary valuation figures. No more appeared to be indicated than a desire to prepare the ground for such policy in this matter as the future might dictate. Similarly, the practice of applying 1914 prices to carrier structures while accepting current market values, as of valuation date, for carrier lands, with the announcement that the discrepancy would be eliminated when the final value figures were adjusted to later dates, suggested no intention to resort to any but the usual methods in effecting this adjustment.<sup>277</sup> On the other hand, it is a matter of record that an order was issued, effective July 1, 1917, "requiring every carrier to keep an account in detail by jobs of all additions to the property

<sup>276</sup> *Winston-Salem Southbound Ry. Co.*, 75 I.C.C. 187, 192 (1918). See, also, *Texas Midland R. R.*, 75 I.C.C. 1, 139-140 (1918); *Delray Connecting R. R. Co.*, 106 I.C.C. 192, 193 (1925); *Wyoming Ry. Co.*, 114 I.C.C. 194, 196 (1926); *Cumberland & Manchester R. R. Co.*, 116 I.C.C. 407, 408 (1926).

<sup>277</sup> The following, from *Manistique & Lake Superior R. R. Co.*, 97 I.C.C. 382, 386-387 (1925), is typical: "The estimates of cost of reproduction covered by this report are based upon what is referred to herein as the 1914 level of prices, while the present values of the common-carrier lands covered by the report are based upon the fair average of the normal market value of lands adjoining and adjacent to the rights of way, yards, and terminals of the carrier, as of valuation date. This discrepancy will be removed when the commission adjusts to later dates, in accordance with the requirements of the valuation act, the final value herein reported."

and of all retirements," so that the Commission might know "what additions to the property have been made and the price in fact paid for those additions since 1914."<sup>278</sup> The statute provided, it will be remembered, that upon completion of the valuation the Commission shall "in like manner" keep itself informed of all extensions and improvements or other changes in the condition and value of carrier property, and shall revise and correct its original valuations from time to time.<sup>279</sup> The problem of revision, therefore, was present from the beginning. In discussing the above statutory requirement in the *San Pedro* case, Chairman Meyer, in his separate concurring opinion, said: "We have not yet had the benefit of argument on the meaning of the phrase 'in like manner,' but if it means that in placing a value upon net additions to property since valuation date we must go through all the detailed processes with respect to each of the elements of value called for in the act and stated in the basic valuation, most careful consideration should be given to the advisability of requesting Congress to amend the act."<sup>280</sup> And in the very year in which this ques-

<sup>278</sup> *Texas Midland R. R.*, 75 I.C.C. 1, 140 (1918).

<sup>279</sup> Sec. 19a, par. (f).

<sup>280</sup> *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), at p. 591. Commissioner Eastman, in his elaborate dissenting opinion, was more positive on this issue, and it led him to the repudiation of the judgment method of valuation, despite the fact that for valuations as of June 30, 1914, "much can be said for the judgment method as a means of reaching an approximately fair result" (p. 552). His critique, which bears also upon matters to be subsequently considered, was stated in the following terms: "We are valuing these properties . . . not for the purpose of satisfying curiosity but to secure a basis for rate making. Nothing is more important, therefore, than to determine upon a method for bringing the valuations up to date, so that they may serve this practical purpose. Does the report of the majority indicate this method? It seems to me that the answer must be that it indicates that the same judgment method must be used in ascertaining the value as of to-day as in ascertaining the value as of June 30, 1914. If this be true, it follows that in any valuation as of to-day the cost of reproduction new of the property, including net additions and improvements since June 30, 1914, must be re-estimated on the basis of present-day unit prices; that the 'present value' of land must be re-estimated on the basis of present-day market values of adjoining real estate; that depreciation must be re-estimated on the basis of the present-day condition of the property; and that all intangible values, if there be any such, must be estimated on the basis of present-day circumstances and conditions. Obviously the same process must be repeated each year, and obviously, also, we must continue in our employ a large valuation organization and carry on continual field work" (pp. 552-553). In continuing, he laid stress upon the special difficulties that would emerge in the process of revision upon this basis: "Moreover, there will be this difference, if the judgment method is applied to value as of today, in comparison with its application to value as of June 30, 1914. Instead of a reproduction cost which may perhaps approximate a 'fair average' of the cost of producing and equipping a railroad

tioning attitude was enunciated, the Commission's annual report to Congress carried the following declarations: "Our experience prompts serious doubts as to the practicability of proceeding in 'like manner' in bringing valuations down to date. . . . We direct serious consideration to the necessity of some amendment."<sup>281</sup> Finally, in the *O'Fallon* case, as will appear in due course, the revision of the basic figures was accomplished almost entirely by reference to the actual accounting data rather than through the use of property appraisals.<sup>282</sup> Under these circumstances it would seem to be the part of sound critical analysis to approach the Commission's basic valuation reports as records of an attempt to establish fair rate values for carrier properties as of the primary valuation dates only, in light of the special situation then prevailing, and not as providing standards of railroad valuation binding in all future revisions.

The determination of single-sum values in these basic valuation reports was referred, in the last analysis, to the exercise of judgment. In the *San Pedro* case the Commission announced its adoption of the judgment method in the following terms, which are typical of all of its later utterances on this subject: "The determining of a final single-sum value for rate-making purposes is not a matter of formula or of mathematical computation. We are required by the statute to ascertain and report certain costs, and we are required to ascertain and report, in addition to such costs, the present value of lands, and other values or elements of value if there are any that we can discover. We must give to all of these costs, values, and elements of value that consideration which, in our judgment, they ought to be given, in

'for at least the 20 years preceding,' we shall have a reproduction cost which vastly exceeds such 'fair average.' Instead of a narrow range between the maximum and minimum limits in which our 'judgment' may have play, we shall have a very wide range, with the maximum exceeding the minimum by possibly as much as 100 per cent. In such an event, what weights will it be 'just and right' to give to original cost and reproduction cost and the 'other elements of value,' and shall we be doing our duty if we exercise our 'judgment' within these broad limits without indicating in some clearer and more definite way the process by which the conclusion is reached?" (p. 553).

<sup>281</sup> *Annual Report*, 1923, pp. 17, 18. Compare, also, Part I, chap. iii, note 60. For renewals of the recommendation, see *Annual Reports*: 1926, p. 16; 1927, p. 62.

<sup>282</sup> *Excess Income of St. Louis & O'Fallon Ry. Co.*, 124 I.C.C. 3, 37 (1927). But see *Excess Income of Richmond, F. & P. R. Co.*, 170 I.C.C. 451 (1931), in which, as a result of the Supreme Court's decision in *St. L. & O'Fallon R. Co. v. U. S.*, 279 U.S. 461 (1929), there was a return to the method of property appraisals.



view of all the circumstances and conditions that seem to us properly to have a bearing upon the value of the individual carrier's property."<sup>283</sup> This mode of approach has been pursued in all subsequent proceedings.<sup>284</sup> No single standard of valuation was accepted as controlling. Since the Commission had found it impossible, for the most part, to ascertain original costs, and since its figures for investment were neither adequately corrected for retirements nor so modified as to eliminate imprudent capital commitments, the advocates of origi-

<sup>283</sup> *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), at p. 512. In applying these considerations to the instant proceeding, the Commission continued (p. 513): "We have carefully reviewed all of the evidence collected by the Bureau of Valuation as well as all of that presented by the carrier, including the opinions of its experts upon methods of determining, and the amount to be determined as, the final value of the property. We have endeavored not to reach our conclusion by attaching undue weight to any particular element of value to the extent of shutting out proper consideration of all the elements of value. . . . The final single-sum value which we have determined for the property of this carrier is based upon a careful consideration of all of the relevant facts that have come to our attention. It is, in our judgment, a value which we are authorized by the valuation act to ascertain and report, and we have ascertained and now report it as the final value of the property of this carrier for rate-making purposes. It is the fair value of the property of the carrier devoted to the service of the public upon which the carrier is justly entitled to earn a fair return." By way of judicial support for its adoption of the judgment method, the Commission quoted the following language of Justice Hughes in the *Minnesota Rate Cases*, 230 U.S. 352 (1913), at p. 434: "The ascertainment of that value is not controlled by artificial rules. It is not a matter of formula but must be a reasonable judgment, having its basis in a proper consideration of all the relevant facts." Similarly, it referred with approval to the following declaration of the court in *City of Winona v. Wisconsin-Minnesota Light & P. Co.*, 276 Fed. 996 (1921), at p. 1001: "That there can be no mathematical certainty in such a judgment goes without saying. Nor does any formula exist which can be used in all cases."

<sup>284</sup> Compare, for example, the following from *Kansas City Southern Ry. Co.*, 84 I.C.C. 113, 115 (1924): "The determination of aggregate values for an entire railway system is a process of judicially weighing underlying elements of value in the light of the individual case. . . . The value of a railway system can not be ascertained by the simple process of adding sums attributed to the many units of property, working capital, and a percentage conjecture as to a proper allowance for so-called intangible values. In the instant case original cost to the extent it is ascertainable as a fact, restated investment, reproduction new, and reproduction less depreciation are shown, and the present capitalization and the corporate history of the carriers are stated; and there is in addition an estimate by the carriers of the commercial or economic value of the property. These are checks, one upon the other. No one fact, cost study, estimate, or other factor can be said to be necessarily controlling." See, also, *Atlanta, Birmingham & Atlantic R. R. Co.*, 75 I.C.C. 645, 666-668 (1923); *Petition of National Conference on Valuation*, 84 I.C.C. 9, 11-13 (1923); *Florida East Coast Ry. Co.*, 84 I.C.C. 25, 33 (1924); *Gulf, Texas & Western Ry. Co.*, 97 I.C.C. 29, 35 (1925); *Delray Connecting R. R. Co.*, 106 I.C.C. 192, 194 (1925); *Charleston & Western Carolina Ry. Co.*, 121 I.C.C. 721, 742 (1927); *Lehigh Valley R. Co.*, 34 Val. Rep. 1, 21 (1930).

nal cost or investment as the rate base were perforce unable to establish their standard of final value as that which the Commission should follow. Nor, nominally at least, were the supporters of the reproduction cost theory any more successful. The Commission adopted the view that "the estimated cost of reproduction is a method of ascertaining present value of property which is to be given consideration, but that method ought not to be used to the exclusion of others."<sup>285</sup> The contentions of those who would have permitted carriers to earn upon a rate base itself dependent upon earning capacity were similarly denied. "Value for rate-making purposes and commercial value arising from earning power," the Commission has said, "are so wholly different that they can not be reconciled"; and it tersely directed attention to the basic defect of the method: "The inescapable result of following the vicious circle of prescribing rates upon the basis of values and fixing values upon the returns earned from the rates is a destruction of the whole system of rate regulation."<sup>286</sup> Each of the leading valuation standards, as the sole or controlling factor, was thus rejected. No formula was to be followed; judgment was to be exercised, in the light of all relevant facts, without analysis of the processes whereby such judgment resulted in specific findings.<sup>287</sup>

<sup>285</sup> *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), at p. 509.

<sup>286</sup> *Chicago, Burlington & Quincy R. R. Co.*, 134 I.C.C. 1, 53 (1927).

<sup>287</sup> In *Kansas City Southern Ry. Co.*, 84 I.C.C. 113 (1924), protests were filed by the carriers on the ground that the Commission's valuation "states no 'analysis of the methods of valuation employed in the determination of single-sum values'"; and the contention was made "that this alleged omission has left the carriers without any definite knowledge of the methods of valuation employed in the determination of the single-sum values stated, and therefore not in a position to successfully contest the same" (pp. 114-115). To this protest the Commission replied as follows: "An analysis of the methods of determining original cost, of inventorying the property and fixing the unit prices, of ascertaining land values, of finding reproduction cost new and depreciated, and of readjusting the carriers' investment account is contained in the statement of methods in *Texas Midland Railroad* . . . incorporated in this proceeding by reference. No further analysis of the process of determining the aggregate values of the carriers' property can be stated as expressing the method of collective action by the commission. We are not, however, required by section 19a of the interstate commerce act to describe the methods by which the final single-sum value is fixed" (p. 115). See, also, *Petition of National Conference on Valuation*, 84 I.C.C. 9 (1923), at pp. 11-13, in which the Commission said (p. 13): "A detailed analysis of the method of arriving at a judgment would in the nature of things call for a description of the mental processes of those to whom is delegated that function, and in our case this would involve setting forth the mental processes of 11 men, who may have reached the same conclusion by different paths."

The acceptance of the judgment method, as thus defined, is by no means exempt from legitimate attack, despite the fact that it is a logical outcome of the "fair value" rule, and that it is supported by ample judicial authority. The persistence of the legal doctrine that "fair value" is a matter of "judgment" rather than of "formula" has brought lip-worship to the judgment method from all quarters. But every contention that "dominant" or "controlling" consideration be given to a particular factor—whether it be reproduction cost or prudent investment—necessarily involves a virtual repudiation of the judgment method and of the "fair value" rule upon which it is based; and in so far as the Supreme Court has recognized reproduction cost as the substantial equivalent of value, there has been authoritative departure from the traditional doctrine of *Smyth v. Ames* and the numerous cases following it.<sup>288</sup> Nor was the Commission itself a unit in its acceptance of the judgment method of valuation. Commissioner Eastman, a staunch advocate of prudent investment as the measure of the rate base, after various strictures upon the use of the judgment method, concluded as follows: "I must confess that it seems to me that unless some definite standard can be found for determining the weight to be given to such widely conflicting evidence, the process of valuation will become arbitrary to a degree wholly impossible to defend. Value will become a speculative and capricious matter, varying millions of dollars under exactly parallel sets of facts, dependent upon the bent of mind, temper, and, perhaps, digestion of the particular individuals who happen to exercise the 'judgment.' New occasions teach new duties. The tremendous change in conditions precipitated by the World War and likely to continue for a period in the future impossible to estimate has, it seems to me, thrown new light upon the valuation problem and made it necessary, both for us and for the court, to reappraise the judgment method with a view to determining whether it is under present conditions a sound and safe method to follow. Surely if we can find a method which will accomplish what is 'just and right' but avoid the violent fluctuations, instability, and con-

<sup>288</sup> See *McCordle v. Indianapolis Co.*, 272 U.S. 400 (1926), and compare note 57, *supra*. When, in his special concurring opinion in *S. W. Tel. Co. v. Pub. Serv. Comm.*, 262 U.S. 276 (1923), Justice Brandeis proposed "prudent investment" as the measure of the rate base, he expressly repudiated the judgment method by declaring the so-called rule of *Smyth v. Ames* to be "legally and economically unsound."

tinual uncertainty which it now appears are likely to be characteristic of the judgment method, it will be in the interest, not only of the public, but of the companies themselves."<sup>289</sup> The above views were expressed by a dissenting commissioner who sought to eliminate the judgment method and substitute therefor a definite valuation standard. Commissioner Potter, though a rather extreme adherent of the judgment method, found it defective, as employed by the Commission, because of its failure to disclose the processes whereby final single-sum values were determined. Such an analysis of processes is necessary, he argued, in order to render possible consistency of action by the Commission, intelligent review by the courts, informed legislation by the Congress. "We can say we have considered all of the factors," he declared, "but unless we are able to state how we have considered them and with what effect, we have not as a matter of law considered them."<sup>290</sup> And, more forcefully, in a later proceeding: "The report . . . leaves a reader entirely in the dark as to how its conclusions were reached. This is basic error which should lead to condemnation in its entirety. It is incumbent on us to give sound reasons for what we do. We must apply principles and they must be applied consistently in all cases. We act arbitrarily until we announce the rules and principles which we apply. To state relation of original cost to reproduction cost is not merely an idle 'matching up of figures.' The results are not inconsequential 'coincidences' or 'divergencies.' We must and necessarily do either deny or accord influence to such figures in every case. We should show how we use them in each case. . . . If, in this case, original cost, reproduction cost, reproduction cost less depreciation, value of lands, cost of lands, development cost, amount of outstanding securities, earnings, efficiency, public service, and public need, had each been specifically dealt with as a factor affecting value, and if that method were determined to be adopted for all cases, we would have taken a long step toward sound practice."<sup>291</sup>

<sup>289</sup> *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), at pp. 553-554. Compare, also, note 280, *supra*.

<sup>290</sup> *Ibid.*, p. 577. See, also, *Petition of National Conference on Valuation*, 84 I.C.C. 9 (1923), pp. 17-19.

<sup>291</sup> From Commissioner Potter's dissenting opinion in *Florida East Coast Ry. Co.*, 84 I.C.C. 25 (1924), at p. 42. See, also, his dissenting opinion in *Kansas City Southern Ry. Co.*, 84 I.C.C. 113, 124-139 (1924).

There is much merit in these minority criticisms, regardless of the propriety of the affirmative proposals or the legal validity of the procedure they involve. From a substantive standpoint, the prudent investment theory, as advocated by Commissioner Eastman, would doubtless constitute a fruitful substitute for the judgment method as at present applied, in terms of a discretionary weighing of a vast array of relevant facts,<sup>202</sup> despite the circumstance that it has failed to commend itself to the majority of the Supreme Court.<sup>203</sup> On the other hand, Commissioner Potter's substantive emphasis, which seems to rest, in large measure, upon the recognition of earning power and factors contributing thereto, manifestly cannot be accepted as a proper approach in the ascertainment of the rate base.<sup>204</sup> But entirely apart from questions of law and the relative merits of alternative valuation standards, the Commission's use of the judgment method is open to well-founded criticism. The defect, essentially, consists in failure to explain the processes of single-sum value determination, whatever they may be. The ultimate findings appear to emerge through processes that are mystical and mystifying. Under such circumstances, in the absence of guiding principle and without a reasoned accounting after the event, there is no check upon "arbitrary" determinations, and value may well become "a speculative and capricious matter." Commissioner Meyer attempted to answer these strictures, but his reason-

<sup>202</sup> See Commissioner Eastman's elaborate and convincing dissenting opinion in *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), at pp. 523-567. The views expressed therein coincide, essentially, with those contained in the separate concurring opinion of Justice Brandeis in *S. W. Tel. Co. v. Pub. Serv. Comm.*, 262 U.S. 276 (1923), at pp. 289-312. See, also, Edwin C. Goddard, "Public Utility Valuation," *Michigan Law Review*, vol. 15 (January, 1917), pp. 205-227; "Fair Value of Public Utilities," *ibid.*, vol. 22 (May, 1924), pp. 652-672 (June, 1924), pp. 777-797; and James C. Bonbright, "The Economic Merits of Original Cost and Reproduction Cost," *Harvard Law Review*, vol. 41 (March, 1928), pp. 593-622.

<sup>203</sup> In his dissenting opinion in *St. L. & O'Fallon R. Co. v. U. S.*, 279 U.S. 461 (1929), Justice Brandeis, the leading proponent in the Supreme Court of prudent investment as the measure of the rate base, conceded that "it was held in *Southwestern Bell Telephone Co. v. Public Service Commission* . . . that the rate base on which a public utility is constitutionally entitled to earn a fair return is the then actual value of the property used and useful in the business, not the original cost or the amount prudently invested in the enterprise" (p. 489).

<sup>204</sup> For a critique of Commissioner Potter's views, with special reference to the "close bond of union" found in these views "between the 'value' which he is seeking and which he proposes to use for rate-making purposes and what economists term 'value in exchange,'" see Commissioner Eastman's dissenting opinion in *Kansas City Southern Ry. Co.*, 84 I.C.C. 113 (1924), at pp. 140-144.

ing does not seem convincing. "The statute," he declared, "does not require a description of mental processes and ordinarily that is difficult when only a single person is involved and impossible when several are concerned. If an analysis of the processes by which we collectively arrive at a final value must be formulated before we can lawfully issue a report on final value, such a report can never be issued. . . . The single-sum figure which the majority has agreed to was arrived at by different processes by the different members constituting the majority. Some majority members consider the figure which the report announces as too high; others think it is too low; still others, that it is exactly the right figure. The important thing, however, is that the minds of the majority could meet at this point and agree upon the announced figure, although there are probably as many different justifications for finding this figure as there are commissioners who participated in the finding of it. . . . I am confident that if the majority report had attempted to go into greater detail with respect to methods and processes it would have caused additional dissents with the result that the report could not have commanded a majority vote. . . . Undue insistence upon individual forms of expression and particular phrases in dealing with so difficult a subject as valuation would absolutely paralyze the work and reduce the commission to a state of impotence. It would be most desirable to be able to attach labels to the various elements of value and indicate on each label what weight is to be attached to the element thus labeled. This is humanly impossible."<sup>295</sup>

<sup>295</sup> From Chairman Meyer's separate concurring opinion in *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), at pp. 592, 595. He had said (pp. 592-593): "It may be possible for a single commissioner to attempt to describe the processes by which he arrived at this particular figure, but it must be obvious that it is utterly impossible for 11 men to agree upon a collective process." He then proceeded to analyze the processes which persuaded *him* to support the figure found by the majority of the Commission. The statement is amusingly barren of illumination; it is but a repetition of the usual "relevant facts," without the slightest indication of the weight accorded to any particular element. He revealed only this (p. 593): "After considering the so-called elements of value enumerated in the report—the original cost to date, the cost of reproduction new, the cost of reproduction less depreciation, the cost and value of lands, the restated investment account, and the corporate and financial history of the property—I came to the conclusion that after adding a reasonable sum for working capital \$45,000,000 represented the approximate investment upon which those devoting this property to common-carrier service are entitled to earn a fair return." The most that this statement suggests is that this particular commissioner was seeking "the approximate investment."

The statute may not require an analysis of the processes of single-sum value determination, but such an analysis is none the less necessary, both as a safeguard to proper performance and as a means of making the results intelligible. Differences of opinion within the Commission are inevitable, but these differences would be diminished rather than increased by the formulation and adoption of guiding principles, with such departures in application as the facts of particular proceedings might justify. Disagreements as to precise figures might still have to be adjusted, but controlling factors would mold the general trend of the findings. Otherwise, sheer compromise, without the anchorage of deliberate policy, is bound to result. In any event, the Congress and the carriers and the public should be apprised of the considerations which have in fact supported particular findings; and the courts, too, should have reasoned records placed before them, instead of masses of primary data of conflicting tenor with precise final values "somehow" ascertained, even though such administrative frankness might lead to frequent reversals. The valuation process, especially under the conditions surrounding the Commission's project, unquestionably necessitates a large exercise of judgment. But this judgment should be exercised in the choice of guiding principles, however variable because of the peculiar circumstances of particular situations, rather than in the refusal to recognize or acknowledge any guiding principle at all. There appears to be no warrant for the contention, for example, that it is impossible for an individual to state whether, in a particular determination, he is in fact following, either entirely or in reasonably definite measure, the original cost, reproduction cost, or market value standard; and what can be done by a single individual in this respect can be done by the Commission as a body, assuming that general agreement is reached as to the goal to be achieved. But even if there is such disagreement that final value must be fixed by a process of averaging, or mutual concession, or purely artificial compromise, so much can and should be stated. Whether required by law or not, the valuation reports should disclose completely and frankly how in fact the figures representing final value were reached. The exercise of judgment does not necessitate a total repudiation of principle, nor does it involve such intricacy of mental

processes that all trace of their course must necessarily be lost.<sup>206</sup> The Commission's language might well serve to cover the most arbitrary of determinations; not the slightest change would be required if this were the case. In the words of Commissioner Eastman: "The majority have followed a consistent course. After ascertaining and considering various facts in regard to the properties, they 'reach the conclusion and find' that the value for rate-making purposes is a certain sum. No attempt is made to chart the path by which the conclusion is reached or to indicate the weight given to any particular fact. A quite different sum might be substituted, as the value for rate-making purposes, without changing in any way the discussion which leads up to and is presumably intended to support the finding."<sup>207</sup> This procedure is a distressingly accurate reflection of the Supreme Court's dicta in *Smyth v. Ames*. The language of that case did well enough as a judicial pronouncement, under the circumstances there involved, as early as 1898; but as a pronouncement of policy by an administrative tribunal a quarter of a century later, it is flagrantly lacking in both definiteness and frankness. The courts, when enmeshed in the technicalities of some problem outside the usual range of their activity, frequently convince themselves of the correctness of their determinations by the sheer force of dialectic; it is reasonable to expect a different approach from expert governmental agencies expressly created to deal, in specifically defined spheres, with complicated matters of fact and policy.

In the last analysis, however, the Commission's deeds are obviously more important than its words. Any significant appraisal of its single-sum value determinations must look behind the veil of "judgment" and seek to discover the elements which appear in fact to have been incorporated into the primary single-sum valuations. Materials for such an inquiry are not altogether lacking. It has been asserted re-

<sup>206</sup> That the exercise of judgment is not inconsistent with the adoption and statement of definite policies is evidenced by the Commission's procedure in *Excess Income of St. Louis & O'Fallon Ry. Co.*, 124 I.C.C. 3 (1927). The Commission would be the last to concede that in announcing, in that case, adherence to the principle of actual investment for the revision of primary valuations it was denying the rôle of judgment or abandoning its proper exercise in single-sum value determination.

<sup>207</sup> From his dissenting opinion in *Kansas City Southern Ry. Co.*, 84 I.C.C. 113 (1924), at p. 140.



peatedly, both within the Commission and by outsiders, that despite the nominal repudiation of the "formula" method, the Commission's primary valuations were the result of an application to the underlying figures of a very definite formula. This claim, with supporting data, was officially made by Commissioner Potter. "It appears," he said, "that in practically all of our tentative valuations a figure which averages about 5 per cent has been arbitrarily added to the figure representing reproduction cost less depreciation, plus value of lands, and the resulting figure has been named as representing final value. A list of 330 carriers as to which we have found tentative final value, shows that the figures given as cost of reproduction less depreciation, plus value of lands, plus 5 per cent, correspond so closely with the tentative final values found, less cash and material and supplies, as to lead to the conclusion that the former figures were taken as the basis for arriving at the latter. The aggregate of the items for these carriers showing their cost of reproduction less depreciation, plus present value of lands, plus 5 per cent, is \$2,955,206,577. The aggregate of the tentative final values less cash and material and supplies is \$2,957,504,106. The difference is only one-thirteenth of 1 per cent in excess of the 5 per cent arbitrary."<sup>298</sup> The burden of this

<sup>298</sup> From his dissenting opinion in *Florida East Coast Ry. Co.*, 84 I.C.C. 25 (1924), at p. 41. In the instant case, a single-sum value of \$46,200,000 was fixed by the Commission. This was analyzed by Commissioner Potter, in accordance with the above formula, to consist of the following items: cost of reproduction less depreciation, \$38,569,822; present value of lands, \$4,406,448; arbitrary addition, \$2,523,730, constituting 5.8 per cent of the aggregate of the above figures; working capital, \$700,000. But compare the following from his dissenting opinion in *Kansas City Southern Ry. Co.*, 84 I.C.C. 113 (1924), at p. 130: "A consideration of this case with the cases we have heretofore decided makes plain the lack of logical process in our work. I pointed out in the *Florida East Coast case* . . . our tentative valuations appear to coincide with cost of reproduction less depreciation, plus value of lands and working capital, plus an arbitrary of approximately 5 per cent. In the *Florida East Coast case* the figure of final value coincided, approximately, with an amount thus worked out. In the *San Pedro, Los Angeles & Salt Lake case* . . . the arbitrary was 13.9 per cent. In the *Atlanta, Birmingham & Atlantic case* . . . for reasons not fully explained, an amount, the method of measuring which was not given, was deducted, so the figure of final value was about \$1,000,000, or approximately 5 per cent, less than reproduction cost depreciated, plus value of lands and working capital. In the present case, if the method of adding an arbitrary were used, it would be 10.7 per cent. The reason why one base was applied to the *Florida East Coast case* and another to this case does not appear. Both are essential and meritorious properties. There must have been some consideration to which influence was given in this case which was not given in the *Florida East Coast case*. There must be some reason why the arbitrary was higher in the

claim is borne out by the findings contained in an able treatise on railroads. "Such analysis of the figures as can be made," it is said, "indicates that the final value as reported for most roads is the sum of the cost of reproduction less depreciation, as reported by the Commission's engineers, plus the 'present value' of the carrier lands as determined by the adjacent land test, plus 5 per cent of this total then carried to the next lower or higher round figure (usually the latter) plus an allowance for working capital,—cash, materials and supplies."<sup>299</sup> It is conceded that there are exceptions to the application of this "short cut," evincing resort to expediency on part of the Commission, and, as would be expected, no one of the final valuations matches to the last penny the corresponding figures computed by the "formula" method. Nevertheless, upon examination of the supporting data which the authors have gathered, it is difficult to dispute the conclusion that "there can hardly be doubt concerning the method by which substantially all the figures have been built up."<sup>300</sup>

Independent investigations have produced results tending in the same direction. The figures named for 30 carriers each of whose single-sum values exceeded \$1,000,000, selected at random from the valuation reports issued during the years 1923-1926, inclusive, disclose the following facts: the addition of 5.4 per cent to a base made up of cost of reproduction less depreciation plus present value of lands, gives on the average an amount equal to the final value less the allowance for working capital; the percentage additions vary from 1.5 per cent to 13.7 per cent; in more than half the cases the percentage addition is in excess of 5 per cent; in every case the final single-sum value exceeds the sum of cost of reproduction less depreciation, present value of lands, and working capital.<sup>301</sup> Furthermore, an examina-

*San Pedro case.* What is it, is the question. Apparently there was reluctance to accord the carrier any benefit from its showing of earnings. The same is true respecting selling prices of securities. Yet the case does depart from the rule seemingly applied in our tentative reports of reproduction cost less depreciation, plus value of lands and working capital, plus 5 per cent, and it is to be hoped that this departure is indicative of future policy."

<sup>299</sup> H. B. Vanderblue and K. F. Burgess, *Railroads: Rates—Service—Management* (1923), p. 347.

<sup>300</sup> *Ibid.*, p. 349.

<sup>301</sup> In the following table these 30 carriers are listed. In the first column appears the sum of the cost of reproduction less depreciation plus the present value of lands; in the second column appears the single-sum value as fixed by the Commission, less

tion of the reports issued during the year 1927, in so far as they involved carriers whose single-sum values were fixed at amounts in excess of \$1,000,000, discloses that in 45 out of 46 cases the final value amounted to more than the reproduction cost less depreciation of the property, plus present value of lands, plus working capital.<sup>802</sup> The

the amount allowed for working capital; the third column shows the percentage addition representing the difference between the base given in the first column and the value given in the second column. The figures, in all instances, represent, solely, property "owned and used."

	(1)	(2)	(3)
San Pedro, Los Angeles & Salt Lake Railroad Co., 75 I.C.C. 463 (1923)	\$39,675,117	\$43,960,000	10.8
Ann Arbor Railroad Co., 84 I.C.C. 159 (1924)	10,499,921	10,812,701	3.0
Southern Railway Co. in Mississippi, 84 I.C.C. 253 (1924)	4,128,569	4,340,000	5.1
Raritan River Railroad Co., 84 I.C.C. 463 (1924)	1,104,125	1,160,000	5.1
Maryland, Delaware & Virginia Railway Co., 84 I.C.C. 499 (1924)	2,155,975	2,225,000	3.2
Norfolk Southern Railroad Co., 84 I.C.C. 693 (1925)	20,167,107	21,222,000	5.2
Gulf, Texas & Western Railway Co., 97 I.C.C. 29 (1925)	1,613,921	1,650,000	2.2
Bangor & Aroostook Railroad Co., 97 I.C.C. 253 (1925)	19,795,959	20,700,000	4.6
New York, Philadelphia & Norfolk Railroad Co., 97 I.C.C. 273 (1925)	10,272,087	10,800,000	5.1
Wrightsville & Tennille Railroad Co., 97 I.C.C. 359 (1925)	1,422,910	1,500,000	5.4
Chicago, Terre Haute & Southeastern Railway Co., 97 I.C.C. 535 (1925)	18,708,275	19,900,000	6.4
Savannah & Northwestern Railway, 97 I.C.C. 618 (1925)	1,684,385	1,800,000	6.9
Blue Ridge Railway Co., 97 I.C.C. 744 (1925)	1,773,268	1,800,000	1.5
Central New England Railway Co., 97 I.C.C. 773 (1925)	12,585,729	13,450,000	6.9
Delaware & Northern Railroad Co., 103 I.C.C. 130 (1925)	1,253,287	1,400,000	11.7
Cape Girardeau Northern Railway Co., 103 I.C.C. 315 (1925)	1,186,920	1,250,000	5.3
Cumberland Valley Rail Road Co., 103 I.C.C. 743 (1925)	12,221,852	12,800,000	4.7
Interstate Railroad Co., 103 I.C.C. 795 (1925)	1,660,340	1,775,000	6.9
Louisiana Railway & Navigation Co., 106 I.C.C. 47 (1925)	9,236,950	10,500,000	13.7
Central Indiana Railway Co., 106 I.C.C. 75 (1925)	1,829,629	1,875,000	2.5
Gulf & Ship Island Railroad Co., 106 I.C.C. 111 (1925)	8,299,535	8,700,000	4.8
Georgia Southern & Florida Railway Co., 106 I.C.C. 155 (1925)	8,866,364	9,100,000	2.6
Mississippi River & Bonne Terre Railway, 106 I.C.C. 492 (1926)	3,220,370	3,450,000	7.1
Sandy River & Rangeley Lakes Railroad, 108 I.C.C. 173 (1926)	1,257,844	1,325,000	5.3
Tremont & Gulf Railway Co., 108 I.C.C. 629 (1926)	1,180,366	1,200,000	1.7
Spokane International Railway Co., 110 I.C.C. 173 (1926)	4,499,950	4,750,000	5.6
Ulster & Delaware Railroad Co., 110 I.C.C. 335 (1926)	5,917,741	6,200,000	4.8
Tennessee, Alabama & Georgia Railroad Co., 110 I.C.C. 595 (1926)	1,298,059	1,360,000	4.8
Virginia-Carolina Railway Co., 110 I.C.C. 767 (1926)	1,769,762	1,800,000	1.7
Chicago, Milwaukee & Gary Railway Co., 114 I.C.C. 16 (1926)	2,569,765	2,750,000	7.0

<sup>802</sup> In the following table these 46 cases are listed. In the first column appears the sum of reproduction cost less depreciation, present value of lands, and working capital; in the second column appears the single-sum value as found by the Commission. The figures relate, in all instances, to property "wholly owned and used," including

absolute amount of the added allowance, or the percentage of the base which such allowance constitutes, is of less importance than the character of the elements included in the base and the fact that additions to these constituent elements are generally found. The presence and extent of deviations from any average percentage addition casts serious doubt upon the contention that any rigid formula has been applied in reaching the figures named as final values. But the mere

the carrier's portion of jointly owned and used facilities. The first column does not include such items, relatively small in amount but to which the Commission has assigned specific values, as "rights in public domain" and "rights in private lands." It will be noted that only in a single case (Ohio River & Western Railway Co., 121 I.C.C. 585) does the final single-sum value fail to exceed the depreciated reproduction cost, plus the value of lands, plus working capital.

	(r)	(a)
Georgia, Florida & Alabama Railway Co., 121 I.C.C. 419 . . .	\$2,664,464	\$2,783,000
Escanaba & Lake Superior Railroad Co., 121 I.C.C. 454 . . .	1,689,254	1,767,725
Aliquippa & Southern Railroad Co., 121 I.C.C. 536 . . .	1,243,056	1,243,407
Detroit & Mackinac Railway Co., 121 I.C.C. 553 . . .	6,287,798	6,559,700
Ohio River & Western Railway Co., 121 I.C.C. 585 . . .	1,934,691	1,924,400
Macon Terminal Co., 121 I.C.C. 705 . . .	1,314,908	1,332,086
Charleston & Western Carolina Railway Co., 121 I.C.C. 721 . . .	9,532,556	9,991,825
Tonopah & Tidewater Railroad Co., 121 I.C.C. 809 . . .	2,555,948	2,709,998
Copper Range Railroad Co., 125 I.C.C. 56 . . .	4,396,376	4,665,180
McKeesport Connecting Railroad Co., 125 I.C.C. 125 . . .	1,135,472	1,143,000
Denver Union Terminal Railway Co., 125 I.C.C. 498 . . .	3,845,438	3,861,000
Georgia Railroad (Lessee Organization), 125 I.C.C. 551 . . .	1,111,503	1,150,741
Wichita Union Terminal Railway Co., 125 I.C.C. 619 . . .	1,907,356	1,935,000
Missouri & North Arkansas Railroad Co., 125 I.C.C. 639 . . .	9,109,568	9,148,460
Great Western Railway Co., 125 I.C.C. 674 . . .	1,698,994	1,766,000
Watertown & Sioux Falls Railway Co., 125 I.C.C. 701 . . .	1,615,415	1,675,000
Gulf, Mobile & Northern Railroad Co., 125 I.C.C. 765 . . .	10,215,635	10,715,000
Newburgh & South Shore Railway Co., 125 I.C.C. 857 . . .	3,122,034	3,112,897
Atchison, Topeka & Santa Fe Railway Co., 127 I.C.C. 1, 105 . . .	373,073,662	397,360,000
St. Paul Union Depot Co., 130 I.C.C. 1 . . .	5,825,679	5,884,000
Manufacturers Railway Co., 130 I.C.C. 23 . . .	1,267,923	1,330,000
Central of Georgia Railway Co., 130 I.C.C. 43 . . .	61,096,810	63,458,485
Pacific & Idaho Northern Railway Co., 130 I.C.C. 169 . . .	2,167,506	2,167,562
Rutland Railroad Co., 130 I.C.C. 205 . . .	20,084,058	21,025,000
Illinois Terminal Railroad Co., 130 I.C.C. 326 . . .	1,160,830	1,204,030
Union Terminal Co. (Dallas, Texas), 130 I.C.C. 393 . . .	4,380,822	4,402,300
Cambria & Indiana Railroad Co., 130 I.C.C. 412 . . .	3,747,035	3,965,000
Colorado & Wyoming Railway Co., 130 I.C.C. 446 . . .	3,276,163	3,316,423
Feoria Railway Terminal Co., 130 I.C.C. 475 . . .	935,890	1,156,000
Pere Marquette Railroad Co., 130 I.C.C. 497 . . .	59,360,155	62,705,398
Northern Alabama Railway Co., 130 I.C.C. 596 . . .	3,068,441	3,223,000
Sunset Railway Co., 130 I.C.C. 628 . . .	1,040,322	1,083,800
Apalachicola Northern Railroad Co., 130 I.C.C. 736 . . .	1,577,478	1,640,000
Gilmore & Pittsburgh Railroad Co., Limited, 130 I.C.C. 821 . . .	3,228,162	3,406,000
Great Northern Railway Co., 133 I.C.C. 1, 144 . . .	367,401,374	382,400,000
Lake Terminal Railroad Co., 133 I.C.C. 497 . . .	1,983,151	2,016,458
Williamson & Pond Creek Railroad Co., 133 I.C.C. 564 . . .	1,164,740	1,292,044
Minneapolis & Rainy River Railway Co., 133 I.C.C. 594 . . .	1,096,471	1,123,004
St. Clair Terminal Railroad Co., 133 I.C.C. 613 . . .	1,319,904	1,400,000
Paducah & Illinois Railroad Co., 133 I.C.C. 651 . . .	4,676,943	4,850,000
Louisiana & Arkansas Railway Co., 133 I.C.C. 687 . . .	7,454,712	7,748,150
Troy Union Railroad Co., 133 I.C.C. 738 . . .	1,014,381	1,101,305
Norfolk & Portsmouth Belt Line Railroad Co., 133 I.C.C. 771 . . .	945,513	1,038,750
New Orleans Great Northern Railroad Co., 133 I.C.C. 825 . . .	6,499,663	6,955,894
Tonopah & Goldfield Railroad Co., 133 I.C.C. 862 . . .	1,752,092	1,812,150
Chicago, Burlington & Quincy Railroad Co., 134 I.C.C. 1, 57 . . .	470,851,324	496,100,000

existence of rather wide variations in these percentage allowances—the absence of exact correspondence between the final valuations and figures computed by the formula method—does not convincingly negative the conclusion that the Commission has resorted to a fairly well-defined valuation method rather than to an entirely distinctive or arbitrary procedure in each case. This is the significant item in the situation; and it provides a reasonably adequate basis for passing judgment, at least in principle, upon the Commission's general method of single-sum value determination. It appears beyond question that, save in exceptional circumstances, the basic single-sum values, as of primary valuation dates, have been built up by the subtraction of depreciation from reproduction cost new of the structures, and the addition to the remainder of an amount representing present value of lands, a sum representing working capital, and a fair allowance—apparently in fact dictated by the exercise of judgment—for other values. Reproduction cost estimates were the only structural figures which the Commission was willing to accept as complete and accurate, and the same may be said of the present value figures for land. The Commission was definitely committed to the policy of deducting accrued depreciation; a precise amount for working capital was invariably included in the reports; and the residue must, it would seem, be imputed to other values—to so-called intangibles or in recognition of vested interests—since the Commission, explicitly, has never gone further than to refuse to approve *specific* allowances for such other values. The figures in the primary valuation reports are, on the whole, strikingly consistent with this analysis of the substantive content of the Commission's single-sum value determinations.<sup>308</sup>

<sup>308</sup> There is little justification for construing the fact that the 1914 prices used by the Commission in its reproduction cost estimates were probably a "fair average" of the prices prevailing for a period of some 20 years preceding, as tantamount to the establishment of the primary valuations on the basis of "actual cost." There may be an approximate coincidence in result; but the tasks undertaken and the methods employed therefor were in no sense those of an actual cost or investment appraisal. The inventory was based upon a "reproduction" hypothesis, and the philosophy underlying specific determinations was of the same sort. In his separate opinion, concurring with modifications, in *Petition of National Conference on Valuation*, 84 I.C.C. 9 (1923), Commissioner Potter went so far as to say (at p. 19): "The final and tentative valuations that we have made to date demonstrate conclusively that we have applied to the extent of domination the inelastic rule of reproduction cost without due regard to whether resulting values are fair, excessive, or too low." But even in *Excess Income of*

Approaching the primary valuations from this angle—not as hazy expressions of uncertain and unpredictable judgment, but essentially as an endorsement of reproduction cost less depreciation, plus market value of lands, working capital, and intangibles—and remembering the conditions which surrounded their determination, what may be said of them? Comment upon the intrinsic merits of the original cost and reproduction cost principles will be reserved till the problem of revising these primary figures is introduced for consideration. At this point the Commission had no satisfactory original cost data on which to proceed. This fact is undoubtedly to be regretted, since, as previously contended and as confirmed by later experience, it was reasonably possible to have gathered, by resort to estimate, sufficiently complete and accurate figures on undissipated actual and prudent investment. But even if such figures had been available, it is not at all certain that the situation would have permitted their direct use as a measure of the rate base. Even enthusiastic advocates of the investment doctrine are generally willing to check their claims for its adoption so far as retrospective valuation is concerned, and to press them only with respect to valuations for the future. This concession recognizes the consideration due to investors whose capital commitments were made in the past and for the character of whose interests and expectations the government's own regulatory policy may be largely responsible. Reproduction cost is far more acceptable as the main constituent of a compromise rate base for the past than it is as a measure of value upon which earnings are to be permitted for all time to come. Moreover, in view of the Supreme Court's repeated affirmance of the fair value rule, and in view of the express requirement of the statute that reproduction costs be ascertained, there appears to be almost no likelihood that primary valuations deliberately constructed on an original cost or investment basis would have received judicial approval. Under these circumstances, although hypothetical reproduction cost is defective in principle and almost certainly

*St. Louis & O'Fallon Ry. Co.*, 124 I.C.C. 3 (1927), in which the actual cost principle was applied in bringing valuations to date, the majority of the Commission, speaking through Commissioner Meyer, said (at p. 37): "In all probability they [the basic single-sum values] are above rather than below the amounts which would have resulted if complete records had been available and the investment theory of valuation had been employed."

unworkable as the basis of a continuing valuation program, it may well have commended itself to the Commission as the only fair, expedient, and generally acceptable standard for the purposes immediately at hand. So, too, with the Commission's treatment of land in the primary valuations. The considerations which support the incorporation of the reproduction cost of carrier structures also serve the cause of a market value measure for carrier lands. The unearned increment in the case of lands is the counterpart of the enhancement in value resulting from price advances in the case of physical structures. It is true, of course, that market value for lands does not correspond fully to reproduction cost for physical structures. Logical consistency would require the addition of condemnation or acquisition costs to market value. But since the strict application of the reproduction cost method to carrier lands would make that element enter into the value computations at even higher figures, the considerations justifying the Commission's use of the reproduction cost data at least support the use of present values for the land item. Whereas the use of reproduction costs for structures may be a gesture in favor of vested interests, the refusal to add hypothetical costs of condemnation or acquisition for lands may be regarded as a similar move in the direction of protecting the users of the service. But to the judgment allowances for intangibles—the residue of the single-sum values over and above depreciated reproduction costs plus value of lands and working capital—approval can not be so readily granted. Every contention which the Commission brought to bear against specific allowances may be advanced with equal force against such consideration as results in fact in substantial additions to the rate base. If costs of assembling the plant, expenditures incurred in establishing the business, early losses, and realized earning power are expressly rejected, of what other factors is the Commission's consideration to take cognizance? On what stuff was its judgment as to other values to be exercised?<sup>804</sup> If it be argued that past investors anticipated the privilege of earning on the basis of such intangible values, the Com-

<sup>804</sup> In his dissenting opinion in *Atchison, Topeka & Santa Fe Ry. Co.*, 127 I.C.C. 1 (1927), Commissioner Eastman made the following pertinent comment (at p. 100): "In the case of the Santa Fe proper, the cost of reproduction less depreciation, i.e., the cost of reproduction of the property in existence on valuation date, is found to be

mission's own disposition of specific allowances constitutes a sufficient answer, since by far the most persuasive of the claims for the specific inclusion of other values were of the vested interest type. Yet this defect is scarcely a vital stricture on the Commission's performance: the absolute amounts involved, though considerable, are not staggering; and they comprehend a large diversity of residual items. On the whole, then, the primary valuations clearly merit acceptance. One cannot but commend the realistic manner in which, from the bare beginnings of March 1, 1913, the Commission has mastered and executed the stupendous task then thrust upon it. From the mites and threads of valuation detail involving hundreds of carriers in every corner of the country, a gigantic mass of data has been assembled and analyzed, and from this underlying material primary single-sum values have been evolved which, upon proper revision, should provide fair and workable figures for regulatory purposes. The Commission's vast undertaking has been largely accomplished, and the results, despite inevitable opposition and protest, will increasingly serve to mold the course of regulatory policy.<sup>805</sup>

#### §6. THE REVISION OF PRIMARY VALUATIONS

But for effective use in the current regulatory process, these single-sum values must be brought up to date; which leads us to a consideration of the problem of revision of the primary valuations. In this aspect of the Commission's project, the controlling circumstances appear to differ materially from those surrounding the initial determi-

\$314,008,244. The present value of lands is found to be \$49,210,377, and the allowance for working capital is \$12,360,000. The total of these items is \$375,578,621, or \$21,781,379 less than the final value found. How this \$21,781,379 is to be accounted for I am unable from the opinion of the majority to determine." See, also, to the same effect, his dissenting opinion in *Great Northern Ry. Co.*, 133 I.C.C. 1, 142 (1927).

<sup>805</sup> Compare the following, for example, which appeared justified long before the primary valuations were completed: "The contemplation is undoubtedly that the future valuations will in fact be the sum of the 'final value' and amounts which are, under accounting rules, properly added to capital account. . . . Such totals will really be heterogeneous totals—but the whole valuation, let it again be emphasized, is to be judged, not by standards of statistical accuracy, but by results. A rapt attention to a demonstration of the inconsistencies of the Valuation Act is liable to leave the critic in the position of those, who, in the Sixteenth Century, demonstrated the flatness of the earth while adventurous spirits were actually sailing toward the West to reach the East." H. B. Vanderblue and K. F. Burgess, *op. cit.*, p. 352.



nation of single-sum values. In fixing upon a policy of revision, the Commission is dealing with the present and the future; and accurate data, particularly as to cost and investment, are fully available. The situation becomes transformed, it would seem, into one requiring that scant heed be given to factors rooted in the past; principles and practices may be directed, in the main, to the demands of effective and expedient regulation as an original matter. The need of equitable treatment for investors is necessarily involved, of course, in any valuation task; but valuation for the future differs from retrospective valuation in that equity, in a forward-looking procedure, tends to become merged with other relevant factors, whereas, in an appraisal directed solely to past capital commitments, it tends to subordinate other considerations, however persuasive, to the dominance of its influence. The passage of the Valuation Act was a highly significant development. Since March 1, 1913, persons committing capital to the railroad industry have done so with the opportunity for knowledge that an authoritative valuation was in progress—a valuation which, when completed, would serve as the basis of regulatory policy. For the future, expectations were to be grounded in property valuations; and the task of making these property valuations, in the light of the demands of the regulative process, was delegated to the Commission, subject to such limitations only as the courts might impose.

The *O'Fallon* case, the first proceeding which dealt with the problem of revision of single-sum values, involved, curiously enough, not the matter of adjusting one of the Commission's regular primary valuations for possible use when occasion should arise, but rather the dual process of fixing a basic valuation as of June 30, 1919, and then revising this for annual periods thereafter for immediate use in administering the recapture provisions of the Transportation Act.<sup>306</sup> When this proceeding was instituted, no valuation of that carrier's

<sup>306</sup> *Excess Income of St. Louis & O'Fallon Ry. Co.*, 124 I.C.C. 3 (1927). The Commission expressly pointed out the differences of approach noted above in the two aspects of its task, with special reference to the influence of available data. First, it expressed a leaning toward the investment principle as a general standard for the determination of the rate base: "A system of valuation for rate-making purposes based on actual, legitimate investment would have many appealing features. By reason of the replacements of units of railroad property which are continually taking place, such a system would tend to adjust itself to changes in the general price level. But this tendency would be manifested so gradually and slowly that changes in rates necessi-

properties had been made. The carrier protested that hearings for purposes of recapture of earnings, in advance of such definite determination of property values, were premature and without legal authority; but the Commission held that to delay the operation of the recapture provisions until valuations and revisions under section 19a had been made for each of the years in which individual carriers might be subject to recapture, "would most certainly defeat the purpose of such provisions."<sup>807</sup> The Commission found that the valuations, whether under section 19a or in furtherance of the recapture clause, were alike designed to serve rate-making purposes, the sole point of difference being one of procedure—that valuations for recapture "might be made in a more summary manner than valuations under section 19a."<sup>808</sup> Accordingly, hearings were held, and along with other testimony of the characteristic sort, there were introduced the underlying accounting, engineering, and land reports prepared by the Bureau of Valuation in connection with the regular section 19a investigation then in progress. The original cost to date of the property as a whole could not be ascertained; nor, because of missing records, could a satisfactory analysis of the road and equipment investment account be made. The reproduction cost new of road, equipment, and general expenditures, not including land, was stated as \$927,884; the reproduction cost less depreciation for the same items was stated as \$678,506. The property covered by these figures was that inventoried as of June

tated by value changes could be made without violence or disruption to business or any other interests. Such a system would also recognize and protect every dollar invested in railroad property, whether at high prices or at low prices" (pp. 36-37). It then directed attention to the obstacles, because of lack of reliable data, to the application of such a standard in its primary valuations, and to its freedom from such obstacles in the process of revision: "But there are practical difficulties in the way of the adoption of such a system. As we have already pointed out, there is an almost complete lack prior to 1907 of the definite and dependable records which would be essential. In reality, the valuation problem is divided into two parts, which can be quite clearly distinguished, and the date when our valuation work under section 19a began marks roughly the division line between these two parts. Since that date we have required the carriers to report in detail all property changes and their costs, and these costs can be verified and checked. In the case of all property which came into existence prior to that date we have an inventory made by our own engineers, but no complete, reliable information as to original costs. The first part of our problem, therefore, is to determine upon a fair single-sum value for this older property. The second part of our problem is to bring this value down to any subsequent date, in the light of the property changes since our valuation work began, of which we have complete reports" (p. 37).

<sup>807</sup> *Ibid.*, pp. 7, 19.

<sup>808</sup> *Ibid.*, p. 8.

30, 1919, and the usual 1914 unit prices were applied. For purposes of adjusting these figures to valuation date, it was found that "the actual cost of items included in the inventory, installed between July 1, 1914, and June 30, 1919, exceeded by \$38,843.12 the amount of the estimated reproduction cost new of such items."<sup>809</sup> The value of lands, as of June 30, 1919, was taken as \$50,500; and working capital was included at \$50,000. The sum of the figures for reproduction cost less depreciation, for excess actual cost of the items installed between July 1, 1914, and June 30, 1919, for lands, and for working capital was \$817,849.12. No question was raised as to the accuracy of the basic figures.<sup>810</sup> Weighing the figures "in the light of these considerations, and the entire record, and viewing the carrier as a common carrier in successful operation and with an established business," the Commission concluded "that the value for rate-making purposes of the entire common carrier property of the O'Fallon on June 30, 1919, was \$850,500."<sup>811</sup> The innovation of this finding lay in the method adopted for removing the discrepancy which exists in the valuations of all carriers whose valuation dates are later than June 30, 1914. This discrepancy arose in the case of a carrier valued as of June 30, 1919, as here, from the fact that lands were appraised as of June 30, 1919, while structures, although inventoried as of that date, were accorded unit prices as of June 30, 1914. In more than 400 reports the Commission had promised that "this discrepancy will be removed when the commission adjusts to later dates, in accordance with the requirements of the Valuation Act, the final value herein reported."<sup>812</sup> The discrepancy was here removed, not by applying unit prices as of

<sup>809</sup> *Ibid.*, p. 40.

<sup>810</sup> "This record," said the Commission, "does not contain any evidence questioning the accuracy of the detailed inventory of 1919, made in the field by our engineers, nor disputing the adequacy of the 1914 unit prices. In the 1919 reproduction cost new and less depreciation schedules are included as overheads such general expenditures incident to construction as expenses of organization, general officers, law, stationery, printing, taxes on structures and interest during construction, which, together with construction engineering, also included, aggregate 5.5 per cent of the total costs of reproduction less depreciation estimates. The inventoried quantities include large amounts added during operation, as a part of maintenance, which under a different method of valuation might be regarded as coming under the head of costs of appreciation." *Ibid.*, p. 40.

<sup>811</sup> *Ibid.* For the regular "section 19a" valuation of the O'Fallon, see *St. Louis & O'Fallon Ry. Co.*, 125 I.C.C. 821 (1926).

<sup>812</sup> *Excess Income of St. Louis & O'Fallon Ry. Co.*, 124 I.C.C. 3 (1927), p. 38.

valuation date (June 30, 1919), but by taking into consideration the excess of amounts actually paid for items of property installed between June 30, 1914, and June 30, 1919, over the reproduction cost of these items at 1914 prices. The rate base, as thus constructed, was of heterogeneous composition: lands were taken at 1919 market value; structures in existence in 1914 were entered at 1914 reproduction cost and the remainder at actual cost; allowance was made for working capital; consideration was given to the established business; and judgment was exercised over all. The procedure will be recognized, however, as a repudiation of the reproduction cost doctrine in its application to structures for any period beyond 1914; it foreshadowed the decision as to the method of revising the Commission's primary valuations.

And what of the method of revision—for determining the value of the property of the O'Fallon as of December 31, 1920, 1921, 1922, and 1923, the end of each of the recapture periods under consideration? The method which the Commission found "logical and proper for determining the value in the subsequent recapture periods is to add to or subtract from the 1919 value the net increases or decreases in the investment in property devoted to transportation service as determined from the carrier's returns to valuation order No. 3, with due regard to the element of depreciation."<sup>813</sup> It had declared earlier, as a groundwork for this specific conclusion, that in revising the basic valuations "no good reason appears for doing more than making the necessary adjustments to reflect the property changes which have since occurred and which have been fully reported to us, and to reflect any further depreciation of the property."<sup>814</sup> Application of this method in the instant proceeding produced the following results. For the ten months ended December 31, 1920, the value was found to be \$856,065. This amount was composed of the basic 1919 value of \$850,500, plus the sum of \$4,133 which had been found to be the net cost of additions and betterments less retirements during the period from July 1, 1919, to February 29, 1920, plus the further sum of \$1,432 which had been found to be the average net cost of property added during the period of ten months extending from March 1, 1920, to

<sup>813</sup> *Ibid.*, p. 42.

<sup>814</sup> *Ibid.*, p. 38.

December 31, 1920. For the calendar year 1921 the value was found to be \$875,360. This amount was composed of the sum of \$856,065 which had been fixed as the value for the ten months ended December 31, 1920, plus the sum of \$9,237, "which is the difference between the average net costs of property added during these 10 months and the total amount thereof which remained as an investment in the property on December 31, 1920," plus the further sum of \$9,968 which was found to be the average net cost of property added during the year 1921. By the same method the value for the year 1922 was fixed at \$978,874, and for the year 1923 at \$978,246.<sup>815</sup> Carrier lands were taken at their market value—not only in the basic valuation as of June 30, 1919, but for all subsequent periods.<sup>816</sup> The Commission, in describing for Congress the method pursued in this proceeding, spoke of adding to the basic 1919 value, less land and working capital, "the actual net cost of property installed between June 30, 1919, and each of the recapture periods, and amounts representing the present value of lands and working capital for each period."<sup>817</sup> It thus appears once more that a rather heterogeneous and all-embracing valuation procedure—involving an admixture of market value, reproduction cost, and investment elements—was employed. The procedure was of such character, however, that through the gradual retirement of items of property installed prior to 1914, it would come in time to measure the value of structures—by far the major item in all appraisals—by actual net investment; and these findings would be supplemented by current market values for lands, reasonable allowances for working capital, and, possibly, a residue of the original consideration given to intangibles or other values.

The Commission's determination in the *O'Fallon* case unquestionably constituted the high-water mark of its valuation project, despite the subsequent reversal by the Supreme Court. As an acceptance, for the most part, and at least for the future, of the actual investment principle—thereby reducing the tasks of "valuation" largely to a process of bookkeeping—it was outstanding among authoritative determinations in this field. The element of investment, chiefly in the

<sup>815</sup> *Ibid.*, pp. 42-43.

<sup>816</sup> *Ibid.*, pp. 23, 42-43.

<sup>817</sup> *Annual Report*, 1927, pp. 76-77.

form of original cost of the property, had always been included among the relevant facts to be considered, though it was generally subordinated to other factors. Students of valuation had long sought to elevate investment to a position of dominance in the determination of the rate base; but authoritatively, despite the growing dissatisfaction with the vagaries of the reproduction cost theory, there had been no marked trend in the direction of according exclusive or even controlling weight to actual capital commitments.<sup>318</sup> The Supreme Court, in any event, appeared to have definitely declined to substitute the "prudent investment" doctrine for the "fair value" rule. Under these circumstances, although the Commission's position was foreshadowed by prior collateral holdings, its acceptance of actual investment as the single consideration to be given effective weight in revising the primary valuations of carrier structures for the purposes of executing the provisions of the Transportation Act came as a rather startling development. An appraisal of this phase of the valuation project must first examine the reasons advanced by the Commission itself in support of its decision.

It is well to bear in mind that the Commission recognized the *O'Fallon* proceeding as a test case. It declared that "what we do in this case we must in principle do for all the railroads in the United States," and that "having in mind, as we must, the whole railroad situation, the decision is of the greatest consequence from both private

<sup>318</sup> But compare the following from the separate opinion of Justice Brandeis in *S. W. Tel. Co. v. Pub. Serv. Comm.*, 262 U.S. 276 (1923), at pp. 301-302: "The conviction is widespread that a sound conclusion as to the actual value of a utility is not to be reached by a meticulous study of conflicting estimates of the cost of reproducing new the congeries of old machinery and equipment, called the plant, and the still more fanciful estimates concerning the value of the intangible elements of an established business. Many commissions, like that of Massachusetts, have declared recently that 'capital honestly and prudently invested' must, under normal conditions, be taken as the controlling factor in fixing the basis for computing fair and reasonable rates." Examine also, in note 61 to the above, the analysis by the learned Justice of 363 cases in the Public Utility Reports for 1920, 1921, 1922, and 1923 (to March 1), in which questions of value were determined. His general conclusion as to these cases was as follows: "Reproduction cost at unit prices prevailing at the date of valuation appears to have been the predominant element in fixing the rate base in only 5. In 63 the commission severely criticized, or expressly repudiated, this measure of value. In nearly all of the 363 cases, except 5, the commission either refused to pay heed to this factor as the measure of value, or indeed as evidence of any great weight." See, also, Edwin C. Goddard, "The Evolution of Cost of Reproduction as the Rate Base," *Harvard Law Review*, vol. 41 (March, 1928), at p. 574.

and public viewpoints.<sup>819</sup> The Commission felt, furthermore, that the situation was so novel in character as to justify a reëxamination and possibly a substantial modification of the traditional valuation principles which had been worked out in the multitude of commission and court cases relating for the most part to local utilities. "It may well be," was its frank announcement, "that the valuation of railroads on a national scale requires the beginning of a new chapter in valuation."<sup>820</sup> The Commission's argument, thorough and well reasoned, was couched almost exclusively in pragmatic terms. That permitting reproduction cost to determine the rate base would produce undesirable practical effects upon the primary interests involved—upon the national transportation system, upon the industrial structure of the country, upon the regulative process itself—was the dominant note of its attack upon the claims of the carriers and the controlling impetus of its sponsorship of the investment principle. The Commission's point of departure was a telling critique of the current reproduction cost doctrine being urged upon it. "This insistence upon cost of reproduction new at current prices to the exclusion of everything else, at least of everything that might tend to a lower value, calls for the closest scrutiny," said the Commission, particularly in view of "the price revolution" which had taken place since the World War.<sup>821</sup> Specifically, the Commission argued: first, that the use of the reproduction cost method is attended by serious practical difficulties; second, that it would occasion extreme fluctuations in rates, to the decided detriment of the transportation system and the users of the service; third, that the actual course of events disclosed both the absence of need, and the impracticability, of inflating the rate base above the levels which had been applied since the beginning of the war period; and fourth, that the benefits of current reproduction costs, by accruing primarily to the holders of common stock, would serve principally to stimulate speculative activity. It is necessary, now, to note briefly the Commission's analysis of each of these considerations.

(1) By way of introduction, and merely as "an incidental objec-

<sup>819</sup> *Excess Income of St. Louis & O'Fallon Ry. Co.*, 124 I.C.C. 3 (1927), at p. 26.

<sup>820</sup> *Ibid.*, p. 27.

<sup>821</sup> *Ibid.*, pp. 28-29.

tion to the use of current cost of reproduction as the basic measure of 'fair value,' the Commission directed attention to the unreliability of such reproduction cost estimates. It was conceded that the method had been used in the past, but largely because no alternative was available. Because "railroads and public utilities, so far as they were constructed in the last century, and to some extent in the early years of this century, were in general built and financed and administered in such a way that no dependable record was kept of either what they should have cost or what they actually did cost . . . it was natural that cost of reproduction should come into use as an important factor in determining a reasonable rate base."<sup>822</sup> But not only is the reproduction hypothesis speculative and laden with uncertainty, but serious practical difficulties are inevitably encountered, because of a dearth of reliable data from which accurate estimates may be made. This is particularly true of any short period of time. The character of the record in the instant proceeding provided a convincing illustration. An attempt was made to estimate reproduction costs for the period of 1920 to 1923, inclusive. But there had been very little new railroad construction in these years, so that the witnesses, both for the carrier and for the bureau, were forced to rely "in large part upon manufacturers' records and price statistics appearing in various publications, and to a lesser extent upon cost of construction actually incurred by railroads in that period."<sup>823</sup> Synthetic estimates of reconstruction costs derived from statistics of price and wage changes fail to make allowance for improved methods of building and assembly. The Commission had found that between 1900 and 1914 improvements in the art of construction had largely offset the increase in the cost of labor and materials during those years; how far a similar offset had developed between 1920 and 1923 was not disclosed by the record.<sup>824</sup>

<sup>822</sup> *Ibid.*, p. 29. "In the absence of complete and reliable records," continued the Commission, "it was regarded, in a period of gradually rising prices, as providing a rate base amply remunerative to the private owners, for there was reason to believe that it was at least somewhat in excess of the original outlay."

<sup>823</sup> *Ibid.*

<sup>824</sup> In applying these considerations to the specific record before it, the Commission declared that "even if the cost of reproduction new in 1920 were to be regarded as a controlling element there is not in the present record evidence showing what it might have cost to reproduce the property of the O'Fallon at that time." "The only evidence



(2) Passing on to its chief contention from the standpoint of policy-governing principle, the Commission found the current reproduction cost doctrine seriously defective as a matter of policy. Rate regulation necessarily involves limitations upon private rights; the only requirement is that these limitations be not confiscatory. But the constitutional prohibitions do not define confiscation; "what is just and in harmony with sound public policy," as conceived by the Supreme Court, constitutes, ultimately, the controlling factor. "Nor is there any abstract standard of justice that can be applied. The question in many aspects is one of fact, and the answer, if it is to be wise and sound, requires knowledge of actual conditions and a consideration of practical results."<sup>825</sup> The objective of the regulatory process, particularly in the matter of income control of which the task of valuation is a part, is the maintenance of an adequate national system of railroad transportation. The maintenance of such a system requires a continuous inflow of capital; and, under private ownership, assurance that this inflow of capital will be forthcoming must rest in a policy of so treating the capital already committed to the public service as "to invite and encourage further investment." Under such treatment there can be no confiscation. Nor is there justification for a regulatory policy "which is to any considerable degree more liberal to the private owners than is necessary to maintain good credit under reasonably prudent, economical, and efficient management."<sup>826</sup> With

in this respect," it continued, "is that of the relation of general prices in 1914 and in 1920 and the other recapture years. Costs of railroad building, owing to improvements in methods and economies thereby effected, did not vary greatly during the period of 20 years preceding 1914, although the prices of labor and material fluctuated. There is no testimony here as to how much it cost to build any railroad or any substantial part of one in any of the recapture periods, and for that reason it is impossible to make a comparison of such costs in the two periods. It is not safe to assume, as the O'Fallon has assumed, that costs of building railroads have varied in recent years in direct ratio to the variation in costs of commodities in general use, or in the costs of materials or labor generally." *Ibid.*, p. 41.

<sup>825</sup> *Ibid.*, p. 30.

<sup>826</sup> *Ibid.* The Commission recalled the fact that, along with the "fair value" rule, Justice Harlan had also enunciated the following doctrine in *Smyth v. Ames*, 169 U.S. 466 (1898), at p. 544: "A railroad is a public highway, and none the less so because constructed and maintained through the agency of a corporation deriving its existence and powers from the State. Such a corporation was created for public purposes. It performs a function of the State. Its authority to exercise the right of eminent domain and to charge tolls was given primarily for the benefit of the public." Furthermore, and as bearing more directly upon its contention that railroads are not entitled to any

these ends in view, the Commission declared that "plainly stability of income and return is a prime requisite"; which, in turn, necessitates stability in the rate base. As to income and return: "To say nothing of the disastrous effect upon the business and commercial world, violent fluctuations from heights of prosperity to depths of poverty are railroad conditions utterly inconsistent with the necessary attraction of private capital"; and as to the rate base: "If it is permitted to fluctuate with each change in general price level, and if rates must be adjusted accordingly, there can be no promise of a stable return to investors."<sup>827</sup> But these sharp variations, with their deleterious effect upon credit, would necessarily follow the adoption of current reproduction costs as the measure of the rate base—"wide and frequent fluctuations both up and down are inevitable."<sup>828</sup> For purposes of illustration, the Commission pointed out the range and frequency of the fluctuations that would thus ensue, both for the O'Fallon and for the railroad system as a whole. In case of the O'Fallon, using the bureau's price ratios, as compared with the 1914 level, of 230 for 1920, of 195 for 1921, of 157 for 1922, and of 174 for 1923, the increases and decreases in the elements of rates and charges attributable to return on capital would have been as follows: an increase of 114.64 per cent in 1920; a decrease of 14.38 per cent in 1921; a further decrease of 18.23 per cent in 1922; an increase of 9.98 per cent in 1923. And turning to the effect of applying the current reproduction cost doctrine to the property of the railroads as a whole, the Commission, taking 18 billions as the basic value of carrier structures at 1914 unit prices, as of June 30, 1919, and applying the bureau's ratios thereto, found that "the value of precisely the same structures would have become 41.4 billions in 1920, 35.1 billions in 1921, 28.3 billions in 1922, and 31.3 billions in 1923."<sup>829</sup> Even in a static property, therefore, immense increases and decreases in the rate base would necessarily have

higher returns than are necessary to maintain good credit, the Commission quoted the following pronouncement of Chief Justice Taft in *Dayton-Goose Creek Ry. v. U.S.*, 263 U.S. 456 (1924), at p. 481: "By investment in a business dedicated to the public service the owner must recognize that, as compared with investment in private business, he cannot expect either high or speculative dividends but that his obligation limits him to only fair or reasonable profit."

<sup>827</sup> *Excess Income of St. Louis & O'Fallon Ry. Co.*, *supra*, p. 30.

<sup>828</sup> *Ibid.*, p. 31.

<sup>829</sup> *Ibid.*, p. 32.

followed: an increase of 23.4 billions in 1920; a decrease of 6.3 billions in 1921; a further decrease of 6.8 billions in 1922; an increase of 3 billions in 1923. "These huge 'profits' and 'losses' would have occurred," said the Commission, "without change in the railroad property used in the public service other than the theoretical and speculative change derived from a shifting of general price levels. To put it still more graphically, by the application of the current reproduction cost doctrine the assumed base of 18 billions would have been increased in 1920 by a sum greater than the present national debt (about 19 billions), and the transportation burden upon the people of the country would have been correspondingly increased without the investment of a single dollar by those who would reap the benefits."<sup>880</sup> But railroad property is in fact not static. Between the years 1920 and 1926, inclusive, for example, an approximate net investment of 4 billions was made in additions, betterments, and new construction. These accretions to carrier property were paid for at prices current at time of acquisition—prices which all exceeded, and some in very great measure, the prices prevailing at the time of this proceeding. Upon the assumption of an average decline of 25 per cent in unit prices, "a valuation under the current reproduction cost doctrine would wipe out one billion of that additional investment."<sup>881</sup> Reliance upon changing prices in the establishment of the rate base might thus prove directly harmful to the investor as well as to the user of the service.<sup>882</sup>

<sup>880</sup> *Ibid.*

<sup>881</sup> *Ibid.* The Commission applied this analysis, concretely, to the case of the O'Fallon: "The fallacy of basing reproduction cost upon price curves or ratios is clearly indicated by the tabulations introduced by the carrier. As we have shown, a witness for the carrier developed reproduction costs for the several recapture periods by the use of ratios, using as a base the cost of reproduction new resulting from application of 1914 prices to the inventory as shown in the underlying engineering report. By this method he developed for the O'Fallon a reproduction cost of road and equipment, not including land, of \$2,112,708 for the period ended December 31, 1920. For the period ended December 31, 1922, this method developed for the same property, to which had been added in the meantime net additions and betterments of \$125,156, a reproduction cost of \$1,471,026, or a decrease of slightly more than 30 per cent in the value base in a period of tremendous national prosperity during which the business of the railroads of the country reached new records for volume, with marked increases in net revenue from railway operations." *Ibid.*, p. 41.

<sup>882</sup> Compare the following from the opinion of Justice Brandeis in *S. W. Tel. Co. v. Pub. Serv. Comm.*, 262 U.S. 276 (1923), at pp. 302-304: "To require that reproduc-

(3) From a consideration, as above, of the consequences that inhere in the adoption of the current reproduction cost doctrine, the Commission passed to a survey of the actual course of events, in order to determine the need of the higher values contended for under this doctrine and the practicability of applying them. During the period of Federal Control, it was recalled, the owners of the railroads were paid a rental for the use of their properties based upon the average net railway operating income for the three years ending June 30, 1917—a rental which proved generally satisfactory to the carriers, but which was determined “without regard to the rapidly mounting general price level.” In 1920, upon the return of the roads to their private owners, the general rate increases authorized were computed on an aggregate figure, as a base, which was below that representing the recorded investment for which the carriers contended; no claim was made for a rate base reflecting “the current price level,” and the increases authorized were accepted “without complaint.” In the general reduction in rates required by the Commission in 1922, the value figures used were similar to those employed in 1920, and “this reduction was not contested by the carriers.” And in 1926, when a general rate increase proposed by the roads in the western district was denied by the Commission, the carriers “asked only that their aggregate recorded investment in road and equipment and working capital be used as a base,” conceding “that traffic probably could not bear rates based on any higher amount.”<sup>888</sup> “It appears, therefore,” concluded the Commission, “that since the price revolution brought about by the World War, the railroads have not had nor have they sought returns based upon ‘values’ swollen in harmony with the rise in general price

tion cost at the date of the rate hearing be given weight in fixing the rate base may subject investors to heavy losses when the high war and post-war price levels pass—and the price trend is again downward. The aggregate of the investments which have already been made at high costs since 1914, and of those which will be made before prices and costs can fall heavily, may soon exceed by far the depreciated value of all the public utility investments made theretofore at relatively low cost. For it must be borne in mind that depreciation is an annual charge. That accrued on plants constructed in the long years prior to 1914 is much larger than that accruing on the properties installed in the shorter period since.” See, also, notes 63 and 64 to the above, in which the probable behavior of prices, in the light of past experience, was analyzed, and in which the course of investment at the then prevailing high price level was indicated.

<sup>888</sup> *Excess Income of St. Louis & O'Fallon Ry. Co.*, *supra*, pp. 32-33, 33.

level."<sup>384</sup> They even failed, on the average, to earn the fair return which the rates fixed as above were designed to yield. They were disinclined, despite this circumstance, to seek further general advances in rates because of a realization "that to do so would be to risk conflict with inexorable economic conditions."<sup>385</sup> The Commission then proceeded to set forth the results, with special reference to the credit standing of the carriers, which flowed from this state of facts. Between 1920 and 1926, inclusive, railroad investment, derived in substantial part from earnings, had increased by \$4,000,000,000; the market for railroad securities had steadily improved, with a downward trend in interest rates; the credit of the carriers had been so rehabilitated that new financing through stock issues was becoming feasible; though the trend of general prices had been downward since 1920, the trend of railroad securities had been decidedly upward, with a very great enhancement of their aggregate market values. Such a showing, it was submitted, could not reasonably be construed as involving confiscation; yet the conclusion that confiscation existed, even in case of some of the most prosperous carriers, could not be avoided if the claims for inflated values, in terms of the reproduction cost theory, were recognized as valid.<sup>386</sup> And these claims were being pressed, in face of the generally admitted inability of the traffic to bear charges based on such values. In the words of the Commission: "If it had been applied in 1920, the current reproduction cost doctrine would have required general increases in rates very much higher than those which we authorized. The latter ranged from 25 to 40 per cent.

<sup>384</sup> *Ibid.*, p. 33.

<sup>385</sup> *Ibid.*

<sup>386</sup> Commissioner Eastman, in his separate concurring opinion, directed attention to the income that would remain with the carrier after recapture, "lest there be any possible impression that the O'Fallon has been treated harshly in this proceeding." Such remaining income, for the three full recapture years, would constitute the following percentages of the amount found to be the "fair value" of the property: 13.44 per cent for 1921; 11.43 per cent for 1922; and 11.64 per cent for 1923. "Bear in mind," he declared, "that the fair value represents a maximum estimate of every dollar that has gone into the property less a probably inadequate deduction for depreciation. The remaining income in each of these years . . . would have permitted, after the accumulation of the reserve fund provided for in section 15a, the payment of interest on all indebtedness and the declaration of dividends on the outstanding stock of 24 per cent in 1921, 21 per cent in 1922, and 23 per cent in 1923. Of the \$410,000 of stock outstanding, \$260,000 represents the equivalent of a stock dividend declared in 1917. Is this confiscation?" *Ibid.*, p. 57.

It is quite conceivable that with the then current reproduction cost as the rate base increases of from 75 to 90 per cent might have been necessary. Neither the country nor the carriers could have endured such a rise in freight charges. Even now, when the general price level is materially lower than it was in 1920, a rate base so determined would in all probability require rates which the carriers would as a matter of self-interest hesitate to charge. . . . This amounts to saying that under such a doctrine of fair value the carriers would as a matter of self-interest choose confiscation. Plainly a doctrine which leads to such a conclusion is irrational."<sup>887</sup>

(4) Finally, as a further practical consequence of the adoption of the current reproduction cost doctrine, the Commission emphasized the familiar fact that the gains and losses resulting from changing price levels would accrue, in greatly magnified measure, primarily to the common shareholders, and would thus operate as a stimulant to unrestrained speculation in the securities markets. The acceptance of current reproduction costs was being increasingly urged as a means of affording compensation, under rising prices, for the decline in purchasing power of the monetary unit. But who would reap the benefit of thus making allowance for the depreciated dollar? About one-third of railroad investment is represented by common stocks, the income of which is contingent upon earnings; the remainder is represented by bonds and other securities which carry a fixed income return, as a maximum, regardless of the amount of carrier earnings. It is apparent, therefore, that the benefits of any increase in valuation resulting from a general rise in the price level "would be reaped three-fold by the holders of common stock"; and that under the very high level of prices then prevailing, the result, assuming that the traffic would bear the necessary increases in charges, "would involve returns to the common-stock holders grotesque in their proportions, and particularly grotesque when considered as the limit below which confiscation would ensue."<sup>888</sup> Nor, contended the Commission, would

<sup>887</sup> *Ibid.*, p. 34. See, also, on the general matter of the fairness of the Commission's valuations to existing investors, James C. Bonbright, "Railroad Valuation with Special Reference to the O'Fallon Decision," *American Economic Review*, vol. 18 (March, 1928, Supplement), at pp. 198-205.

<sup>888</sup> *Ibid.*, p. 35. Compare the following concrete illustration as applied to the field of local utilities: "If a plant had been built in times of low costs, at \$1,000,000, and

corresponding losses, as an offset, necessarily be suffered by the common shareholders in the event of a declining price level. As a practical matter, the need of maintaining an adequate transportation system would serve as an effective check, regardless of the matter of theoretical consistency, upon permitting stockholders to suffer such losses as would impair railroad credit, to the serious detriment of the entire industrial structure. Experience has demonstrated that the general price level is never stable, and reliance upon its shifting currents would but intensify speculative activity in the securities markets. "The conception of a rate base and returns thereon fluctuating up and down with changes in the level of general prices is a conception which, if carried into actual operation, could have no appeal except to stock-market speculators. It would be difficult to conceive of any plan more conducive to the encouragement of unrestrained speculation in railroad shares than such a method of valuation. In all probability it would provide a feast superior to anything which the bulls and bears have enjoyed since the creation of stock exchanges."<sup>889</sup> In these circumstances, the Commission returned to its emphasis upon stability as the prime requisite, from the standpoint of investors as well as of the users of the transportation service. By way of summarizing its attack upon the current reproduction cost doctrine, the Commission concluded: "There is nothing more disturbing to commerce and industry than the prospect of frequent and abrupt shifts in the general freight rate level; and there is nothing more disturbing to investors, as distinguished from speculators, than the prospect of frequent and wide shifts in security values. Public regulation of railroads, if it is to be successful, must rest upon a firm foundation and be guided by principles which will lend confidence to industry and investment. The current reproduction cost theory of 'fair value' is

the capital had been raised to the extent of \$750,000 by an issue at par of 5 per cent. 30-year bonds and to the extent of \$250,000 by stock at par, and 10 years later the price level was 75 per cent. higher and the interest rates 8 per cent., it would be a fantastic result to hold that a rate was confiscatory, unless it yielded 8 per cent. on the then reproduction cost of \$1,750,000; for that would yield an income of \$140,000, which would give the bondholders \$37,500, and to the holders of the \$250,000 stock \$102,500, a return of 41 per cent. per annum." From the opinion of Justice Brandeis in *S. W. Tel. Co. v. Pub. Serv. Comm.*, 262 U.S. 276 (1923), at p. 305.

<sup>889</sup> *Excess Income of St. Louis & O'Fallon Ry. Co.*, *supra*, p. 35.

utterly inconsistent with this end, and in our judgment it is equally inconsistent with any sound conception of justice."<sup>840</sup>

From this analysis of unreliable estimates of current reproduction costs, sharp fluctuations in both rate base and charges, unnecessary and futile inflation of values, grotesque earnings for common shareholders, and orgies of speculation on the securities markets, the Commission turned to a more alluring picture, by way of positive justification for the methods it had employed. Much of the Commission's constructive case was implicit in its trenchant attack upon the claims of the carriers; it was but necessary to draw the threads together and articulate the rationale of its procedure. Basically, the Commission contended that the determination of the rate base must be guided by the realities which govern the development of the railroad system. There is a perpetual flow of new materials into the system; at any one moment it is the result of a great diversity of contributions, made at different times and under varying conditions. "Just as the water of the Mississippi at New Orleans is composed of waters from myriads of different sources," said Commissioner Meyer graphically, "so a railroad system is a composite of materials acquired at myriads of different prices and at infinitely varying periods of time, and put into the plant at many different levels of wages. Neither the highest price nor the lowest, nor the average, nor any price in between, represents the outlay made for the system. The only thing that does and can represent what the investor has contributed to the value of the property is the aggregate amount which was paid for the many different items in the perpetual stream of metamorphosing railroad structures."<sup>841</sup> A recognition of the realities of the situation, according to this view, would lead to the acceptance of the principle of actual investment in the establishment of the rate base. But the Commission was engaged in a severely practical task, rather than in a mere academic determination of guiding principles. The lack of reliable data as to original cost or past investment—that is, for the period preceding strict accounting control and the initiation of the valuation project—necessitated the fixing of primary valuations, as already described, in

<sup>840</sup> *Ibid.*, pp. 35-36.

<sup>841</sup> *Ibid.*, p. 36.



reliance upon a great variety of relevant facts; but full and accurate data were available as to the actual experience of the carriers in the matter of capital commitments since 1914, and no good reason appeared, in bringing these primary valuations to date, for going further than to make such adjustments, in terms of recorded investment, as would reflect the property changes that had occurred in the interim. "By the adoption of such a method of bringing values down to date," said the Commission, "we shall achieve the stability of rate base which we have found to be essential to a wise and just plan of public regulation. The method has the further advantages, also, that it is simple and easy of application and involves no great expense or delay and that its results are capable of reasonably accurate forecast. It insures fair treatment to the investor because a fair return will be secured for every dollar that has gone into the project, provided, of course, that traffic is available. Whatever the price level may be, however severe the fluctuations, this method will result in yielding a fair return on every dollar invested and remaining in the property. This is the greatest assurance that can be held out to prospective investors. No stronger inducements can be offered in fairness to all the interested parties."<sup>42</sup> Finally, recalled the Commission, the rate of return, as well as the rate base, is an integral constituent of the process of regulating earnings and of the constitutional protection against confiscatory action. The Commission is not only charged with the duty of allowing a fair return on the value of the property, and of determining from time to time what percentage of such value constitutes a fair return, but it is expressly directed to give due consideration "to the transportation needs of the country and the necessity (under honest, efficient, and economical management of existing transportation facilities) of enlarging such facilities in order to provide the people of the United States with adequate transportation." In other words, the Commission is under obligation, regardless of the rate base, to adjust earnings in such a way as will encourage investment and maintain credit. If this mandate is carried out by the Commission—and the substantive end involved can be accomplished more readily and more justly through direct modifications in the fair return allowed than through the indirect method of changing

<sup>42</sup> *Ibid.*, p. 38.

the basic value—confiscation cannot result. "The prime requisites for the rate base," the Commission emphasized once more by way of conclusion, "are stability, reliability, and relative ease of adjustment to property changes."<sup>348</sup>

The reasoning of the Commission has been set forth at length in order that it may speak very largely for itself. It is of the sort, essentially, which a responsible administrative tribunal, conscious of the obligations imposed upon it, would be expected to advance. In the controversy as between reproduction cost and actual investment as the controlling measure of the rate base, the Commission's conclusions appear to be sound, and they were supported, on the whole, by convincing considerations. One cannot but accord approval to the Commission's decision to speak out its mind on the question, regardless of the status of judicial authority. Both of its reasons for doing so are persuasive: valuation is essentially a technical matter, on which the Commission, as an expert body in constant touch with the realities of the situation, might well expect to influence if not to guide the courts; and the problem, in its national aspects, was essentially a novel one, in solving which the Commission was the natural agency to blaze the trail. But its discussion, running almost wholly in terms of the practical effects of alternative policies, probably served these general purposes less well than it did the immediate one of establishing the adequacy of the specific valuation at issue. Its reliance on pragmatic considerations, without elaborating the fundamentals in which they were grounded, and its failure to articulate fully the relationship between valuation and the larger ends of the regulatory process, are chiefly responsible for such shortcomings from a general standpoint as may be said to characterize the report.

The Commission declared that the ascertainment of reproduction

<sup>348</sup> *Ibid.*, p. 39. There were vigorous dissents from the majority decision. These dissents were of two kinds: those going to the merits of the alternative valuation principles, and those proceeding on the ground that the Commission had adopted a procedure contrary to the law of the land as laid down by the Supreme Court. The latter view was embraced in the separate dissenting expression of Commissioner Aitchison (p. 64); and it was the principal basis of the dissenting opinion of Commissioner Hall (pp. 59-64), concurred in by Commissioners Aitchison, Woodlock, and Taylor. Commissioner Woodlock, in a separate expression (pp. 64-66), found himself in fundamental disagreement with the majority's "main arguments of an economic nature"; and Commissioner Taylor, though his separate expression (pp. 66-69) is rather confused, also appeared to dissent on the merits. See, also, pp. 134-137, *supra*.

costs is beset with practical difficulties; but the difficulties it stressed, while sufficient to prevent a finding of value on the basis of current reproduction costs in the instant proceeding, did not go to the heart of the matter. The vitiating difficulties that inhere in the reproduction cost theory—the artificial character of the entire procedure, with its fanciful hypotheses and ridiculously detailed inventories, the bog of uncertainty that surrounds its results, the inevitable dilatoriness with which these results are achieved for use in a regulatory process that should be sensitively responsive to changing needs, the costliness of the methods involved, and the permanence of the required valuation tasks—were either entirely ignored or referred to only incidentally. Yet no authoritative body was ever in better position to emphasize these aspects of the reproduction cost doctrine; its experience with the primary valuations afforded testimony of the most potent sort. The Commission's argument from the standpoint of policy, moreover, while very telling in its practical implications, raised questions of principle which it would have done well to answer, or to eliminate as irrelevant to the valuation issue. Concern was expressed by the Commission over the frequent and wide fluctuations in both the rate base and the level of charges that would ensue upon the use of current reproduction costs, with attendant gains and losses to common shareholders. But are not these fluctuations part and parcel of our industrial and financial structure and experienced by all businesses? Again, if, as the Commission conceded, operating costs normally increase during periods of rising prices, why should capital costs be artificially restrained from rising, since it is often assumed that the investor furnishes the services of his capital currently, even though it was originally committed during periods of low prices? Further, it may be asked, are not the users of transportation service better able to pay high rates during periods when general prices are rising than to continue to pay the same rates during periods when general prices are falling? A similar question is raised by the contention that the current reproduction cost doctrine alone affords a means for drawing into the railroad industry the proper amount of capital, in view of the alternative outlets for its use, and thereby facilitates the most effective application of the community's productive resources. Would not protection of the actual investment, it may be

urged, tend artificially to stimulate capital commitments for railroad purposes during periods of falling prices, and correspondingly to restrict such commitments during periods of rising prices? While the disposition of these questions was implicit in the reasoning of the Commission's opinion,<sup>344</sup> failure to accord them express consideration might invite misgivings as to the fundamental validity of the Commission's position.<sup>345</sup>

Yet in part, at least, the Commission was justified in avoiding discussion of these larger issues, since they involve not merely the matter of determining the rate base, but the whole complex of considerations affecting the level of rates and earnings. In discussions of valuation there prevails a common tendency to identify unduly policies affecting the rate base with policies respecting transportation charges and financial returns; and there prevails a similar and related tendency to conceive these problems in terms too static to be realistic. In its very proper emphasis upon the importance of stability in the railroad industry, the Commission appears to have claimed too much in suggesting that the investment doctrine would lead, not only to stability of the rate base, but of rates and of income as well. When it is admitted, as it must be, that the rate of return upon the rate base is a coördinate factor in income control, and may be adjusted as conditions demand, the door is left open for fluctuations in financial return; and when it is further admitted, as it must be, that whatever the rate base, earnings must be adjusted with reference to the transportation needs of the country, the debate over valuation doctrine,

<sup>344</sup> For a more direct consideration of some of these issues, see Commissioner Eastman's separate concurring opinion, at pp. 49-59. See, also, his elaborate dissent in *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), at pp. 523-567.

<sup>345</sup> For able support of the current reproduction cost doctrine on economic grounds, with detailed consideration of the issues briefly raised above, see Frederic G. Dorety, "The Function of Reproduction Cost in Public Utility Valuation and Rate Making," *Harvard Law Review*, vol. 37 (December, 1923), pp. 173-200; and especially H. G. Brown, "Railroad Valuation and Rate Regulation," *Journal of Political Economy*, vol. 33 (October, 1925), pp. 505-530, vol. 34 (August, 1926), pp. 500-508, "Economic Basis and Limits of Public Utility Regulation," *Reports of American Bar Association*, vol. 53 (1928), pp. 717-737, "Present Costs," *Public Utilities Fortnightly*, March 7, 1929, pp. 237-246, and other publications by same author. For a critique of the views of Dorety and Brown, with special reference to the acceptance of reproduction costs as a device for maintaining rates at competitive price levels, see James C. Bonbright, "The Economic Merits of Original Cost and Reproduction Cost," *Harvard Law Review*, vol. 41 (March, 1928), at pp. 609-614.

from this standpoint, loses some of its seeming importance. The test of credit standing, by which the Commission demonstrated the adequacy of railroad earnings during the middle 1920's, unquestionably served to show the impropriety of such operating returns as the reproduction cost method of valuation might have indicated, but it served equally well to show the tenuous influence of any valuation policy upon the course of development. Had the immediate task in the *O'Fallon* case been the adjustment of rates and not the recapture of past earnings, with its greater possibility of confiscation and its obviously direct use of property value, the Commission might well have refrained from arguing the valuation issue. The looseness, as a practical matter, of the relationship between valuation and rate and income control becomes even more apparent when it is recognized that, under the immediate circumstances surrounding cases pressing for solution, dynamic rather than static considerations are chiefly operative. Under such conditions, and they are well illustrated by the developments of the depression, little merit attaches either to the argument that rates based on reproduction cost will vary with the ability of traffic to bear them, while earnings will conform to the competitive situation, or to the argument that regard for actual cost will provide an oasis of stability, with respect to both rates and earnings, amid the general economic uncertainty. Variations in the price level are commonly accompanied by even more pronounced variations in the physical volume of business and of traffic, as a result of which rates and income are likely to lose connection not only with any rate base but also with each other. With rising prices and increasing traffic, stationary rates, despite advances in operating expenses, may yield as great an increase in net return as the reproduction cost theory would require; and under the actual cost standard, if stability of rates is the chief end, the fuller utilization of facilities may cause income to mount to excessive levels, and if income is to be kept stable, rates may have to be lowered despite the general upward trend. Similarly, with falling prices and general recession in business, advances in rates burdening traffic inopportunely may be required in order to maintain stability of earnings under the actual cost standard, though such an attempt may be defeated by resulting additional declines in traffic; and under the reproduction cost theory no change in rates may be required in

order to produce the appropriately lowered income. In other words, the assumption of a direct and inevitable relationship between the operative rate base, the transportation charges to be imposed, and the earnings to be derived therefrom loses sight of the complex realities of the economic processes involved. Under the pressure of sharply fluctuating business conditions the major rate determinations are likely to be governed only in slight degree by the prevailing valuation doctrine, and the railroads are likely to attract much speculative interest even in the face of the stabilizing influence of regulation.

But despite these considerations the Commission would have done well to articulate its analysis in somewhat more fundamental terms. The controlling rationale of the reproduction cost theory, which is based upon price and income behavior in competitive industry, implies for the Commission a guiding objective from which it should, once and for all, be released. The very fact of public control of railroads, its long history, and the complex circumstances surrounding its exercise support the view that it should not be developed with sole regard to the tenets of competitive economics, in an effort to duplicate the results of competitive enterprise.<sup>346</sup> The price and income be-

<sup>346</sup> Compare the following: "The basic economic warrant for support of the cost of reproduction standard is found in the principles of competitive price determination. It is urged that the public must pay and the companies may properly demand a return on such capital costs as would have to be incurred by a new entrant into the field. Such a result, the contention runs, is automatically reached in competitive industry, and this result should be approximated in the railroad field through the regulative process. This reasoning, in the first place, would lead to the acceptance, as a rate base, of the cost of replacing the service rather than the cost of reproducing the identical plant. The difficulties involved in ascertaining such a replacement cost are well-nigh insurmountable. The outcome would be so highly speculative as to lose all practical utility. In the second place, it assumes the desirability of affording opportunities for differential competitive gains, through automatic appreciation of the rate base, in an industry which is largely monopolistic in fact, and in which there is increasing public protection against competitive pressure. There are doubtless possibilities that economic maladjustment may arise in isolated situations because of neglect of purely competitive forces; but these possibilities are largely negligible when we view the transportation system as a whole, in its present extensive and reasonably stabilized condition. Moreover, the prevailing system of regulation, taken in its entirety, clearly evinces the assumption of an affirmative public responsibility towards the carriers, and this responsibility involves at least a corresponding public duty towards the users of the service. Railroad regulation does not seek solely to duplicate the results which normally characterize competitive industry. There are also conscious public ends. One of these ends is to safeguard the industry against domination by the lure of speculative profits, with its demoralizing shifts from flagrant exploitation of the public and resulting over-extension of facilities to unconscionable restriction of the income of investors and con-

havior of ordinary businesses argues nothing of necessity as to what should be sought or allowed under regulated monopoly. The problem of railroad regulation is a problem in public policy, and its solution must be molded by considerations of policy. Policy should, of course, be grounded in principle; but it transcends any one principle or set of principles, economic or otherwise: it must coordinate all relevant considerations, with an eye to the conscious achievement of major public ends. It is obvious that no valuation practice can so embrace the manifold elements of regulatory policy, or so positively and directly point to action appropriate under specific circumstances, as to be self-sufficient; but as one of the tools of regulation it should be molded in the direction of greatest usefulness, and for this purpose the investment standard, as urged by the Commission, holds forth the

sequent impairment of plant and equipment. An approach to this positive goal of minimizing risk and uncertainty in the railroad field necessitates reasonable assurance of an adequate return upon prudent investment. Profits and losses are alike reduced. The rights of the parties are definitely determinable, whether in periods of rising prices or in periods of falling prices. Actual rather than hypothetical capital costs are controlling. The realities of each situation govern." I. L. Sharfman, "Valuation of Public Utilities," *American Economic Review*, vol. 18 (March, 1928, Supplement), at p. 208. Note, also, the following from James C. Bonbright, "The Economic Merits of Original Cost and Reproduction Cost," *supra*, at pp. 621-622: "In bringing to a close this discussion of the valuation problem, the point that should be stressed above all others is the folly of attempting to regulate the prices of public monopolies so that they will conform as closely as possible to the prices that are assumed to prevail under conditions of free competition. Overlooking the fact that the proposed imitation of competition is a very poor one, overlooking the fact that a governmental control of rates designed to yield a stated return on reproduction costs is not even a good caricature of the automatic control of prices that takes place in a dynamic competitive market, we must still recognize that the attempt to carry over into the field of the large-scale monopoly the same price system that is assumed to prevail in the field of the small competitive enterprise, is bound to result in a serious misfit. One reason why it is a misfit is that the competitive price system disregards so ruthlessly the financial needs of the individual producer. To the low-cost producer it yields profits far beyond the current rate of interest on invested capital; to the high-cost producer it brings deficits that spell bankruptcy and ruin. As long as competition is full and free this process, harsh though it be to the unfortunate producer, may serve very well the interests of the consumer. For what matters it to him that any one producer is crippled, so long as he can turn to a more fortunate rival for his necessary services and commodities? Not so under monopoly. Not so with a railway that is alone in serving a community. Why, say the defenders of reproduction cost, should railway security holders be given any greater insurance against the fluctuations of price levels than is given to the holders of securities in an unregulated enterprise? The answer is that when the investors in small competitive enterprises fall, they may fall alone, but when the holders of railway securities fall, they force the whole-community to become unwilling mourners of their downfall."

more abundant promise. Rail transportation is an essential service, both in the aggregate and in the instance of each individual carrier, and those pronounced fluctuations in business activity which produce excessive returns and destroy many enterprises in competitive industry must in some measure be mitigated for the railroads. Since the reproduction cost doctrine implies that the extreme heights and depths of business change should be experienced by the carriers, its acceptance as a controlling valuation standard would be clearly harmful. It is unnecessary, under rising prices, that a level of earnings be maintained which may be far more than adequate to bring to the roads the capital which they can effectively use; and it is unnecessary, under falling prices, that a level of earnings be required which may cause widespread default on railroad obligations and undermine capacity for service. The reproduction cost principle involves the acceptance of a line of action that may prove seriously embarrassing, whereas actual investment, combined with a recognized discretion to adjust the rate of return in accord with the needs of prevailing circumstances, affords a basis for constructive policy, in addition to avoiding the practical pitfalls of the reproduction hypothesis and permitting prompt revisions as required at relatively small expense. If it is the understanding of the investor that he stands to earn a flexible rate of return on a rate base represented by the number of dollars actually committed, whether at high prices or low, no inequity can result from the disregard of price changes in the valuation process; and enhancement of earnings under this approach would be based, not on arbitrary adherence to a valuation theory, but on the requirements of transportation and financial conditions. The contention, furthermore, that only the reproduction cost standard can be relied upon to induce the proper flow of capital into the railroad industry is by no means unanswerable. For one thing, competitive enterprises do not tend to earn a return upon the cost of reproducing the identical plant, as conceived in valuation procedure, but upon the cost of reproducing a substantially identical service under current technological and economic conditions; again, the valuation and rate of return which would duplicate the earnings of comparable competitive enterprises in the interest of effecting proper apportionment of productive resources is almost impossibly difficult of ascertainment because of



basic differences of conditions as among different undertakings; and, finally, regulation has already gone so far in establishing authoritative control over railroad plant and facilities, in connection with abandonments, new construction, and security issues, that the process of investment in the railroad industry is not in any event an automatic one. Thus the case for reproduction cost largely dissolves under examination, and actual investment appears to provide a standard both more suitable and more practicable. This was plainly the Commission's view, despite some gaps in its reasoning. Save in the treatment of land, where quite inconsistently the Commission was dominated by present-value considerations,<sup>847</sup> its findings in the *O'Fallon* case marked a notable advance in official formulation of valuation doctrine.<sup>848</sup>

The foregoing characterization of the Commission's holdings is believed to be well founded, despite the fact that its order in this pro-

<sup>847</sup> On principle the Commission's acceptance of the "market value" measure for carrier lands appears indefensible, and the more so in revised valuation figures in the determination of which the Commission had expressly disregarded pertinent dicta of the courts. In essence the Commission's procedure as to land is subject to substantially the same frailties as were stamped upon the current reproduction cost doctrine. Although the question of land valuation was not discussed in the majority report, the continuance of the policy of the primary valuations in this respect was clearly inconsistent with the new approach in connection with the structural portions of the property. Note the following, as to the use of "present value" of lands, from the concurring opinion of Commissioner Eastman: "Here the report departs from the principle followed in the case of structures and uses, in constructing the rate base, not the actual or approximate money outlay in the lands, but an amount based on the current market value of adjacent lands. Here the consequences of this deviation from principle are not important; but in other cases they may be of vital importance, particularly where railroads have extensive land holdings in the heart of great cities. . . . Suffice it to say that there has never been any proof that if a carrier were able to sell the land which it uses for railroad purposes, it could command prices approaching the values which adjoining land enjoys with the railroad in operation. In most cases it is clear that it could not. But even if it could, under what theory does a carrier substituting for the State in the operation of a public highway become constitutionally entitled to unearned increment? . . . The land-value doctrine followed in this case apparently means that when land has been donated by the State or by individuals to a railroad in aid of construction, the carrier from the moment it begins operation is entitled to exact from the public served a full return upon the value of that land based on the then market value of adjoining lands." *Excess Income of St. Louis & O'Fallon Ry. Co.*, 124 I.C.C. 3 (1927), at pp. 58-59. See, also, Commissioner Eastman's dissenting opinion in *San Pedro, Los Angeles & Salt Lake R. R. Co.*, 75 I.C.C. 463 (1923), at pp. 535-537, 546-550.

<sup>848</sup> Compare Edwin C. Goddard, "The Evolution of Cost of Reproduction as the Rate Base," *Harvard Law Review*, vol. 41 (March, 1928), at pp. 579-592.

ceeding was set aside by the highest judicial authority.<sup>849</sup> The Supreme Court, by a five to three decision, with Justice Holmes, Justice Brandeis, and Justice Stone dissenting, found that the Commission had exceeded its powers under the statute. The majority opinion, presented by Justice McReynolds, was very brief, in view of the vital issues involved, and was strikingly lacking in illumination. There was no grappling with the facts of the proceeding, nor was there any recognition of the relationship between valuation procedure and the regulatory process. The "new era" in railroad regulation introduced by the Transportation Act, involving the conception of the railroads as a national transportation system entrusted to "the fostering guardianship and control" of the Commission, was seemingly forgotten; and the broad discretionary powers repeatedly recognized as inhering in the Commission were seemingly disregarded. The Court's reasoning, dealing with the issue in abstract legal terms rather than as a practical problem in public policy, is logically unimpeachable, once its interpretation of the law and the facts is accepted as sound. This reasoning consisted of three simple propositions, from which the adverse conclusion naturally followed. First, the statute provided that in determining values in aid of recapture the Commission "shall give due consideration to all the elements of value recognized by the law of the land for rate-making purposes"; second, among the elements of value so recognized was "the present cost of construction or reproduction," as indicated in numerous decisions of the Court; third, the Commission failed to give consideration to present or reproduction costs in estimating the value of the carrier's property.<sup>850</sup> Accordingly, the Commission's action could not be approved, and the challenged order

<sup>849</sup> *St. L. & O'Fallon R. Co. v. U. S.*, 279 U.S. 461 (1929), reversing the final decree of the District Court for the Eastern District of Missouri, in 22 Fed. (2d) 980 (1927), which, without passing upon the valuation controversy involved, had upheld the Commission's order.

<sup>850</sup> "The report of the Commission," said Justice McReynolds, "is long and argumentative. Much of it is devoted to general observations relative to the method and purpose of making valuations; many objections are urged to doctrine approved by us; and the superiority of another view is stoutly asserted. It carefully refrains from stating that any consideration whatever was given to present or reproduction costs in estimating the value of the carrier's property. Four dissenting Commissioners declare that reproduction costs were not considered; and the report itself confirms their view. Two of the majority avow a like understanding of the course pursued." *Ibid.*, pp. 485-486.

was annulled. This, in sum, was the substance of the entire argument. "In the exercise of its proper function," said Justice McReynolds, "this Court has declared the law of the land concerning valuations for rate-making purposes. The Commission disregarded the approved rule and has thereby failed to discharge the definite duty imposed by Congress."<sup>851</sup>

Assuming, as we must, that the substantive rule of fair value is established law, and that the issue in this proceeding was solely one of statutory construction, was the Commission's order entitled to approval? There are numerous factors that would seem to justify an affirmative answer. It is not unreasonable that the Court, in reviewing the order of the Commission, should be guided primarily by the action of that tribunal rather than by its words. While the Commission gave voice to severe criticisms of the current reproduction cost doctrine and expressed approval of actual investment as the most desirable measure of the rate base, its findings of value for recapture purposes were by no means a mere application of the investment standard, in total disregard of reproduction costs. The law of the land does not make reproduction costs the equivalent of value—that, indeed, would be a repudiation of the fair value rule; and the entire burden of the Commission's attack was directed against the acceptance of current reproduction costs as the virtual determinant of value. But current reproduction costs, along with other relevant data, were received in evidence as bearing upon the values to be found, and they were accorded such weight as in the judgment of the Commission they merited. The single-sum figures announced were a composite of many elements: for the property in existence prior to 1914, reproduction costs at 1914 unit prices were included; for the property acquired after that date, actual costs, reflecting the high level of prices of the war and post-war period, were given full weight; carrier lands were taken at their current market value; and the final values, as fixed by the Commission, exceeded the sum of the figures representing all these items. No single valuation standard was adopted; no formula was employed. Not only were the above elements, in terms of precise figures, taken into account, but the ultimate determinations were grounded also in a record which presented "descriptions of the car-

<sup>851</sup> *Ibid.*, p. 487.

rier, of its traffic, of the territory in which it operates, its history, and summaries of the results of its operation." All of the factors bearing upon value exerted an influence upon the final result. The Commission "endeavored to give heed" to the direction that all the elements of value recognized by the law of the land be accorded due consideration. Its findings were the result of the exercise of judgment upon all of the evidence, including that of current reproduction costs, in the light of the reliability of the reproduction cost estimates introduced in the record, in the light of their relationship to other evidences of value possessed of equal relevancy, in the light of the purposes and processes of rate regulation in the railroad field. To insist that the older portions of the property must of necessity be revalued in terms of current reproduction costs—or that the single-sum values must, as a matter of legal requirement, and regardless of the particular circumstances involved or of the probative force of the evidence adduced, result in a figure more nearly approximating reproduction cost than actual investment—is virtually to change the law of the land for the determination of fair value, and to deprive the Commission, as a fact-finding body, of the discretionary power with which it was clothed in the premises.

These considerations were found to be amply persuasive by the dissenting members of the Court. Their carefully formulated views, though minority utterances, throw much light upon the nature of the Commission's performance and of its relationship to legal doctrine. The essential steps in the argument of Justice Stone may be stated briefly in his own words: "The report of the Interstate Commerce Commission is rejected and its orders set aside on the sole ground that . . . it has failed to consider present reproduction cost or value of appellant's property and so to 'give due consideration to all the elements of value recognized by the law of the land for rate making purposes.' . . . That the Commission gave consideration to present reproduction costs appears not only from its own statement, but from the fact that it gave full effect to increased current market values in determining the value of land and to additions and betterments since June 30, 1914, taken at their cost less depreciation. . . . I cannot avoid the conclusion that in substance the objection, now upheld, to the order of the Commission is not that it failed to consider or give appro-

priate weight to evidence of present reproduction cost of appellant's road, but that it attached less weight to present construction costs than to other factors before it affecting adversely the present value of the structural property. . . . Without discussion of the evidence and other data which received the consideration of the Commission, the opinion of this Court seems to proceed on the broad assumption that the evidence relied on, mere synthetic estimates of costs of reproduction, must so certainly and necessarily outweigh all other considerations affecting values as to require the order of the Commission to be set aside. In effect the Commission is required to give to such index figures an evidential value to which it points out they are not entitled when applied to railroad properties in general or to this one in particular. . . . This Court has said that present reproduction costs must be considered in ascertaining value for rate making purposes. But it has not said that such evidence, when fairly considered, may not be outweighed by other considerations affecting value, or that any evidence of present reproduction costs, when compared with all the other factors affecting value, must be given a weight to which it is not entitled in the judgment of the tribunal 'informed by experience' and 'appointed by law' to deal with the very problem now presented.<sup>852</sup> These aspects of the case, aside from all other considerations, were deemed sufficient to sustain the Commission's findings. And Justice Brandeis presented a like interpretation of the legal issue and reached a like conclusion: "The question on which the Commission divided is this: Did Congress require the Commission when acting under §15a to give, in all cases and in respect to all property, some, if not controlling, effect to evidence establishing the estimated current cost of reproduction? Or did Congress intend to leave to the Commission the authority to determine, as in passing upon other controverted issues of fact, what weight, if any, it should give to that evidence? . . . The claim of the O'Fallon is in substance that, since construction costs were higher during the recapture periods than in 1914, the order should be set aside, because the Commission failed to find that the existing structural property and equipment which had been

<sup>852</sup> *Ibid.*, pp. 548-552. In addition to this brief separate expression, Justice Stone, along with Justice Holmes, joined in the more elaborate dissenting opinion of Justice Brandeis.

acquired before June 30, 1914 was worth more than it had been then. The Commission undertook . . . to find present actual value and, in so doing, both to follow the direction of Congress and to apply the rule declared in the *Southwestern Bell* case. It is true that this Court there declared that current reconstruction cost is an element of actual value; and that Congress directed the Commission 'to give due consideration to all the elements of value recognized by the law of the land for rate making purposes.' But, while the Act required the Commission to consider all such evidence, neither Congress nor this Court required it to give to evidence of reconstruction cost a mechanical effect or artificial weight. They left untrammelled its duty to give to all relevant evidence such probative force as, in its judgment, the evidence inherently possesses. The Commission concluded that in respect to the evidence of reproduction costs the differences between the *Southwestern Bell* case and that at bar were such, as to lead to different results in the two cases. It did so mainly because 'in the administration of the valuation and recapture provisions,' ascertainment of value 'is affected by a vast variety of considerations that either do not enter into, or are less easily perceived in, problems incident to the regulation of local public utilities.'<sup>858</sup>

But Justice Brandeis went much further than this. In an extended analysis characterized by an incisively realistic survey of the elements affecting value and of the Commission's relationship to its determination he set forth his reasons for deeming the conclusions of the Commission well founded. It will suffice to indicate the general course of the argument and its principal constituents. As a point of departure it was submitted that a fact-finding body like the Commission has never been required under our law "to give to evidence an effect which it does not inherently possess."<sup>854</sup> Unless, therefore, Congress required that some actual weight be given to evidence of current reproduction costs, regardless of its persuasiveness, the Commission was free to determine for itself the probative force of such evidence; and it is clear that reconstruction costs which are higher than original costs do not "necessarily tend to prove a present higher value."<sup>855</sup> Did Congress impose such a mandate upon the Commis-

<sup>858</sup> *Ibid.*, pp. 489-492.

<sup>854</sup> *Ibid.*, p. 492.

<sup>855</sup> *Ibid.*, pp. 494-496.

sion? Both the terms of the rate-making section of the Act and its legislative history preclude such an assumption. Though costs were high in 1920, no word or suggestion found its way into the statute directing the Commission to accord weight to this fact; on the contrary, even the proposal of the carriers that the property investment account be taken as the measure of the base in the rule of rate-making was rejected as involving too high a valuation.<sup>356</sup> There was obviously no intent to impose restrictions upon the Commission's exercise of discretion. Such slight increase in return on existing carrier property as was deemed necessary under the circumstances was effected through raising the rate of return above that prevailing during the preceding six years; the history of the enactment indicates clearly that it was not within legislative contemplation that both the rate base and the rate of return should be increased as a means of adjusting compensation to higher price levels.<sup>357</sup> What, then, were the Commission's duties in the circumstances? Since it was the declared purpose of the rate-making section of the Act to maintain an adequate national system of railway transportation, the Commission proceeded in the light of that purpose and of the economic factors bearing thereon. "From its wide knowledge of actual conditions and its practical experience in rate making, it concluded that to give effect to enhanced reproduction costs would defeat that purpose": that returns on a rate base so constructed would be beyond the ability of the carriers to earn, and that its fluctuating character, both up and down, would endanger not only the development of commerce and industry, but the flow of funds, on an economical basis, into the railroad field.<sup>358</sup> Furthermore, since the Commission, under the substantive rule of the Supreme Court, is seeking actual value, "it must in making the finding consider the effect upon value of both the commercial and the legal limitations upon rates and, among other things, the effect of competition upon the volume of traffic."<sup>359</sup> The experience of the railroads after 1920 disclosed a constant lowering, in numerous instances through the voluntary action of the carriers, of the weighted average of rates;<sup>360</sup> that the competition of other transportation agencies, notably water lines and motor carriers, seriously restricted both actual

<sup>356</sup> *Ibid.*, pp. 496-498.

<sup>359</sup> *Ibid.*, p. 505.

<sup>357</sup> *Ibid.*, pp. 500-501.

<sup>360</sup> *Ibid.*, pp. 507-509.

<sup>358</sup> *Ibid.*, pp. 501-503.

and potential railroad traffic and earnings;<sup>861</sup> and that even "rates which are not so high as to prevent commercially the movement of traffic are often required to be lowered because they conflict with some statutory provision."<sup>862</sup> And another important limitation upon the weight to be accorded to reproduction costs sprang from the fact that the Commission was directed, in the exercise of its rate-making power, so to adjust charges that a fair return upon value will be earned "under honest, efficient and economical management." This injunction implied "employment of the right instrument and material as well as their use in the right manner"; in other words, "Congress made efficiency of the plant an element or test of value."<sup>863</sup> Under these circumstances the cost of constructing a substitute plant capable of rendering the same service became the controlling consideration; and in the use of evidence of reproduction costs as applied to the identical plant the item of functional depreciation, came to be a very important offsetting factor.<sup>864</sup> The prevailing facts as to railroad construction and equipment and operation provided ample support for the conclusion that such functional depreciation existed in large measure, and "that this functional depreciation, arising through external changes, through competitive means of transportation, and through progress in the art of transportation, may, in respect to a particular railroad, have become so large as to more than counterbalance that increase in its actual value which would otherwise flow from the rise in the price level since 1914."<sup>865</sup> Finally, since evidence of reproduction cost possesses much less persuasiveness in the case of railroads than in the case of local public utilities—in view, chiefly, of the commercial and legal limitations upon rail rates which do not apply to

<sup>861</sup> *Ibid.*, pp. 511-512.

<sup>862</sup> *Ibid.*, p. 515. It is necessary, in this connection, to avoid falling into a subtle form of the "market value" fallacy. These limitations upon rates, whether commercial or legal, and whether induced by competitive pressure or otherwise, were decidedly pertinent to this analysis, because they were urged as reasons for not establishing the inflated values called for by the current reproduction cost doctrine. Since, for these reasons as well as others, the traffic would not bear charges computed on any such base, it would be futile, in any realistic sense, to accord weight to enhanced reproduction costs for rate-making purposes. But if the present or prospective level of earnings, as influenced by these limitations upon rates, were urged as a *measure* of "actual value," then the vitiating defect of circularity of reasoning would be inevitably encountered.

<sup>863</sup> *Ibid.*, p. 517.

<sup>864</sup> *Ibid.*, pp. 517-518.

<sup>865</sup> *Ibid.*, pp. 519-534.



"most local utilities enjoying a monopoly of a necessary of life"—the Commission's findings were not inconsistent with the prior determinations of the Supreme Court.<sup>866</sup> Unless, then, the Commission was guilty of an abuse of discretion in declining to give effect to current reproduction costs for the structural property in existence prior to June 30, 1914, its conclusions must be upheld. The record disclosed no such abuse. The Commission considered all the evidence, including that of current reproduction costs, weighed it carefully, in the light of its intrinsic probative value as well as in its relationship to other relevant facts, and, without resort to any formula, exercised an informed judgment thereon. Such findings should not be disturbed.<sup>867</sup>

But however sound these considerations may be, the Commission was apparently required to change its valuation methods. For an understanding of current practice, therefore, in the revision of primary valuations, it is necessary to examine its reaction to the Supreme Court's decision in the *O'Fallon* case. Despite the definiteness of judicial disapproval of its methods in that case, it is at least possible to assume that a change in policy more formal than real might have been effected without eliciting further objection from the Court, since the explicit reasoning and extreme candor with which the Commission's original findings were presented had constituted a chief source of difficulty. In the words of Justice Stone: "Had the Commission not turned aside to point out in its report the economic fallacies of the use of reproduction cost as a standard of value for rate making purposes, which it nevertheless considered and to some extent applied, I suppose it would not have occurred to any one to question the validity of its order."<sup>868</sup> Nor would such nominal compliance by the Commission have meant the flouting, by indirection, of the judicial will. The Court merely required that consideration be given to current reproduction costs; it did not hold that such costs constitute the measure of value or indicate the weight to be accorded to them in its determination. Justice McReynolds had said: "The question on which the Commission divided is this: When seeking to ascertain the value of railroad property for recapture purposes, must it give consideration to current, or reproduction, costs? The weight to be accorded thereto is

<sup>866</sup> *Ibid.*, pp. 535-538.

<sup>867</sup> *Ibid.*, pp. 540-548.

<sup>868</sup> *Ibid.*, p. 550.

not the matter before us. No doubt there are some, perhaps many, railroads the ultimate value of which should be placed far below the sum necessary for reproduction. But Congress has directed that values shall be fixed upon a consideration of present costs along with all other pertinent facts; and this mandate must be obeyed.<sup>869</sup> The Commission avowed that it had considered such costs, but without convincing the mind of the Court; perhaps in the future its claims might have achieved the required persuasiveness, if coupled with findings altered less in substance than in manner of presentation.<sup>870</sup> Such, however, has not been the Commission's course. While no

<sup>869</sup> *Ibid.*, p. 487. Compare the following from the dissenting opinion of Justice Stone, at p. 552: "But if 'weight in the legal sense' must be given to evidence of present construction costs, by the judgment now given we do not lay down any legal rule which will inform the Commission how much weight, short of its full effect, to the exclusion of all other considerations, is to be given to the evidence of synthetic costs of construction in valuing a railroad property. If full effect were to be given to it in all cases then, as the Commission points out in its report, the railroads of the country, valued by the Commission in 1920 at nineteen billion dollars, would have had in that year a reproduction value of forty billion dollars and we would arrive at the economic paradox that the value of the railroads may be far in excess of any amount on which they could earn a return. If less than full effect may be given, it is difficult for me to see how, without departure from established principles, the Commission could be asked to do more than it has already done—to weigh the evidence guided by all the proper considerations—or how, if there is evidence upon which its findings may rest, we can substitute our judgment for that of the Commission."

<sup>870</sup> Dissenting in part in the leading case following the *O'Fallon*, Commissioner Eastman stoutly asserted the Commission's authority, despite the recent reversal, to give to each element of value "such weight as may be just and right in each case," even though current values would thus be wholly excluded. After pointing out that at least three of the value elements specified in *Smyth v. Ames* had been consistently disregarded without judicial censure, and that in its *O'Fallon* decision the Supreme Court had mistakenly identified "giving weight" to, and "consideration" of, the value factors, he summed up his position as follows: "But as the law now stands, unless I have wholly misconstrued the decisions, neither this commission nor any other public regulating authority is yet foreclosed from determining, in the light of such wisdom and experience as it has, what the nature and function of 'value for rate-making purposes' or 'base value' or 'rate base,' as it has been variously termed by the court itself, should reasonably be, and by what principles judgment should be governed in deciding the weight, if any, which it is just and right to give each of the 'elements of value' which must be considered in arriving at the final figure." To this attitude Commissioner Lewis, of the majority, specifically took exception, holding that a real revision of method was required. "The dissenting-in-part expressions," he said, "while valuable studies of, and possibly contributions to, the solution of the multitude of difficult problems encountered in valuation of the railroads of the United States, and also as to what the law should be, nevertheless tend to confuse the determinations reached by the majority in this case. Some of us who constitute the majority are . . . on record as favoring certain changes in the law. But the changes have not been made and the Su-

change was made in the determination of the primary valuations, the method of their revision for use in recapture cases was altered materially along lines indicated by the Court.<sup>871</sup> The changes made, as first reported in the case of the Richmond, Fredericksburg, and Potomac Railroad, and followed in subsequent cases, were chiefly in three directions: first, the underlying reproduction cost figures, covering both the original inventory and subsequent additions thereto, were modified to reflect prices prevailing at the time of revision; second, the original cost of the property, undetermined in previous proceedings for lack of data, was found for each recapture period by a combined process of investigation and estimate; and third, the revised single-sum values, though not mathematically explicable, were clearly the resultant of a composite weighing of current reproduction costs and other elements of value.

In ascertaining cost of reproduction new for any recapture date, the Commission employed as a starting-point the corresponding figure from the primary valuation, with overheads subtracted; to this base was added an amount covering net additions to property other than land and working capital, these additions being priced as of 1914; to this result index factors were applied which were designed fairly to reflect the price situation as of the date of revision; and finally the

preme Court in its decision in the O'Fallon case declared that we had 'failed to discharge the definite duty imposed by Congress' in not applying the 'law of the land concerning valuations for rate-making purposes' and said 'this mandate must be obeyed.' It remanded us to certain decisions of the courts, principal among them being *Smyth v. Ames*. . . . By the final interpreter of the law we are told that in administration of the recapture law we are 'not to act as an arbiter in economics' but 'as an agency of Congress to apply the law of the land to facts developed of record in matters committed by Congress to our jurisdiction.' The Supreme Court said what we are required to find is value." *Excess Income of Richmond, F. & P. R. Co.*, 170 I.C.C. 451, 521-526, 526, 548 (1931).

<sup>871</sup> The methods of the primary valuations did not go altogether unquestioned. Dissenting in *New York Central R. Co.*, 27 Val. Rep. 1, 74 (1929), Commissioner Eastman declared: "The decision of the Supreme Court on May 20, 1929, in *St. Louis & O'Fallon Ry. Co. v. United States* makes it desirable, I believe, for us to review our methods of valuation and consider whether they are consistent in all respects with the views expressed by the court. I doubt whether they are altogether consistent, for apparently it is the view of the court that value for rate-making purposes should correspond with its conception of the actual value of the property, using the word 'value' as it is used in common parlance." With a reference to the foregoing statement he again registered dissent in *New York, N. H. & H. R. Co.*, 30 Val. Rep. 1, 43 (1929). Apparently his view of the meaning of the O'Fallon decision had changed substantially when action was next taken in a recapture case. See note 370, *supra*.

overheads were calculated anew. In the computation of the index factors, which were the heart of the new procedure, the chief question was whether, for the post-war period of violent price fluctuations, year-by-year prices, however ephemeral, should be accepted for each successive revision date, or whether some measure of normal price behavior should be devised. Thus, for the four recapture periods involved in this proceeding, the Bureau of Valuation estimated yearly index factors for the item of grading of 230 for 1920, 170 for 1921, 145 for 1922, and 161 for 1923. The respondent, while suggesting a current price factor of 215 for 1920, recommended a so-called stabilized post-war factor of 170 for the other years. But the bureau urged instead the adoption of factors based on so-called "period prices"—that is, average prices arrived at for any year "from a consideration of prices current prior to, and subsequent thereto, as well as during, the year in question"—which in the case of the grading item were 170, 158, 159, and 157, respectively, for the years involved.<sup>872</sup> The case for year-by-year factors was weakened by the excessive violence of early post-war fluctuations, while evidence was lacking to support the existence of an "established post-war level." Accordingly, the Commission accepted the bureau's recommendation of period prices, finding some measure of judicial support for its conclusion in the Supreme Court's decision in the *McCardle* case.<sup>873</sup> Judgment of this position on economic grounds is difficult. Whether the same reasons exist in recapture as in rate-making proceedings for preferring normal to spot prices, is a question not easy to answer in the rarefied atmosphere of hypothesis surrounding its formulation, since the recapture procedure resists translation into the competitive analogy that underlies the reproduction cost approach; and it is also hard to determine, on the basis of the scant detail available as to the nature of the methods

<sup>872</sup> *Excess Income of Richmond, F. & P. R. Co.*, 170 I.C.C. 451, 476, 478 (1931).

<sup>873</sup> *Ibid.*, pp. 483, 477. The following passages were quoted from *McCardle v. Indianapolis Co.*, 272 U.S. 400, 408, 411 (1926): "But in determining present value, consideration must be given to prices and wages prevailing at the time of the investigation; and, in the light of all the circumstances, there must be an honest and intelligent forecast as to probable price and wage levels during a reasonable period in the immediate future. In every confiscation case, the future as well as the present must be regarded. . . . While the values of such properties did not vary with frequent minor fluctuations in the price of material and labor required to produce them, they are affected by, and generally follow, the relatively permanent levels and trends of such prices." But see notes 57 and 142, *supra*.

used, whether the device of period prices as applied by the Commission conformed reasonably to any relevant concept of normal price.<sup>874</sup> But while large sums of doubtfully recapturable income might have been at stake, depending on the method of pricing adopted, if reproduction cost were the sole determinant of the final value figure employed, the fact that other elements of value were to enter into that result reduced greatly the importance of the issue. In any event, the method of period prices was followed in later recapture cases.<sup>875</sup>

With depreciated reproduction cost, land value, going value, and

<sup>874</sup> In a partially dissenting opinion, Commissioner Mahaffie urged a number of reasons for preferring spot to period prices. As to the difference between recapture and rate making as purposes of valuation, he said: "In the use of period prices to the exclusion of spot prices reliance is placed in certain decisions of the Supreme Court in utility cases where the inquiry was directed to the determination of service charges or rates to be projected into an indefinite future. This, it seems to me, is not analogous to the inquiry we are required to make under the recapture clause of section 15a of the act where we must deal separately with each of a series of elapsed years." Another of his objections concerned the uncertain and irregular nature of the methods employed: "The report fails fully to disclose the methods employed in determining the period prices used in the Bureau's reproduction estimates. As I understand it, these period prices are not a composite of prices for the various primary accounts embraced by the inventory arrived at by a common method, but are the result of applying different methods to the various primary accounts. For some of the accounts the peak prices current in 1920 have been considered, whereas for other accounts the 1920 prices appear to have been disregarded. For some accounts the period embraces the years with which we are here concerned and for other accounts the prices of years both prior and subsequent thereto have been given effect." Finally, he saw in the use of period prices an undesirable interference with the adjustment of income to changing conditions: "The use of period, instead of spot, prices results in the maintenance of higher values in a time of declining prices just as it holds down values in an era of price advances. From an administrative standpoint this, no doubt, is desirable. Ease in administration would be greatly facilitated by the entire elimination of fluctuations in value. But it is necessary to recognize the fact that values do fluctuate. We are now apparently in a declining cycle. Values based on period averages, if the decline continues, will for some years be on what seems to me an artificially high basis. Just as the carrier, as to 1920, is entitled to demand that effective consideration be given to the high levels then prevailing, so the public, in 1930, should have the benefit of the decreases that have occurred. Under the principles adopted by the majority a decline in prices can be reflected only very gradually in value." *Excess Income of Richmond, F. & P. R. Co.*, 170 I.C.C. 451, 538-541 (1931).

<sup>875</sup> See the following: *Excess Income of Tuckerton R. Co.*, 175 I.C.C. 318, 323 (1931); *Excess Income of Lessee of Batesville S. W. R.*, 175 I.C.C. 665, 668 (1931); *Excess Income of Oil Fields Short Line R. Co.*, 175 I.C.C. 672, 677 (1931); *Excess Income of Central Ry. Co. of Arkansas*, 175 I.C.C. 680, 684 (1931); *Excess Income of Hannibal Connecting R. Co.*, 175 I.C.C. 713, 719, 722 (1931); *Excess Income of Lake Term. R. Co.*, 175 I.C.C. 754, 758 (1931); *Excess Income of Jonetboro, L. C. & E. R. Co.*, 175 I.C.C. 786, 791 (1931); *Excess Income of Roscoe, S. & P. Ry. Co.*, 180 I.C.C. 383, 389-391 (1932).

working capital handled, despite carrier protests, precisely as in the primary valuations,<sup>876</sup> the only other underlying figure receiving new treatment was that of original cost. It may seem paradoxical that after a consistent record of refusal to ascertain original cost because of its conjectural character, the Commission should now, for the first time and despite a like absence of cost records, make such a finding in a revision of procedure induced by the legal obligation to have greater regard, not for original cost, but for reproduction cost. But the paradox is easily resolved. In the primary valuations no immediate end was served in going beyond the record to make estimates of problematical utility; and in the revision of value accomplished in the *O'Fallon* case the dominant rôle accorded reproduction cost at 1914 unit prices was deemed to be tantamount to approximate recognition of original cost. With the use of current prices in ascertaining cost of reproduction, however, original cost could no longer enter in the guise of 1914 reproduction costs, but required explicit recognition and separate determination as an independent element of value in order to exert any influence.<sup>877</sup> In the absence of a complete record of original outlays, reproduction cost at 1914 prices, as determined in the primary valuations and as revised to cover additions, betterments, and retirements, was accepted by the Commission as an adequate basis of estimate, subject to check by actual cost data where available and by the restated capital investment.<sup>878</sup> To the carrier objection that original

<sup>876</sup> See *Excess Income of Richmond, F. & P. R. Co.*, 170 I.C.C. 451, 484-486, 487-489, 496-499, 499-504 (1931); also cases cited in note 375, *supra*.

<sup>877</sup> While meeting with carrier opposition, there can be little doubt of the right of the Commission to estimate original cost, despite its prior refusal to do so. For the Commission's defense of its position, see note 82, *supra*.

<sup>878</sup> The Commission said: "Railway valuations pursuant to section 19a embracing investigations of original cost have demanded our attention for nearly 17 years, and upwards of 1,000 cases have been disposed of. This experience confirms the conclusion of the bureau's witness that while it is seldom possible to ascertain the complete original cost of railroad properties from accounting records nevertheless what we have determined as reproduction cost at normal prices as of 1914, arrived at by consideration of cost data covering periods of 5 or 10 years or more previous to June 30, 1914, produce, by and large, a fair average of the cost of constructing railroads in most parts of the country during those previous years when the great bulk of railway property then in use had come into existence or was brought to modern form and development. This generalization is supported by the comparison on many systems or parts of systems throughout all sections of the country made in the course of our administration of the valuation section of the act. In other words, the present cost of construction (cost of reproduction new) computed in the manner followed in our

cost, as thus calculated, failed to cover many expenditures incurred in creating a railroad, but which are excluded by the reproduction hypothesis, the Commission replied that such a limitation could be allowed for, though its effect was not greatly to impair the result.<sup>879</sup> As carrier lands are not covered by estimates of reproduction cost, the investment therein required separate determination on the basis of records of acquisition—a limitation rendering it inadvisable to report the original cost of land in a number of recapture cases.<sup>880</sup> Finally, it should be noted that the Commission, having broken precedent to embark upon a search for original cost, frequently saw fit to continue the quest until a depreciated original cost had been found, which it was able to offer as one further evidence of value.<sup>881</sup>

primary valuation, compared with the original cost of construction, where ascertainable, has been found to be in general approximately the same. It has been agreed that the recorded costs of property installed between June 30, 1914, and June 30, 1916, did not exceed such normal prices." *Excess Income of Richmond, F. & P. R. Co.*, *supra*, p. 467. For the correspondence of original cost, as thus determined, with the restated investment, see *ibid.*, p. 468.

<sup>879</sup> Among these expenditures were such items as "preliminary surveys, relocation of highways, assessments for public improvements, taxes and interest on land during construction, crossing bridges built for use of senior carriers and many items incidental to the abolition of grade crossings, and other crossing improvements." After pointing out the inadequacy of supporting evidence supplied by the carrier, the Commission continued: "In general it should be noted that the estimate is designedly limited to physical property not including intangibles, contract rights, or working capital, and no reason can be seen why it can not properly be considered with this limitation if the limitation is not overlooked." Moreover, the effect of using 1914 reproduction cost was deemed to be such that "the apparent errors in omitting such items as preliminary surveys, relocation of highways, and other items not considered in theoretical reproduction are apparent only and do not seriously impair the result. This is especially true in view of the circumstance . . . that there are important instances where the cost of reproduction, computed in the manner followed in our primary valuations, is higher than the original cost of the same property. In the net result the railroads suffer no disadvantage." *Ibid.*, pp. 466-467.

<sup>880</sup> See, for example, *Excess Income of Tuckerton R. Co.*, 175 I.C.C. 318, 323 (1931); *Excess Income of Central Ry. Co. of Arkansas*, 175 I.C.C. 680, 683-684 (1931); *Excess Income of Lake Term. R. Co.*, 175 I.C.C. 754, 757 (1931).

<sup>881</sup> Depreciation was here conceived in precisely the same sense as in the Commission's estimates of reproduction cost less depreciation. Its recognition was protested on the ground that a finding of original cost less depreciation is authorized neither in *Smyth v. Ames* nor in section 19a; but the objection was overruled on the ground that the former authority fails also to mention reproduction cost less depreciation, while the latter clearly authorizes the ascertainment of all relevant facts. To the substantive objection that original cost "measures the investment in the property, which can not possibly become less because of depreciation," the Commission replied: "An article when new contains a certain number of units of service and as those units are exhausted the article depreciates. In order to make any figure, whether of original cost

With these evidentiary facts, as well as the fate of its former procedure, before it, how was the Commission to revise values for recapture purposes? "The issue," as seen in the leading *Richmond* case, was "narrowed to a question of the relative weight or effect to be accorded original cost and cost of reproduction in determining the value of the structural part of the property." Relying chiefly upon the Supreme Court's decision in the *McCardle* case, the carrier contended that reproduction cost should be accepted as the equivalent of value; but the Commission was not persuaded, and approved the alternative view "that both cost of reproduction and original cost must receive consideration in the determination of final value for rate-making purposes"—for which it found judicial support in an imposing series of cases from *Smyth v. Ames* through the *O'Fallon*. Without authoritative direction as to the weights to be accorded these two elements, and with the low status of formulas in mind, the Commission simply affirmed its reliance on a judgment of value "justified by the record," incidentally noting that the specific importance of the constituent elements of value "may well vary according to the conditions affecting different railroads." Without further revelation of processes except the usual recognition of the carrier as a going concern, final value was found for recapture purposes.<sup>882</sup> But if the Commission has itself provided no explicit explanation of its value findings, can any definite inferences be drawn from the conclusions reached as to the manner of their calculation? An examination of the limited number of cases decided on this basis clearly supports a negative answer. Somewhere within the wide range of possibilities whose boundaries are marked by the underlying figures, values were determined; but all that can be said of their determination is that no formula was used and that exclusive weight was accorded neither the highest nor the lowest indicia of value. Scrutiny of the figures discloses that these values have been consistently, and in most cases considerably, higher than those which

or cost of reproduction, representative of the condition of the property at the time of the inquiry it would seem on principle to be necessary to make due allowance for the expired units of service life." *Excess Income of Richmond, F. & P. R. Co.*, *supra*, pp. 468-470. See, also, *Excess Income of Jonesboro, L. C. & E. R. Co.*, 175 I.C.C. 786, 790 (1931).

<sup>882</sup> *Excess Income of Richmond, F. & P. R. Co.*, *supra*, pp. 505-509. See, also, the cases cited in note 375, *supra*.



would have been produced by the valuation method employed in the *O'Fallon* case; that they have been consistently, and often considerably, lower than would have been established by the method used in the primary valuations, in which values rested chiefly on reproduction cost less depreciation; and that usually, though not invariably, they have exceeded appreciably the estimates of original cost. But the multiplicity of value elements, including the avowedly recognized but not separately measured superiority in worth of a developed and seasoned carrier, makes it impossible to assign weights in the individual case, and it is clear that such weights as may be implicit in one case received no continued application in other cases.

It is in this last stage of its evolution that the valuation process seems least worthy of commendation. When, as in the case of the Richmond, Fredericksburg, and Potomac Railroad, a valuation based on depreciated reproduction cost, increased by the current worth of land, working capital, and going value, would be nearly double the depreciated original cost, and judgment unrestrained by definable criteria has scope to roam at will within such widely separate limits, the result, whatever it is, can possess no convincing validity, nor give assurance of approximate consistency with other value findings, even within the brief periods of unaltered commission personnel. Not only might any one of a wide range of findings have emerged equally well from the Commission's analysis of the facts, but it is a fair assumption, supported from within the Commission, that any attempt to describe processes and rationalize results would have but confirmed its suspected futility.<sup>883</sup> This outcome had been anticipated by the

<sup>883</sup> As stated in the partially dissenting opinion of Commissioner Eastman: "Certain 'values' are arrived at, but we are not told *how* they were arrived at or what weights, if any, were given to each of the 'elements of value.' A description of the process would no doubt be possible, but I question whether it could be phrased in terms of rational thought. . . . It would not, in short, be impossible or illogical or even inappropriate to substitute 'values' very different from those which are actually arrived at, without changing in the least the discussion leading up to the conclusions." In extenuation of the absence of any account of how final value was determined, Commissioner Lewis declared: "In this instance 11 minds were operating in common on one of the most complicated and difficult problems that commissions have had before them in half a century, a problem quite different from those before the courts, where only the law is to be determined and applied. It is complicated by a maze of technical engineering studies and accounting issues, and questions requiring penetration into the conduct of the business, at least to the determination of whether the operation has been

Commission in the *O'Fallon* case: "It has been suggested that while it may be going too far to take current cost of reproduction as the basic measure of value, some weight ought to be given to changes in general price levels. Under the method outlined above we do give weight to such changes in so far as they have been reflected in prices paid for new construction or replacements, and we value lands at their prevailing market values. We know of no other way of giving weight to this factor which is not dependent upon caprice, unless full weight be given under the current reproduction cost doctrine. There is, in our judgment, no intermediate process possible which is capable of being applied by any rule independent of the caprice of those who apply it."<sup>884</sup> This view was amply confirmed by the character of these later determinations; and the strictures already set down respecting the Supreme Court's decision in the *O'Fallon* case are directly applicable to the valuation process which was its natural outcome.<sup>885</sup> While at-

honest, efficient, and economical in so far as it has effect on earnings. It is impossible that 11 minds would, under such complicating conditions, follow the same course or unite on all details. It seems to me, however, that in the final-value chapter there are marshaled and definitely presented the facts on which the 11 minds, having first reached many decisions on underlying details, operated and came to a conclusion. While it is impossible to put into a composite statement the weight attached to each factor, it is significant that, when the values individually reached by each of 11 commissioners were brought together, the span between the highest and lowest was so narrow as to be well within the degree of tolerance generally conceded in valuation matters." For himself, however, Commissioner Lewis welcomed "the opportunity afforded by the dissenting expressions to indicate in some detail how and why I [he] reached the valuations found by the majority." But his explanation, after extended recognition of the several individual elements of value, came down to this brief disposition of the crucial issue: "As for myself, I took as my basis for such weighting, the 'present as compared with the original cost.' Such weighting in this case of the estimated original cost and of theoretical cost to reproduce all of the property, much of which was built decades ago, escapes on one hand the objection that an arbitrary formula has been applied and on the other hand the objection of caprice." "Other commissioners," it was admitted, "may have adopted different methods and applied different weights to the reproduction factor in arriving at their conclusions." But whether they did or not would not be shown by a like statement on the part of each and every one of them. *Excess Income of Richmond, F. & P. R. Co.*, *supra*, pp. 525-526, 549-552.

<sup>884</sup> *Excess Income of St. Louis & O'Fallon Ry. Co.*, 124 I.C.C. 3 (1927), at p. 39.

<sup>885</sup> The minority opinion of Commissioner Eastman in the *Richmond* case is an admirable exposition of the grounds on which these strictures rest. Pointing out that later decisions have "passed over without comment" the important declaration in *Smyth v. Ames* that "what the public is entitled to demand is that no more be exacted from it for the use of a public highway than the services rendered by it [the company] are reasonably worth," he continued: "I submit that it is a proper interpretation that services are 'reasonably worth' their reasonable cost, including in that figure

tempts were made to bring about judicial censorship of even these findings,<sup>886</sup> the repeal of the recapture provisions removed the controversy from the courts;<sup>887</sup> and the likelihood of judicial review of valuation findings in the general field of rate control was minimized by the amendment of the rule of rate-making whereby the express requirement of a fair return on fair value was eliminated.<sup>888</sup> But these factors added in no way to the propriety of the methods employed in this latest phase of the valuation project. A reconstitution of the revision process, in terms of modifying the primary valuations on the basis of recorded changes in investment, must be, with the aid of Congress, the next important step.<sup>889</sup>

such cost of capital as is involved in securing the funds necessary for both the establishment and the successful continuance of the business." Then, after stressing considerations already sufficiently treated in the present study, he reached the conclusion: "In theory, therefore, and as a matter of constitutional right, the 'value for rate-making purposes' which I would use in applying the *Smyth v. Ames* rule in connection with 'fair return,' would be determined by adding to the best possible estimate of the reasonable original cost of existing property a fair allowance for working capital and deducting an allowance for depreciation based on the best available evidence as to exhaustion of service capacity." In the instant case he went on to show that a value thus determined would, if used in calculating recapturable income for 1922, leave "respondent with a remaining income of \$1,899,163, which is about 10.7 per cent on the outstanding capitalization or about 8.2 per cent if the stock dividend be included"—the latter being one authorized by the Commission, and sufficient to increase capitalization to substantial equality with the rate base as thus determined, plus non-carrier properties. Considerations of expediency, he held, would warrant the use of 1914 reproduction cost in place of actual investment in the primary valuation. *Excess Income of Richmond, F. & P. R. Co.*, *supra*, pp. 529-538, 529, 536.

<sup>886</sup> See *Annual Reports*: 1931, p. 92; 1932, p. 96.

<sup>887</sup> By the Emergency Railroad Transportation Act of 1933 (Public No. 68, 73d Congress), the recapture provisions were retroactively repealed (Sec. 206). Accordingly, on July 5, 1933, the Commission entered an order "vacating all final orders for the recovery of excess net railway operating income, and dismissing all other pending proceedings under the recapture provisions. Among the orders vacated was that issued in the case of the Richmond, Fredericksburg & Potomac Railroad Co., which had been in litigation." *Annual Report*, 1933, pp. 76-77.

<sup>888</sup> Under the new rule, as enacted by the 1933 legislation (note 387, *supra*), section 15a merely provides that "in the exercise of its power to prescribe just and reasonable rates the Commission shall give due consideration, among other factors, to the effect of rates on the movement of traffic; to the need, in the public interest, of adequate and efficient railway transportation service at the lowest cost consistent with the furnishing of such service; and to the need of revenues sufficient to enable the carriers, under honest, economical, and efficient management, to provide such service" (Sec. 205).

<sup>889</sup> By the 1933 legislation (note 387, *supra*), paragraph (f) of section 19a was so amended as to relieve the Commission of the necessity of revising its primary valuations "in like manner" as when originally made, but no new standard was established

As the foregoing discussion has indicated, the revision of primary valuations has been exemplified most significantly in recapture cases. The work of accumulating data to facilitate general revision, so that necessary findings may be available whenever wanted and for whatever purpose, has proceeded rapidly; but the actual revisions of this nature have been, for the most part, of a comprehensive and approximate character, designed to serve as a rough guide in general rate-level proceedings. Such figures were actually utilized in connection with the rate increases of 1920 and the rate reductions of 1922;<sup>890</sup> and during the current depression comprehensive exhibits of value facts were submitted, though without influence upon the outcome, in connection with the proposed rate advances of 1931 and the general rate investigation of 1933.<sup>891</sup> For the last of these proceedings the Bureau of Valuation computed the cost of reproduction new of the steam-railway property other than land of the carriers in existence on December 31, 1932, as \$23,953,546,235 at period prices as of June 1, 1933, and \$23,742,958,869 at spot prices as of that date; the cost of reproduction less depreciation as \$17,754,467,309 at period prices and \$17,599,113,778 at spot prices; the original cost, except land, at \$22,860,365,394; the present value of lands and rights as of June 1, 1933, at \$3,032,799,826; and the necessary working capital, including materials and supplies, at \$338,854,000.<sup>892</sup>

for the revision of values. It is merely stipulated that "upon completion of the original valuations . . . the Commission shall thereafter keep itself informed of all new construction, extensions, improvements, retirements, or other changes in the condition, quantity, use, and classification of the property of all common carriers as to which original valuations have been made, and of the cost of all additions and betterments thereto and of all changes in the investment therein, and may keep itself informed of current changes in costs and values of railroad properties, in order that it may have available at all times the information deemed by it to be necessary to enable it to revise and correct its previous inventories, classifications, and values of the properties; and when deemed necessary, may revise, correct, and supplement any of its inventories and valuations" (Sec. 208).

<sup>890</sup> *Increased Rates, 1920*, 58 I.C.C. 220, 227-230 (1920); *Reduced Rates, 1922*, 68 I.C.C. 676, 684-685 (1922).

<sup>891</sup> *Fifteen Per Cent Case, 1931*, 178 I.C.C. 539 (1931); *General Rate Level Investigation, 1933*, 195 I.C.C. 5 (1933).

<sup>892</sup> *Annual Report, 1933*, p. 76. For an analysis of the value figures pertaining to particular carriers, in connection with the determination of compensation to be paid for the use of terminals, see *Missouri-K.-T. R. Co. v. Kansas City Term. Ry. Co.*, 198 I.C.C. 4 (1933).

## §7. SUMMARY AND CONCLUSION

The valuation project looms large among the Commission's activities from at least two significant angles. It is noteworthy not only because its execution has involved, to an exceptional degree, those vexing issues and conceptions which inhere basically in the public regulation of private enterprise, but also because the sheer magnitude and complexity of the undertaking have taxed the Commission's resources to the utmost. When an industry is withdrawn from the domain of competitive control and subjected to authoritative regulation, the shift is never complete; the hand of the old *régime* continues to lie heavy upon it. The standards of reasonableness of income whose violation leads to public control have their origin in the broad field of private enterprise, and these standards necessarily influence the regulative process. On the one hand, they fix the upper limit of allowable return, else regulation would fail in its primary purpose; and, on the other, they tend to fix the lower limit as well, under comparable conditions of risk, since the capital requirements of regulated industry must be met from the same reservoir of savings which supplies all industry. Of like origin, too, are those equitable considerations which actuate the courts in their supervision of regulatory justice. But it is even more significant that competitive industry reveals no easy index, definable beyond dispute, of adequacy of income, or of its regard under changing circumstances for the integrity of capital commitments already made; nor could such an index, if available, be applied directly to the railroads. The different railroads serve largely their own particular markets, and hence must be maintained individually, and not merely as an industry of sufficient aggregate capacity. Because their capital structures are loaded, if not overloaded, with bonded debt, a stability of income not generally required is also necessary. Moreover, there are objectives of a broadly social nature which may warrant special recognition; and the regulatory power itself must be exercised along lines which are administratively effective. The value of the rail carriers is sought as a tool in this process; but it is sought not as the sole basis of railroad income, but as one of many factors relevant to its determination. Accordingly it becomes necessary to exclude certain considerations which bear ultimately upon the adequacy of carrier returns, and at the same time to make sure that the

values arrived at reflect such considerations as are appropriate to the measurement of the rate base. It is the performance of these tasks, within limits roughly set by legislative and judicial mandates, that infuses the valuation process with such baffling theoretical complexity. Thus to seek value, when the value sought has no independent existence but can emerge only as a creature of the purpose actuating the quest, is to engage in an undertaking only incidentally fact-finding in character. Yet it is primarily as a fact-finding project that Congress imposed the task, and it is in fact-finding activity that the Commission has expended an amount of energy and thought which alone would make the project highly important. Merely to search all records and books of account that would throw light upon the original cost of, and investment in, 250,000 miles of railroad line, owned by hundreds of companies of complex corporate past, would have been a formidable task; to achieve a complete inventory of the properties of these companies, to determine how their facilities might be reproduced under conditions existing on valuation date, and to ascertain for the vast mass of items, including carrier lands, and for the reproductive process itself, costs or prices typical for specified periods, was a stupendous undertaking. And while these enormous labors were going on, so also was the process of change in railroad properties through addition, substitution, and retirement. Revision of primary values to later dates would have proved an easier task could it have been accomplished simply by reference to the accounting record, properly checked. But the obligation "in like manner . . . to revise and correct its valuations" prolonged the process of inventory, and the ascertainment anew for each revision date of the value of carrier lands and the reproduction cost of other properties increased the burden. The valuation project thus presented a vast array of difficult substantive issues, and it involved, on the administrative side, an undertaking both imposing and continuing in character.

How the Commission has performed this great function, the present chapter has analyzed in detail, and with critical comment. To direct emphasis, it is important to repeat that, despite the uncertainties of its objective and the great effort required to reach it, the Commission throughout has prosecuted the task with energy and decision, and with no disposition to escape the arduous investigations required

by Congress or the independent responsibilities flowing therefrom. Systematically it formulated programs and policies whose details were characterized, on the whole, by practical effectiveness and consistent applicability. Its pragmatic approach was apparent at the very outset of the work—in the formation and development of the bureau organization, in the procedure adopted, and in the relations established with the carriers; and it was manifest again in the handling of the hundreds of items involved in the underlying appraisals, and in the finding, without express legislative requirement, of single-sum values designed to serve the ends of regulation. In recognition of its ultimate subjection to the rule of law, the Commission has accepted the guidance of Congress and the courts in fixing the ends and limits of its action; but within the boundaries thus set, the realities of the task, rather than the indirect and uncertain implications of the law, have, on the whole, molded its decisions. As an administrative body, it has performed a typically administrative task with appropriate wisdom, initiative, and discretion. Thus viewed in its entirety, the Commission's performance seems worthy of highest commendation; nor is serious detraction therefrom intended if attention is directed to certain questionable features of the work.

One such feature is the Commission's handling of original cost. If one may judge by present practice, its consistent refusal to reach conclusions regarding original cost in the primary valuations was but poorly explained by the need of resort to estimate. So small an obstacle should scarcely have disturbed the Commission when, with vastly greater expenditure of effort, it was finding a reproduction cost whose sole warrant for being lay in its mistakenly assumed correspondence to a hypothetical competitive norm, and whose discovery required the imaginary recreation of properties the conditions of whose absence and reconstruction could hardly be defined on a strict logical basis. Certainly at least equal reality attaches to the actual cost of the railroads, even though in part estimated. Such a finding, moreover, was equally the requirement of Congress, and it was at least equally significant, in the Commission's view, for the processes of regulation. The failure to arrive at inclusive original cost figures in the primary valuations is not a serious defect if, whenever valuations are put to practical use, it is appropriately rectified; but the observation is never-

theless warranted that in this aspect of its task the Commission forgot the purposive character of the valuation process and forsook its usual pragmatic approach. Of more serious import is the failure of the Commission, as the outstanding agency of public service regulation, to dispose unmistakably and quantitatively of the claims for intangibles. Going value, for example, either is relevant in the determination of value for rate-making purposes, or it is not; if it is relevant, and final value is made larger because of it, the increase is necessarily by a certain amount. As an act of public leadership where authoritative analysis is greatly needed, and as an aid, one may suspect, to the clarity of its own thinking, it would have been much better if the Commission had determined each value factor separately, instead of merging the estimate of the intangible elements in the larger exercise of judgment by which all the factors were combined. By the latter procedure the individual items were left in complete obscurity, and the final judgment attained, if possible, a heightened mystery. That mystery, however, lay chiefly in the combination of elements, whether definite or not in themselves, by a process wholly unexplained—and failing of clarification most dismally when individual commissioners have volunteered to explain it. That the situation thus created is the least satisfactory aspect of the valuation work can hardly be gainsaid. When divergent elements of unmeasured relevance contribute to a result unlike any one of them, the processes which produce that result are so important that their concealment reflects upon the worth of all the labor that went before and precludes all exercise of needed leadership at this critical point. It is true that extenuation of the Commission's procedure can be found in the legal environment of the project. When value determination faces an uncertain fate in the courts, value factors of doubtful relevance may be admitted, either *pro forma* or in actuality, to forestall reversals. Governed by the implications of previous judicial decrees, the Commission may appropriately make nominal allowance, not numerically stated, for developmental costs, accord carrier lands a questionable market value, and steer an uncharted course between reproduction cost and original cost; else, it may be argued, nothing effective will be accomplished. But such an exculpation is not altogether convincing. With valuation doctrine still in a somewhat fluid state, not only in the railroad field but in the entire regulatory



sphere, sound and intelligible foundations are necessary. If certain value factors are relevant and compatible, in final value determination, a group of qualified experts should be able to explain why and how, and infuse the process with manifest reasonableness; similarly, if particular value elements are found to lack probative force, and are excluded on that account, or even if they are included unwillingly because of legal compulsion, it would make for progress to eliminate all mystery and all pretense—to exclude with candor, and to include with patent misgiving and protest, any elements that are not deemed appropriate.

It may be contended that the foregoing pronouncements constitute a counsel of perfection, which assumes a clarity of analysis prevented by existing circumstances. An undeviating course cannot be run toward a goal but vaguely apprehended; and in the minds of many the value sought by the Commission—its nature and its rôle—appears to be an objective of that uncertain character. Vestigial evidences persist that the courts, and even the Commission, have not sufficiently penetrated the nimbus of commercial associations with which the term "value" has come to be surrounded. And even if value for rate-making purposes is seen as a distinct thing, conceived solely in terms of a purpose to be accomplished, the idea is a persistent one that it can somehow spring from a compromise between logically inconsistent elements whose appropriate weights no one dares explain. Such incongruities seem not to be offensive to many persons of high standing and undoubted competence. This logical confusion was of little practical significance in the primary valuations; but as soon as their revision entered the period of post-war prices, the weight to be given diverse value elements became all-important. The Commission's first revision under these circumstances, realistically accomplished from an administrative standpoint, suffered judicial condemnation; while a second, representative of the present status and calculated to escape judicial censure, must bring disappointment to all who covet for so prolonged and significant an undertaking a useful and intelligible outcome. Such an outcome, however, is not too much to expect. All that seems to be necessary is a clearer understanding, first, that the value sought is primarily an instrument of income control, and second, that in this capacity it is only one of a number of factors on

which income depends, possessing no mechanical or compelling relation thereto. By themselves the values found can effect no equitable adjustments between carriers and public; by themselves they cannot take property without due process. Whatever rate base is deemed most useful, the return to be allowed thereon must be considered as its complement, to be determined in terms of all relevant interests. And even that determination will not fix the income actually received by groups of carriers, in view of the unpredictable relation of the flow of traffic to business conditions, to competitive policies, and to rates themselves, and of the fluctuating character of operating expenses; and individual roads will still feel financial stringency or abundance as they depart from average conditions. Movements for general increases or decreases in rates are not primarily grounded in whether carrier income amounts to a given percentage of an approved valuation; they spring, rather, from more direct indications of the railroads' credit status and the prosperity, or lack of it, of those who support the roads. The rôle of valuation, in connection with rate making, is thus a secondary one and should be kept in the background. As thus conceived, valuation procedure and its controlling principles may properly be adjusted with sole reference to the economic and administrative factors which they involve.

When the Commission's valuation procedure came to grief in the *O'Fallon* case, judgment was passed, not upon the determination of a rate base, but upon a special and unique aspect of income control. In the administration of the recapture clause, when excess earnings of past periods were being computed, the valuation arrived at did fix mechanically the portion of recoverable income. The recapture situation, moreover, was such that it was difficult for the Commission to establish that the rates which yielded a particular return were fixed in close relation to any specific rate base, even for large groups of carriers, to say nothing of the individual road in question. The statute, finally, called for an annual determination of excess income, and thus prevented any pooling of the results of good and bad years—a circumstance which lent color to the claim that the value factor in the calculation should mirror the immediately current conditions of the recapture year. For these reasons, and because the actual recovery of past earnings seemed to entail a more serious invasion of private rights

than the uncertain control of future income, the fixing of values for recapture purposes faced in logic and in law a more severe test than is involved in value determination for general rate-making purposes and for the other regulatory ends that values serve. The disruptive influence of the recapture clause upon valuation doctrine is one of the circumstances which led to its repeal, and this elimination of the recapture issue is likely to remove an important source of judicial restraint upon the valuation process. Similar consequences, as well as a more realistic attitude toward income control, will probably flow from the recent exclusion from the rule of rate-making of direct mention of "value," with its load of commercial connotations and legal freightage; and the valuation task will doubtless be simplified by the new enactment whereby the revision of values is expressly made less a repetition of the ordeal of their original ascertainment and is to be consummated only when required to serve the ends of regulation. In addition to these salutary changes the outstanding need is for a Congressional enunciation of a standard of value, for the future, free from the uncertainty and arbitrariness which inhere in any attempt to conform to established legal doctrine. If thus further reconstituted, the statutory basis of the valuation task would permit such a procedure in value determination, and such a performance of the regulatory functions dependent thereon, as could elicit full approval from the standpoint of economic soundness and administrative effectiveness. And the outlook for the suggested change is by no means hopeless. It is significant that its accomplishment need not rely for support wholly upon the inherent logic of the problem—that circumstantial aid is being provided by the turn of events in the business world. The gradual decline in prices from the high post-war level, and particularly the sharp break since late in 1929, have struck hard at the alignment of forces on the valuation issue. "In the past," Commissioner Eastman suggestively declared as early as the spring of 1931, "those who advocated original cost or prudent investment as the controlling factor in determining the rate base were regarded in conservative circles as enemies of 'property rights' and advocates of 'confiscation.' The time is rapidly approaching, and to some extent has already arrived, when they will instead be regarded as forces working for the protection of legitimate investment. For the most part the positions taken on the

'valuation' question have been wholly opportunistic, regardless of principle, and already the opportunists have begun to shift. Without doubt we shall in the future find many supporters of prudent investment in the ranks of erstwhile devotees of reproduction cost.<sup>398</sup>

But one's general appraisal of the valuation project should not be conditioned upon problematical legislative action. Whatever may develop in the future, the undertaking must be recognized as constituting a significant landmark in the Commission's record of performance. The values ascertained have not just grown, nor have they been produced in a fortnight's research; they are literally the result of more than two decades of exacting labor. The sheer immensity of the task which confronted the Commission on March 1, 1913, must give one pause; the present status of the project constitutes in itself a monument to the Commission's genius for accomplishment.

<sup>398</sup> *Excess Income of Richmond, F. & P. R. Co.*, 170 I.C.C. 451, 532-533 (1931).

## CHAPTER XIII

### CONTROL OF ORGANIZATION AND FINANCE

#### §1. Extensions and Abandonments

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#### §2. Coöperation and Combination

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### CHAPTER XIII

## CONTROL OF ORGANIZATION AND FINANCE

ALMOST without exception the activities of the Commission which involve directly and primarily the control of railroad organization and finance are of relatively recent origin. Prior to the enactment of the Transportation Act of 1920 the powers and duties of the Commission had been concentrated upon the establishment and maintenance of reasonable and non-discriminatory rates and practices, to the virtual exclusion of other important and distinct, though related, phases of railroad policy. Except for the authority which it derived from safety legislation and under the practically untested Car Service Act of 1917, the Commission was without direct jurisdiction over matters of service and facilities. It had little in the way of either power or obligation to insure adequacy of service or to control the extent of plant and equipment. Again, the Commission was lacking in discretionary authority in the matter of intercorporate relations. The pooling of traffic or of revenues was unconditionally prohibited by the Act to Regulate Commerce; and the combination of competing railroads, through whatever form or device, was held to be subject to the prohibitions of the anti-trust laws. Under these circumstances the Commission was without power to permit, and may indeed be said to have been under obligation to prevent, even such co-operative efforts as were calculated to further operating economy, financial advantage, or service need. Finally, while the Commission's authority over rates brought the flow of operating revenues under its influence, it was without jurisdiction to regulate the financial management of the carriers, either in the raising of capital funds through the issuance of securities or in the expenditure of their proceeds. This inability to control matters vitally related to the credit status of the roads not only limited the effectiveness of the Commission's determinations in dealing with transportation charges, but reduced still further its power to mold the character of the service to be rendered to the public. Rates which would yield unfairly high returns to conservatively financed and well-managed carriers might barely suffice for

overcapitalized or loosely administered properties; and the very necessity of supporting inflated or maladjusted capital structures led to impairment of service. In all these directions, as has been amply indicated in an earlier volume, serious difficulties progressively emerged.<sup>1</sup>

The extension of the regulatory process to plant and equipment, to competitive and cooperative relations, and to capital structures and financial practices involved a more far-reaching invasion of the domain of management than Congress had been willing to sanction prior to 1920; but developments during the pre-war decade, culminating in the war experience, clearly demonstrated the necessity of a change of attitude toward these problems. Because of the broader conception of public interest which gained wide acceptance, whereby adequacy of service came to receive at least as great emphasis as reasonableness of rates, and because it was generally recognized that effective rate control was itself dependent upon more comprehensive regulation of railroad enterprise, the Commission was clothed with a highly significant group of enabling powers in the field of organization and finance—embracing, as its chief constituents, authority to regulate extensions and abandonments, cooperation and combination, and the issuance of securities and assumption of obligations.<sup>2</sup> Without subjecting plant and equipment to some measure of centralized control, both as to expansion and contraction, there could be no assurance of satisfactory service, from the standpoint of quantity, quality, or cost. There was need of curbing unwise or extravagant extensions, not only as an independent safeguard against dissipation of finances and impairment of service, but by way of support to the new rule of rate-making, which was affirmatively designed to strengthen railroad credit and to promote adequate service; there was need of regulating abandonments of line, not only as a safeguard against unjustified termination of essential public services, but as a means of preventing the imposition of undue burdens upon interstate traffic because of the unwillingness of state authorities to sanction justifiable discontinuance of service. Under the influence of this

<sup>1</sup> For a detailed analysis of these defects of the legislative structure, see Part I, especially at pp. 79-81 and 86-103.

<sup>2</sup> For a detailed analysis of the provisions of the Transportation Act in this sphere, see Part I, pp. 183-189 (combinations), 189-195 (securities), and 235-244 (service).

new approach, and on the basis of the fruitful war-time experience with railroad unification, it also became apparent that controlled co-operation and combination might better serve the public interest than strict adherence to the traditional policy of enforced competition. The legalization of the pooling device was believed to afford one avenue of possible relief from the wasteful duplications of unrestrained rivalry; the authorization of acquisitions of control through lease or stock ownership was deemed to provide opportunities for coördination, economy, and financial gain; the provision for actual consolidation of properties was designed to establish a permanent structure for less costly operation, for improved service, and for the removal, through a measurable approach to equality among competitive railroad systems, of the difficulties which spring from the coexistence of strong and weak roads. But the public stake in all these intercorporate relations was altogether too great to be freely entrusted to the beneficence of the carriers, necessarily operating under the pressure of corporate self-interest; the coöperation and combination thus validated were made subject, in all their important ramifications, to the Commission's continuing control. And as part of the same general policy, a like jurisdiction was established over the issuance of railroad securities. There was almost universal agreement, on the basis of a long and revealing experience, that neither the self-restraint of the carriers nor the public control of the states could be safely relied upon to prevent financial practices which were not only harmful to investors but destructive of railroad credit. Under the *régime* of freedom in the issuance of securities the Commission had been frequently embarrassed by its inability to control the capital structures and financial policies of the roads; it had been often confronted, on the one hand, with "the claimed necessity of approving such rates as will [would] under private control establish credit and invite new capital for the public service," and on the other, by "a history of waste and wrecking, demonstrating that lower rates might have been adequate had the carrier corporation managed its business with some fair regard to law and sound principles."<sup>8</sup> With the new emphasis upon adequacy of rates and service introduced by the 1920 legislation, thoroughgoing

<sup>8</sup> *Proposed Increases in New England*, 49 L.C.C. 421 (1918), at p. 435.



supervision of security issues became imperative. Control of organization and finance, primarily along the channels indicated, thus became an integral part of the regulatory process.

These newer phases of the Commission's activity are closely inter-related. They are all largely ancillary to its duties to protect the public interest in reasonable rates and adequate service, and the exercise of power in any one of these spheres virtually presupposes the possession of ample authority with respect to the others. Applications for abandonments involve not only a consideration of financial factors, but often the possibility of coöperative arrangements for the provision of substitute services, and those for extensions generally necessitate an inquiry into the credit of the carriers, their relations with other roads, and the appropriateness of the proposed methods of financing the new construction; petitions for approval of the various forms of cooperation and combination require an examination not only of possible operating economies and service improvements, but usually also, of the propriety of the contemplated financial expedients for effectuating the unifications; proposals for the issuance of securities and assumption of obligations are frequently bound up with parallel proceedings involving extensions of line, acquisitions of control, or the merger of properties. The Commission has dealt with these interrelationships repeatedly in its reported decisions, and it has accorded them administrative recognition by concentrating practically all of its authority over these matters, in the first instance, in Division 4 and its subordinate Bureau of Finance. In all these directions, too, the Commission exercises a wide range of discretionary authority. It is guided, for the most part, by the uncharted standard of public interest, not only in approving or denying applications in whole or in part, but in prescribing the terms and conditions under which the proposed courses of action may be pursued. The powers so exercised, however, are enabling powers rather than directing powers. Initiative is generally taken by the carriers themselves, and the Commission's determinations, in most instances, are permissive rather than mandatory. Accordingly, although the regulation of organization and finance impinges upon managerial functions more drastically than the traditional exercise of the powers of rate control, the origination of policies in this sphere is still left to private management, and it remains

a matter of voluntary determination by the carriers as to whether they will accept or reject such modifications of these policies as may be deemed in the public interest. The Commission is thus enabled to veto proposed courses of action and to suggest ways and means of rendering them acceptable, but it possesses no affirmative power to substitute public administration, in the sense of direct enforcement of controlling policies, for private management.

With these common characteristics of the field as a whole as a starting-point, we shall attempt to analyze and appraise the character and direction of the Commission's substantive determinations with respect to extensions and abandonments, coöperation and combination, and the issuance of securities and assumption of obligations.<sup>4</sup>

#### §1. EXTENSIONS AND ABANDONMENTS

The prohibitions imposed upon the carriers and the powers vested in the Commission with respect to extensions and abandonments are of sweeping character.<sup>5</sup> The Interstate Commerce Act, as amended in 1920, provides that "no carrier by railroad . . . shall undertake the extension of its line of railroad, or the construction of a new line of railroad, or shall acquire or operate any line of railroad, or extension thereof, or shall engage in transportation . . . over or by means of such additional or extended line of railroad, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity require or will require the construction, or operation, or construction and operation, of such additional or extended line of railroad, and no carrier by railroad . . . shall abandon all or any portion of a line of railroad, or the operation thereof, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity permit of such abandonment."<sup>6</sup>

<sup>4</sup> For an analysis and appraisal of the Commission's performance in this sphere from the standpoint of state and federal relationships, see Part II, pp. 216-224, 247-269; for a presentation of the extent of the Commission's activities in the field of organization and finance, see pp. 20-33, *supra*.

<sup>5</sup> Sec. 1, pars. (18) to (22).

<sup>6</sup> Par. (18). The Commission has consistently declined to assume jurisdiction over abandonments where operations had ceased prior to the effective date of this paragraph. See *Public-Convenience Application of M. & E. T. Ry.*, 67 I.C.C. 365, 744

Furthermore, the Commission is authorized, on its own initiative as well as on complaint, to *require* any such carrier subject to the Act to extend its line or lines.<sup>7</sup> These powers were conferred upon the Commission to further the maintenance of adequate railroad service, as an integral part of the new policy introduced by the Transportation Act.<sup>8</sup> "By that measure," it has been judicially declared, "Congress undertook to develop and maintain, for the people of the United States, an adequate railway system. It recognized that preservation of the earning capacity, and conservation of the financial resources, of individual carriers is a matter of national concern; that the property employed must be permitted to earn a reasonable return; that the building of unnecessary lines involves a waste of resources and that the burden of this waste may fall upon the public; that competition between carriers may result in harm to the public as well as in benefit; and that when a railroad inflicts injury upon its rival, it may be the public which ultimately bears the loss."<sup>9</sup> And more concretely, on another occasion: "The purpose of paragraphs 18 to 22 is to prevent interstate carriers from weakening themselves by constructing or operating superfluous lines, and to protect them from being weakened by another

(1921); *Public-Convenience Certificate to A. & L. M. Ry.*, 67 I.C.C. 781 (1921); *Abandonment of K. C. N. W. Ry.*, 105 I.C.C. 291 (1925); *Abandonment by Wilkes-Barre & Eastern*, 111 I.C.C. 67 (1926); *Abandonment by D. & R. G. W. R. Ry.*, 111 I.C.C. 415 (1926); *Abandonment by P. R. R. Co.*, 117 I.C.C. 139 (1926); *Abandonment by C., R. I. & P. Ry.*, 131 I.C.C. 421 (1927). Similarly, the Commission has held that certificates are not required in the case of extensions or new construction entered upon in good faith and prosecuted with reasonable diligence prior to the effective date of the paragraph. See *Public-Convenience Application of T., O. & E. R. Ry.*, 67 I.C.C. 484 (1921); *Public-Convenience Application of U. & N. Ry.*, 67 I.C.C. 554 (1921); *Public-Convenience Application of G. P. T. Ry.*, 71 I.C.C. 759 (1922). This approach has been referred to approvingly by the courts in *Detroit Terminal R. Co. v. Pennsylvania-Detroit R. Co.*, 4 Fed. (2d) 705, 707 (1925), 15 Fed. (2d) 507, 508 (1926); certiorari denied in 273 U.S. 758 (1927). But in *Construction by San Antonio & Aransas Pass Ry.*, 111 I.C.C. 483 (1926), the Commission found that the cessation of building operations for a period of more than 20 years subjected the new construction to its jurisdiction. See, also, *Construction by Piedmont & Northern Ry.*, 138 I.C.C. 363, 367-368 (1928), where a lapse of the railroad's charter for a period of 6 years was held to interrupt "the claimed continuity of intention" and to have a like effect.

<sup>7</sup> Par. (21). The Commission is also empowered to require carriers by railroad to provide themselves with safe and adequate facilities for performing their "car service," upon a finding "that the expense involved therein will not impair the ability of the carrier to perform its duty to the public."

<sup>8</sup> See Part I, pp. 177-244, especially at pp. 235-244.

<sup>9</sup> From the opinion of Justice Brandeis in *Texas & Pac. Ry. v. Gulf Ry.*, 270 U.S. 266 (1926), at pp. 277-278.

carrier's operating in interstate commerce a competing line not required in the public interest."<sup>10</sup> While the Commission's authority in furtherance of this purpose is restricted to carriers by railroad<sup>11</sup> and is expressly made inapplicable to the construction or abandonment of spurs and industrial tracks located wholly within one state<sup>12</sup> or of

<sup>10</sup> From the opinion of Justice Brandeis in *Texas R. R. v. Northside Ry.*, 276 U.S. 475 (1928), at p. 479.

<sup>11</sup> For proceedings in which the Commission has held that certificates of convenience and necessity are not required for the extension or abandonment of services by water carriers, see *Routing from Southwest to East and New England*, 91 I.C.C. 455, 456 (1924); *Nelson S. S. Co. v. B., A. & P. Ry. Co.*, 109 I.C.C. 529, 537 (1926). In *Procedure under Barge Line Act*, 148 I.C.C. 129, 132 (1928), the Commission declared: "That act [the Interstate Commerce Act] does not authorize us to grant certificates of convenience and necessity to carriers by water, nor are such carriers prohibited from operating or abandoning operation until such a certificate has been obtained. The provisions of paragraphs (18) to (20) of section 1 relate only to carriers by railroad." For judicial support for this view, see *Lucking v. Detroit Nav. Co.*, 265 U.S. 346, 352 (1924). In *Oyler & Son v. American Ry. Express Co.*, 83 I.C.C. 160, 162 (1923), which involved the right to order the acquisition of facilities, the Commission reached a like conclusion with respect to the applicability of the provisions to express companies.

<sup>12</sup> Par. (22). In determining whether the facilities involved are "spur, industrial, team, switching or side tracks" the construction and abandonment of which are excepted from its jurisdiction, the Commission is generally guided by the function of the trackage and its relationship to the operating situation and competitive status of the carrier rather than by its nominal character or mere length. See, for example: *Public-Convenience Application of Western Pacific R. R.*, 67 I.C.C. 135 (1921); *Abandonment of Line by Missouri Pacific R. R.*, 76 I.C.C. 635 (1923); *Abandonment of Barnegat R. R.*, 79 I.C.C. 506 (1923); *Construction of Line by D., L. & W. R. R.*, 94 I.C.C. 541 (1925); *Acquisition by Iberia & Vermilion R. R.*, 111 I.C.C. 660 (1926); *Operation by L. A. & S. L. R. R.*, 124 I.C.C. 207 (1927); *Construction by Alabama, T. & N. R. Corp.*, 154 I.C.C. 308 (1929). The Commission's determinations appear to be in general harmony with the following declarations of the Supreme Court, which are specifically applicable to extensions: "The carrier was authorized by Congress to construct, without authority from the Commission, 'spur, industrial, team, switching or side tracks . . . to be located wholly within one State.' Tracks of that character are commonly constructed either to improve the facilities required by shippers already served by the carrier or to supply the facilities to others, who being within the same territory and similarly situated are entitled to like service from the carrier. The question whether the construction should be allowed or compelled depends largely upon local conditions which the state regulating body is peculiarly fitted to appreciate. Moreover, the expenditure involved is ordinarily small. But where the proposed trackage extends into territory not theretofore served by the carrier, and particularly where it extends into territory already served by another carrier, its purpose and effect are, under the new policy of Congress, of national concern. For invasion through new construction of territory adequately served by another carrier, like the establishment of excessively low rates in order to secure traffic enjoyed by another, may be inimical to the national interest. If the purpose and effect of the new trackage is to extend substantially the line of a carrier into new territory, the proposed trackage constitutes an extension of the railroad within the meaning of paragraph 18, although the line be short and although the character of the service contemplated be that commonly rendered to industries by means of

street, suburban, or interurban electric railways not operated as part of a general steam railroad system of transportation,<sup>18</sup> it is virtually free of specific substantive limitations. Approval of applications for extensions or abandonments and the issuance of the necessary certificates are merely dependent upon findings that the present or future public convenience and necessity require the extension or permit of the abandonment; and the Commission is empowered "to issue such certificate as prayed for, or to refuse to issue it, or to issue it for a portion or portions of a line of railroad, or extension thereof, described in the application, or for the partial exercise only of such right, or privilege," and to "attach to the issuance of the certificate such terms and

spurs or industrial tracks. Being an extension, it cannot be built unless the federal commission issues its certificate that public necessity and convenience require its construction." *Texas & Pac. Ry. v. Gulf Ry.*, 270 U.S. 266, 278-279 (1926).

<sup>18</sup> In determining whether or not an electric railway is so closely related to a steam railroad system that it may be deemed to be operated as part of it, the Commission is uniformly guided by the realities of the specific situation, as they emerge not only from the facts of ownership, direct or indirect, but from the prevailing traffic arrangements. See, for example: *Public-Convenience Application of Michigan United Rys.*, 67 I.C.C. 452 (1921); *Abandonment of Line by Boise Valley Traction Co.*, 79 I.C.C. 167 (1923); *Proposed Abandonment by L. & Y. F. Ry.*, 124 I.C.C. 219 (1927); *Construction by Piedmont & Northern Ry.*, 138 I.C.C. 363 (1928); *Unified Operation at Los Angeles Harbor*, 150 I.C.C. 649, 661 (1929); *Glendale & M. Ry. Proposed Abandonment*, 166 I.C.C. 625 (1930). The Commission's order in *Construction by Piedmont & Northern Ry.*, *supra*, in which it was found that the applicant's lines did not constitute an interurban electric railway within the meaning of the exemption contained in paragraph (22), was upheld on the merits in 30 Fed. (2d) 421 (1929); but in *Piedmont & Nor. Ry. v. U.S.*, 280 U.S. 469 (1930), the Supreme Court held that the lower court should have dismissed the complaint for want of jurisdiction—because the Commission's order denying a certificate of convenience and necessity was "negative in substance as well as in form"—rather than upon the merits. See, also, *Piedmont & N. R. Co. v. I.C.C.*, 286 U.S. 299 (1932). For an analysis of the problem of judicial review, in its relationship to so-called affirmative and negative orders, see Part II, pp. 406-417. The Commission has repeatedly urged that the scope of its jurisdiction over electric railways, not only with respect to extensions and abandonments, but in the application of the rule of rate-making, the recapture of excess earnings, and the regulation of security issues, be extended and clarified. Toward this end, its latest recommendation provided: "That the present exemption provisions of sections 1(22), 15a(1), and 20a(1) of the interstate commerce act, applicable to electric railways, be amended by substituting provisions exempting all electric railways except such as interchange standard freight equipment with steam railroads and participate in through interstate freight rates with such carriers, provision to be made for exemption of particular electric railways falling within the excepted class, if upon application they are able to show to the satisfaction of the commission, after notice and opportunity to be heard, that they are not affected with an important national interest so far as the provisions in question are concerned." *Annual Report*, 1932, pp. 102-103. For a discussion of the difficulties which resulted in this recommendation, see *Annual Report*, 1928, pp. 79-81.

conditions as in its judgment the public convenience and necessity may require."<sup>14</sup> Even in *ordering* the extension of lines the Commission's action is expressly conditioned only upon a finding that the new construction is reasonably required in the interest of public convenience and necessity and that the expense involved therein will not impair the ability of the carrier to perform its duty to the public.<sup>15</sup> An analysis of the Commission's performance in this field will disclose the controlling influence exerted by the broad purpose of the legislative provisions, the undefined character of public convenience and necessity, and the flexible scope of the contemplated determinations. There can be no question as to the vastness of the discretionary authority with which the Commission is clothed; our inquiry will be chiefly concerned with the character of its administrative processes and substantive results. Toward this end we will examine briefly the nature of its policies and practices with respect to abandonments, voluntary extensions, and compulsory new construction.

### *Abandonments*

Broadly speaking, applications for abandonments are of two principal types: those incidental to readjustments in plant and service; and those designed to relieve carriers of the burdens of unprofitable operation. The proceedings resulting from the first of these groups of applications can be disposed of very briefly. They are generally initiated for the purpose of increasing efficiency, effectuating economies, or promoting safety, and they contemplate no material diminution in the scope or quality of the service rendered to the patrons and communities involved. In these circumstances the Commission tends to accord approval to the plans of the management whenever it is made to appear that there is a reasonable prospect of securing the advantages sought<sup>16</sup> and that the costs of the proposed changes are not ex-

<sup>14</sup> Par. (20).

<sup>15</sup> Par. (21).

<sup>16</sup> But see, for example, *Abandonment of Branch Line by Great Northern*, 72 I.C.C. 25 (1922), in which, in view of the limited savings to be realized and the adverse effects upon the users of the service, the carrier's application was denied. In supporting its conclusion the Commission said: "The applicant does not contend that the operation of the Portland branch is unprofitable. It is apparent that the saving to be effected by the proposed abandonment would be relatively small. It also appears that the towns

cessive.<sup>17</sup> While the Commission must find that convenience and necessity will be served by the projected readjustments, the public interest to be safeguarded does not arise from any direct threat to the adequacy of the transportation service. Abandonments of this character are usually proposed in connection with projects involving new construction,<sup>18</sup> being incidental, for example, to terminal rearrangements<sup>19</sup> and relocation of lines.<sup>20</sup> In such proceedings the propriety of the abandonment is largely determined by the nature of the gains calculated to flow from the substitute facilities; and since operating loss does not furnish the controlling impetus for the proposed relinquishment of plant, and curtailment of service is not its unavoidable outcome, the difficulties of such balancing of the respective interests of carriers and communities as characterizes the disposition of the great bulk of abandonment proceedings are largely absent.

But in most instances carriers seek permission to abandon their lines, in whole or in part, because of the pressure of unprofitable op-

erved by the Portland branch would be placed at a commercial disadvantage, as compared with towns on the Mayville branch, because of the resultant increase in freight charges, which would put an added burden upon the local consumers" (p. 28).

<sup>17</sup> But see, for example, *New York Central R. Co., Abandonment*, 158 I.C.C. 309 (1929), in which the carrier was authorized to abandon approximately 5 miles of line and to construct and operate a line, approximately 4.5 miles in length, in another location, both being in the Borough of Manhattan; and 158 I.C.C. 687 (1930), in which the same carrier was authorized to abandon certain portions of its lines and to construct and operate corresponding lines in new locations in the city of Syracuse. In the first proceeding the project involved an estimated expenditure of more than \$120,000,000 by the applicant; in the second proceeding the project involved an expenditure of approximately \$15,000,000 by the applicant. In both instances the construction and abandonment were largely incidental to the elimination of grade crossings.

<sup>18</sup> See, for example: *Construction by N. P. Ry.*, 124 I.C.C. 728 (1927); *Construction by S. P. R. R.*, 145 I.C.C. 323 (1928).

<sup>19</sup> See *Los Angeles Passenger Terminal Cases*, 100 I.C.C. 421 (1925), 142 I.C.C. 489 (1928). For an analysis of these proceedings, in their relationship to state action and the determinations of the courts, see Part II, chap. ix, note 73.

<sup>20</sup> See *Abandonment and Construction of Lines by L. Ry. & N. Co.*, 99 I.C.C. 731 (1925); *Construction and Abandonment by G. N. Ry.*, 124 I.C.C. 685 (1927); *Construction by Great Northern Ry.*, 131 I.C.C. 79 (1927); *Abandonment by Central Pacific Ry.*, 131 I.C.C. 317 (1927), following new construction authorized in *Construction of Natron Cut-Off by Central Pacific Ry.*, 82 I.C.C. 185 (1923), and in *Construction of Black Butte Cut-Off by C. P. Ry.*, 99 I.C.C. 780 (1925); *Relocation by D., G. H. & M. Ry.*, 138 I.C.C. 268 (1928); *Abandonment of Toledo-Detroit R.*, 154 I.C.C. 444 (1929), following authorizations granted in *Construction of Line and Bond Issue by D. & I. R. R.*, 90 I.C.C. 502 (1924), and in *Operation by Detroit, T. & I. R. Co.*, 154 I.C.C. 239 (1929); *Detroit, T. & I. R. Co. Abandonment*, 162 I.C.C. 523 (1930), following authorization in *Construction of Line and Bond Issue by D. & I. R. R.*, *supra*.

eration; and the proposed abandonments generally evoke protest because of their probable transportation effects upon the communities being served by the existing facilities. The factor of unprofitable operation emerges under a great variety of circumstances. Sometimes it appears that losses have been suffered from the very beginning, and that in view of the capital costs and probable traffic the construction of the lines in question should never have been undertaken. In many cases lines which may have been economically justified at the time of their construction find themselves operating at a loss because of a decreasing demand for their services attributable to a diversity of causes—movements of population, shifting of industries, competition of motor carriers, diversion of traffic to other railroads, and the like. Most frequently the proposed abandonments induced by financial embarrassment involve short lines built to provide special services which are no longer necessary or to tap natural resources which have become exhausted.<sup>21</sup> But whatever the source of the carriers' difficulties, and however pressing they may be, the localities affected generally resent and oppose the relinquishment of established services. The protestants often give little thought to the actual utilization of the existing facilities or to the financial burdens incident to their continued maintenance; but the fact that in many instances economic enterprise and social well-being are integrally bound up with the prevailing transportation service—that industries and communities have been developed in reliance upon the facilities involved and that they are

<sup>21</sup> An analysis of railroad mileage abandoned during the years 1920–1928 under certificates granted by the Commission indicates that 53.5 per cent of the mileage was abandoned primarily because of the exhaustion of natural resources (including timber, oil, and the products of mines), 15 per cent because of highway competition, 13.7 per cent because of insufficient traffic, 9.8 per cent because of railroad competition, and 2.5 per cent for miscellaneous reasons. John H. Frederick, Frank T. Hypps, and James M. Herring, *Regulation of Railroad Finance* (1930), p. 47. See, also, Henry R. Trumbower, "Railroad Abandonments and Additions," *Journal of Political Economy*, vol. 34 (February, 1926), pp. 37–60, 45. Such compilations are necessarily inaccurate, since the Commission's findings are almost always based upon a variety of considerations, but they do serve, in a rough way, to indicate the relative importance of the underlying causes of financial difficulty. It is interesting to note that during the current depression the number of applications for abandonment and the number of miles of road involved in these applications have increased rather sharply. In 1929, 69 applications were filed, involving approximately 834 miles of road; in 1930, 1931, 1932, and 1933, the number of applications increased to 75, 88, 114, and 153, and the number of miles of road involved increased to 980, 1,075, 2,281, and 3,263. See pp. 24–25, *supra*.



wholly or in predominant measure dependent upon their uninterrupted operation—constitutes a highly significant factor in determining the demands of convenience and necessity, even in the face of operating deficits. Neither the interests of the carriers nor those of the shippers or other protestants, however persuasive each may be when considered independently of the other, are necessarily controlling. Since the enabling power with respect to abandonments was vested in the Commission in furtherance of the public good, the administrative judgment which issues in the approval or denial of an application cannot avoid a weighing of conflicting advantages and disadvantages—a balancing of the interests of carriers and communities under the specific circumstances and conditions shown of record. In this process of balancing interests, matters of degree, rather than of kind, most frequently fashion the outcome. The amount of the operating deficits, the duration of their incidence, the likelihood of their continuance, the causes of their emergence, and, where a branch is involved, the relationship which they bear to the operating results as a whole, are obviously considerations relevant to an appraisal of carrier claims; the presence or absence of any basic economic justification for the maintenance of the service, the extent to which financial support is actually accorded to it through traffic demand, the feasibility of suggested expedients for rendering it more remunerative, the probable social and industrial effects of its discontinuance, and the degree to which alternative or substitute services are available are obviously considerations relevant to an appraisal of community claims; and a final judgment as to whether public convenience and necessity permit of the abandonment is the resultant of all such considerations, in their numerous interrelations, as they are developed in each proceeding.<sup>22</sup>

<sup>22</sup> The Commission recognized from the first that for the exercise of a sound discretion in this sphere full information is indispensable. A carrier filing an application for authority to abandon the whole or a portion of its line must answer, under oath, a detailed questionnaire bearing upon every important aspect of the proceeding. Among the data required are the following: date of construction, purposes, and cost of the line; its operating and financial history, including that of receiverships; public aid, if any, granted in consideration of its construction; outstanding securities which may be affected by the proposed abandonment; financial position of the applicant, as disclosed by its latest balance sheet and its income accounts for the preceding five years; where entire mileage is not covered by application, gross and net revenues allocated to the line involved on a mileage pro rata basis, and probable effect of continued operation upon the earnings of the system as a whole; the towns and villages, with their approximate

While the circumstances of each case inevitably govern specific administrative determinations, the nature of the Commission's approach can be gathered in some measure from the character of some of its general pronouncements. "The term 'public convenience and necessity,'" the Commission has declared, "implies both convenience and necessity. . . . Necessity does not exist unless the inconvenience would be so great as to amount to an unreasonable burden on the community. . . . The words imply an urgent, immediate public need."<sup>23</sup> The burden of showing such need is placed upon the applicant: "It is incumbent upon a carrier seeking to abandon a line of railroad to establish by clear and convincing proof every element of the case from which we are expected to determine that the present or future public convenience and necessity will permit of the proposed abandonment."<sup>24</sup> On the basis of the facts thus presented, however, there must be a balancing of the interests of the railroad system seeking abandonment and of the communities being served by it. In considering numerous proposed abandonments in New England territory by the Boston & Maine Railroad, for example, the Commission gave extended expression to this need of balancing interests: "The people of New England understand the importance to them of the Boston & Maine Railroad. This railroad and the people it serves are peculiarly interdependent and in these abandonment cases there must be kept constantly in view the necessity for the preservation of as much as possible of the present mileage in the service of the greatest number of the people. The evidence seems to be conclusive that not a

populations, located on the line, the other railroads serving them, and the distances from the towns and villages of these other roads; the railroad connections of the line involved; its traffic for the preceding five-year period classified by commodities and divided into that which is interchanged with connecting carriers and that which is originated at or is destined to points on the line; the nature, history, and dependence upon the carrier of industries located along the line; the passenger traffic of the preceding five years, classified as local and connecting-line passengers and revenues; reasons for any decrease in traffic, whether freight or passenger or both, which may have occurred during recent years; efforts which may have been made to dispose of the line to insure continued operation. See *In the Matter of Applications under Paragraphs (18) to (21), Inclusive, Section 1, of the Interstate Commerce Act for Certificates of Convenience and Necessity Authorizing the Abandonment of Lines of Railroad or the Operation Thereof*, July 8, 1921.

<sup>23</sup> *Public-Convenience Application of A. & S. A. B. Ry.*, 71 I.C.C. 784 (1922), at p. 792.

<sup>24</sup> *Abandonment of Branch by Pere Marquette*, 72 I.C.C. 303 (1922), at p. 307.

few of the lines which it is now proposed to abandon should never have been built. Under present conditions they would not be built. . . . But irrespective of the origin of an existing line, people gather about it and create for themselves an interest in and a dependence upon it. Under these circumstances abandonment brings about the kind of hardships with which it is so difficult to deal. The sufferers in such cases have no redress against those guilty of the original error, nor were they responsible for that error. . . . Differences of opinion exist with reference to the wisdom of certain features of the Boston & Maine management for decades past, but . . . the important thing is the vitality of the present Boston & Maine system. Not only New Hampshire but all New England needs that system. The serious and difficult problem is how to sustain both the railroad system and New England territory as a whole without undue hardship on particular local territories. Benefits to the system of particular abandonments must be weighed against the inconveniences and losses which those abandonments will inflict upon the communities immediately affected. Benefits to particular communities of continued operation must be weighed against the burdens and retarding effect of such operation upon the development of the Boston & Maine system as a whole."<sup>25</sup> Under such an approach it is obvious that bare need for the service cannot be controlling and that operating losses cannot be ig-

<sup>25</sup> *Abandonment of Branches by B. & M. R. R.*, 105 I.C.C. 13 (1925), at pp. 15-16. For a concrete application of this balancing process, note the following: "It is evident from the record that the operation of the old line now sought to be abandoned is a burden upon the interstate commerce of the applicant, since the expenses incident to such operation are much greater than the revenue derived by the applicant therefrom. While the burden is slight and can not be said to have any appreciable effect on the applicant's credit, it doubtless depletes its resources to the extent of several thousand dollars a year. It would therefore seem to be in the public interest to discontinue this operation unless the loss which the communities served by the line would suffer from its abandonment would outweigh the benefit to the applicant. The population of some 250 people, which the old line now serves, or many of them, would be considerably inconvenienced . . . by the abandonment of the line. It can not, however, be said that they would be left without railroad service, since the stations on the new line are not far away, as distances are reckoned in that part of the country. The applicant . . . will arrange for a roadway from White Pine to the new line, which should give the people on the table-land reasonably good service, even if the hauling of lumber thereon may be attended with some difficulty. Practically every abandonment of a line of railroad injures or inconveniences some of the people who have been served by it. In this case, the record shows that the number of people and the property interests served are so inconsiderable that it does not seem to be in the interest of the public at

nored: "We are urged to construe these paragraphs as requiring us to consider only the question of whether there is a public need for the service and to hold that the question of loss in operation is a matter which we can not take into account at all. The argument is that the question of gain or loss is a matter entirely unrelated to public convenience and necessity, and that if we find from the evidence that there is any degree of public need for the service, we must, as a matter of law, deny the application. Such a construction, however, loses sight of the familiar doctrine of the courts that the very fact that a line of railroad does not pay the expense of running its trains is cogent evidence that public convenience and necessity does not require it to be kept in operation. . . . A further persuasive consideration against this contention is found in the result of its adoption on the validity of the act itself. For while we may not with propriety decide that an act of Congress is unconstitutional, we must as clearly avoid any suggested construction of a statute which would render it ineffectual and adopt a construction, when called upon to construe it, which will sustain it, if such a construction is reasonable and consonant with the language employed. . . . The past earnings and probable future earnings are evidentiary facts which, in the light of all circumstances disclosed of record, enable us to make a finding under which the appropriate certificate may be granted. . . . These provisions, we think, bring within our consideration all matters touching the feasibility of continued operation on the part of the carrier and permit us to take into account, among such matters, the question of whether the line has been or can be operated without financial loss."<sup>28</sup> In other words, while the burden of justifying a proposed abandonment is placed upon the carrier, the mere fact that the discontinuance

large to require the continued operation of the old line, particularly as the old and new lines are so close together that for the most part they merely duplicate the service of each other." *Abandonment by Northern Pacific Ry.*, 138 I.C.C. 213 (1928), at pp. 218-219.

<sup>28</sup> *Public-Convenience Certificate to D. & N. M. Ry.*, 71 I.C.C. 795 (1922), at pp. 799-801. Indeed, the Commission had declared earlier that a disregard of financial results "would condemn the provision [section 1, paragraph (18)] on constitutional grounds, since any refusal on our part to consider operating losses might very well . . . result in a denial of the application, so that the effect of the paragraph would then be to require the carrier to continue to operate at a loss, and amount to confiscation." *Abandonment of Hawkinsville & Florida Southern Ry.*, 70 I.C.C. 566 (1921), at p. 568.

of the service would result in some injury or inconvenience to the public is not deemed sufficient to prevent its authorization. As will appear from the following, public need for the service must be reflected in a reasonable measure of public support: "The protestants have shown a substantial local need for the facilities afforded. This together with the long-continued operation of the branch, and the fact that a substantial investment therein will be dissipated if the abandonment is authorized, make it incumbent upon the applicant to establish with certainty that operation in the future will constitute so great a burden upon its revenues as to be against the public interest. . . . It must be borne in mind that under paragraph (18) of section 1 of the interstate commerce act abandonment of a line of railroad or the operation thereof is made unlawful and that any carrier by railroad proposing such abandonment bears the burden of proving that it is consistent with the present and future public convenience and necessity. . . . On the other hand the people who are interested in the continued operation of this branch, especially those protestants who are dependent upon it, must realize that they have a duty to perform and that the future of this branch rests largely in their hands. The mere desire to have a railroad is not enough. There must exist the will to cooperate in its operation and the ability to support it adequately."<sup>27</sup>

In disposing of applications for abandonments, the Commission always sets forth the relevant facts which support its findings, but generally without express indication of the controlling factors. The nature of these factors can be gathered, however, from those proceedings in which the evidence of record is explicitly interpreted. Two illustrations will suffice for our present purpose. In authorizing the Chicago & Alton Railroad and its receivers to abandon the operation of the Rutland, Toluca & Northern, one of its leased lines in Illinois, the Commission summarized as follows the considerations supporting its conclusion: "We have considered as essential factors in reaching our finding the value and magnitude of the carrier's service, the financial results of its operation, the character and extent of the population and industries served, and the probable effect of abandonment upon

<sup>27</sup> *Abandonment of Branch by Pere Marquette*, 72 I.C.C. 267 (1922), at p. 271. See, also, *Abandonment of Chicago, Peoria & St. Louis R. R.*, 76 I.C.C. 801, 807 (1923); *Georgia & Florida R. Abandonment*, 166 I.C.C. 539, 545-546 (1930).

both the general community and the Alton system. It appears that the R., T. & N. performs a comparatively small transportation service, at a considerable loss to the system of which it is a part; that this system should be relieved of the burden of such loss. The local population and its farming and livestock industries are, with the exception of those . . . generally centering on Magnolia, served or capable of being served by rail lines other than that of the R., T. & N. The Magnolia section is not without highways leading to several stations on other lines at no great distances, and there is prospect of additional and improved State roads. The probable inconvenience to be suffered by the communities as a whole is not sufficiently serious to warrant continued operation of the railroad for purely local reasons, under all the circumstances shown. Its value as a connecting or bridge line, in view of the numerous points of interchange in this part of the State, can not be considered important."<sup>28</sup> Similarly, in authorizing the Southern Railway to abandon the Knoxville & Bristol, one of its branch lines in Tennessee, the Commission spelled out in detail the circumstances found to justify the discontinuance of the service: "From the history of past operation, as developed in the record, it appears that the K. & B. has been economically operated, that wherever and whenever possible economies in operation have been effected; that for the past several years less sums have been spent upon it than should have been spent upon a going line of like character, as evidenced by the deferred maintenance that must be made up at once or in the immediate future; that concurrently the passenger traffic has decreased and the freight traffic, although somewhat erratic, has shown a decided tendency to decrease both in volume and in the grade of the commodities offered for shipment. . . . The result of this condition is that the K. & B. has been and will be operated at a continually increasing loss. With the advent of the automobile, automobile busses, and trucks, and the improved highways, the territory adjacent to the K. & B. is within reasonable distance of the main lines of the applicant and may be considered as served by them. It does not appear that the abandonment of the K. & B. will materially affect the community as a whole. Those persons affected have had nearly four years, since the first application was filed in this case, in which to ex-

<sup>28</sup> *Abandonment by Chicago & Alton R. R.*, 117 I.C.C. 711 (1927), at pp. 714-715.

pedite the manufacture of their products and in which to remove them. There has not been disclosed anything more that the applicant might have done or may do, than it has done to attract business to the K. & B. and to operate it economically in accordance with the purposes it can serve. There seems to be no need of the K. & B. and no practicable way in which it may be used as a bridge line between the main lines of the applicant or as part of any through route which the applicant or any other carrier may consider, nor is there any justification for it as an independent line, if its construction were now sought. The record as a whole indicates that the continued operation of the K. & B. will require an immediate large expenditure by the applicant without prospect or hope of any return and an increasing annual loss disproportionate to any use made of it and the value of the service rendered by it to the territory it serves. The applicant might continue operation of the K. & B. under present conditions, without impairing the former's ability to perform its other duties to the public. Such continued operation, however, would be a drain upon its resources, which might, without this, be used elsewhere to advance the welfare of its system and through it the vast region which it serves. The burden placed upon the applicant through the rehabilitation and continued operation of the K. & B. can not be viewed as in the public interest. We therefore conclude that the point has been reached which permits the abandonment of the K. & B."<sup>29</sup>

While the interests of the general community, as influenced especially by the presence or absence of substitute services, are uniformly held in view in connection with proposed abandonments, the Commission is guided primarily by financial considerations. When continued operation can result only in losses to the carrier, this very fact is deemed to be persuasive evidence that public convenience and necessity permit of the abandonment. Under such circumstances there is neither economic justification for retaining the service nor legal basis for preventing its discontinuance.<sup>30</sup> The Commission has thus accorded controlling weight to the inability of the applicant to earn

<sup>29</sup> *Abandonment by Southern Ry.*, 145 I.C.C. 355 (1928), at pp. 360-361. For earlier dispositions of the same proceeding, see 105 I.C.C. 228 (1925), 131 I.C.C. 264 (1927).

<sup>30</sup> See *Brooks-Scanlon Co. v. R. R. Comm.*, 251 U.S. 396 (1920); *Bullock v. R. R. Comm. of Florida*, 254 U.S. 513 (1921).

fixed charges<sup>81</sup> or even operating expenses,<sup>82</sup> as well as to such general evidences of impaired position as excessive financial needs for the rehabilitation of the property,<sup>83</sup> particularly where the record of loss has been long continued<sup>84</sup> and the prospects for the future are not reassuring.<sup>85</sup> Where an entire line of railroad, independently operated, is involved, these considerations are virtually conclusive.<sup>86</sup> When, however, the proposed abandonment involves an unprofitable branch of a profitable system, the Commission's problem becomes more complex. Not only is it necessary to scrutinize closely the allocation of

<sup>81</sup> See *Public-Convenience Certificate to Orangeburg Ry.*, 67 I.C.C. 789 (1921); *Abandonment of St. Louis, El Reno & Western Ry.*, 79 I.C.C. 77 (1923); *Abandonment of L., A. & S. R. R.*, 99 I.C.C. 69 (1925).

<sup>82</sup> See *Public-Convenience Certificate to Ocean Shore R. R.*, 67 I.C.C. 760 (1921); *Public-Convenience Certificate to Seaboard Air Line Ry.*, 70 I.C.C. 497 (1921); *Abandonment of Line by S., M. & P. Ry. Co.*, 90 I.C.C. 497 (1924); *Abandonment of Branch Line by M. & St. L. R. R.*, 99 I.C.C. 527 (1925); *Abandonment by Southern Pacific*, 131 I.C.C. 439 (1927); *Abandonment by S. A. L. Ry.*, 138 I.C.C. 725 (1928).

<sup>83</sup> See *Abandonment of Part of Louisiana & Northwest R. R.*, 70 I.C.C. 392 (1921); *Abandonment of Calumet Branch of D. & R. G. W. R. R.*, 82 I.C.C. 785 (1923); *Abandonment of Line by A., T. & S. F. and C., A. & S. F. Rys.*, 86 I.C.C. 422 (1924); *Abandonment of Central New York Southern R. R.*, 86 I.C.C. 830 (1924); *Abandonment of Pelham & Havana R. R.*, 90 I.C.C. 51 (1924); *Abandonment of Lines by C. N. E. Ry.*, 94 I.C.C. 405 (1925); *Abandonment of Line by M. & N. E. R. R.*, 99 I.C.C. 344 (1925); *Abandonment of Red Mountain Branch*, 99 I.C.C. 618 (1925); *Abandonment of Line by Kinston Carolina R. Co.*, 154 I.C.C. 35 (1929); *Baltimore & O. R. Co. Abandonment*, 166 I.C.C. 642 (1930).

<sup>84</sup> See *Abandonment of Branch Lines of C. & G. R. R.*, 71 I.C.C. 725 (1922); *Abandonment of M., B. & S. R. R.*, 90 I.C.C. 31 (1924); *Abandonment by Central Indiana Ry.*, 124 I.C.C. 264 (1927); *Abandonment of Line by Northwestern P. R. Co.*, 150 I.C.C. 417 (1929).

<sup>85</sup> See *Abandonment of Lines by Alabama & Mississippi R. R.*, 70 I.C.C. 531 (1921); *Abandonment of Line by Morenci Southern Ry.*, 71 I.C.C. 589 (1922); *Abandonment of Central New York Southern R. R.*, 86 I.C.C. 830 (1924); *Abandonment by Thornton & Alexandria Ry.*, 138 I.C.C. 416 (1928); *Abandonment by C., R. I. & P. Ry.*, 138 I.C.C. 793 (1928); *Tampa Northern R. Co. Abandonment*, 166 I.C.C. 515 (1930).

<sup>86</sup> Note the following, for example, from the Commission's authorization of the abandonment of the entire line (234.32 miles) of the Chicago, Peoria & St. Louis Railroad Company, in face of vigorous opposition from shippers and communities: "The burden of establishing a case which will justify us in finding that the public convenience and necessity permit of the abandonment of a line of railway or the operation thereof rests upon the applicant. The present record establishes that the receivers can no longer operate the line as an independent unit. Long-continued deficits in railway operating income, with resultant undermaintenance, render further operation by the receivers unsafe and impracticable, and maintainable only by further dissipation of capital resources. . . . The record justifies the finding that the operation of the line as a whole may be abandoned." *Abandonment of Chicago, Peoria & St. Louis R. R.*, 76 I.C.C. 801 (1923), at pp. 806-807.



revenues and expenses as between the owning or controlling system and the branch line,<sup>87</sup> but it is rendered essential that a balance be struck between the interests of the carrier and those of the industries and communities dependent upon its service, since the ultimate economic losses incident to the abandonment might far outweigh the immediate financial gains of the proprietary system. It has been assumed, therefore, that the continuance of unprofitable branches may be justified if the system as a whole is able to carry the burden, and the financial status of the petitioning system has been held to constitute a pertinent factor in the disposition of applications.<sup>88</sup> But the mere fact that the system as a whole is prosperous has not been deemed to be controlling; a strong road cannot be expected to support an unprofitable branch indefinitely,<sup>89</sup> and in the absence of com-

<sup>87</sup> See *Abandonment of Part of Branch Line by N. P. Ry.*, 71 I.C.C. 169 (1922); *Public-Convenience Application of A. & S. A. B. Ry.*, 71 I.C.C. 784 (1922); *Proposed Abandonment of Lincoln Branch by D. & M. Ry.*, 94 I.C.C. 624 (1925); *Abandonment of Branches by B. & M. R. R.*, 105 I.C.C. 13 (1925); *Abandonment of Line by S. Ry.*, 105 I.C.C. 228 (1925); *Abandonment by Brownwood North & South Ry.*, 105 I.C.C. 729 (1926); *Abandonment by D. & M. Ry.*, 131 I.C.C. 156 (1927).

<sup>88</sup> See *Public-Convenience Application of G. B. & W. R. R.*, 70 I.C.C. 251 (1921); *Abandonment of Branch by Pere Marquette*, 72 I.C.C. 303 (1922); *Abandonment of Branch by G. B. & W. R. R.*, 72 I.C.C. 647 (1922); *Abandonment of Line by C., M. & St. P. Ry.*, 99 I.C.C. 493 (1925); *Chicago, M., St. P. & P. R. Co. Proposed Abandonment*, 162 I.C.C. 89 (1930); *Pennsylvania, O. & D. R. Co. Proposed Abandonment*, 162 I.C.C. 755 (1930). But note the following from *Abandonment of Hawkinsville & Florida Southern Ry.*, 70 I.C.C. 566, 568 (1921): "Protestants also contend, in effect, that the Hawkinsville line is in reality a part of the Georgia, which, in turn, is controlled by the Southern through stock ownership, and that, therefore, the controlling principle of the case is . . . that consideration must be given to the business of the carrier as a whole. It is obvious, however, that that principle is not to be extended so as to include operating losses of a carrier in the operation of its affiliated companies, since that view would disregard rights of the minority."

<sup>89</sup> In *Abandonment of Branch Line by Southern Pacific Co.*, 72 I.C.C. 404 (1922), the Commission said: "The record shows that past operations have resulted in substantial losses, and affords little assurance that future operations would show a more favorable return. In our opinion the applicant should not be required to continue indefinitely the operation of a branch line which will not pay the cost of operation, maintenance, and taxes, on the theory that its system as a whole is operated at a profit" (p. 407). Note, also, the following from *Abandonment of Line by S. Ry.*, 105 I.C.C. 228 (1925): "It should not be held that the mere fact that a branch line of railroad does not yield a profit from operation will in every case justify its abandonment. On the other hand, there is no doubt a point at which lack of earning power will justify the abandonment of a portion of a system regardless of the prosperity of the system as a whole. The point at which abandonment shall be considered justifiable is a matter of sound judgment, and must be determined by the circumstances of each case" (p. 233).

elling evidence of the importance of the service to the public its abandonment will be authorized.<sup>40</sup>

Although the Commission requires the carrier to assume the burden of proving that its proposed abandonment will impose no serious hardship upon the public, it examines carefully the counterclaims of shippers and communities, and it discounts those which appear to be based "more upon optimism and hope than upon any definite assurance" of increased traffic and decreased losses.<sup>41</sup> Recognizing that practically every abandonment affects adversely some interests dependent upon the service, the Commission insists that the controlling convenience and necessity is that of the general public, and that the desire for continued operation must be accompanied by a willingness to support the road through provision of a reasonably adequate flow of traffic.<sup>42</sup> The virtual disappearance of demand not only produces operating losses but negatives the claim of public need. This is obviously true in the case of branches constructed primarily to serve special purposes which are no longer possible of attainment,<sup>43</sup> or to tap

<sup>40</sup> See, for example, *Abandonment of Line by St. L.-S. F. Ry.*, 105 I.C.C. 691 (1926); *Long Island R. Co. Abandonment*, 162 I.C.C. 363 (1930), 166 I.C.C. 671 (1930); *Oregon-W. R. & Nav. Co. Abandonment*, 175 I.C.C. 492 (1931). Occasionally the application is unopposed and the record affords a clear basis for abandonment. In *Certificate to Atchison, Topeka & Santa Fe Ry.*, 65 I.C.C. 386 (1920), for example, involving a short branch which had moved ore from an area the resources of which were apparently exhausted to a reduction mill which had been dismantled, the Commission could say: "The facts present a clear case, indicating that there is now no public need to be served by the continued operation of the branch. If railroad facilities serve no useful purpose, if there is no transportation need to be met, such facilities may be withdrawn without serious injury or inconvenience to the public" (p. 388).

<sup>41</sup> *Abandonment by Hill City Ry. Co.*, 150 I.C.C. 159, 165 (1928). Note, also, the following from *Abandonment of Hawkinsville & Florida Southern Ry.*, 70 I.C.C. 566, 568 (1921): "On the part of the protestants evidence is offered tending to show that the territory served is developing agriculturally, and that a substantial increase may be anticipated in the business available to the Hawkinsville. . . . It is obvious, however, that the hope of increased business in the future can hardly prevail against the results of actual experience in the operation of the line."

<sup>42</sup> See *Public-Convenience Application of A. & S. A. B. Ry.*, 71 I.C.C. 784 (1922); *Abandonment of Line by P. T. S. R. R.*, 99 I.C.C. 501 (1925); and cases cited in note 27, *supra*.

<sup>43</sup> In the following cases, for example, the authorized abandonments involved lines built to serve, respectively, an army camp which was being dismantled, a discontinued whaling station, an ice house which had been destroyed by fire, a community which formerly produced citrus fruits but which had become entirely residential, a dismantled brick plant, and a discarded cement plant: *Public-Convenience Certificate to M. C. R. R.*, 70 I.C.C. 425 (1921); *Abandonment by Northern Pacific Ry.*, 117 I.C.C. 421

raw materials—such as timber,<sup>44</sup> coal,<sup>45</sup> or oil<sup>46</sup>—which have been depleted or which can no longer be produced and marketed on a profitable basis. Similarly, if a substantial volume of traffic has never been developed over the line,<sup>47</sup> or if resort to the road appears to necessitate special inducements,<sup>48</sup> or if tonnage has been seriously curtailed through motor competition or otherwise,<sup>49</sup> despite all reasonable efforts to stimulate business,<sup>50</sup> no vital public need is found to exist and discontinuance of the service is authorized. On the other hand, when the remaining traffic, though inadequate to support the branch, is of

(1926); *Abandonment of Macopin R. R.*, 111 I.C.C. 262 (1926); *Abandonment by L. A. & S. L. R. R. Co.*, 131 I.C.C. 491 (1927); *Abandonment by P. O. & D. R. R.*, 145 I.C.C. 319 (1928); *Chicago, R. I. & P. Ry. Co. Abandonment*, 175 I.C.C. 297 (1931).

<sup>44</sup> See *Public-Convenience Certificate to K. & N. R. R.*, 70 I.C.C. 189 (1921); *Public-Convenience Certificate to K., G. & S. W. R. R.*, 70 I.C.C. 201 (1921); *Abandonment by Fairchild & Northeastern Ry.*, 111 I.C.C. 275 (1926); *Abandonment of Operation by N. & S. R. R.*, 117 I.C.C. 23 (1926); *Abandonment by Alabama Central R. R.*, 117 I.C.C. 643 (1927); *Abandonment of Line by Trinity Valley & N. Ry. Co.*, 154 I.C.C. 179 (1929); *Abandonment of Lines by Red River & G. R.*, 154 I.C.C. 467 (1929); *Seaboard Air Line Ry. Co. Abandonment*, 158 I.C.C. 745 (1930); *Chicago, M., St. P. & P. R. Co. Abandonment*, 158 I.C.C. 758 (1930); *Intermountain Ry. Co. Abandonment*, 166 I.C.C. 776 (1930).

<sup>45</sup> See *Abandonment of Branch Line by B. & O. R. R.*, 71 I.C.C. 389 (1922); *Abandonment by Southern Pacific*, 124 I.C.C. 497 (1927); *Abandonment of Line by Louisville & N. R. Co.*, 154 I.C.C. 7 (1929); *Denver & R. G. W. R. Co. Abandonment*, 158 I.C.C. 217 (1929); *Nashville, C. & St. L. Ry. Abandonment*, 158 I.C.C. 339 (1929); *Colorado & W. Ry. Co. Abandonment*, 162 I.C.C. 183 (1930); *St. Paul & K. C. S. L. R. Co. Abandonment*, 166 I.C.C. 702 (1930).

<sup>46</sup> See *Public-Convenience Certificate to A., T. & S. F. Ry.*, 70 I.C.C. 377 (1921); *Abandonment of Oil Fields Short Line R. R.*, 86 I.C.C. 701 (1924); *Oklahoma-Southwestern Ry. Co. Abandonment*, 158 I.C.C. 488 (1929).

<sup>47</sup> See *Public-Convenience Certificate to S. & B. C. Ry.*, 67 I.C.C. 384 (1921); *Abandonment of Barnegat R. R.*, 79 I.C.C. 506 (1923).

<sup>48</sup> See *Abandonment of Wyoming & Missouri River Ry.*, 131 I.C.C. 145 (1927); *Abandonment by Miss. Vy. Co.*, 145 I.C.C. 289 (1928).

<sup>49</sup> See *Certificate for Pere Marquette Ry.*, 65 I.C.C. 410 (1920); *Public-Convenience Certificate to P. & W. R. R.*, 67 I.C.C. 746 (1921); *Public-Convenience Certificate to Ocean Shore R. R.*, 67 I.C.C. 760 (1921); *Abandonment of Branch Line by B. & O. R. R.*, 71 I.C.C. 386 (1922); *Abandonment of Operation of Line by O. & G. Ry.*, 94 I.C.C. 171 (1924); *Abandonment of Branches by B. & M. R. R.*, 105 I.C.C. 13 (1925); *Abandonment by Boston & Maine R. R.*, 111 I.C.C. 500 (1926); *Abandonment by P. R. R.*, 131 I.C.C. 547 (1927); *Abandonment by Detroit & Mackinac Ry.*, 138 I.C.C. 576 (1928); *Abandonment of Line by Denison, B. & N. O. R. Co.*, 154 I.C.C. 135 (1929); *Abandonment of Line by Canada S. Bridge Co.*, 154 I.C.C. 4 (1929); *Bristol R. Co. Abandonment*, 158 I.C.C. 704 (1930); *Northwestern Pac. R. Co. Abandonment*, 158 I.C.C. 736 (1930).

<sup>50</sup> See *Abandonment of Branch by N. P. Ry.*, 117 I.C.C. 575 (1927); *Abandonment by Central Indiana Ry.*, 124 I.C.C. 264 (1927); *Abandonment by D. & M. Ry.*, 131 I.C.C. 156 (1927); *Detroit & Mackinac Ry. Co. Abandonment*, 162 I.C.C. 205 (1930).

substantial volume,<sup>51</sup> and particularly when improvement is in prospect,<sup>52</sup> petitions for abandonment have been denied. Under such circumstances the Commission often dismisses the application only for the time being, so that, through special efforts to augment traffic or to effectuate economies,<sup>53</sup> the possibility of avoiding abandonment may be experimentally determined; and it does not hesitate to admit the failure of these efforts upon expiration of the test period.<sup>54</sup> Finally, the Commission is guided by the availability of adequate substitute services. Not only has the denial of applications been influenced by the absence of such substitute services,<sup>55</sup> but even when certificates are

<sup>51</sup> See *Abandonment of Branch by Pere Marquette*, 72 I.C.C. 303 (1922); *Abandonment of Frankfort & Cincinnati Ry.*, 86 I.C.C. 740 (1924); *Abandonment of Lincoln Branch by D. & M. Ry.*, 94 I.C.C. 624 (1925); *Abandonment by B. & M. R. R.*, 117 I.C.C. 679 (1927); *Abandonment by W. N. Y. & P. Ry.*, 131 I.C.C. 783 (1927).

<sup>52</sup> See *Abandonment by N. P. Ry.*, 124 I.C.C. 657 (1927); *Gainesville Midland Reorganization*, 131 I.C.C. 355 (1927), 138 I.C.C. 585 (1928); *Abandonment by Delaware & Hudson*, 145 I.C.C. 195 (1928).

<sup>53</sup> Note the following, for example, from *Colorado & Southern Ry. Co. Abandonment*, 166 I.C.C. 470 (1930): "The record before us, so far as it relates to existing operations, would justify the issuance of the certificate sought. It shows continuing losses in large amounts for many years from the operation of the line in question. Operations at the cost of so serious a burden upon interstate commerce can not be expected to be continued indefinitely. We must, however, consider the needs of the communities and interests served and their showing as to future prospects of traffic for the railroad. Although, as indicated herein, the testimony as to those prospects is conflicting, we are sufficiently impressed with the representations of the protestants to afford an opportunity to test their predictions. Accordingly, we will deny the application without prejudice to its renewal by the applicant after the expiration of 36 months from the date hereof if it can show that the situation has not materially improved. In the meantime, possible economies in operation, such as might be effected by reducing passenger service, changing freight schedules, and perhaps improvement of equipment, should be developed. It is also possible that the cooperation of the State through reduction in taxes can be secured. The public served by the road should realize that the continuation of the service is dependent primarily on the traffic furnished. If the people desire to retain the service of the railroad they will no doubt appreciate the necessity of providing it with sufficient traffic to enable it to live" (p. 492). See, also, *Abandonment of Line by S. Ry.*, 105 I.C.C. 228 (1925); *Abandonment by Southern Ry.*, 131 I.C.C. 264 (1927). In some instances the abandonment of certain portions of an unprofitable line has been deemed to strengthen the remaining portions and to preclude the necessity of abandoning them, at least for the time being: *Abandonment of Portion of Southern Ry.*, 117 I.C.C. 47 (1926); *Abandonment by D. & M. Ry.*, 131 I.C.C. 156 (1927). See, also, *Abandonment by Nevada-California-Oregon Ry.*, 72 I.C.C. 433 (1922).

<sup>54</sup> See *Abandonment of Branch by N. P. Ry.*, 117 I.C.C. 575 (1927); *Abandonment of Wyoming & Missouri River Ry.*, 131 I.C.C. 145 (1927); *Abandonment by Southern Ry.*, 145 I.C.C. 355 (1928); *Fairchild & N.-E. Ry. Co. Abandonment*, 158 I.C.C. 144 (1929); *Detroit & Mackinac Ry. Co. Abandonment*, 162 I.C.C. 205 (1930).

<sup>55</sup> See *Abandonment of Line by Kansas City Southern*, 79 I.C.C. 431 (1923); *Abandonment of Branch by P. & A. R. R.*, 105 I.C.C. 762 (1926); *Abandonment by C., R. I. & P. Ry.*, 131 I.C.C. 421 (1927). In the last of these proceedings the Commission

issued the Commission frequently imposes conditions designed to provide satisfactory transportation facilities for the areas affected.<sup>56</sup> Conversely, the case for abandonment is materially strengthened when alternative services are available, whether over the lines of the applicant carrier or of some other road,<sup>57</sup> or merely by virtue of the existence of adequate highways over which goods can be hauled directly to market or to intermediate transport facilities.<sup>58</sup> Through such processes and such expedients the conflicting claims of carriers and communities are flexibly adjusted in the public interest.

concluded: "We . . . find that the present and future public convenience and necessity do not now permit the abandonment by the Rock Island of the use and operation of the railroad and terminal facilities of the Denver Company used by the former at Denver and at and near Colorado Springs. The application, so far as it relates to such abandonment, will therefore be denied, without prejudice to its resubmission if and when the Rock Island provides itself with other suitable terminal facilities reasonably sufficient to handle its present and prospective traffic at Denver and Colorado Springs" (p. 432).

<sup>56</sup> Most frequently the applicant is required to sell the line within a specified period to anyone who will buy it at its scrap value for continued operation. See *Abandonment by D. & M. Ry.*, 131 I.C.C. 9, 17 (1927); *Abandonment of Wyoming & Missouri River Ry.*, 131 I.C.C. 145, 154 (1927); *Abandonment by P. R. R.*, 131 I.C.C. 547, 555 (1927); *Fairchild & N.-E. Ry. Co. Abandonment*, 158 I.C.C. 144, 147 (1929); *Mineral Point & Northern Ry. Co. Abandonment*, 158 I.C.C. 591, 600 (1930); *Intermountain Ry. Co. Abandonment*, 166 I.C.C. 776, 786-787 (1930). In *Abandonment of Branch Line by N. Y., N. H. & H. R. R.*, 90 I.C.C. 3, 5 (1924), the certificate was issued upon the express condition that the applicant shall sell the branch line to the city of Boston, which proposed "to equip the line for electrical operation and to lease it to the Boston Elevated Railway Company for a term of years, to be operated by the latter company as a part of its rapid-transit system" (p. 4). In *Abandonment by Southern Ry.*, 145 I.C.C. 355, 361 (1928), the certificate was issued in reliance upon the provision by the applicant, up to a specified date, of "a truck service or other means for the transportation of freight delivered to it along the line of the K. & B. for shipment, charging for such service the same rates it now charges for freight service." In *Long Island R. Co. Abandonment*, 162 I.C.C. 363, 376 (1930), the certificate was conditioned "upon the establishment by the carrier, if it may lawfully do so, of adequate bus service . . . and truck service for less-than-carload freight traffic" at specified points. In *Abandonment by Northern Pacific Ry.*, 138 I.C.C. 213, 219 (1928), the certificate was not to take effect "until the completion of a roadway from White Pine to a station on the new line."

<sup>57</sup> See *Abandonment of Part of Central New England Ry.*, 70 I.C.C. 441 (1921); *Abandonment of Part of Line by Oregon Trunk Ry.*, 72 I.C.C. 679 (1922); *Abandonment of Line by B., B. & M. R. Ry.*, 86 I.C.C. 150 (1923); *Abandonment of Line by C., R. I. & P. Ry.*, 90 I.C.C. 645 (1924); *Abandonment by Oregon E. Ry. Co.*, 145 I.C.C. 449 (1928); *Fonda, J. & G. R. Co. Abandonment*, 158 I.C.C. 379 (1929); *Southern Pac. Co. Abandonment*, 158 I.C.C. 439 (1929); *Jacksonville, G. & G. Ry. Abandonment*, 162 I.C.C. 125 (1930); *Chicago, M., St. P. & P. R. Co. Abandonment*, 162 I.C.C. 141 (1930); *Atchison, T. & S. F. Ry. Co. Abandonment*, 162 I.C.C. 474 (1930).

<sup>58</sup> See *Abandonment by S. A. L. Ry.*, 138 I.C.C. 715 (1928); *Abandonment of Line by Sligo & E. R. Co.*, 154 I.C.C. 725 (1929); *St. Louis-S. F. Ry. Co. Abandonment*, 158 I.C.C. 602 (1930); *Wiscasset, W. & F. Ry. Co. Abandonment*, 166 I.C.C. 617 (1930).

The Commission appears to have exercised its authority in sound fulfilment of the purposes of the Transportation Act, both in authorizing the discontinuance of unnecessary operations and in preventing the abandonment of needed services. Careful consideration has been given to all relevant factors bearing upon the profitability of the operations and the importance of the services sought to be terminated, and such dissatisfaction as inevitably attends the disposition of specific proceedings must be based, not so much upon disagreement as to guiding principles, as upon differences of judgment as to the significance of particular facts of record. In so far as the financial ability of the carrier to continue operations has constituted the dominant test of convenience and necessity, the Commission has been giving effect to the controlling standard recognized by the courts prior to the establishment of its statutory jurisdiction in this sphere. This does not mean, however, that its administrative performance has not involved an advance upon the method of judicial determination. The administrative method has made possible more fully informed judgments, greater uniformity of decision, the more frequent use of conditional decrees, and resort to experimentation, under provisional orders of denial or dismissal, designed to safeguard the interests of both the carriers and the users of the service. It is unquestionably necessary, in view of the rapid development of alternative transportation agencies and the sharp curtailment of traffic, that a more liberal policy of railroad abandonment be now pursued than in the decade of the 1920's. Such a policy is essential to the scaling down of capital structures, to the elimination of wasteful competition, and to the co-ordination of the various elements of the transportation system; and it is altogether likely that the needs of most shippers and communities affected by such a liberalized approach could be adequately and economically met through the remaining rail and other facilities, and particularly through the readily expansible instrumentalities of highway transport. For the achievement of these ends, however, initiative under existing legal provisions necessarily rests in the carriers. Once the owners of the properties evince a determination to subordinate their purely private and competitive interests to the common good, there is little likelihood of the interposition of obstacles by governmental authority. The Commission has in the past accorded approval

to the vast majority of applications for abandonment, and there is every reason to believe that it would accord sympathetic cooperation to the carriers in any efforts on their part to eliminate so-called "obsolescent lines" and their financial burdens on a more extensive scale.<sup>59</sup>

### *Voluntary Extensions*

In the interest of maintaining an adequate transportation system, free from unnecessary financial burdens, the Commission was empowered by the 1920 legislation to control extensions as well as abandonments. This power of control over new construction assumed two forms: the right to approve or disapprove of building projects voluntarily proposed by the carriers, and the right to compel the extension of lines. In the field of voluntary undertakings, with which we are immediately concerned, the least controversial applications, as in the case of abandonments, are those involving readjustments in existing plant and service. The Commission has frequently authorized the relocation of facilities,<sup>60</sup> the construction of cut-offs and belt lines,<sup>61</sup>

<sup>59</sup> For a detailed analysis of the problem of "obsolescent lines," see Harold G. Moulton and Associates, *The American Transportation Problem* (1933), prepared for the National Transportation Committee, at pp. 147-178. In its own report, the Committee, in recommending that "unprofitable railroad services should be replaced by cheaper alternative transport methods," declared: "In view of the rapid development of automotive and other transport, there is no justification for maintenance by railroads of losing services and lines, and there devolves upon regulatory bodies and controlling interests something more than a negative duty to hasten their replacement by alternative methods, such as motor transport, which can render adequate service on a profitable basis in cases where rail transportation can operate only at a loss." *Ibid.*, p. xxvii.

<sup>60</sup> See *Construction and Abandonment of Lines by W. & M. R. R.*, 94 I.C.C. 245 (1924); *Construction by D., G. H. & M. Ry.*, 124 I.C.C. 338 (1927); *Construction by N. P. Ry.*, 124 I.C.C. 728 (1927); *Construction by Sacramento Northern Ry.*, 138 I.C.C. 111 (1928); *Relocation by D., G. H. & M. Ry.*, 138 I.C.C. 269 (1928); *Construction and Abandonment of Lines by Euclid R. Co.*, 145 I.C.C. 409 (1928); *Construction of Line by St. Louis E. T. Ry. Co.*, 150 I.C.C. 59 (1928).

<sup>61</sup> See *Public-Convenience Certificate to Big Four*, 71 I.C.C. 803 (1922); *Construction of Natron Cut-Off by Central Pacific Ry.*, 82 I.C.C. 185 (1923); *Construction of Line by K. & M. Ry. & Term. Co.*, 82 I.C.C. 612 (1923); *Construction of Line by Southern Ry.*, 86 I.C.C. 435 (1924), 90 I.C.C. 399 (1924); *Public-Convenience Application of C. of G. Ry.*, 90 I.C.C. 19 (1924); *Construction of Line and Bond Issue by D. & I. R. R.*, 90 I.C.C. 502 (1924); *Construction of Line by Pennsylvania R. R.*, 90 I.C.C. 657 (1924); *Construction of Line by D., L. & W. R. R.*, 94 I.C.C. 541 (1925); *Extension of F. E. C. Ry.*, 99 I.C.C. 1 (1925); *Construction by St. Louis Connecting R. R.*, 111 I.C.C. 147 (1926); *Construction by Morris & Essex R. R.*, 117 I.C.C. 57 (1926); *Construction by T., P. & W. R. R.*, 124 I.C.C. 278 (1927); *Construction by Pere Marquette Ry.*, 138 I.C.C. 699 (1928); *Construction of Line by C., M., St. P. & P. R. Co.*, 154 I.C.C. 353 (1929).

and such rerouting arrangements and track changes as were designed to improve transportation services<sup>62</sup> or to effect operating economies.<sup>63</sup> The benefits to be derived from such readjustments by the users of the lines are generally direct and apparent, and the proposals calculated to produce these benefits seldom evoke protests from other roads; under these circumstances the Commission's determinations have largely hinged upon the reasonableness of the proposed capital expenditures and the financial ability of the carriers to undertake them. The more controversial issues involved in this sphere of control—those that will be dealt with at greater length—have emerged in connection with applications designed to extend the service into new areas. In these situations the need for the service, its probable financial effects upon the applicant carrier, and its relationship to the general competitive set-up are all deemed relevant to the determination of public convenience and necessity. The crucial questions are: first, whether the operation of the new line is likely to prove self-sustaining; and second, whether adequate support for it is likely to be forthcoming without needless intensification of competitive pressure and the diversion of traffic from existing facilities.<sup>64</sup> Under the group system of rate making and the flexible control of rate divisions intro-

<sup>62</sup> See *Public-Convenience Certificate to D. & I. R. R. Co.*, 67 I.C.C. 600 (1921); *Public-Convenience Certificate to Ala., Fla. & Gulf R. R.*, 70 I.C.C. 53 (1921); *Public-Convenience Certificate to Idaho Central R. R.*, 70 I.C.C. 265 (1921); *Construction of Lines by F. W. & N. R. R.*, 90 I.C.C. 221 (1924); *Construction of Lines by S. A. & M. Ry.*, 90 I.C.C. 597 (1924); *Construction of Line by St. L., B. & M. Ry.*, 90 I.C.C. 780 (1924); *Construction of Extension by A. C. L.*, 105 I.C.C. 209 (1925); *Construction by San Antonio & Aransas Pass Ry.*, 111 I.C.C. 483 (1926); *Construction by Western Pacific R. R.*, 138 I.C.C. 779 (1928); *Construction by S. P. R. R.*, 145 I.C.C. 323 (1928); *Construction of Lines by St. Louis S. W. Ry. Co.*, 150 I.C.C. 685 (1929).

<sup>63</sup> See *Public-Convenience Certificate to C., M. & G. Ry.*, 70 I.C.C. 846 (1921); *Construction of Line by New York Central*, 82 I.C.C. 267 (1923); *Proposed Extension by C., R. I. & P. Ry.*, 99 I.C.C. 473 (1925); *Construction of Extension by L. V. R. R.*, 99 I.C.C. 793 (1925); *Construction by Ala., Tenn. & Northern R. R.*, 117 I.C.C. 176 (1926); *Construction of Branches by Pittsburgh, L. & W. R. Co.*, 150 I.C.C. 43, 619 (1928); *Construction of Line by Sacramento Northern Ry.*, 154 I.C.C. 65 (1929).

<sup>64</sup> In the case of new lines to be owned or controlled by industries primarily to be served by them, the Commission is also influenced by the inhibitions of the so-called "commodities clause" (section 1, paragraph (8), of the Interstate Commerce Act), which is designed to separate industry from transportation. See, for example, *Construction of Line by Jefferson Southwestern*, 76 I.C.C. 778 (1923), 86 I.C.C. 796 (1924). In the original proceeding, in which the application for a certificate was denied, the Commission found, among other things, that control of the line was to be vested in the interested coal company, and that special advantages would accrue to the coal company in its dealings with connecting lines: "The line has been projected and promoted in the



duced by the Transportation Act, it is obvious that both unprofitable operation of carrier properties and unnecessary duplication of existing lines would inevitably prove burdensome to the public, and that the prevention of extensions and new construction calculated to pro-

interests of the coal company. It was originally intended . . . that the interests controlling the coal company would finance the proposed railroad. The promoters concluded, however, that it was best to procure subscriptions from persons not stockholders of the coal company and that has been done to the extent and in the manner stated. Three, at least, of the applicant's five directors are officers and directors of the coal company and the only witnesses appearing in this case as incorporators or directors of the applicant, or as having any pecuniary interest therein, are officers of the coal company. . . . It is evident that the purpose of the promoters is to benefit from competition between the applicant's proposed connections. The president of the applicant and of the coal company, being asked why he wished to build the line, testified that the more transportation a coal mine has, the better off it is. Undoubtedly, advantages would be sought in connection with through rates and divisions, absorption of switching charges, and the supply of cars. Indeed, the promoters have already entered into negotiations with the trunk lines for favorable arrangements as to these matters" (76 I.C.C., at pp. 780, 782). On rehearing, the significance of these facts was explicitly brought to issue. One of the connecting roads opposing the application contended that the proposed interstate transportation of coal by the applicant for the coal company would constitute a violation of the commodities clause, and this contention molded the Commission's final determination. Said the Commission: "It was because of this commodities clause, undoubtedly, that the promoters of applicant concluded 'that it was best to procure subscriptions from persons not stockholders of the coal company.' Whether or not they have succeeded in escaping from the clause may be doubted, for its language is very broad and it has been broadly interpreted by the United States Supreme Court. . . . Control of or affiliation with a short-line railroad by an industry furnishing a large volume of traffic opens the door to grave abuse, particularly when the short line connects with more than one trunk-line railroad. By playing one connection against the other they have frequently been able to gain concessions in divisions, or in car supply, or in other matters, which have, in practical effect, amounted to a preference of, or rebate to, the controlling or affiliated industry. Many such cases have taken our time and attention in the past, and they continually arise. Moreover the connecting trunk lines, because of their competition with each other, often hesitate to bring such cases to our attention, and they have usually been considered either upon our initiative or upon complaint of some industry which is aggrieved by the preference. . . . We are not empowered to administer or enforce the commodities clause, but certainly we ought not to grant a certificate of public convenience and necessity for the construction of a railroad whose operation, it seems reasonable to believe, may prove to be in violation of that clause" (86 I.C.C., at pp. 801-802). Accordingly the Commission, utilizing its authority to attach terms and conditions to the issuance of a certificate, found that convenience and necessity would require the construction and operation of the line by the applicant only if and when an arrangement had been entered into and approved whereby the connecting lines, jointly or severally, might within a fixed period assume control of the applicant or its property. For an analysis of the commodities clause and its interpretation by the courts, see Part I, chap. i, note 41. The Commission has also discouraged the construction and operation of industrially controlled and independently organized short lines in the interests of operating economy. See *Operation of Lines by C. R. & E. Ry. Co.*, 94 I.C.C. 389, 397 (1925); *Construction by R. G., M. & N. Ry.*, 117 I.C.C. 19, 21-22 (1926).

duce such consequences was the primary purpose of the requirement of certificates of public convenience and necessity; but it is equally obvious that these ends cannot be achieved automatically—that findings of unprofitable operation or unnecessary duplication are complex conclusions based largely upon future prospects, with respect to which the Commission was clothed with a vast amount of administrative discretion, to be exercised in the light of the circumstances and conditions of each proceeding.<sup>65</sup>

<sup>65</sup> The broad scope of the Commission's inquiry is evidenced by the character of the questionnaire which must be answered under oath by applicants for the construction or extension of a line of railroad. Among the data required, of a non-technical character, are the following: the affiliations, ownership, and control of the applicant; the securities authorized or issued for the proposed line; the functions and purposes of the project; whether a substantial public service will be rendered, producing material revenue, or whether it will primarily benefit some other industry or business; in the case of public services, the nature of the population, the territory, and the industries involved, the existing carriers serving the region, the points not served and their distances from existing carriers, the conditions of highway transportation, and the contemplated railroad connections; if the proposed line is an extension of an existing road, the degree to which it will be profitable in itself and its effect in creating traffic for the established line; if the proposed line is a connecting link between existing roads, the kind and volume of interchange traffic expected, the amount of such traffic which cannot be moved by established lines, and the economies to be effected; the agreements or understandings with other roads as to operation, trackage, interchange, and divisions; the aids, grants, gifts, and donations incident to the construction, and the proposed methods of financing; estimates of traffic, revenues, expenses, and income for each of the first five years of operation and thereafter; the extent to which the expected traffic will constitute a net addition to the business of the railroads and that to which it will merely be diverted from existing lines; the enterprises whose establishment is contingent upon the proposed construction, together with their probable contributions to the traffic of the line; and if the applicant is already a going concern, its latest balance sheet and profit and loss statement, together with its income accounts for the preceding five years. Other carriers serving the territory involved are made respondents in these proceedings, and they are required to provide data by way of check upon some of the information furnished by the applicant and to express their judgment as to whether the project is likely to prove self-sustaining, as to its relationship to the competitive situation and their own operating results, and as to its general effect upon the public service. The extent and character of these data, which are further supplemented and expanded at hearings, indicate the nature of the issues involved, the numerous factors deemed relevant to their determination, and the care with which each situation is examined. See *In the Matter of Applications under Paragraphs (18) to (21), Inclusive, Section 1, of the Interstate Commerce Act for Certificates of Public Convenience and Necessity for the Construction or Extension of Lines of Railroad, and Applications under Paragraph (18), Section 15a, of said Act, for Permission to Retain the Excess Earnings of Newly Constructed Lines of Railroad*, January 22, 1924. The Commission has not infrequently denied applications because of the immaturity of the project as proposed or the inadequacy of the data supplied with respect thereto. See *Construction Application of National Line R. R.*, 71 I.C.C. 556 (1922); *Construction Application of S. & N. Ry.*, 71 I.C.C. 586 (1922);

When the proposed extension or new construction promises to be self-sustaining, there is at least a presumptive economic justification for the project which cannot be ignored. Except for the possibility that the traffic relied upon may be diverted from existing facilities, such a state of facts reflects a public need for the service and the ability to support it. It is necessary, of course, that traffic estimates which are unduly extravagant or too highly speculative be discounted,<sup>66</sup> that the special value of projected feeder lines be accorded recognition,<sup>67</sup> and that in the case of facilities designed primarily to tap natural resources which are subject to depletion, consideration be given to the amortization of the investment, unless the prospective returns are likely to be maintained by traffic arising from the general development of the area involved.<sup>68</sup> But when an analysis of the facts of record, along these and other lines, discloses a likelihood that reasonable returns will be realized on the invested capital, the Commission deems such evidence highly persuasive that public convenience and necessity require the extension or new construction;<sup>69</sup> conversely, a finding that the projected line is likely to prove unremunerative is generally

*Public-Convenience Application of C., C. & M. R. R.*, 86 I.C.C. 18 (1923); *Proposed Construction by D. G. B. R. R. Co.*, 105 I.C.C. 669 (1926); *Extension by South Georgia Ry.*, 111 I.C.C. 85 (1926); *Proposed Construction of Line by Imperial R. Co.*, 150 I.C.C. 274 (1929).

<sup>66</sup> See *Construction of Extension by Wyoming Ry.*, 86 I.C.C. 707 (1924); *Construction of Lines by S. A. & M. Ry.*, 90 I.C.C. 597 (1924); *Proposed Extension by San Antonio Southern*, 90 I.C.C. 608 (1924); *Proposed Construction by M. & W. R. R. Co.*, 94 I.C.C. 372 (1925); *Proposed Construction by Southeastern Ry.*, 105 I.C.C. 53 (1925).

<sup>67</sup> See *Public-Convenience Certificate to N. H., H. & Mt. V. R. R.*, 71 I.C.C. 119 (1922); *Construction of Extension by Arkansas W. Ry. Co.*, 154 I.C.C. 87 (1929); *Chicago, R. I. & P. Ry. Co. Construction*, 158 I.C.C. 413 (1929).

<sup>68</sup> See *Construction of Branch Line by C. & N. W. Ry.*, 99 I.C.C. 543 (1925); *Construction of Line by M. & S. V. R. R. Co.*, 99 I.C.C. 606 (1925).

<sup>69</sup> In an early case, for example, the Commission concluded: "Apparently the proposed extension should earn an adequate return on the investment. It appears that the public interest would be served by affording rail transportation to a region now lacking such facilities, and by the development of large coal deposits not otherwise accessible to market." *Virginian & Western Extension*, 72 I.C.C. 55, 57 (1922). See, also, *Construction by Detroit & Mackinac Ry.*, 79 I.C.C. 753 (1923); *Construction of Extension by C., C. & C. Ry.*, 94 I.C.C. 811 (1925); *Construction by Southern Pacific Co.*, 99 I.C.C. 201 (1925); *Construction by Receivers of C., M. & St. P. Ry.*, 105 I.C.C. 4 (1925); *Construction by T. & C. R. R.*, 131 I.C.C. 186 (1927); *Construction of Extension by Kansas City, M. & O. Ry. Co.*, 154 I.C.C. 215 (1929); *Levisa River R. Co. Construction*, 158 I.C.C. 210 (1929); *Texas Short Line Ry. Co. Construction*, 162 I.C.C. 237 (1930).

deemed to support a denial of the certificate.<sup>70</sup> Within the area between these extremes, where the evidence is not fully persuasive either of probable success or of probable failure, the Commission has sought to avoid a too conservative attitude toward projects involving considerable financial uncertainty but containing substantial promise of public service. The following pronouncements, supporting its authorization of an extensive construction project despite a finding that "apparently the earnings in prospect for the applicant will be insufficient for some time to sustain the project as an independent enterprise," are indicative of the Commission's broad construction of the earnings test: "Ability to earn is not the sole test of public convenience and necessity, although always a factor to be given consideration. When such ability is shown to exist a strong presumption may arise that public need for the new facility exists. When not shown to exist it may frequently be concluded that such need is too slight to warrant the expenditure necessary for the proposed construction. When it is established, however, that a project will render important public service, and its sponsors are willing to assume the risk of loss in the expectation of ultimate gain either directly through the property or indirectly through benefits to themselves and to the shipping community, the requirements as to the public interest may be fully satisfied, although losses to investors seem more probable than gains. We are to consider what is best in order to foster, build, and make efficient trans-

<sup>70</sup> In an early case, for example, the Commission concluded: "It thus appears that the handling of the available supply of timber is the chief motive for building the line, and without the expected tonnage from this timber there is nothing in the record that indicates a reasonable hope of the development of a sufficient volume of traffic in this territory to pay a return on the investment, if indeed there will be enough to pay operating expenses. If it should not do so, the only recourse would be the abandonment of operation, which, of course, would seriously prejudice the interests of communities and individuals that might establish themselves in the region because of the existence of this means of transportation. We can not find in this record that degree of assurance of a reasonably successful enterprise which would warrant the issuance of certificate of public convenience and necessity." *Application of Uvalde & Northern Ry.*, 67 I.C.C. 204, 207-208 (1921). In *Public-Convenience Application of Golden Belt R. R.*, 67 I.C.C. 370 (1921), 70 I.C.C. 73 (1921), 71 I.C.C. 233 (1922), the Commission, in affirming on rehearing its original denial of the application, concluded (71 I.C.C., at p. 234): "That the proposed line would prove a convenience to a considerable number of people may be conceded, but that fact alone can not be relied upon to justify the addition to the transportation resources of the country of an enterprise which gives no promise of being self-sustaining." See, also, *Yates & W. T. Ry. Co. Proposed Construction*, 158 I.C.C. 535 (1930).

portation facilities as a whole in the interest of the greatest number. Where only the private aspect is involved, individuals are at liberty to take risks. So far as the public is concerned, the advantages of new or better service may be so great as to justify increasing the burden upon shippers generally by the amount necessary to sustain the facility. If it should prove later, however, that the line, because of competitive conditions, lack of business, or other circumstances, can not be operated profitably under fair divisions and fair rates, the burden of the loss would properly fall upon the investors and not upon the shipping public. Our approval of a new enterprise neither constitutes nor requires a finding that such enterprise will prove successful. Our responsibility is to determine the public interest involved in the construction of the line. The history of railway construction illustrates that prospective tonnage depending for its development upon transportation facilities, rather than tonnage immediately in view, has been the main justification for railway construction. Progress has involved risks. It is not to be presumed that Congress contemplated discarding, as insufficient, conditions which in the past have furnished the warrant for a constructive policy in the upbuilding of the system of transportation. It is rather to be presumed that the Congress did not contemplate an interpretation of its enactment which, applied as a policy in the past, would have prevented the construction of many railway properties now serving the public interest in an important way. Prospective earnings or losses may properly be considered as one of the factors evidencing the public interest, but, taken alone, do not determine whether a particular enterprise is or is not required by public convenience and necessity.<sup>71</sup> This position, which led to a refusal by the Commission to substitute its judgment for the judgment of the promoters and to a recognition of the relevancy of remote and indirect, as well as early and direct, financial prospects, was clearly in line with the tradition of American railroad enterprise; but just as clearly it involved the danger of creating for the future those difficulties which render the problem of abandonments so perplexing.<sup>72</sup>

<sup>71</sup> *Construction of Line by Wenatchee Southern Ry. Co.*, 90 I.C.C. 237 (1924), at pp. 255-256.

<sup>72</sup> The Commission's interpretation of the requirements of convenience and necessity in this proceeding resulted in sharp disagreement within its own ranks. In an expression of dissent in which Chairman Hall and Commissioners Meyer, Esch, and Lewis

But even when profitable operation is reasonably assured, there still remains the question as to the probable effect of the proposed extension or new construction upon competitive relationships. In considering the requirements of convenience and necessity, the determination of the public need for the new facilities is influenced by the adequacy of the existing lines and by the degree to which traffic is likely to be diverted from them. The objective is to avoid economic waste and to safeguard the financial interests of the carriers already in the field. "In determining whether the construction of new railroad lines should be authorized," it has been said, "doubts should . . . be resolved in favor

concurrent, Commissioner Aitchison said (pp. 258-259): "Though a demonstration that success would attend a projected railroad enterprise is not indispensable to the grant of a certificate authorizing construction, the prospective earnings are a consideration of weight in determining the relative public convenience and necessity involved. The likelihood of continued loss is cogent evidence that the public interest does not require the proposed facilities. A long-continued inability to meet expenses and fixed charges might well lead to impairment of service or complete failure to meet the requirements of the public through bankruptcy and receivership or through actual abandonment of the line, with attendant losses to investors who might have placed some reliance upon our certificate. The greatest burden, in the event of failure, generally falls upon those who invest in homes, business enterprises, schools, and churches along the projected line. These people are likely to lose everything, while investors in an abandoned railroad lose only their investment in an enterprise which they knew to be speculative. But during the life-or-death struggle the expense of operation, including maintenance, must be met by somebody. If not met by the shippers over the projected line, it will fall, directly or indirectly, upon shippers over connecting lines, or else impair to that extent the ability of those connecting lines to serve their patrons. This burden should not be laid upon the public unless there is reasonable assurance that the public benefit to result from construction and operation of the projected line will at least offset the public burden. Such assurance is not given upon this record, nor is it to be found in exposition of general views, not shared by all of us, as to what matters may be considered seriously upon applications for certificates." In the view of the minority, also, the financial plan of the applicant was not such as to assure the execution of the project; and subsequent events confirmed the soundness of this view. After granting a number of extensions for the beginning and completion of the project [94 I.C.C. 673 (1924), 99 I.C.C. 349 (1925), 105 I.C.C. 347 (1926)], the Commission finally concluded [150 I.C.C. 386, 390-391 (1929)]: "Both from the standpoint of original financing and the standpoint of adequate earnings during the early period of operation, the hope of the applicant's project has been largely the support of the people and shippers of the territory represented to be in need of an additional railroad. Yet, after the expiration of more than eight years from the incorporation of the applicant in September, 1920, for the purpose of constructing and operating the railroad, efforts to attract the necessary initial capital have been ineffective. In view of all the circumstances, we can not escape the conclusion that there is little likelihood of a higher degree of success in enlisting the aid of investors whose chief concern in the project would be security of their funds and at least reasonably certain assurance of a satisfactory return." Accordingly, the petition for further extension of time was denied, which resulted in a lapsing of the certificate by its own terms.

of their construction, particularly where new territory not already supplied with railroad service is being opened up. . . . But desire to avoid any undue restriction of enterprise ought not to lead us to approve new construction which involves needless, costly, and wasteful duplication of existing facilities. That is what the law was intended to prevent.<sup>73</sup> Accordingly, the Commission has denied construction applications where existing services were deemed reasonably adequate, where needless duplication of facilities would result, and where the traffic relied upon would be secured largely at the expense of other roads.<sup>74</sup> But in this connection, as in case of the revenue aspect of pro-

<sup>73</sup> From the concurring opinion of Commissioner Eastman in *Construction by Piedmont & Northern Ry.*, 138 I.C.C. 363 (1928), at p. 401. The Commission's denial of the certificate in this proceeding was supported by the following considerations (pp. 400-401): "The proposed lines would closely parallel existing railways throughout their entire length. They would touch no local point of importance not served by existing lines, and the territory to which they would bring rail transportation closer is very small and of limited possibilities in agriculture. The territory to be traversed has excellent highways. There is bus and truck service on highways that closely parallel the proposed route. The railways have good and prompt service to all points that could be reached by the proposed lines and their connections. Some defects are shown in the less-than-carload service of the Southern in this territory, but they are not inherent in the physical property and should be removed, or at least diminished, by administrative measures which are being taken. The existing lines have a present developed capacity in excess of present traffic requirements, and a much greater potential capacity. The through routes proposed in connection with the applicant's extended line are generally longer than existing routes, so far as the record permits comparison, and are not shown to have substantial advantage in other respects, or any economy in the cost of transportation. . . . The proposed lines would earn a revenue sufficient to justify their construction, if it were not to be diverted from existing lines, particularly from the Southern, which they would closely parallel. They would owe this revenue in part to the power of the applicant to control traffic of companies owned by the same interests, and in some degree to the power of those interests to influence the routing of traffic other than their own. There would no doubt be some benefit to the region immediately served, notwithstanding some impairment that would be likely to result, temporarily at least, in the service of existing lines. These benefits would be largely of a competitive nature, that is at the expense of other localities, and could probably be urged in favor of duplicating most of the railway lines in the United States. Competition reasonably necessary should be provided without extensive duplication. The construction of the applicant's railroad and of its proposed and projected extensions present a rather extraordinary case of paralleling an existing line. The presumption against such paralleling as is now proposed can not be overcome by such evidence as is here presented."

<sup>74</sup> Note the following conclusion, for example, from *Western Pac. Calif. R. Co. Proposed Construction*, 162 I.C.C. 5 (1930), at p. 25: "The San Joaquin Valley is traversed by three or more parallel lines of railroad, owned by two actively competing systems, the S. P. and the Santa Fe. The proposed line, paralleling them, would nowhere be more than 6 miles from the main line of the S. P. It would reach no towns that are not served by existing railways, and would not provide better or cheaper routes to any market. The case for it rests substantially on two claims: First, that it would shorten

posed projects, no invariable policy has been established to be rigidly applied in all proceedings. In the nice balancing of interests often required by the facts of record, in terms of the relationship of the public welfare to the conflicting claims of the carriers involved, duplication of facilities and diversion of traffic have not been uniformly condemned. Although the Commission has sometimes held such applications for new construction in abeyance pending efforts to obtain its alleged advantages from existing lines,<sup>75</sup> it has also sanctioned some

the hauls to a railroad in parts of the region traversed, thereby promoting more intensive agricultural development; and second, that it is necessary as a feeder of the W. P. and its allied lines . . . which need more business to assure their proper support. In view of testimony to the contrary on behalf of farmers in California, it can not be presumed that to promote more intensive culture now would be in the public interest. All the territory south of the San Joaquin River and much to the north is fully developed, mainly in crops that are overproduced. . . . The saving in truck haul is the only certain benefit shown to the community. The evidence indicates that this saving would be very small in proportion to the cost of providing the additional railroad service. . . . The testimony concerning the needs of the W. P. does not justify such inherently wasteful paralleling of existing railways." See, also, *Public-Convenience Certificate to Interstate R. R.*, 67 I.C.C. 141, 143-144 (1921); *Public-Convenience Application of W. N. Ry.*, 71 I.C.C. 42 (1922); *Construction by Aroostook Valley R. R.*, 105 I.C.C. 643 (1926); *Construction of Extension by M. W. R. R. Co.*, 111 I.C.C. 377, 387 (1926); *Construction of Line by Northern Oklahoma Rys.*, 111 I.C.C. 765 (1926); *Construction by Reader R. R.*, 131 I.C.C. 51 (1927); *Proposed Construction by Grand Rapids & I. Ry. Co.*, 145 I.C.C. 564 (1928); *Proposed Construction of Line by Pecos & N. T. Ry. Co.*, 150 I.C.C. 457 (1929); *Proposed Construction by Western Pac. R. Co.*, 154 I.C.C. 330 (1929); *Proposed Construction by Sacramento Northern Ry.*, 154 I.C.C. 447 (1929).

<sup>75</sup> A few illustrations will suffice to indicate the character of this tentative method of preventing duplication that might prove unnecessary and wasteful: "The applicant's proposed main line will parallel existing facilities for its entire length. The tracks which it proposes to purchase from the cement and brick companies . . . now connect with the line of the Frisco. No service will be furnished that is not now available. It is represented that the service of the proposed line would be more efficient but there is no showing in the record that sufficient attempts have been made to secure more efficient service through the united efforts of the existing carriers. Certain administrative remedies are available. These have apparently not been invoked. Until a genuine effort has been made to secure reasonably adequate service through the carriers now operating in this community we would not be justified in granting authority for new construction which would be a duplication of facilities. . . . If the efforts suggested above should not result in a proper improvement of the situation for the remedying of which the instant application is said to have been filed, the interested parties may again bring it to our attention." *Construction by Southern Kansas Industrial Belt Ry.*, 117 I.C.C. 210, 212 (1926). "The evidence shows that it is practicable and desirable that the Youngstown district should have access to the Ohio River by rail line or lines which will afford them substantially the transportation advantages, including rates, proposed by the applicants in this case. . . . It is also clear of record that the construction of the proposed new line would result in unnecessary duplication of facilities, if it is possible to make advantageous use of the existing lines of the Pennsylvania and the Pittsburgh & Lake Erie.



measure of competitive railroad building.<sup>76</sup> In other words, the Commission has recognized the importance of competition as a means of assuring adequate service and stimulating efficient operation, and it has approved of applications calculated to produce these competitive advantages.<sup>77</sup> While this approach—culminating in the dictum that

. . . Authority to construct the proposed new line will not be granted until we are fully satisfied that a use of the existing rail routes between the Ohio River and the Youngstown district which will produce substantially the results proposed by the applicant is impracticable. As already indicated, the present record is not sufficient to justify a satisfactory conclusion upon that question. The record will therefore be held open and the proceedings assigned for further hearing in order that that phase of the evidence may be amply developed." *Construction of Branches by Pittsburgh, L. & W. R. Co.*, 150 I.C.C. 43, 54-55 (1928). Upon further hearing, disclosing that the trunk lines would provide adequate service and reasonable rates in connection with the river traffic, the application for new construction was denied. 150 I.C.C. 619 (1929). For proposals by the Commission that the interested carriers cooperate in effecting arrangements for joint use of trackage in order to avoid unnecessary duplication of facilities, see *Construction of Lines in Eastern Oregon*, 111 I.C.C. 3 (1926), 117 I.C.C. 737 (1927), 124 I.C.C. 529 (1927); *Quannah, A. & P. Ry. Co. Construction*, 158 I.C.C. 546 (1929). Along the same lines is the following from the partly dissenting opinion of Commissioner Eastman in *Western Pac. Calif. R. Co. Proposed Construction* (see note 74, *supra*): "I agree that the three parallel lines of railway which already exist in the San Joaquin Valley are amply sufficient to handle the traffic, and that it ought not to be necessary to build a fourth parallel line. However . . . the Western Pacific is undoubtedly hampered by the fact that it has no good means of drawing traffic at present from the San Joaquin Valley for its competitive central route. The evidence also indicates that trackage rights and joint use of existing facilities are entirely feasible. . . . For these reasons I believe that we could appropriately find that the evidence does not justify the construction of the proposed line by the Western Pacific, provided the Southern Pacific will extend to the latter trackage rights over its eastern line through the valley and joint use of terminal facilities as far as and including Fresno. We could then hold the case open for a reasonable period to obtain the results of negotiations for such an arrangement, before taking final action in the case." 162 I.C.C., at p. 26.

<sup>76</sup> See, for example, *Construction of Line by Wenatchee Southern Ry. Co.*, 90 I.C.C. 237 (1924); *Construction of Lines in Eastern Oregon*, 111 I.C.C. 3 (1926), 117 I.C.C. 737 (1927), 124 I.C.C. 529 (1927).

<sup>77</sup> The Commission's position, as set forth by Commissioner Aitchison, appears from the following: "The advantages of competition are stressed by these lumber companies; in fact, it seems to be the policy of one of them to locate no important mills at points served by only one carrier. The advantages of a diversified car supply, recognized in the coal industry, are equally important to lumber producers. There are the possibilities of failures of operation or of management, calamities, labor disturbances, and surplus production or consumers' demands upon one railroad which might well be overcome if the service of another carrier were available. Especially would this be a probability where the two carriers approach from different directions and meet at the common point. Competition as a stimulus for efficient operation has been recognized by us. . . . Notwithstanding all that may be said favorable to the dominant carrier in this section, and its present service, it has failed at times to meet demands made upon it. Advantages to the shippers of an additional outlet for their product are apparent. . . . The assurance of access to lines other than the Southern Pacific at critical periods is a factor of

"competition, within reason, rather than monopoly, is in the public interest"—has evoked protest from within the Commission,<sup>78</sup> it has received judicial sanction as constituting a not unreasonable interpretation of the operative statutory provisions.<sup>79</sup>

prime importance to such shippers and is clearly in the public interest. It is probable that the competition afforded would stimulate the Southern Pacific to further improve its service. Competition, within reason, rather than monopoly, is in the public interest." *Construction of Lines in Eastern Oregon*, 111 I.C.C. 3 (1926), at pp. 37-38. See, also, *Construction of Line by Wenatchee Southern Ry. Co.*, 90 I.C.C. 237 (1924), at pp. 256-257.

<sup>78</sup> Commissioner Meyer, for example, though concurring in the results in the *Oregon* case, made sharp strictures with respect to the emphasis placed upon competition in the majority report as a justification for new railroad building: "The increased tonnage of lumber which the country will demand from the Pacific Northwest and the other traffic that it is known will accompany an increase in the lumber traffic justifies a certain amount of new railroad mileage and new arrangements for the operation of some of the old and new mileage. It is necessary and proper that adequate provision should be made for this future development so far as its extent can reasonably be determined at this time, although the actual development which will take place in the future will demonstrate whether the program which we are approving in this report is somewhat premature. In the prospective tonnage lies the justification for what we are doing. The introduction of competition in a different form and in a territory where it does not now exist to the extent that some regard as desirable is an elusive and theoretical consideration upon which much emphasis is laid in the report but which railroad development everywhere in this and in other countries has demonstrated to be unsound. The theory of competition as applied to railroads and a more or less dogmatic reliance upon it has been in my judgment the greatest single error in our national policy toward railroads. The undue stress which this report lays upon competition tends to perpetuate this fallacy." *Construction of Lines in Eastern Oregon*, 111 I.C.C. 3 (1926), at p. 49. Similarly, Commissioner Woodlock, though likewise concurring in the results, commented as follows: "Congress has enjoined upon the commission the duty of 'preserving competition' so far as possible in the grouping of railroads through consolidation. If, however, it had desired to introduce yet more 'competition' into the industry, through control in the hands of this commission over new construction and extensions, it would doubtless have instructed us to that effect, instead of referring us to 'public convenience and necessity' as the test to be applied to new projects. 'Competition' means alternative service available to a shipper or a district; it implies existence at all times of more facilities than are actually needed to move the traffic. The law clearly contemplates that railroad plant in existence shall, as a whole, receive a 'fair return' from the rates. It is impossible, therefore, to avoid the conclusion that when Congress gave us power to govern new construction it did so with the intent that we should prohibit the building of unnecessary new facilities. New facilities become necessary when existing facilities become inadequate. 'Monopoly' is not necessarily synonymous with inadequacy. 'Competitive' facilities are not 'necessary' merely because they are 'competitive.' Doubtless, every shipper is ready at all times to welcome another railroad into his territory; doubtless every railroad is ready at all times to enter another railroad's territory and share the business that the other has developed; doubtless no railroad desires a new 'competitor'; these are all very natural states of mind. But somebody must pay for the new facilities and they must be supported by the rates. There is no purse of Fortunatus to be tapped, and both carrier and shipper may well bear that in mind." *Ibid.*, at p. 51.

<sup>79</sup> In *Ches. & Ohio Ry. v. U. S.*, 283 U.S. 35 (1931), sustaining the Commission's

Finally, the question arises as to how far the applicant's plans for financing the extension or new construction may be deemed relevant to the determination of public convenience and necessity. While authority to regulate security issues is conferred upon the Commission by a separate grant of power, and while applications for certificates are not generally accompanied by contemporaneous requests for the issuance of securities, the outcome of a proposed project may, as a practical matter, depend not only upon the probable flow of traffic but upon the requirements of the financial structure. An undue load of fixed charges, for example, may threaten the maintenance of the newly authorized service, with the imposition of heavy losses upon investors and great hardships upon the community in the event of forced abandonment. If the carriers are to be effectively protected against unnecessary financial burdens and the public is to be spared the untoward consequences of ill-conceived ventures, the character of the proposed financing of the project cannot be ignored. In most instances, it is true, the problem of costs of construction and of the ability of the applicant to meet them satisfactorily is merged with the more general problem as to the need for the service, its probable operating results, and its relationship to existing facilities.<sup>80</sup> But occasion-

authorization on competitive grounds in *Construction by Virginian & Western Ry.*, 145 I.C.C. 167 (1928), the Supreme Court declared: "There is no specification of the considerations by which the Commission is to be governed in determining whether the public convenience and necessity require the proposed construction. Under the Act it was the duty of the Commission to find the facts and, in the exercise of a reasonable judgment, to determine that question. . . . Undoubtedly the purpose of these provisions is to enable the Commission, in the interest of the public, to prevent improvident and unnecessary expenditures for the construction and operation of lines not needed to insure adequate service. In the absence of a plain declaration to that effect, it would be unreasonable to hold that Congress did not intend to empower the Commission to authorize the construction of new lines to provide for shippers such competing service as it should find to be convenient or necessary in the public interest. Indeed §5(4) of the Act, authorizing the Commission to adopt a plan for the consolidation of railway properties into a limited number of systems, clearly discloses a policy on the part of Congress to preserve competition among carriers. . . . And the Commission has recognized the advantages of competitive service to shippers especially in respect of a diversified car supply for the shipment of coal and lumber; it suggests the possibility of failure of operation from various causes, that under some circumstances competition operates to stimulate better service and that reasonable competition may be in the public interest" (pp. 42-43).

<sup>80</sup> Note the following, for example, from *Construction of Lines in Eastern Oregon*, 111 I.C.C. 3 (1926), at p. 45: "There is no question . . . as to the stability of the financial structure of any of the carriers or as to their general results from operation.

ally methods of financing have been deemed to be sufficiently crucial to receive consideration even after an apparently independent finding that public convenience and necessity required the extension or new construction, and, under such circumstances, the certificates granted have been conditioned upon the observance of restrictions with respect to the issuance of bonds or the financial structure as a whole.<sup>81</sup> The rationale of this procedure, with special reference to the necessity of controlling fixed charges, has been stated as follows: "Paragraph (20) of section 1 provides that the Commission 'may attach to the issuance of the certificate such terms and conditions as in its judgment the public convenience and necessity may require.' The public convenience and necessity preeminently require that a railroad, if constructed, be in a position to continue to function. Whether or not a new railroad can live depends, to a considerable extent, on the fixed charges it is required to earn. The public calamity attendant upon the failure of service of a railroad upon which industries have become dependent and along which settlements have grown up is a thing we must constantly keep in mind in issuing certificates authorizing construction. Such construction should be authorized only if there is a reasonable prospect that the project can be expected to live. With continued operation necessarily dependent in a measure on the burden of

The most unfavorable view of the various projects could be taken, and yet, if all of them were consummated the ability of the major systems to serve the public adequately would be but inconsiderably impaired thereby."

<sup>81</sup> In *Public-Convenience Certificate to Jackson & Eastern Ry.*, 70 I.C.C. 110 (1921), for example, the certificate authorizing the construction of an extension was issued "upon the express condition that said Jackson & Eastern Railway Company shall not issue any bonds, or other evidences of indebtedness, for the construction of said extension or for the refunding of any obligations arising out of such construction, directly or indirectly, for a period of five years from the date upon which actual construction of said extension shall commence" (p. 114), although the extension was required to be completed and placed in operation not later than about a year and a half from the issuance of the certificate. On this basis authority to issue bonds in connection with this construction was denied in *Bonds of Jackson & Eastern Ry.*, 94 I.C.C. 248 (1924). Similarly, in *Construction of Extension by N. M. C. Ry.*, 99 I.C.C. 389 (1925), the certificate was issued upon the express condition "that the face amount of bonds to be executed shall not exceed 50 per cent of such expenditures for constructing the proposed extension, making the contemplated improvements on the present line, and purchasing equipment, as are properly chargeable, under our classification, to capital account; that the aggregate par value of stock, bonds, and other securities to be issued for the purposes stated shall not exceed the aggregate amount of such expenditures; and that proper accounts of construction expenditures shall be kept in accordance with our classification" (p. 403).

fixed charges, it seems entirely proper that a limitation in respect to such charges be imposed by appropriate condition attached to our authorization.<sup>82</sup> Whether actual financial conditions are imposed or the probable direction of financial control is merely indicated,<sup>83</sup> this procedure appears to be advantageous to the applicant carriers as well as to the general public, since it serves to prevent or discourage at their inception undertakings which, though necessary, may be wrecked by unsound or unduly hazardous financial plans. As with respect to the other guiding considerations, however, the Commission's performance has been flexible in character, depending upon the distinctive circumstances of each proceeding, and both its apparent disregard of financial plans and its actual imposition of financial conditions have evoked protest from within its membership.<sup>84</sup> These issues have generally arisen only in borderline cases, marked by uncertainty as to the

<sup>82</sup> From concurring opinion of Commissioner Meyer in *Construction of Extension by N. M. C. Ry.*, *supra*, at p. 398.

<sup>83</sup> In *Public-Convenience Certificate to W. F. & S. R. R.*, 67 I.C.C. 184 (1921), for example, an unconditional certificate authorizing new construction was issued, but the Commission made the following declarations with respect to the applicant's financial plan: "The applicant presented its general plan covering the amount and character of securities to be issued, but as it is neither necessary nor desirable to pass upon such plan in this proceeding, nothing herein is to be taken as an approval of the contemplated arrangements for refunding the cost of construction. It should be said, however, that the applicant will be expected to confine its issue of securities to the actual cost of the road and equipment; that the cost of construction will be correctly recorded; and that in issuing bonds the applicant will be required to limit the amount to not more than 50 per cent of the total cost of road and equipment, exclusive of amounts donated, so that fixed charges will in no event exceed the estimate of net income from local traffic" (p. 187). Similarly, in *Construction by W., B., T. & S. Ry.*, 124 I.C.C. 769 (1927), the Commission, in authorizing new construction, made the following declarations with respect to the applicant's financial plan: "If the financial plan contemplated by the applicant were final and were the only one possible, the objections to it would outweigh such measure of public convenience and necessity as is shown for the extensions. The plan is not final, however, and is not before us for approval. It appears that the applicant will probably be unable to finance its project on its own credit and must look to one or more of its connections for support. Without expressing any final opinion as to the financial plan, we feel that the applicant and those interested in financing its project should be advised that they face the probability of our requiring the applicant to confine its issue of securities to the actual cost of road and equipment. Nothing contained herein is to be construed as authorizing the applicant to issue any securities" (pp. 804-805).

<sup>84</sup> In *Construction of Line by Wenatchee Southern Ry. Co.*, 90 I.C.C. 237 (1924), for example, the dissent of five members of the Commission was based in part upon the failure of the majority to attach significance to the character of the financial plan. In the words of Commissioner Aitchison: "The majority opinion proceeds upon the theory that in the instant proceeding we need decide only the issue of public convenience and

outcome of the proposed project.<sup>85</sup> In the great bulk of proceedings the Commission has confined itself to the determination of convenience and necessity on the basis of the need for the facilities, as evidenced by their relationship to the existing service and the outlook for their profitable operation, merely adding, with respect to the financial

necessity, and may appropriately defer consideration of the financial plan until application is made to issue securities. Though such a course may be proper in some cases, in many others the financial plan is of primary importance in determining whether a certificate should be granted. Especially is this the case under conditions such as are here presented. The probability of the construction work being properly and successfully done depends upon the financial ability of the applicant. We have no means of assuring the execution of the project according to the plans submitted, and the fact of public convenience and necessity may rest upon the physical fitness of the proposed line for the purposes it is intended to serve. In my judgment the applicants have underestimated the cost of their project, and have overestimated its physical capacity to carry the great volume of traffic they count upon receiving, and which they regard as necessary to pay even their low estimate of operating costs. Further, the financial plan furnishes a key to the motives for the application and a test of the faith of the promoters in the earning power of the line. Moreover, an outstanding certificate in the hands of persons unable properly to carry out the project might while in force obstruct the public interest by preventing the issuance of a certificate covering practically the same route to others financially able to construct a more suitable and adequate railroad" (pp. 259-260). For the circumstances leading to the lapse of the certificate, because of the inability of the applicant to raise the necessary capital, see note 72, *supra*. In *Construction of Extension by N. M. C. Ry.*, 99 I.C.C. 389 (1925), on the other hand, in which the issuance of the certificate was conditioned upon the observance of financial restrictions, Commissioner McChord dissented because he deemed the character of the financial plan to be irrelevant to the determination of public convenience and necessity: "We find that the present and future public convenience and necessity require the extension of the line. How can it be said that public convenience and necessity do not require it if the applicant plans to obtain all the necessary funds by issuing bonds? Yet that, in effect, is what the majority says. The question as to whether public convenience and necessity require or will require the construction and operation of a certain line of railroad is not . . . so bound up with the question of methods of securing the money to construct the line that we must in passing upon the first question make our finding depend upon the second, particularly as we have in another section of the act plenary power to control the issuance of securities by which money may be secured. . . . There is . . . no adequate or just reason for imposing upon this applicant a condition designed to forestall a possible failure of the enterprise to prosper at some visioned future time. Public convenience and necessity in my opinion are not dependent upon methods of financing a proposed road. Proper financing is of course an important question and in the public interest, but is a secondary one in the case before us and one to be carefully considered after, and not contemporaneously with, the question of public convenience and necessity" (pp. 401-402).

<sup>85</sup> Thus, in *Public-Convenience Certificate to Jackson & Eastern Ry.*, 70 I.C.C. 110 (1921), the Commission declared: "The record as a whole fails to afford reasonable assurance that the project will become a permanently successful enterprise. However, since local interests are ready and willing to assume the burden with full knowledge of what the future may hold for the enterprise, it seems proper that they should be permitted to do so. But in view of the uncertain future of the road, we do not think it

plan, that no application being before it for the issuance of securities, no conclusion need be reached for the time being as to the appropriateness of the contemplated methods of financing.<sup>86</sup>

In placing primary stress upon the avoidance of unprofitable operation, whether because of insufficient traffic prospects or probable fi-

would be proper for us to sanction at this time the issuance of bonds to finance its construction" (p. 113). Again, in *Construction of Extension by N. M. C. Ry.*, 99 I.C.C. 389 (1925), the Commission declared: "It does not appear from the record that the applicant's railroad, as extended, could earn a fair return on the cost of the proposed extension without a materially increased development in the tributary area. That the traffic from the proposed extension would assist in keeping the existing line in operation may be conceded. A conservative financing of the project would also be an aid to that end" (p. 397). For the financial conditions imposed in connection with the certificates issued in these proceedings, see note 81, *supra*.

<sup>86</sup> It should be noted here that paragraph (18) of section 15a provided that the Commission, in its discretion, might permit carriers proposing to undertake the construction and operation of new lines of railroad to retain all or any part of their excess earnings for a period of not more than ten years, such permission to be conditioned upon the completion of the construction work within a period to be designated by the Commission. This policy is more closely related to the Commission's control of new construction than to its regulation of rate levels. Its primary purpose appears to be clear: to encourage the building of new lines found to be in the public interest, by providing for the possibility of recoupment, during the period of exemption from recapture, of such losses as early operation might impose. It was to be expected that most requests for permission to construct or to operate would be accompanied by requests for exemption from recapture; the carriers had everything to gain and nothing to lose by such a procedure. It is manifest, however, that the paragraph was not intended to serve as a general avenue of escape from the exactions of the recapture provisions, and that a strict construction of its terms was necessary. Accordingly, in the case of lines partially or completely built before the effective date of the paragraph, as well as in the case of applicants which, because they were not proposing to undertake the construction and operation of new lines of railroad, did not fall within the class of corporations contemplated by the statute, requests for permission to retain excess earnings were denied. See, for example: *Public-Convenience Certificate to G., A., S. & C. Ry.*, 71 I.C.C. 616, 617 (1922); *Lease of Virginian & Western Ry.*, 72 I.C.C. 454, 457-458 (1922); *Operation of Hines Yellow Pine Trustees R. R.*, 76 I.C.C. 59, 62 (1922); *Operation of Line by Superior & Southeastern Ry.*, 86 I.C.C. 403, 405 (1924); *Acquisition of Line by H. P., T. & D. R. R.*, 90 I.C.C. 72, 73 (1924); *Acquisition of Line by Statesboro Northern Ry.*, 90 I.C.C. 413, 416 (1924); *Application of Charleston Port Utilities Commission*, 90 I.C.C. 743, 745 (1924); *Acquisition of Line by B. & H. S. R. R. Co.*, 94 I.C.C. 355, 359 (1925); *Acquisition of Line by D., C. & S. Ry. Co.*, 99 I.C.C. 573, 575 (1925); *Acquisition by Canton & C. R. Co.*, 145 I.C.C. 467, 468 (1928). The Commission also denied requests for exemption from recapture where the new construction constituted a portion of an operating system. See, for example: *Virginian & Western Extension*, 72 I.C.C. 55, 57 (1922); *Construction by Johnstown & Stony Creek R. R.*, 76 I.C.C. 546, 548 (1923); *Construction of Branch Line by Southern Pacific*, 79 I.C.C. 284, 286 (1923); *Control of Jackson & Eastern*, 111 I.C.C. 587, 591-592 (1926); *Construction in Cameron County, Tex.*, 124 I.C.C. 513 (1927). In the last of these proceedings the Commission said, at pp. 520-521: "In view of the present and prospective financial strength of the applicants, there is no apparent necessity for the

nancial difficulties, and upon the prevention of unnecessary duplication of facilities, whether because of the adequacy of existing service or the likelihood of excessive diversion of traffic from established lines, the Commission has undoubtedly accorded recognition to the major factors pertinent to the determination of public convenience and necessity. Financial losses and economic wastes have frequently sprung from the traditional policy of freedom of investment in extensions and new construction; and their avoidance and prevention, as an expression of the national concern for the maintenance of an

exemption. The impracticability of a satisfactory segregation of the income of a portion of an operating system affords good ground for the belief that the provision was intended to apply only to the construction of separately operated systems or lines." Another guiding consideration was disclosed in the following pronouncement from *Kansas, Oklahoma & Gulf Extension*, 72 I.C.C. 392 (1922), at p. 395: "We do not feel that on the showing presented we would be justified in granting permission to the applicants to retain the excess earnings of the extension. It is to be built primarily to benefit the applicants, and indirectly the public, in the handling of through traffic, and not to develop traffic in territory which is deficient in transportation facilities. Paragraph (18) of section 15a was designed primarily to encourage enterprises of the latter sort, and its application should not be extended to situations such as the present one." In numerous instances, however, the Commission denied requests with no further explanation than this: that in its opinion "the matters of record" did not justify the grant of permission to retain excess earnings. See, for example: *Construction of Line by Fort Wayne Union Ry.*, 79 I.C.C. 442, 443 (1923); *Construction of Branch Line by Northern Pacific Ry.*, 79 I.C.C. 687, 689 (1923); *Public-Convenience Application of C. of G. Ry.*, 90 I.C.C. 19, 22 (1924); *Construction by Florida Western & Northern R. R.*, 90 I.C.C. 528, 529 (1924). Favorable action upon carrier applications, in so far as supporting reasons have been set forth, was generally based upon financial considerations. In *Certificate to Union Pacific R. R.*, 65 I.C.C. 382 (1920), the Commission said, at p. 384: "Upon consideration of the record we find . . . that because of the cost of such extension and the uncertainty of adequate return during the first few years of operation, that applicant should be permitted to retain all of its earnings derived from such extension for a period not to exceed 10 years, such certificate and retention of excess earnings to be conditioned, however, upon the completion of the work of construction on or before the 31st day of December, 1921." Again, in *Public-Convenience Certificate to C. of G. Ry.*, 67 I.C.C. 273 (1921), the Commission said, at p. 275: "The showing of prospective net income renders it improbable that a segregation of the accounts of the branch line for a period of 10 years will show any excess earnings to which the permission of paragraph 18, section 15a, can attach. However, if the applicant is able during that period to secure better results than the above estimates indicate, it will be proper that any excess be retained in order to offset the probable deficit in the early years." In most instances, however, the grounds of the Commission's grant of permission were not explicitly set forth. See, for example: *Construction of Line by G. C. R. Co.*, 99 I.C.C. 264, 266 (1925); *Construction of Line by M. & S. V. R. R. Co.*, 99 I.C.C. 606, 608 (1925). In view of the unlimited discretion conferred upon the Commission in this special sphere, the validity of such summary determinations, whether affirmative or negative, is not open to serious question; but more reasoned support for these findings would doubtless have rendered the Commission's performance more illuminating.



adequate transportation system, was the principal goal of the requirement of enabling certificates from the federal regulatory agency: such certificates are calculated to diminish, if not to eradicate, unjustifiable capital expenditures, in the interest not only of applicant carriers and communities which come to be dependent upon the projected facilities, but of soundness and economy in the aggregate of railroad operations. Furthermore, in view of the undefined character of the statutory criterion of permissive action, there is ample basis for the elasticity which has characterized the Commission's performance. There is no definite intent, expressed or implied, that authorizations be confined to undertakings assured of financial success, that vested interests of existing lines be invariably protected and prevailing competitive situations crystallized unalterably, and that the necessary financial structures be cramped into any uniform authoritative mold. On the contrary, since initiative in matters of new construction is recognized to rest in the carriers, since the principle of competition is explicitly retained in other connections, and since the administrative determinations are permissive rather than mandatory, it is clear that administrative discretion was not narrowly restricted. But the legal validity of the Commission's approach in departing from the criteria of unquestioned need of additional facilities and reasonable assurance of sustaining traffic is not necessarily persuasive of the desirability of such an approach from the standpoint of policy. In a commendable desire to withhold undue interference with the enterprise of the carriers, the Commission has tended, in some instances, to subordinate the long-time interests of the railroad system as a whole to the immediate advantages of the parties directly concerned. The willingness of local investors to assume risks in the first instance does not protect the general community against the burdens which may ultimately be imposed upon it by the financial failure of the extension or new construction; similarly, the benefits to local shippers of securing competitive service, however real they may be, do not adequately offset the burdens that may ultimately be imposed upon the general community by unnecessary duplication of facilities. In the early years of the railroad industry, with the resources of the country yet largely undeveloped, with the future of the steam carriers apparently secure, and with little or no authoritative regulation in the public interest, speculative

boldness and competitive vigor, despite the many evils to which they led, were on the whole very fruitful: railroad building in advance of actual needs and under the spur of intense rivalry was in no small measure responsible for the rapid development of plant and equipment and for the progressive improvement in service standards. But in the maturity of the industry, functioning under highly developed economic conditions, surrounded by rapidly growing and easily expandible alternative carrying agencies, and subject to an elaborate system of affirmative governmental control, the community becomes increasingly less dependent upon the speculative and competitive elements of progress, and these very elements tend to complicate the tasks of regulation and to retard the achievement of a properly coordinated transportation system. In face of the crucial problem of excess carrying capacity, the considerations which we have found to require a more liberal policy in matters of abandonment also serve as justification for a more stringent policy in matters of new construction.

#### *Compulsory New Construction*

But the maintenance of an adequate transportation system, as contemplated by the 1920 legislation, not only involves control of voluntary extensions but authoritative assurance of such construction as is demanded in the public interest. While it is important to avoid the economic wastes and financial burdens which tend to flow from unrestricted freedom in railroad building, it is essential that needed lines be made available even in the absence of initiative or acquiescence on the part of the carriers. Accordingly, as a complement to its authority to approve or disapprove of voluntary construction projects, the Commission was empowered to order any carrier by railroad subject to its jurisdiction "to extend its line or lines."<sup>87</sup> This power of compulsion may be exercised, after hearing, upon its own motion as well as upon complaint; and its discretion is expressly conditioned only upon findings that the extension is reasonably required in the interest of public convenience and necessity, and that the expense involved will not impair the ability of the carrier to perform its duty to the public. These

<sup>87</sup> Sec. 1, par. (21). For a preliminary analysis of the nature and implications of this power, see Part I, pp. 241-244.

limitations provide standards of action not unlike those governing the issuance of certificates upon application of the carriers, and they have been so executed by the Commission. But no express restrictions are imposed upon the extent of the new construction which may be ordered, and the Commission deemed itself free in this respect. Because of this circumstance the most significant problem in this sphere has concerned the scope of its statutory authority. Is the Commission's mandatory power confined to extensions within the area which the carrier has bound itself to serve, or does it apply to the construction of new lines, irrespective of the carrier's previous commitments, as in the case of voluntary undertakings? Since compulsory investment of capital not restricted to territory already served or obligations actually assumed involves drastic encroachment upon managerial freedom and property rights, questions of legislative intent and constitutional validity have come to the forefront. In examining the Commission's performance, therefore, we shall note, first, the guiding considerations which have controlled its decisions on the merits, and second, the interpretation it has placed upon the scope of its power as reviewed in the courts.

There have been few proceedings involving the propriety of compelling new construction, and in all instances they have arisen out of complaints of shippers or communities.<sup>88</sup> In other words, there has been little pressure for requiring unwilling carriers to extend their lines, and none whatever on motion of the administrative agency. Furthermore, in passing on the merits of complaints and the desirability of according the requested relief, the Commission has been guided by substantially the same considerations which have controlled its disposition of carrier petitions—that is, it has required a showing both of need for the service and of financial ability. "An order requiring a carrier to extend its line in the interest of public convenience and necessity, and involving as a necessary incident expenses which would impair the ability of the carrier to perform its duty to

<sup>88</sup> See *Ridge Coal Mining Co. v. M. P. R. R. Co.*, 62 I.C.C. 259 (1921); *Cooke v. C., B. & Q. R. R. Co.*, 66 I.C.C. 452 (1922); *Gunderson v. C., M. & St. P. Ry. Co.*, 91 I.C.C. 702 (1924); *Construction of Lines in Eastern Oregon*, 111 I.C.C. 3 (1926), 117 I.C.C. 737 (1927), 124 I.C.C. 529 (1927), 138 I.C.C. 99 (1928); *Public Service Commission of Oregon v. Central Pac. Ry. Co.*, 159 I.C.C. 630 (1929); *Clarkston Chamber of Commerce v. Northern Pac. Ry. Co.*, 160 I.C.C. 752 (1930).

the public would be a contradiction. On the other hand, even though such proposed extension would not impair the ability of a carrier to perform its duty to the public, no order could be issued against a carrier requiring an extension of its line, unless such extension was reasonably required in the interest of public convenience and necessity. Both of the conditions must be satisfied precedent to the issuance of an order.<sup>89</sup> These interdependent considerations are dealt with by the Commission with the same careful emphasis upon an adequate record that characterizes its disposition of proceedings involving voluntary extensions.<sup>90</sup> Account is taken, as bearing upon the necessity of the extension and the financial ability of the carrier, of the nature of the territory and population seeking the new service, the character of the existing facilities, the outlook for traffic, the estimated costs of construction, the indicated expenses of operation, and the probable return upon investment. As in voluntary extension cases, too, there is no insistence upon complete elimination of risk, and system earnings as well as revenues derived from local traffic are deemed relevant. In the words of the Commission: "Complainants are not required to make a showing which will eliminate all or even substantial risk in the construction of the proposed line, because all railroad enterprises are subject to risks which the best human foresight can not anticipate. . . . Nor is it indispensably requisite that local business will be sufficient to justify the extension as an independent line. . . . The saving to be brought about in the movement of existing traffic may be sufficient to justify substantial expenditures for extensions. . . . The value of an extension as a feeder for the system may be the controlling factor in determining whether or not the extension should be constructed."<sup>91</sup> But financial considerations have none the less exerted a dominant

<sup>89</sup> *Cooke v. C., B. & Q. R. R. Co.*, 66 I.C.C. 452 (1921), at pp. 452-453. Note, also, the following from *Gunderson v. C., M. & St. P. Ry. Co.*, 91 I.C.C. 702 (1922), at p. 706: "The first condition contains the second, and of necessity an order could not be made under the second condition unless the first is also satisfied."

<sup>90</sup> Thus, in *Construction of Lines in Eastern Oregon*, 111 I.C.C. 3 (1926), the Commission dismissed the complaint of the Oregon commission seeking an order for new construction, on the ground that, because of changed conditions, the record could not be depended upon with respect to future traffic and its financial results. Subsequently, in *Public Service Commission of Oregon v. Central Pac. Ry. Co.*, 159 I.C.C. 630 (1929), upon a full and satisfactory record, an order was issued requiring the construction of the new east-and-west line which had been sought earlier.

<sup>91</sup> *Clarkston Chamber of Commerce v. Northern Pac. Ry. Co.*, 160 I.C.C. 752

influence. Neither the remoteness of communities from existing rail lines nor the fact that system earnings may be reasonably satisfactory is permitted to outweigh the prospect of a continued course of inadequate returns upon the particular investment.

In pursuance of this approach, the Commission has in most instances dismissed the complaints involving compulsory new construction. The proposed extensions, though affecting territory which lacked immediate rail facilities and lying within the general area served by the defendant carriers, were found not to give promise of sufficient traffic to justify the necessary outlays. Thus, in dismissing a complaint against the Burlington requesting the compulsory construction of 32 miles of road in Nebraska, the Commission concluded, after an analysis of building costs, operating expenses, and traffic prospects: "The issuance of the order prayed for would require defendant to invest a large sum of money in an undertaking which at the outset would not be a financial success, and would not hold out hope for the future."<sup>92</sup> Similarly, in dismissing a complaint against the Milwaukee requesting the compulsory construction of 19 miles of road in South Dakota, the Commission, after a like analysis, concluded as follows: "It is evident that the extension would be of benefit to the inhabitants of the region described. Complainant maintains that he has shown that the extension would return more favorable results than the Milwaukee system as a whole or that part of it within South Dakota, and argues that it can not be said that the expense involved therein will impair the ability of the carrier to perform its duty to the public. Even on complainant's showing, however, the return on investment at the outset would be but 1.57 per cent. If defendant borrows the money with which to construct the extension it will be compelled to pay a higher rate of interest than this, and to supply the difference from other revenues. If it spends part of its capital or current revenues, under the conditions as disclosed by the record it will be at the sacrifice of its other lines, which serve many times the number of

(1930), at p. 772. For support of these declarations in voluntary extension cases, see *Construction Application of Michigan Northern R. R.*, 65 I.C.C. 480 (1920); *Construction of Line by Oregon Short Line R. R.*, 82 I.C.C. 40 (1923); *Construction of Naton Cut-Off by Central Pacific Ry.*, 82 I.C.C. 185 (1923); *Construction of Extension by O.-W. R. R. & Nav. Co.*, 86 I.C.C. 264 (1924).

<sup>92</sup> *Cooke v. C., B. & Q. R. R. Co.*, 66 I.C.C. 452, 456 (1922).

people who would be served by the proposed extension. The record shows that the proposed extension would not at the outset earn a fair return on the investment, and that the prospects for the future would be highly uncertain.<sup>93</sup> In finding, in these instances, that the extensions were not reasonably required in the interest of public convenience and necessity, the Commission confined itself to the merits of the proposals and placed controlling emphasis upon the probable financial results of the particular projects. The defendant carriers were already operating in the general territory to be served by the new facilities, and no question was raised, therefore, as to the validity of mandatory enlargement of the undertakings which they had voluntarily assumed. It was conceded, furthermore, that the new construction would have yielded some benefit to the persons and places directly concerned. In light of the record, however, the Commission found that the public need for the proposed services was not sufficiently urgent to justify the imposition upon the roads of the burden of unprofitable operation which would have been entailed; and in reaching these conclusions it was but following the path of its determinations in voluntary extension proceedings.

Like considerations have governed the Commission's dismissal of a petition involving a much more extensive project of new construction.<sup>94</sup> A number of complaints were filed by civic and commercial bodies of Idaho and Washington, and by the public service commissions of these states and of Oregon, seeking to require the Northern Pacific and Union Pacific systems, directly or through their subsidiaries, to extend their lines in these areas. The major proposal was that the roads be compelled to build 126 miles of line, running north and south along the Snake River, between Lewiston, Idaho, and Homestead, Oregon.<sup>95</sup> This line was intended primarily to establish a short and direct route between the northern and southern portions of Idaho. "Movement of passengers and property between the northern and southern sections," said the Commission, "is now over a some-

<sup>93</sup> *Gunderson v. C., M. & St. P. Ry. Co.*, 91 I.C.C. 702, 706 (1924).

<sup>94</sup> *Clarkston Chamber of Commerce v. Northern Pac. Ry. Co.*, 160 I.C.C. 752 (1930).

<sup>95</sup> The other proposals, closely allied to the main project, were likewise found, on the record, not to be in the interest of public convenience and necessity, and the several complaints were dismissed. See *ibid.*, pp. 773-779.

what circuitous route and through neighboring States. At present it takes from 20 to 24 hours to travel from the capital at Boise, in the southern part of the State, to Lewiston. The proposed construction would reduce the distance necessary to travel between these points by about 200 miles and reduce the time by approximately 10 hours."<sup>96</sup> The state had expended more than \$8,000,000 for the construction of its North-and-South Highway, but this highway was primarily designed for and adapted to passenger traffic. The new line, it was urged, would also result in great improvement in freight traffic. While some tonnage in lumber, minerals, and agricultural products was expected to be provided by the intermediate territory, the existing isolation of the northern and southern portions of the state was the chief concern of the complainants. It was predicted by them that through the proposed construction there would be a reduction of rates, a considerable movement of potatoes and hay between the southern and northern sections, and a substantial development of the livestock industry. But upon a careful analysis of the facts of record, including construction costs, operating expenses, and traffic volume, originated and diverted, the conclusion was found inescapable that the extension "could not be constructed and operated except at a huge loss."<sup>97</sup> Under these circumstances, although the anticipated public benefits were duly recognized, no basis was discerned for a finding of public need which would justify the issuance of an order. As in voluntary extension cases and in earlier proceedings involving compulsion, lack of a reasonable prospect of self-sustaining operation was decisive in the dismissal of the complaint: "While the record will not permit even an approximate estimate of the revenues or earnings which may reasonably be expected from the proposed Lewiston-Homestead line, the conclusion

<sup>96</sup> *Ibid.*, pp. 757-758. In describing the position of the complainants, the Commission continued: "Much discussion and feeling among the residents of Idaho have resulted from the lack of more direct means of transportation and travel between the northern and southern sections. This feeling has at times been the basis of the thought that the northern section of Idaho should constitute a new State of itself, or that it be annexed to some other State. Improved means of communication between the various sections of the State has been the subject of discussion and reports of various State officials as far back as 1885 and up to the present. The situation has often been considered by the Governor and by the Legislature of the State. The Governor and the president of the Public Utilities Commission testified in this proceeding as to the pressing needs of the State for improved means of transportation."

<sup>97</sup> *Ibid.*, p. 772.

can not be escaped that construction and operation of the line would result in a large deficit. This is true even after considering the proposed diversion of traffic from existing facilities which would still have to be maintained and operated. If a deficit should result from the operation and the present earnings of the carrier are to be maintained, an increase in rates would seem inevitable. . . . The topography of the State and its extensive mountainous areas create a natural condition which would render construction and operation very expensive. The same conditions also prevent any substantial development within much of the area which would be tributary to a north-and-south line. . . . It is true that the people of Idaho have long entertained the thought that this line should be built and their views are deserving of the most careful consideration, but it is quite probable that they have never had the benefit of such a study as the record contains with respect to the cost of construction and the probable financial results of its operation. After careful consideration of the record, and bearing in mind the public benefit which would result from its construction, together with the cost and probable loss to the carrier, we find that public convenience and necessity have not been shown to justify an order requiring the construction of the Lewiston-Homestead extension.<sup>98</sup>

In the only proceeding which has resulted in the issuance of an order requiring extensive new construction,<sup>99</sup> the major issue, which led to a decision of the Supreme Court adverse to the views of the Commission,<sup>100</sup> has concerned the extent of the Commission's power of

<sup>98</sup> *Ibid.*, pp. 772-773. The defendant carriers not only opposed the complaints on the merits, but questioned the authority of the Commission to grant the requested relief. "They urge," said the Commission, "that if section 1(21) of the interstate commerce act be construed as conferring upon us authority to require these carriers to construct and operate the requested extensions and terminal facilities, said paragraph is unconstitutional in that the same would operate to deprive them of their property without due process of law, and take from them their private property for public use without just compensation, in violation of the fifth amendment to the Constitution." The Commission disposed of this contention summarily, by referring to its decision in *Public Service Commission of Oregon v. Central Pac. Ry. Co.*, 159 I.C.C. 630 (1929), which we shall presently analyze: "In . . . [that proceeding] we held that authority has been vested in us to authorize or require such an extension if the conditions set out in the statute are satisfied and the fact[s] otherwise warrant the construction." *Clarkston Chamber of Commerce v. Northern Pac. Ry. Co.*, *supra*, pp. 753, 754.

<sup>99</sup> *Public Service Commission of Oregon v. Central Pac. Ry. Co.*, 159 I.C.C. 630 (1929).

<sup>100</sup> *Interstate Commerce Commission v. Oregon-Washington R. Co.*, 288 U.S. 14 (1933).



compulsion. On the merits, as will appear from a brief survey of this proceeding, the Commission did not depart from established principles. In 1927 the Public Service Commission of Oregon filed a complaint against eleven railroads, including the Union Pacific and Southern Pacific and some of their subsidiaries, alleging that the defendant carriers had failed and refused to provide reasonable and adequate railroad facilities to a large area within the State of Oregon, and praying that one or more of them be required to construct a new east-and-west line across the central part of the state connecting the Union Pacific and Southern Pacific systems.<sup>101</sup> The territory involved probably constituted the largest area in the United States without rail facilities, and the proposed construction was designed to remove the hampering effects of this condition and to assist in the development of the State of Oregon.<sup>102</sup> After a full hearing, and on the basis of a detailed analysis of the nature of the territory, the character of existing facilities, the possibilities of new tonnage, the incidence of operating economies and traffic diversion, and the probable financial outcome of the enterprise, the Commission ordered the construction of the extension substantially as proposed by the complainants. Specifically, the Oregon-Washington Railroad & Navigation Company, a subsidiary, through the Oregon Short Line, of the Union Pacific, was directed to build a road, 185 miles long, from Crane, on its own line, to Crescent Lake, on a connecting line of the Southern Pacific. The Commission found, in accordance with the stipulations of the statute, first, that the extension was reasonably required in the interest of

<sup>101</sup> Essentially the same allegations and a prayer for the same relief were first presented in a complaint of the Oregon commission in *Construction of Lines in Eastern Oregon*, 111 I.C.C. 3 (1926), in which a variety of voluntary construction undertakings by some of the same carriers were authorized. The complaint of the Oregon commission involving the compulsory construction of a cross-state line was there dismissed because the record was not deemed adequate to support the requested order. See, also, 117 I.C.C. 737 (1927).

<sup>102</sup> "It is urged that Oregon's development, as compared with other States, has been held back and seriously hampered, due to the lack of direct routes to the markets for her products and that the construction of the proposed extension is an important part of anticipated development of adequate rail transportation facilities within the State. The evidence of complainant and defendants brings out clearly and forcibly that no section can develop without transportation. The major portion of the State of Oregon is without adequate transportation facilities and this is particularly true with respect to the portion which would be served by the proposed construction." *Public Service Commission of Oregon v. Central Pac. Ry. Co.*, *supra*, at p. 635.

public convenience and necessity, and second, that the expense involved would not impair the ability of the carrier to perform its duty to the public. The finding of convenience and necessity was based not only upon the manifest benefits of the proposed facilities, but upon the prospect that the new line, when viewed in its relationship to the Union Pacific system, would prove adequately profitable.<sup>108</sup> The revenue outlook, as disclosed of record, was at least as promising as the financial showings which had been found to justify authorization in voluntary undertakings, and the Commission deemed the applicable standards to be essentially the same in both types of proceeding. In the words of Commissioner McManamy, speaking for the majority: "The convenience and necessity of the public depends not at all upon the willingness or unwillingness of the carriers to provide the facilities or render the service sought. The requisites set forth in the statute are practically identical whether the construction is to be voluntary or compulsory. Case after case might be cited where applications of the carriers for certificates covering construction under less favorable circumstances, as related to probable traffic, revenues, and public benefit, than are present in this case have been granted. There can be no justification for granting requests of the carriers under given circumstances and under similar or more favorable circumstances denying appeals of the people for relief and for a reasonable chance to develop a great State. There can be no better criterion or guide to follow in determining what the carriers, including defendant carriers, consider a prudent investment which is justified in the interest of public convenience and necessity than the instances where certificates have been sought and granted authorizing construction of rail extensions."<sup>104</sup> Even less difficulty was encountered with respect to the second of the required findings. In view of the prosperous financial sta-

<sup>108</sup> "It is not necessary in establishing that the extension is reasonably required in the interest of public convenience and necessity to show that the extension would of itself, and considered as standing alone, earn sufficient revenues to make it profitable. The relation of the extension to the Union Pacific system and its possibilities as a developer of traffic for that system must be considered. We have recognized this principle in many cases." *Ibid.*, p. 663. For an example involving the same subsidiary of the Union Pacific in the same general territory, see *Construction of Extension by O.-W. R. R. & Nav. Co.*, 86 I.C.C. 264 (1924).

<sup>104</sup> *Public Service Commission of Oregon v. Central Pac. Ry. Co.*, *supra*, p. 664. For an example involving a subsidiary of the Southern Pacific in the same general territory, see *Construction of Natron Cut-Off by Central Pacific Ry.*, 82 I.C.C. 185 (1923).

tus of the Union Pacific system, as indicated, *inter alia*, by its current realization of income, disbursement of dividends, and acquisition of surplus, it was "clear" to the Commission that the expense involved in constructing the extension would not impair the ability of the carrier to perform its duty to the public.<sup>105</sup>

But before the Commission could make this finding that the facts of record were sufficient to justify the issuance of its order, it was called upon to determine whether it possessed the necessary authority in law to grant the requested relief. It was upon this issue that the Commission itself divided,<sup>106</sup> and with respect to which it found itself in conflict with the courts. The carriers contended that the legislative provisions did not authorize compulsory new construction involving substantial enlargement of the scope of their voluntary undertakings; and, if construed as conferring such authority, that they were in violation of the constitutional safeguards of due process. In finding this contention without merit, the Commission was guided by the plain tenor of the language of the statute. Pointing out that it is not its function to determine questions of constitutionality, but rather to give effect to the intent of Congress, the Commission held that this intent was unambiguously indicated on the face of the enactment em-

<sup>105</sup> The new construction was regarded as a required undertaking of the Union Pacific system: "As previously shown the O.-W. R. & N. is owned by the Oregon Short Line which, in turn, is owned by the Union Pacific. All eastbound traffic moving from and over this extension will move practically the full length of the latter carriers. Under such circumstances it would be inconsistent and contrary to fairness to consider the new construction with relation only to the O.-W. R. & N., and apart from the Oregon Short Line and the Union Pacific. In view of these facts, it is expected that the cost of the construction will be financed by the Union Pacific in a manner similar to that which it voluntarily followed in the construction of the Burns extension. . . ." *Public Service Commission of Oregon v. Central Pac. Ry. Co.*, *supra*, pp. 665-666.

<sup>106</sup> Commissioners Porter, Brainerd, Farrell, and Woodlock dissented. Only the dissent of Commissioner Porter, however, was on the merits: "While as at present advised, I am persuaded we have authority to compel the construction of the line of railway involved in this case, I am not convinced we should make such an order upon the record now before us. . . . The extraordinary character of the power lodged with us to say to a carrier against its will that it shall construct a piece of railway 187 miles in length costing from nine to twelve millions of dollars, should require a clear and convincing showing of the public necessity requiring it, and of the probable favorable results therefrom, before we should exercise it. I am not convinced that such a showing has been made in the record we have here, and hence I am unable to agree with the report." *Ibid.*, pp. 666-667. The other dissents, as will appear presently, were based upon the conviction that the Commission was without authority to make the order.

powering it without restriction to order a carrier to extend its line or lines, and that the authority thus conferred was in harmony with the general purpose and method of the Transportation Act. "This paragraph," declared Commissioner McManamy, "plainly empowers us to authorize or require a carrier subject to the act to extend its line or lines. Defendants by construction endeavor to restrict our power to comparatively short extensions in territory already served by the carrier or carriers involved. There is not the slightest foundation in the language of Congress for such a limitation. The language is so clear and its meaning so plain that no difficulty attends its construction. Adherence to its terms leads to nothing impossible or plainly unreasonable. We are therefore bound by the words employed and are not at liberty to conjure up conditions to raise doubts in order that resort may be had to construction. It is elementary that where no ambiguity exists there is no room for construction."<sup>107</sup> The Commission thus concluded, though not without dissent,<sup>108</sup> that it was vested with the

<sup>107</sup> *Ibid.*, p. 634.

<sup>108</sup> In expressing the judgment that the Commission was without authority to require the construction of the proposed line, Commissioner Brainerd relied upon the following declaration of Chief Justice Taft in *Interstate Commerce Commission v. Los Angeles*, 280 U.S. 52, 70 (1929): "If Congress had intended to give an executive tribunal unfettered capacity for requisitioning investment of capital of the carriers and the purchase of large quantities of land and material in an adverse proceeding, we may well be confident that Congress would have made its meaning far clearer and more direct than in the present meager provisions of the Transportation Act." *Ibid.*, p. 666. In reaching a like conclusion, Commissioner Farrell declared that "the extension of lines referred to can not properly be construed as covering a new line of railroad, but must instead be confined to such extension as is necessary to enable the carrier to serve the public adequately with some railroad which has already been constructed and in territory which has already been occupied by the carrier." *Ibid.*, p. 667. Commissioner Woodlock dissented without opinion, but see his separate expression in *Construction of Lines in Eastern Oregon*, 111 I.C.C. 3 (1926), at pp. 50-52. It is interesting to note that the declaration of the Supreme Court in *Interstate Commerce Commission v. Los Angeles*, *supra*, upon which Commissioner Brainerd relied was not at variance with the position of the Commission in the same proceeding. In *Los Angeles Passenger Terminal Cases*, 100 I.C.C. 421, 426 (1925), the Commission said, through Chairman Aitchison: "Careful study of the interstate commerce act convinces us that Congress has not conferred upon us authority to require carriers to construct union passenger stations under conditions such as are here present. . . . The authority to require a carrier to extend its line may include authority to require it to construct stations necessary and incidental thereto. That question is not now before us. But assuming such authority, we conclude that paragraph (21) does not empower us to order the construction of a union passenger station where, as here, the station would be the principal thing and the extension of lines the incident."

necessary authority; and the statutory requirements upon which its action was conditioned being satisfied, it ordered the new construction as already indicated.

But the United States Supreme Court, affirming a decree of the District Court enjoining the enforcement of the order,<sup>109</sup> held that the Commission had exceeded its authority.<sup>110</sup> The main issue was one of statutory construction. In the Commission's view, declared Justice Roberts for the majority of the Supreme Court, "the power given to compel a carrier 'to extend its line or lines' is unlimited and the way is open for an order to extend for any distance, at any cost, for the purpose of developing virgin territory hitherto unreached by railroads, or for supplying competition in a remote region served by other carriers."<sup>111</sup> Such an interpretation was found not to be justified by the language of the statute, or by established judicial determinations in connection with like powers exercised by the states, or by constitutional doctrines of statutory construction. In the first place, the power to compel extensions of line is coupled, in a single sentence, with the power to order the acquisition of facilities for car service. "The reasonable conclusion is, therefore, that the extensions mentioned have to do with car service, and are not intended to create a wholly independent subject of jurisdiction. . . . We should expect, if Congress were intending to grant to the Commission a new and drastic power to compel the investment of enormous sums for the development or service of a region which the carrier had never theretofore entered or intended to serve, the intention would be expressed in more than a clause in a sentence dealing with car service."<sup>112</sup> Again, the statute makes no mention of "new lines" in connection with mandatory undertakings, as it does in the case of voluntary construction, and this diversity of treatment was deemed significant of the Congressional intent. The Court argued as follows: "The terms of paragraph 18 . . . throw light on the meaning of paragraph 21. The former presupposes voluntary action by a carrier, and provides that no company shall undertake 'the extension of its line of railroad, or the construc-

<sup>109</sup> *Oregon-Washington R. & Nav. Co. v. U. S.*, 47 Fed. (2d) 250 (1931).

<sup>110</sup> *Interstate Commerce Commission v. Oregon-Washington R. Co.*, 288 U.S. 14 (1933).

<sup>111</sup> *Ibid.*, p. 35.

<sup>112</sup> *Ibid.*

tion of a new line of railroad . . . unless and until there shall first have been obtained from the Commission a certificate that the *present or future* public convenience and necessity require or will require' the construction and operation thereof. The difference of phraseology in the two paragraphs emphasizes the distinction between extensions and new lines. . . . The purpose of Congress in enacting paragraph 18, as repeatedly explained by this court, was that though a carrier should desire to extend existing facilities or to construct new ones in territory not previously served, the free exercise of discretion should not be permitted, but the Commission must be convinced that the proposed venture would not drain the railroad's resources and disable it from performing those duties of public service under which it then rested, with consequent detriment to the public in the matter of service and rates. . . . Paragraph 21, on the other hand, contains no provision whatever for new lines. If the power be as broad as contended by the Commission there seems to be no good reason for the omission. The same principles and the same needs might equally require the building of a new line as the extension of an existing one, unless, indeed, Congress recognized a radical difference between compelling embarkation in a new venture and ordering a mere extension of facilities required as the natural concomitant and complement of those presently used for the rendition of service to which the carrier has committed itself."<sup>118</sup> Secondly, the Court pointed out that in construing the powers of state authorities to order extensions it had restricted their lawful incidence to the scope of the undertakings voluntarily assumed: "Prior to the adoption of the Transportation Act,

<sup>118</sup> *Ibid.*, pp. 36-37. The Court was also influenced by the fact that in connection with voluntary construction the "present" or "future" public convenience and necessity are explicitly specified, whereas, in connection with compulsory extensions, the required finding merely runs in terms of public convenience and necessity: "That paragraph 21 refers to the service the carrier has bound itself to render is further emphasized by the omission to make the future public convenience a factor to be considered. A presently existing public need is expressly stated as prerequisite to the compulsory extension of a line. On the other hand, paragraph 18, which covers voluntary construction, conditions approval on present or future convenience or necessity. Congress therefore drew a distinction between what might be permitted and what compelled. These differences in the two sections were disregarded by the Commission, and are overlooked by the appellants." *Ibid.*, pp. 37-38. It should be noted that only by implication is the required finding in the case of compulsory extensions limited to "a presently existing public need"; as a matter of practice, of course, it is virtually impossible to reach a sound conclusion without taking into account the reasonably near future.

1920, the Commission had no authority to authorize or to compel extensions of existing lines of railroad. Such power as existed in that behalf rested in the States. In a number of cases this court passed upon and defined the authority of a State to require extensions of existing service and facilities. Orders made were attacked as compelling the companies, against their will and judgment, to devote property to the public service without compensation, contrary to the guaranty of due process. They were sustained, however, upon the express ground that the railroads had undertaken the service and must supply facilities adequate and reasonably necessary to its performance. The requirements were found not to involve the rendition of a new or different service from that to which the owners had agreed when they dedicated their property to a public use. Where, however, the State's mandate involved the rendition of a service beyond the agreement of the carrier, the order was annulled."<sup>114</sup> These determinations, it was argued, "furnish a background which must have been in the minds both of the Commission and of the Congress at the time of the passage of the Transportation Act."<sup>115</sup> Finally, the Court was constrained to adopt a narrow construction of the statutory provisions because of the question of constitutional validity: "Our duty is to construe the statute, if fairly possible, so as to avoid not only the conclusion that it is unconstitutional, but also grave doubts upon that score. The views advanced by the appellants, to say the least, raise serious questions in this respect. The railroads, though dedicated to a public use, remain the private property of their owners, and their assets may not be taken without just compensation. The Transportation Act has not abolished this proprietorship. State courts have uniformly held that to require extension of existing lines beyond the scope of the carrier's commitment to the public service is a taking of property in violation of the federal constitution. The decisions of this court will be searched in vain for the announcement of any principle of Constitutional interpretation which would support the order of the Commission. . . . The construction we adopt makes it unnecessary to pass upon the grave questions of constitutional validity raised by the appellants' argument."<sup>116</sup> In the light of all these considerations,

<sup>114</sup> *Ibid.*, pp. 32-33. The Court's citations are omitted.

<sup>115</sup> *Ibid.*, p. 39.

<sup>116</sup> *Ibid.*, pp. 40-42.

the Court concluded that the power granted to the Commission "is confined to extensions within the undertaking of the carrier to serve, and cannot be extended to embrace the building of what is essentially a new line to reach new territory."<sup>117</sup>

Despite its manifest plausibility the Court's analysis is not altogether convincing, and the resultant curtailment of the Commission's power creates a gap in the policy of affirmative control of the transportation system which was sought to be established. Fundamentally the defect of this judicial determination lies in its placing a strained

<sup>117</sup> *Ibid.*, p. 40. Nor were the facts of record found to render this controlling interpretation inapplicable to the particular proceeding. Two significant contentions were made toward this end: first, that the required construction constituted only a negligible part of the mileage of the Union Pacific system, and hence might appropriately be regarded as an extension instead of a new line; and second, that the Oregon-Washington company was authorized by its charter to provide such a line, and hence the required construction was embraced within the scope of its voluntary undertaking. Both contentions were held to be without merit. On the first issue the Court said: "It is urged that as the order involved trackage amounting to only 1.2% of that now maintained by the Union Pacific System, the requirement may properly be considered an extension rather than a new line, though a different view might prevail if the Oregon-Washington alone be considered. But whether the order be treated as a command to the Oregon-Washington Company as a separate corporate entity, or as an injunction to the Union Pacific System, it is an attempted exertion of a power not conferred. Assuming, without deciding, that the Commission was entitled to treat the Oregon-Washington Company as an instrument of the Union Pacific System, and the required extension, therefore, as one adding only a small percentage to the present mileage of the system, still the purpose is to compel a new investment for the development of a new area at the request and in the interest of the State of Oregon, whose desire is that its natural resources shall be exploited." And the Court was equally uncompromising on the second issue: "Finally it is claimed that however narrowly the power to compel extensions be construed, the order was justified by the facts developed before the Commission. They are said to disclose an undertaking by the Oregon-Washington Company to serve the region in question. Much is made of the circumstance that when the complaint was filed the company had a charter under which it was authorized to build a line on the location of that which the order describes. The possession of the franchise is said to give rise to an implied agreement to serve the district. The company's having in contemplation the building of the road would in this view render the Commission's action unassailable. But authority to build the line, if the company were so minded, involved no commitment to construct it. Though by appropriate legislation the State might forfeit the charter for non-user, the continued existence of the franchise imposed no obligation to exercise the charter powers. The Oregon-Washington Company chose not to serve the territory which the cross-state line would reach; has not desired and does not now desire to enter upon the project. The possession of a charter which would have made the building of a railroad legal is insignificant as to the company's actual undertaking. Whether the railroad held itself out to serve the region in question must be decided in the light of all the facts. The record demonstrates that the territory to be traversed was one the company had neither actually nor impliedly agreed to serve with transportation facilities." *Ibid.*, pp. 42-43.



construction upon a plain legislative mandate and in its failing to recognize the intimate relationship of that mandate to the purposes and methods of the Transportation Act as a whole. The statutory provisions make no express distinction between large and small extensions, nor is there any basis in the actualities of railroad construction for distinguishing sharply between extensions and new lines. Needed extensions, financially justified, may well involve rather substantial construction projects; and in a sense every extension may be deemed to be a new line. The Commission's power, in this sphere as in other fields, must of course be exercised reasonably; but neither in the instant case nor in any of the other proceedings involving an invocation of the power of compulsion does the Commission appear to have overstepped the bounds of reason. The mere fact that the arbitrary imposition of entirely new investment obligations, on an extensive scale, may be theoretically possible under the Commission's interpretation of its authority scarcely justifies its restriction to the scope of the undertakings voluntarily assumed by the carriers. Since the best evidence of the carriers' intentions is to be found in what is actually done by them, such restriction virtually destroys the power of compulsion, contrary to the plain tenor of the legislative provisions and in contravention of the purpose of the Transportation Act affirmatively to develop and maintain an adequate transportation system. Under these circumstances judicial precedents antedating the Transportation Act, whether involving state or federal action, possess little, if any, relevance. Not only are different statutory provisions in issue, but the measure of constitutional power, in its concrete applications, was also changed by the 1920 legislation, since the expansion of governmental authority was accompanied by constructive safeguards for the interests of the carriers. The most important of these safeguards was provided by the rule of rate-making, under which it was made the duty of the Commission so to adjust charges as to provide a fair return, as far as practicable, for the carriers as a whole or by designated rate groups. It was on the basis of this national conception of the railroad system and in reliance upon this and other evidences of positive public responsibility toward the carriers that no insurmountable obstacles were encountered in upholding the constitutional validity of the provisions for the exercise of federal power over the level of intrastate

rates,<sup>118</sup> for the apportionment of joint rates in the public interest,<sup>119</sup> and for the recapture of excess earnings.<sup>120</sup> By contrast, in confining the Commission's power to compel new construction to the scope of the voluntary undertakings of the carriers, the Supreme Court appears to have disregarded the nature and purposes of the Transportation Act and to have departed from the broad conception of governmental power implicit in its earlier outstanding determinations.

Considerations of this character account for the dissent of Justice Cardozo, in which Justice Brandeis and Justice Stone joined. Because the dissenting opinion of Justice Cardozo develops this approach, in all its significant interrelations, in distinguished and stimulating fashion, it merits somewhat extended quotation. The following excerpts provide a fitting conclusion to our analysis of the problem of compulsory new construction.

The Transportation Act of 1920 was framed with the design of securing to the United States an adequate and efficient system of railroad transportation. Everything contained in it with reference to extensions, voluntary and involuntary, is tributary to that end, and unless related thereto, is misconceived and misapplied. On the one hand, the carriers are to be permitted to make voluntary extensions of their lines, but only with the consent of the Commission, lest waste may otherwise ensue. . . . On the other hand, they are made subject to a correlative duty, if so ordered by the Commission, to build extensions, even though unwillingly, when transportation will otherwise be inefficient or inadequate. The limits of this duty are not appropriately defined by dividing the field into extensions big and little, with a power of regulation excluded from the one section and admitted in the other. On the contrary, the word extension is to be taken in no forced or artificial sense, but with the meaning attributed to it in the common speech of men. It does not fairly connote a prolongation so vast and sudden as to work an utter transformation of the character of the road, making what was extended the incident and the extension the principal. . . . On the other hand, the power of the Commission is not limited to extensions that are merely trivial. The purpose of the Congress to make the power more than this, to make it an effective instrument for the development of railroad transportation, is revealed at every step. . . .

<sup>118</sup> *Wisconsin R. R. Comm. v. C., B. & Q. R. R. Co.*, 257 U.S. 563 (1922).

<sup>119</sup> *New England Divisions Case*, 261 U.S. 184 (1923).

<sup>120</sup> *Dayton-Goose Creek Ry. Co. v. U. S.*, 263 U.S. 456 (1924).

Another basis of division, in addition to that of size, is put forward in argument as separating the extensions that Congress had in view from others so substantial that they are to be taken as excluded. We are to find the test, so it is said, in the expectation or intention, presumable or actual, of the incorporators or stockholders. The test, however, is illusory. If expectation or intention is the measure of the power of the nation, development must always wait upon the pleasure of the carrier affected. By hypothesis, the territory already served is the only territory that the carrier has evinced a willingness to serve. If its road is to be built for a greater distance or between other points, there is a frustration of its purpose that the terminus for construction shall be wherever stockholders and directors have willed that it shall be. . . .

If the test proposed were not illusory, it would none the less be inappropriate. The time has gone by when the subjection of a public service corporation to control and regulation by the agencies of government is to have its origin and justification in the terms of a supposed contract between the corporation and the state. The origin of the subjection and its justification are to be found, not in contract, but in duty, a duty imposed by law as an incident to the enjoyment of a privilege. The discretion of managers and stockholders, at one time nearly absolute, is now subject in countless ways to compulsion or restraint in the interest of the public welfare. . . . The argument is not persuasive that alone among all these inroads upon the freedom of managerial discretion the provision for compulsory extensions is to be struck down as ineffective. As long as governmental orders are kept within the range of reason, their operation is unaffected by expectation or desire.

The Fifth Amendment of the Constitution is invoked by the carriers but invoked without avail. Consistently with that Amendment Congress may delegate to the Commission the power to force upon unwilling carriers an extension of their lines into fields of old service and of new. Much of what has been written in this opinion as to the meaning of the statute is pertinent also to an inquiry as to power. Again the thought is to be kept before us that the need of the public, not the acquiescence of the carrier, is the measure of the service, provided only that for such service there is adequate requital. Whether such requital has been assured is a question not susceptible of answer except in the setting of the circumstances. Objection that it is lacking is to be viewed in the light of the entire scheme and framework of the Act of 1920, and of all the relevant provisions for the carriers' protection. There must be kept in view the provision whereby

rates are to be maintained at such a level as to yield to the carriers of the country, or to the several groups into which they are to be divided, a fair and reasonable return, and whereby the surplus earnings of the strong roads may be recaptured and applied to the use of weaker ones. True indeed it is that courts are wont to lean to the construction of a statute that will avoid serious doubts of its validity, though they might hold it to be valid if pressed to a decision. . . . Even so, they will not carry hesitation to the point of devitalizing the essence to preserve the husk alone. When the scheme of the Act is viewed in the totality of its meaning and probable operation, there is a quick end to the objection that in fixing the bounds of duty to render service to the public, the area of the possible must coincide, at least generally and roughly with that of the actual and voluntary. Congress does not transcend the limits of the Constitution when it establishes a national system of transportation by rail. It does not transcend those limits when in aid of the system thus established, it lays a duty upon the railroads to furnish the extensions requisite for the attainment of the end in view. The conclusion is the same whether the immediate purpose of the order is to develop the resources of the country in territory contiguous to roads already built, or to promote the convenience of communities served imperfectly or not at all. . . .<sup>121</sup>

## §2. COÖPERATION AND COMBINATION

The principal channels of the Commission's jurisdiction over the intercorporate relations of the railroads were also established by the Transportation Act of 1920, and the execution of the powers incident thereto must likewise be appraised in the light of the general purposes and methods of that legislation. A survey of the Commission's activities in this sphere, dealing with the propriety of various types and projects of coöperation and combination, must embrace the character of its performance with respect to interlocking directorates, pooling arrangements, acquisitions of control, and consolidations.<sup>122</sup>

In setting up, in 1920, its "new departure" in railroad regulation,

<sup>121</sup> *Interstate Commerce Commission v. Oregon-Washington R. Co.*, 288 U.S. 14 (1933), at pp. 43-51.

<sup>122</sup> Sec. 202, par. (12); and sec. 5, pars. (1), (2), and (4) to (6). For an analysis of the difficulties arising from the traditional policy of enforced competition and of the general character of the new legislation, see Part I, pp. 79-81, 111-117, 183-189, and 193-195.

Congress undertook to sanction the substitution of a large measure of concerted action, unified control, and actual consolidation for the traditional policy of enforced competition. It was not its purpose, however, to abandon the competitive spur to progressive and efficient operation, or to force the roads to combine into a small number of great systems according to some predetermined pattern. Although, as a result of the war-time experience with railroad unification, a movement in this general direction had come to be regarded as highly desirable, no provision was made for compulsion.<sup>123</sup> The wastes incident to unbridled rivalry were viewed as constituting a source of injury to the carriers and as imposing an unnecessary burden upon the community, and there was repeated recognition of the obstacles to effective public regulation resulting from the coexistence of strong and weak lines; but initiative for removing these difficulties was largely left to the roads themselves, and the new authority conferred in the premises was fashioned almost exclusively in permissive terms.<sup>124</sup> This does not mean, however, that the carriers were free to resort to concert of action, unification of control, or merger of properties solely on the basis of self-interest; a reasonable assurance of advantage to the public was required, through a showing of such benefits as achievement of economy, improvement of service, strengthening of credit, simplification of control. There was no repeal of prior enactments prohibiting cooperation and combination calculated to effect serious curtailment of competition; the chief factor of change lay in the grant of authority to the Commission to investigate proposals involving such intercorporate relations and to attempt to mold them in the public interest. No person was permitted to hold the position of officer or director of

<sup>123</sup> For interesting accounts of the British policy of compulsory consolidation into regional monopolies following the World War, see C. E. R. Sherrington, *The Economics of Rail Transport in Great Britain* (1928); Howard C. Kidd, *A New Era for British Railways* (1929).

<sup>124</sup> While the Commission was directed to prepare a comprehensive consolidation plan and authorized to approve of consolidations found to be in the public interest and in harmony with that plan, the assent of all the carriers involved was required. Sec. 5, par. (6). Similarly, while the Commission was empowered to initiate proceedings to determine whether the pooling of traffic or of revenues would be in the public interest, the assent of all the carriers involved was required. Sec. 5, par. (1). It should be noted, however, that mandatory power was conferred upon the Commission in connection with joint or common use of terminal facilities and in the regulation of car service under emergency conditions. Sec. 3, par. (4); sec. 1, pars. (15) to (17).

more than one carrier, except upon authorization of the Commission; the pooling of traffic or of revenues as between different and competing railroads was prohibited, except upon specific approval of the Commission; the acquisition by one carrier of control of another, through lease or by stock purchase or in any other manner not involving consolidation into a single system for ownership and operation, required the approval and authorization of the Commission; actual consolidations, even when in harmony with the comprehensive plan as promulgated and otherwise satisfying the statutory conditions, necessitated the approval and authorization of the Commission. Only when acting under orders of the Commission in effecting pooling arrangements, acquisitions of control, or consolidations, and only to the extent made necessary by such orders, were the roads involved relieved from the operation of the anti-trust laws and of all other restraints or prohibitions of state and federal law.<sup>128</sup> Through these means, supplemented by the exercise of its authority to grant or withhold certificates of public convenience and necessity and to regulate the issuance of securities and assumption of obligations, the Commission was enabled to influence the alignment of existing roads, as to ownership and control and operation, at least to the extent of curbing changes which it might find to be detrimental to the public interest.

But in practical effect the Commission was also clothed with a large measure of directing power, despite the fact that its jurisdiction was predominantly permissive in character. Not only did the Act provide that its consolidation plan, which might be changed even after "final" adoption if believed to be publicly advantageous, should be the guiding factor in the grouping of properties and should be applied in particular instances with such modifications and under such terms and conditions as the Commission might prescribe, but with respect to all proposals for coöperation and combination it was free, not merely to grant or deny the authority sought, but to mold affirmatively the relationships to be effected. When the Commission sanctions pooling arrangements or acquisitions of control, for example, it may do so under such rules and regulations, for such consideration, and on such terms and conditions as it finds just and reasonable, and only to such

<sup>128</sup> Sec. 5, par. (8).

extent as it may indicate.<sup>126</sup> The Act contained, of course, some limitations upon the Commission's freedom of action; but for the most part these limitations merely provided a basis for the exercise of a wide administrative discretion. Authorization of interlocking officers or directors was conditioned upon a showing that neither public nor private interests will be adversely affected; authorization of pooling expedients was conditioned upon a finding that they will promote better service or greater economy and will not unduly restrain competition; authorization of acquisitions of control was conditioned only upon a finding that they will be in the public interest. In the case of consolidations more detailed legislative standards were prescribed, but these standards also afforded an almost unlimited opportunity for fashioning the pattern for the reorganization of the railroad net in conformity with administrative judgment. In the preparation of its consolidation plan the Commission was required to group the carriers into a limited number of systems, preserving competition as fully as possible and maintaining established channels of trade as far as practicable, the various groupings to be so arranged as to equalize transportation costs, as nearly as may be, between competitive systems; and in approving proposed consolidations the Commission was required to find that they are in harmony with and in furtherance of its complete plan, that the securities at par of the corporations which are to become the owners of the consolidated properties do not exceed the value of these properties as determined by itself, and that the public interest will be promoted by the projected mergers for ownership, management, and operation. It thus appears that a controlling rôle was assigned to the Commission for effectuating the new Congressional policy concerning intercorporate relations. It is now necessary to examine the character of its performance with respect to the various aspects of the field of coöperation and combination.

#### *Interlocking Directorates*

In declaring it unlawful for any person to hold the position of officer or director of more than one carrier without the approval of the

<sup>126</sup> Furthermore, in the case of pooling arrangements and acquisitions of control, the Commission was expressly empowered, for good cause shown, to make such supplemental orders as it might deem necessary or appropriate. Sec. 5, par. (3).

Commission or to profit from dual railroad and banking connections,<sup>127</sup> Congress was cognizant of the adverse effects of such interlocking of interests, not only upon the competitive relations of the roads but upon their financial management.<sup>128</sup> This grant of power to the Commission, by way of supplement to the more formal and complete regulation of combinations and securities, provided a weapon for the control of organization and finance when objectionable relationships assume this convenient and overt form, although it has been recognized that through indirection and the use of "dummies" some of these relationships can be effected despite the prohibition of the statute or the action of the Commission.<sup>129</sup> Most of the applications for authority have involved the selection of common officers or direc-

<sup>127</sup> Sec. 202, par. (12).

<sup>128</sup> Prior to the passage of the Transportation Act the Commission recommended the "emancipation of railway operation from financial dictation." By way of support it had declared: "It would serve no good purpose to recite the many instances in comparatively recent years in which, through financial deals for which it is difficult to find any word of excuse, railroad properties have been bankrupted or saddled with almost overwhelming burdens of indebtedness, which have not increased the amount or value of property devoted to the public service, have not improved the service rendered, and have on the whole had the effect of increasing the charges for service. There should be some way by which under the law these things could be prevented, or, if not prevented, by which the perpetrators could be required to adequately answer for their acts. A transportation line operating by virtue of a public grant, and upon which the industrial, commercial, and social life of communities depends, should not be a football of speculation. The records of investigations made and reported upon by us in cases of financial wrecking of railroad companies suggest the advisability of extending the terms of the Clayton Act with reference to common or interlocking directors so as to render them applicable to common-carrier corporations, even when they are not competitors." *Annual Report*, 1919, p. 5. Accordingly, Congress not only prohibited the interlocking of officers or directors without the Commission's authorization, but as part of the same paragraph made it unlawful, under penalty, "for any officer or director of any carrier to receive for his own benefit, directly or indirectly, any money or thing of value in respect of the negotiation, hypothecation, or sale of any securities issued or to be issued by such carrier, or to share in any of the proceeds thereof, or to participate in the making or paying of any dividends of an operating carrier from any funds properly included in capital account." Sec. 202, par. (12). Under section 10 of the Clayton Act, moreover, common carriers had been prohibited from having any dealings in securities, supplies, or other commodities, or from entering into contracts for construction or maintenance of any kind, aggregating more than \$50,000 in any one year, with concerns having interlocking directors or other specified officials, except upon the basis of competitive bidding under regulations prescribed by the Commission. Taken together these provisions were designed to protect the carriers against the exploitation of directing personnel having interests in conflict with those of the carriers. For a further analysis of the financial implications of the provisions dealing with interlocking personnel, see Part I, pp. 114-117 and 193-195.

<sup>129</sup> Note the following, for example, from the dissenting opinion of Commissioner



tors for different components of the same railroad system, and these applications have generally been approved without hearing or published report, as a matter of administrative routine. For the most part, too, the selection of common officers and directors for roads having conflicting interests has been deliberately avoided by the carriers and individuals involved; in other words, the policy of the statute, supported by the sanction of heavy penalties, has been in large measure self-enforcing. But in determining whether the proposed interlocking of officers and directors, through its influence upon the competitive relations and financial management of carriers, would affect public or private interests adversely, the Commission has proceeded on the basis of full information, supplemented by hearings where

Eastman in *Interlocking Directors*—*N. Y., C. & St. L. and C. & O.*, 76 I.C.C. 549 (1923), in which seven individuals were authorized to serve as directors of the Chesapeake & Ohio and some of its subsidiaries while continuing to hold positions with the Nickel Plate and other roads: "I am well aware that the Nickel Plate interests could circumvent the law by the appointment of dummy directors, although it has evidenced no such intention. But because the law may be circumvented is no reason why we should fail to exercise our authority for what it may be worth. Upon any other theory our only recourse would be to throw up our hands and grant all applications under paragraph (12) of section 20a" (p. 553). In some instances, however, a recognition of the possibility of circumvention has led to an opposite view—that is, that authority be granted, in conformity with the realities of the situation, rather than formally denied. Note the following, for example, from the dissenting opinion of Commissioner Woodlock in *Directors of Wheeling & Lake Erie*, 138 I.C.C. 643 (1928), in which seven individuals were denied authority to act as directors or officers of the Wheeling & Lake Erie while continuing to hold similar posts in certain other roads: "It seems to me that in denying these applications the majority chases the shadow and loses the substance. The law (like many other laws which seek to operate within the *forum conscientiae*) is fatally weak in a vital spot. . . . Its aim is to prevent suppression of competition. To that end it forbids one man acting as director of two competing railroads *without permission of this commission*. That this dispensing power is placed in our hands indicates that in the opinion of Congress dual directorships are not in themselves necessarily evil. Evil is as evil does, and if we think that no evil will be done, we may permit the duality. . . . Now, acts in suppression of competition are not always easy to recognize. The law can, upon proper evidence, prevent two (naturally competitive) companies from conspiring or agreeing not to compete, but the law can not force them to compete. Many things can be done or left undone by these companies which they can not openly agree to do or not to do. With directors, or some directors, common to both companies, actions of this sort done or omitted acquire a significance which may easily ripen into a presumption and open the door to remedial measures of the law. With boards seemingly different in composition but containing in fact common purposes expressed in separate personalities (they need not even be 'dummies') the necessary evidence becomes far more difficult of procurement, and the law is effectively nullified. Is this 'in the public interest'? . . . To grant them [the applications] is merely to give frank and honest expression to the state of the facts, such as they are, and render more easy the application of the law to those facts" (pp. 656-657).

necessary.<sup>180</sup> The controlling factors in the Commission's decisions can be briefly stated and exemplified.

The Commission has utilized its power to disapprove of proposed interlocking of directing personnel as a means of preventing a community of interest among roads which, under its comprehensive consolidation plan, had been assigned to different systems. Thus, because the St. Louis-San Francisco had been allocated to the Rock Island system, while the Cleveland, Cincinnati, Chicago, & St. Louis had been made part of the New York Central system,<sup>181</sup> the Commission refused to permit an individual to become a director of the former while continuing to serve in similar capacity for the latter.<sup>182</sup> "Actual independence of the systems concerned," it was declared, "will not be subserved by permitting the same persons to serve upon the boards of directors of two major carriers, each of which is an important member of a different system."<sup>183</sup> In this connection the Commission called attention to its earlier declaration that the systems which it proposed "must be independent in fact as well as in name," in order that the required competition might be preserved, and to its further pronouncement that "the continuation or acquisition of inter-system interests directly or indirectly through holding companies, stock ownership, or otherwise, will be inconsistent with the independence necessary to true competition."<sup>184</sup> This approach was deemed to be applicable not only to directly competitive systems serving the same territory, but to systems generally, serving different territories. Only in this way, it was averred, can complete independence and impartiality be maintained. "Under our proposed consolidation plan, the eastern trunk-line systems will connect and interchange traffic at Chicago, Omaha, Kansas City, and St. Louis with other systems directly serving the Northwest, the West, and the Southwest. In many cases the systems will have the election between two or more connecting systems for the routing of traffic. The act specifically requires that car-

<sup>180</sup> See *In the Matter of Regulations Governing Applications Under Section 20a(12) of the Interstate Commerce Act, To Hold the Positions of Officer or Director of More Than One Carrier*, December 31, 1931. The earlier regulations were promulgated October 11, 1921, and revised June 19, 1922.

<sup>181</sup> *Consolidation of Railroads*, 159 I.C.C. 522 (1929).

<sup>182</sup> *In re Rand*, 175 I.C.C. 587 (1931).

<sup>183</sup> *Ibid.*, p. 587.

<sup>184</sup> *Consolidation of Railroads*, *supra*, p. 523.

riers establish and maintain nondiscriminatory facilities and practices in the matter of traffic interchange with their connections, and it seems apparent that the performance of this obligation will be best insured by the preservation of the independence of each system."<sup>185</sup> The Commission was therefore unable to find that neither public nor private interests would be adversely affected by the proposed interlocking.<sup>186</sup>

Again, where acquisitions of control have been effectuated without prior authorization, the Commission has sometimes declined to permit an interlocking of directorates as between the acquiring and the acquired roads. This position was taken in connection with the efforts of some of the eastern trunk lines to secure joint control of the Wheeling & Lake Erie.<sup>187</sup> In 1927, without application to the Commission for approval, the New York Central, the Baltimore & Ohio, and the Nickel Plate, acting in unison, purchased a controlling block of the stock of the Wheeling, in furtherance of a plan for consolidating the properties in eastern trunk-line territory into four great systems.<sup>188</sup> Applications were then filed by three directors of the New York Central, three directors of the Baltimore & Ohio, and one director of the Nickel Plate, for authority to serve the Wheeling in similar capacities while continuing to hold their positions with the trunk lines.<sup>189</sup> The Pittsburgh & West Virginia and the Wabash, as inter-

<sup>185</sup> *In re Rand*, *supra*, p. 588.

<sup>186</sup> See, also, *Annual Report*, 1932, p. 27.

<sup>187</sup> *Directors of Wheeling & Lake Erie*, 138 I.C.C. 643 (1928).

<sup>188</sup> "As already shown," declared the Commission, "the present applications are made pursuant to the acquisitions of Wheeling stock by the three trunk lines, and those acquisitions, in turn, were an important step in the carrying out of a plan for the consolidation of all of the carriers in eastern trunk-line territory into four great systems. It is further apparent that, although the purchases already made are sufficient to give the trunk lines control of the Wheeling, it is their purpose ultimately to secure all of its stock. Therefore, notwithstanding the form of this proceeding, the issue of the most advantageous disposition of the Wheeling in a general consolidation is presented." *Ibid.*, p. 654.

<sup>189</sup> The position of the applicants on the merits, together with the Commission's reaction thereto, was stated as follows: "While the applicants admit that each of the carriers represented by them is in competition to some extent with the Wheeling, they claim that much of the so-called competition is theoretical rather than actual, by reason of conditions which operate to give one route advantage over another. Such circumstances are the location of tracks, shorter haul, facilities for loading or delivering, and the like. It is not claimed, however, that the limiting conditions are peculiar to the competitive situation here under consideration, and it may be assumed that they are

veners, opposed the applications. Fearing a discontinuance of their free coöperative relations with the Wheeling, they charged that the stock purchases violated the anti-trust laws and alleged that such joint action could not properly be approved as an acquisition of control in the public interest. After a careful consideration of the transport functions, traffic activities, and competitive relations of the Wheeling, the Commission denied the applications. This denial, however, was not based upon the merits, but upon an inadequacy of record springing from the circumstance that no authorization of the stock purchases had been secured. The question as to whether the acquisitions vio-

general in character and are present in some degree in every territory served by competing lines. Applicants also seek to distinguish between railroad competition and market competition, claiming that Congress in requiring the preservation of competition had in mind the former. Competition between carriers, within the purposes of section 5 of the act, exists wherever there is such possibility of election of routes as may have an influence upon service or rates. If, as asserted by the applicants, a majority of shippers do make such an election, the fact emphasizes rather than detracts from the importance of competition. In many cases, as stated by the applicants, although a choice of routes is possible, circumstances of transportation may greatly affect the influence which a carrier exerts in the territory it serves. It is impossible to gauge accurately the effect upon other carriers of the service of the Wheeling as an independent line, but it may be said with confidence that as to much of its traffic there is substantial competition with applicants' lines, within the meaning and intent of the act." *Ibid.*, pp. 649-650. Note, also, the following: "The applicants urge that neither public nor private interests will be adversely affected by their holding the positions of officers and directors of the Wheeling. They allege that the stock interests in the Wheeling of the carriers represented by them will inure to the advantage of the Wheeling and of the communities and interests which it serves; that those carriers now have a pecuniary interest in the prosperity of the Wheeling, which will cause them to afford it every assistance in their power. They further say that no one of the carriers could injure the Wheeling if it wished to do so, as any attempt by one of them to divert traffic from the Wheeling would naturally be opposed not only by the stock interests other than those of the three carriers but by the two other carriers, since the three are in strong competition among themselves in the territory served by the Wheeling, and no one of them would allow another to secure an advantage at its expense if it could prevent it. They also call attention to the competition of other carriers, particularly the Pennsylvania and the Erie, at all important traffic points served by the Wheeling, and show that, even though competition between applicants' lines and the Wheeling were entirely eliminated, only 11.31 per cent of the traffic of the latter would be left without competition. The applicants further maintain that the danger of the elimination of competitive through routes and of other measures detrimental to the Wheeling is greatly magnified by the interveners in view of the powers now vested in this Commission in the matters of routing, rates, and service of carriers; and that, under these circumstances, it would be practically impossible for the trunk lines to carry into execution any of the oppressive measures which the interveners fear. That Congress did not rely solely on these powers is evidenced by the fact that it sought to provide for the retention of competition so far as practicable." *Ibid.*, pp. 653-654.

lated the Clayton Act was held not to be in issue in this proceeding;<sup>140</sup> but while the Commission found that it possessed the necessary authority to pass upon such acquisitions, despite the fact that no control had yet been exercised<sup>141</sup> and that they were consummated jointly by several carriers,<sup>142</sup> it did not deem the instant record sufficiently broad for determining the proper disposition of the Wheeling.<sup>148</sup> Accord-

<sup>140</sup> But see *Interstate Commerce Commission v. Baltimore & O. R. Co.*, 152 I.C.C. 721 (1929), in which, after complaint and investigation, the Commission held these acquisitions of stock in the Wheeling to be in violation of section 7 of the Clayton Act, because their effect may be to substantially lessen competition and restrain commerce, and ordered the Baltimore & Ohio, the New York Central, and the Nickel Plate to cease and desist from this violation and to divest themselves of the stock so acquired. The Baltimore & Ohio and the New York Central sold their Wheeling stock to the Alleghany Corporation, an affiliate of the Nickel Plate, and the entire block of stock, including that of the Nickel Plate, was subsequently placed in the hands of an independent holder, under a trust agreement approved by the Commission, pending the disposition of applications filed by the Nickel Plate and the Chesapeake & Ohio under section 5, paragraph (2). See supplemental report of the Commission in 156 I.C.C. 607 (1929).

<sup>141</sup> "Paragraph (2) of section 5 of the act provides for the acquisition of control of one carrier by another, with our approval. It is not shown that the trunk lines have performed any acts of control of the Wheeling since their acquisition of its stock, but it is necessary to conclude that the law aims at the acquisition of controlling power, and does not await an actual demonstration of the power." *Directors of Wheeling & Lake Erie, supra*, p. 654. The same position was taken in the Clayton Act proceeding. Note the following from the concurring opinion of Commissioner Eastman: "It is urged that the trunk lines have done nothing to suppress or even restrain competition by the Wheeling since they acquired a controlling interest in its stock. Particular stress is laid upon the fact that the old board of directors has not been changed, except to permit representation of a minority interest. It would have been changed, but for our decision in the *Directorate case*. However, the statute uses the expression 'where the effect of such acquisition may be to substantially lessen competition.' The wisdom of this form of expression is obvious. Here the acquisition has been under investigation, either in the *Directorate case* or in this proceeding, practically from the time when it was made. Whatever their ultimate intent, respondents would hardly be so foolish as to commit overt acts of suppression or restraint during the course of this investigation." *Interstate Commerce Commission v. Baltimore & O. R. Co., supra*, p. 738.

<sup>142</sup> "Although the statute is silent regarding the acquisition of control of a carrier by two or more other carriers, it is reasonable to assume that Congress had no intention of thus restricting the application of the provision, the general intent of which must be held consistent with the remainder of section 5. There would seem to be no sound reason for believing that the restrictions upon carrier control were intended to apply only to individual control; and it can not be admitted that the statute could be evaded by the cooperation of two or more carriers in an acquisition of control." *Directors of Wheeling & Lake Erie, supra*, pp. 654-655.

<sup>148</sup> That this proceeding, though presented in the form of applications for authority to serve as officers and directors of more than one carrier, was deemed to involve, in essence, the general problem of consolidation in eastern trunk-line territory, appears from the following: "The four-system plan proposed by the carriers . . . provided for the division of control of the Wheeling and other of the smaller carriers in the territory

ingly, the Commission concluded "that the presentation of these applications is premature, and that it should have been preceded by an authorization, secured through appropriate proceedings, to acquire the stock which the applicants desire to represent on the Wheeling board."<sup>144</sup> In this way the Commission sought to integrate its authority over interlocking directorates with its powers over intercorporate relations under other sections of the Act; with five of its members dissenting,<sup>145</sup> it declined to give such sanction to the selection of common officers and directors as might be construed as according approval to the consolidation plan of the applicants or as lending coun-

among two or more of the four systems, the understanding being that, although under joint control they would continue to be operated separately. . . . The four-system plan has never been formally presented to or considered by us. It was opposed by the Pennsylvania . . . and the record shows no change in the attitude of that company, which is not a party to these proceedings. Other important interests have not been heard. Obviously, we are not in position upon this record to render a decision upon the important questions involved, or to take any unnecessary step which might be construed as an approval of this plan or any other." *Ibid.*, p. 654. Note, also, the following from the concurring opinion of Commissioner Eastman in the Clayton Act proceeding: "In the carrying out of any plan of consolidation in eastern territory, competition will necessarily be curtailed or restrained in some degree, but the extent to which this result follows will be dependent upon the particular plan adopted. The greater the number of competitive systems the greater, broadly speaking, the competition will be. When respondents say that they acquired stock control of the Wheeling in furtherance of the four-system plan, they plainly mean that they acquired this stock to keep it out of the hands of any interests which might be desirous of creating a fifth competitive system. . . . It is possible that we may eventually approve such a lessening of competition as is involved in the four-system plan. Our tentative plan of consolidation provided for more than four, and indeed more than five, systems in eastern territory, and certainly we are in no way committed to the proposition that there shall be only four. However, it is conceivable that we may finally reach that conclusion, and in that event our order of approval under section 5 of the interstate commerce act would remove all bars interposed by the antitrust laws which might otherwise prevent such a plan of consolidation from being carried into effect. But because we may at some future time let down the bars does not give respondents any legal right to vault over them in anticipation of that possible event." *Interstate Commerce Commission v. Baltimore & O. R. Co.*, *supra*, p. 739.

<sup>144</sup> *Directors of Wheeling & Lake Erie*, *supra*, p. 655.

<sup>145</sup> Commissioner Meyer, with whom Commissioners Aitchison, Brainerd, Porter, and Woodlock concurred, briefly stated the position of the minority as follows: "In view of the active consideration of plans for unification of the eastern lines, both before and succeeding the acquisition of Wheeling stock by the three trunk lines involved in these proceedings, I am of the opinion that the public interest would be better served by permitting the representation of the stock on the Wheeling board, as sought, pending the presentation and action upon such a plan. The applicants have severally stated their willingness to accept a provision for termination of their directorships by our further order. This expression should not be construed as an indication of a position either favorable or unfavorable toward the four-party plan or any other plan." *Ibid.*, p. 656.

tenance to an acquisition of control achieved without its authorization.

But this approach has not been followed invariably. Where the circumstances appeared to justify the procedure, interlocking of directors has been permitted though the stock acquisitions to be represented had not been previously authorized, the order containing a proviso that the interlocking shall terminate if these acquisitions do not receive the approval of the Commission. Thus, after purchase by the Rock Island of large holdings in the St. Louis Southwestern, the Commission authorized four representatives of the former road to serve on the board of directors of the latter; but the order sanctioning these common directors provided that the authority thus granted "shall cease at the expiration of 30 days after the date of any order denying" the pending application for acquisition of control. Upon sale by the Rock Island of all of its St. Louis Southwestern stock and the withdrawal of its application to acquire control, three of the Rock Island representatives resigned from the board of the St. Louis Southwestern; but the fourth continued to serve both carriers until the Commission formally vacated and set aside its former order of authorization, holding "that the Rock Island and the St. Louis Southwestern are in active competition in various parts of the southern and southwestern territory," and that, in the existing circumstances, there was no showing that this interlocking "would not adversely affect public or private interest."<sup>146</sup> A similarly flexible attitude was disclosed in connection with the directorship of Leonor F. Loree, chairman of the board of the Kansas City Southern, in the Missouri-Kansas-Texas.<sup>147</sup> In 1925, following the purchase by the Kansas City Southern of 250,000 shares of the stock of the Missouri-Kansas-Texas, Division 4 had authorized Loree to serve as director of both carriers "until further order of the Commission," despite the fact that there appeared to be competition between the two roads. Subsequently the Commission refused to approve the control of the Missouri-Kansas-Texas by the Kansas City Southern and of the St. Louis Southwestern by the Missouri-Kansas-Texas,<sup>148</sup> and it also instituted proceed-

<sup>146</sup> *Interlocking Directors, St. L.-S. W. and C., R. I. & P.*, 145 I.C.C. 23, 24 (1928).

<sup>147</sup> *Application of Leonor F. Loree*, 145 I.C.C. 521 (1928).

<sup>148</sup> *Unification of Southwestern Lines*, 124 I.C.C. 401 (1927). The proposed unifica-

ings under the Clayton Act because of the Kansas City Southern's unauthorized acquisitions of stock in these lines.<sup>149</sup> Under these circumstances, and despite the pendency of a new application for the unification of these lines, the Commission, after hearing, vacated that portion of the order of three years earlier which had authorized Loree to serve on the board of the Missouri-Kansas-Texas while continuing on the board of the Kansas City Southern.<sup>150</sup> The fact of conflicting interests having been definitely established,<sup>151</sup> and the Kansas City

tion of the three lines was found not to be in the public interest because of its tendency to disrupt established routes and channels of trade, because of its failure to provide for various short and weak roads in the territory, and because of the undesirable character of the financial transactions which would have been involved.

<sup>149</sup> Complaint was entered alleging violation of the Clayton Act by order issued February 14, 1928, prior to the Commission's consideration of the directorate case. Later, upon a showing that the Kansas City Southern had divested itself of the stock in issue, the proceeding was discontinued. *Interstate Commerce Commission v. Kansas C. S. Ry. Co.*, 156 I.C.C. 359 (1929). From this disposition of the proceeding, Commissioners Eastman, McManamy, Taylor, Lewis, and Campbell dissented. The chief grounds of dissent, as developed by Commissioner Eastman, were first, that the Commission misconceived its duty under the act, and second, that it improperly dissolved doubts as to the effectiveness of the divestment in favor of the defendant: "In a case of this sort our duty under section 11 of the act, after we have served a complaint and held a hearing, is to determine (a) whether or not provisions of the act 'have been or are being violated'; (b) if so, to make a report in writing stating our findings as to the facts; and (c) to issue and serve an order requiring the guilty party to cease and desist from such violations and divest itself of the stock held unlawfully, 'in the manner and within the time fixed by said order.' . . . If I am correct in this interpretation of our duties, they have, I believe, been misconceived in the report before us. It does not determine whether provisions of the act 'have been' violated. On the contrary, the only question considered is one which it is not in the first instance our duty to determine, namely, whether there has been a divestment which is 'bona fide and such as we may approve,' and an order is entered 'approving' such divestment. . . . [Secondly], it seems to me that the evidence indicates that there is considerable doubt whether the Kansas City Southern interests have parted with actual control, direct or indirect, over either the M-K-T or the Cotton Belt. . . . Our power to prescribe the 'manner' of divestment was given to us for the express purpose of avoiding such doubts which are difficult to resolve into proven facts" (pp. 363-366).

<sup>150</sup> *Application of Leonor F. Loree*, 145 I.C.C. 521 (1928).

<sup>151</sup> The Commission directed attention to the following finding in *Unification of Southwestern Lines*, 124 I.C.C. 401, 416 (1927): ". . . The M-K-T competes with the K.C. Southern for traffic moving from or to Kansas City to the Gulf for export and on imports coming through the Gulf ports to and beyond Kansas City. Also through their connections between Houston and Beaumont they compete for traffic originating in the Houston-Galveston district and in the Beaumont-Port Arthur district for Missouri River destinations. In fact, all eastern and northern Texas may be regarded as competitive territory as between the K. C. Southern and the M-K-T for traffic moving between that territory and Kansas City, since such traffic from points on only one of those lines, or from points not reached by either of them, may move hundreds of miles over either of those lines." *Ibid.*, p. 528.



Southern having divested itself of its holdings in the Missouri-Kansas-Texas,<sup>152</sup> the Commission was unable to find "that the holding by Loree of the position of director of the Missouri-Kansas-Texas while continuing to act as director of the Kansas City Southern would not adversely affect public or private interests."<sup>153</sup> Even when the stock to be represented has constituted only a minority interest held by one road in another, the Commission's approval of interlocking of directors has been accompanied by express safeguards for the future. In authorizing, for example, three members of the board of the St. Louis-San Francisco to serve on the directorate of the Rock Island, following the purchase by the former of about 14 per cent of the total outstanding stock of the latter, the Commission added: "This action, however, is taken without prejudice to any findings that may be justified by subsequent proceedings involving the relations of the Frisco and the Rock Island, or the relations of either of these carriers to other carriers, in the administration of the provisions of section 5 of the act. If at any future time it should be shown that the exercise of the authority granted is affecting adversely either public or private interests, an appropriate order may be entered to meet the situation then presented."<sup>154</sup> Through such means the Commission has been able to permit the owners of stock to secure representation in the manage-

<sup>152</sup> As disclosed in the Kansas City Southern's answer to the Clayton Act complaint and as subsequently adjudicated in *Interstate Commerce Commission v. Kansas C. S. Ry. Co.*, 156 I.C.C. 359 (1929).

<sup>153</sup> *Application of Leonor F. Loree*, *supra*, p. 528. Commissioner Aitchison concurred in the result, but regarded "the discussion of Loree's stock transactions as irrelevant and unnecessary." Commissioner Porter concurred "in the principle underlying the majority report," but expressed the view that the decision should have been postponed and the issue determined along with the pending unification proceedings. Commissioner Brainerd dissented on two grounds: first, that nothing had occurred justifying the withdrawal of the authority given earlier by Division 4; and second, that the Commission's action tended to prejudice the issues presented in the pending unification and Clayton Act proceedings. *Ibid.*, pp. 528-529.

<sup>154</sup> *Interlocking Directors of St. L.-S. F. and C., R. I. & P.*, 105 I.C.C. 778, 779 (1926). While it was expected by the applicants that authority to unify the two roads would eventually be sought under paragraph (2) of section 5, no such application or plan was then pending. The Commission pointed out that "the applicants will constitute a small minority of the Rock Island board [of 13 members]." In *Interlocking Directors—N. Y., C. & St. L. and C. & O.*, 76 I.C.C. 549 (1923), the Commission, through Division 4, had gone much further. Although the Nickel Plate interests were alleged, off the record, to control but 10 per cent of the stock of the Chesapeake & Ohio, they were authorized to have seven of the nine members of the board of the latter carrier, while the applicants continued to hold positions with the Nickel Plate. The Commis-

ment, at least temporarily, and at the same time to coördinate its authorizations under this portion of the Act with its broader policies and activities in the general field of railroad unification.

Although, in these proceedings, the Commission has been guided primarily by the probable effects of the proposed interlocking of officers and directors upon the maintenance of competitive conditions within the framework established by law, it has not disregarded altogether the problem of financial management. Usually, however, this phase of the matter has arisen, not when the Commission has been asked to approve applications to serve more than one carrier, but in connection with other railroad proposals subject to its regulatory power, such as those involving acquisitions of control and issuance of securities. Thus, in denying the application of the New York, Chicago & St. Louis Railway Company to acquire control, through lease of properties and purchase of stock, of the Chesapeake & Ohio, the Hocking Valley, the Erie, the Pere Marquette, and the Nickel Plate, on grounds of defect in financial structure and unfairness to dissenting stockholders, the Commission declared: "The record leaves no doubt that the interests dominating the Chesapeake and Hocking, which . . . are those controlling the Nickel Plate, used every weapon at their command to crush all opposition to their predetermined course of action, and that there was an utter lack of independent and impartial representation of all of the stockholders of the Chesapeake and Hocking when consideration was being given by their directors to approval of the plan and the terms of the proposed leases."<sup>186</sup>

sion recognized "that the substitution of seven new directors for seven now serving involves a change in the control of the activities and policies of the company, in so far as they are vested in the board of directors," but it concluded that the closer association of these properties would facilitate traffic interchange, to their mutual advantage and that of the shippers served, and that neither public nor private interests would be adversely affected by the proposed change. By way of safeguard, however, the authority was granted subject to the Commission's further order. *Ibid.*, p. 551.

<sup>186</sup> *Nickel Plate Unification*, 105 I.C.C. 425 (1926), at p. 441. Some of the procedural steps upon which this conclusion was based, being largely rendered possible by interlocking directorates, are enlightening: "The plan of acquiring control of the lessor companies by lease and stock control heretofore outlined, was proposed by O. P. and M. J. Van Sweringen . . . under date of August 20, 1924. At that time more than a majority of the members of the boards of directors of the Chesapeake, Hocking, and Nickel Plate were common to all three companies, with the same chairman. On August 19, 1924, the board of directors of the Nickel Plate approved the proposal and recommended it to its stockholders. On August 25, 1924, at 2:00 p.m., a directors' meeting of

Again, while authority to issue securities has not been withheld because of improper relations between railroad directorates and banking interests, the Commission has frowned upon "the practice of having a member or members of a board of a carrier resign tempo-

the Chesapeake was held at which similar action was taken. Of the eight directors present and voting for approval of the proposal, five had previously approved it on August 19 as members of the Nickel Plate board. Another director was president and a director of the Chesapeake and Hocking. On August 25, 1924, at 2:20 p.m. (which it will be noted was 20 minutes after the Chesapeake board had been convened) a meeting of the Hocking board of directors was held at which the proposal was approved. Of the nine directors present, seven had just voted in the Chesapeake meeting. On January 20, 1925, the boards of the Chesapeake and Hocking in formal meetings lasting a few minutes approved the proposed leases. At each meeting seven of the nine and ten directors, respectively, voting were also directors of the Nickel Plate. On the same day, the articles of incorporation of the new company were drawn up. All of the incorporators were directors of the Nickel Plate and all except one were directors of the Chesapeake and Hocking." The vice of this domination by the Nickel Plate becomes more clear when set against the procedure followed in the case of the Erie and the Pere Marquette, which enjoyed independent managements: "The contrast between the manner in which the interests of all the stockholders of the Chesapeake and of the Hocking were represented and the manner in which the interests of stockholders of Pere Marquette and Erie were protected is striking. In the latter two instances dealings were at arm's length. None of the directors of the Erie or of the Pere Marquette was a director of the Nickel Plate. The board of directors of the Erie had the matter under consideration for months, and the minutes of its several committees as well as those of the board itself show that the stockholders of that company had the benefit of the fullest consideration of the proposal and independent advice as to its terms and conditions, and certain amendments and revisions were insisted upon. . . . A special committee of three directors of the Pere Marquette was appointed to study the proposal and its minutes and those of the board of directors show that the stockholders had the benefit of the fullest consideration, as well as independent advice, which resulted in very substantial changes in the terms and conditions of the proposed lease, the rights and preferences to be enjoyed by stockholders of the new company, and the ratios of stock exchange. . . ." *Ibid.*, pp. 440, 442. It will be recalled that in *Interlocking Directors—N. Y., C. & St. L. and C. & O.*, 76 I.C.C. 549 (1923), seven common directors had been authorized for the Nickel Plate and the Chesapeake & Ohio (note 154, *supra*). Some of the utterances of Commissioner Eastman's dissent in that proceeding were prophetic: "It is well known that where the stock of a large corporation is widely scattered the control exercised by the majority of the stockholders is more theoretical than real. In such cases either the directorate tends to become a self-perpetuating institution or it is dominated by a minority stock interest in concentrated ownership. Even as small an interest as 10 per cent, if held by one person or group or corporation, may insure virtual control. The danger, and it is not a fanciful danger but one that has often been realized, is that those who hold such a dominating minority interest may have a greater and adverse financial interest in some other corporation. Where this is the case the lesser interest may be, and at times has been, sacrificed to the greater" (p. 552). See, also, *Control of Erie R. R. and Pere Marquette Ry.*, 138 I.C.C. 517 (1928). For a detailed study of the complicated interrelationships of the various Van Sweringen properties, see *Regulation of Stock Ownership in Railroads*, House Report No. 2789, 71st Cong., 3d Sess. (1931), Part 2, pp. 819-1183; for a brief summary of the results, see James C. Bonbright and Gardiner C. Means, *The Holding Company* (1932), pp. 253-262.

rarily in order to participate in the purchase of the carrier's securities," declaring that "such a colorable compliance with the provisions of the statutes . . . should not be countenanced."<sup>156</sup> When a similar situation subsequently came to the attention of the Commission, it announced summarily: "In the future we shall expect an abandonment of such practices and a resort to competitive bidding where but for such colorable compliance with the provisions of the statutes the transaction would be lawful only if conducted under competitive bidding."<sup>157</sup> Finally, in connection with the more general problem of

<sup>156</sup> *Bonds of M.-K.-T. R. R.*, 131 I.C.C. 776 (1927), at p. 779. For the provisions of paragraph (12) of section 20a, and of section 10 of the Clayton Act, bearing upon this issue, see note 128, *supra*. The precise nature of the practice involved in this proceeding appears from the following recital: "The record shows that at the special meeting of the board of directors held on November 25, 1927, and prior to its action authorizing the issue and sale of the bonds, three members of the board resigned and three others were elected to fill the vacancies. Two of the newly elected members were present, at once qualified, entered the meeting, and participated therein. Each of the members who resigned from the board was also a member of some one of the banking firms comprising the syndicate proposing to purchase the bonds. Another member of the board is associated with, but is said to have no interest in, one of the banking firms represented in the syndicate. Two of the three newly elected directors are either employed by or associated with some one of the banking firms, and the other is an officer of the applicant. None of them is shown by the applicant's records to have in his name any shares of its capital stock. . . . Following the resignation of the three members of the applicant's board and the election of their successors, the chairman of the board stated that he had been in negotiation with bankers who were willing to purchase the series-D bonds at a price to be agreed upon, and he submitted forms of two letters which he proposed to send to certain banking firms covering the terms of the sale and giving a description of the bonds. Among the firms to which the proposed letters were to be sent were three, each of which had as a member of the firm one of the directors who resigned. The board authorized the letters to be sent in the form submitted by the chairman. A special meeting of the board was held on December 12, 1927, which was not attended by the two newly elected directors who are employed by or associated with some one of the banking firms. At this meeting the minutes of the meeting of November 25, 1927, were approved and the action taken by the chairman in the final arrangements for the refunding of the series-C bonds, the sale of the series-D bonds, and the sending of the letters previously mentioned, was confirmed and ratified" (pp. 778-779).

<sup>157</sup> *Securities of S. A. L. Ry.*, 138 I.C.C. 190, 194 (1928), citing *Bonds of M.-K.-T. R. R.*, *supra*. The nature of the transactions which elicited this declaration appears from the following: "The record in this proceeding shows that at the regular meeting of the board of directors held on December 15, 1927, two directors resigned subsequent to the action of the board authorizing the issue of notes and directing that the sale thereof should meet with the approval of the executive committee. Each of these directors was a member of one of the two banking houses comprising the syndicate that subsequently purchased the notes. It is stated that these directors did not vote or otherwise participate in the action of the board in respect of the proposed notes. One of these directors resigned earlier in the year and subsequently was reelected to the board. It is noted that

financial mismanagement springing from the absence of responsible and independent directorates, the Commission has had occasion to say: "Under present conditions, especially when the stock of a railroad company is held, as it usually is, by a very large number of comparatively small holders, the tendency is clearly towards a self-perpetuating board of directors. Many of the men selected in this way have no substantial financial interest in the property which they are directing, and not infrequently they appear to have little appreciation of the great responsibility of their office and of the degree of trusteeship which they owe to the stockholders. This investigation has shown that many of the St. Paul directors knew comparatively little about the affairs of their company, that many of them did not even attend the meetings of the board with any regularity, and that some of them were affiliated with interests which conflicted in one way or another with the interests of the railroad company."<sup>158</sup>

From the foregoing survey of the Commission's exercise of its powers with respect to interlocking directorates and allied matters of financial import, it appears, on the whole, not only that the immediate ends of the statutory prohibitions have been kept in view, but that their more remote relationships to the larger tasks of regulating organization and finance have received recognition. As a fundamental purpose, the Commission has sought to restrict its authorizations to such circumstances as disclosed no conflict of interest between the carriers to be served. On this basis competition has afforded the controlling test, though even with respect to competitive relations the Commission's approach has been a flexible one. Where interlocking of officers and directors between competing carriers, following upon ac-

during the year a total of four members of the board connected with banking houses resigned. The vacancies caused by the resignation of the two directors on December 15, 1927, had not been filled on January 10, 1928, the date of the meeting of the executive committee at which the sale of the notes was authorized, so that on that date the two banking houses above referred to were not represented on the board. The record also shows that the banking house acting as manager of the syndicate formed to purchase the notes arranged for the participation in the syndicate of a banking house, a member of which is on the board of the applicant. This director did not resign and was in attendance at the meeting of the executive committee at which the sale of the notes was authorized. The participation of this banking house in the syndicate was, however, cancelled subsequent to our request for information concerning the banking houses comprising the syndicate" (p. 194).

<sup>158</sup> *Chicago, Milwaukee & St. Paul Investigation*, 131 I.C.C. 615 (1928), at p. 669.

quisitions of control not previously approved, has been permitted, the authorization has constituted a response to the practical desirability of allowing representation to established stock ownership; and this liberality of treatment has been deemed to be justified because of the safeguards provided by the Commission's continuing authority to reconsider its determinations in the light of actual developments. In so far as the personal interests of officers and directors are found to conflict with those of the carriers, opening the door to financial mismanagement, the situation necessarily comes to the attention of the Commission only as a result of particular transactions. Its jurisdiction over the selection of officers and directors is confined to cases involving common service to more than one carrier; and the prohibitions of certain dealings, except under competitive bidding, and of personal benefit to officers or directors in the disposition of carrier securities, are outright statutory prohibitions, subject to penalty rather than to administrative control. Only in connection with its regulation of acquisitions of control and issuance of securities can the Commission take cognizance of these conflicts of interest as relevant to its enabling determinations. On the whole, then, such evasions and improprieties as have persisted in this sphere are attributable to the nature of the statutory provisions and the inherent difficulty of regulating business relationships of this character, rather than to defects in administrative policy. None the less, the time appears to be ripe, in this as in other aspects of the regulatory process, to apply a more stringent control. The current economic breakdown is amply persuasive of the destructive effects of unrestrained corporate and individual self-seeking. When such enterprise, whether involving intercorporate stockholdings or conflicting interests in security and other dealings, amounts to a violation of legal requirements, prosecution should more surely follow and penalties should more certainly be imposed; and in so far as regulative power exists, it should be affirmatively molded to promote public ends, rather than applied merely as a safeguard against patent and flagrant abuses. Many of the past acquisitions of control, with their complex and confusing financial structures, were but a symptom of the unbridled speculative temper of the time; when consummated without required authorization, they should not be aided and abetted, even temporarily, by approval of interlocking directorates. It has been

the strategy of the carriers to achieve their ends, as far as possible, in the first instance without resort to the Commission; and acquiescence in this course has rendered subsequent regulation the more difficult. The Commission's recent policy of maintaining the absolute independence of the various railroad systems contemplated by its consolidation plan, even when they serve different territories, is a step in the right direction.

### *Pooling Arrangements*

Of the various forms of combination sanctioned under the Transportation Act of 1920, apart from the communities of interest which may be established through the authorization of interlocking directorates, the loosest and least permanent in character is that embraced in so-called pooling arrangements.<sup>159</sup> The legalization of pooling constitutes an integral part of the changed approach toward the maintenance of competition; but while the major elements of the new legislative policy contemplated the authorization of acquisitions of control and consolidations found to be in the public interest, as a means of achieving a reorganization of the railroad system for all purposes, the liberalization of the law with respect to pooling was directed toward validating cooperative agreements among independent and frequently competing lines, largely as a temporary device for effectuating specific ends. In recognition of the fruitful results of unified operation during the war period, and by way of response to the repeated requests of the carriers and the frequent recommendations of the regulating tribunal, Congress modified the absolute anti-pooling clause which had been subject to prolific attack since its enactment in 1887. The pooling of traffic or of earnings by different and competing railroads was still declared to be unlawful; but upon application or its own initiative the Commission was empowered to approve and authorize such pooling, with the assent of all the carriers involved, and to prescribe the rules and regulations, consideration, and terms and conditions which shall govern the cooperative arrangements, if after hearing it is of opinion that the division of traffic or earnings, to such extent as it may indicate, "will be in the interest of better service to the

<sup>159</sup> Sec. 5, par. (1).

public, or economy in operation, and will not unduly restrain competition."

But those who had expected that the relaxation of the anti-pooling provisions would lead the roads to bury their jealousies and, under governmental supervision, unite in a war upon wasteful competition, were doomed to keen disappointment. There was little resort, under the 1920 legislation, to coöperative activity involving the apportionment of traffic or of revenues. The virtual neglect of the pooling device may be explained, in part, by the greater appeal of the close combinations made possible by the same legislation; in part, also, the need for pooling had been decreased, since the extension of the Commission's control to minimum rates and charges provided effective safeguards against the costly and demoralizing general rate-cutting and discriminatory adjustments which in the past had been frequently induced by the pressure of competition and had naturally led to concert of action; in the main, however, the failure to utilize this mechanism of coöperation may doubtless be attributed to the persistent dominance of traditional competitive strategy among the carriers. Whatever the cause of inactivity in this direction, it is important to note that in an amazingly small number of instances did the carriers apply, under the pooling provisions, for approval of coöperative projects calculated to eliminate or reduce unnecessary undertakings, in the interest of better service or more economical operation. This fact is especially striking in view of the financial difficulties of the roads in recent years, the serious problems they encountered in meeting the growing competition of alternative transportation agencies, and the widely recognized need of coördinating transport services. When, however, pooling arrangements were proposed by the carriers which promised to improve service or to lower costs, the Commission accorded its unhesitating approval.

Only two proceedings during the 1920's involved the pooling of freight traffic. As early as 1922 the Commission approved a contract providing for the substantially equal division of the tonnage originating at, or destined to, points on the Gulf & Northern Railway, a short feeder line in the State of Texas, between the Gulf Coast Lines and the Santa Fe System.<sup>160</sup> Most of the cash, material, and labor for

<sup>160</sup> *Division of Traffic G. & N. Ry. and Connections*, 74 I.C.C. 444 (1922).



the construction of the Gulf & Northern had been furnished by the Santa Fe,<sup>161</sup> and it was originally contemplated that physical connection would be established between the two lines, "either through additional construction or by means of trackage rights over the Orange & Northwestern," one of the components of the Gulf Coast Lines.<sup>162</sup> The proposed arrangement, it was urged, would "achieve the same results and at the same time be more in line with the policy of Congress as expressed in the transportation act, 1920."<sup>163</sup> The Santa Fe was to furnish cars for the traffic allotted to it, thereby improving the supply of facilities of the Gulf & Northern, which had been depending exclusively upon the Gulf Coast Lines for freight cars; and the Santa Fe traffic was to be moved by the Orange & Northwestern at specified charges per car. Under the contract the traffic was to move in every instance by the most direct route, and it was specifically provided that the agreement should "under no circumstances be construed as requiring the parties thereto to violate the lawful routing of the shipper."<sup>164</sup> There was clear advantage in the arrangement to all concerned, and it also appeared that on the whole the Santa Fe System and the Gulf Coast Lines were connecting rather than competing carriers. Accordingly, the Commission approved the contract and its terms and conditions as proposed, finding that the contemplated division of traffic would improve service, promote economy, and not unduly restrain competition, and that the details of the arrangement were just and reasonable.<sup>165</sup> But not until 1929 did an occasion present itself for a like determination. In that proceeding the Commission approved the joint operation by the Northern Pacific and the Minneapolis, St. Paul & Sault Ste. Marie of certain of their tracks and facilities serving a portion of the Cuyuna Range in Minnesota, and

<sup>161</sup> See *Bonds of Gulf & Northern Ry.*, 71 I.C.C. 859 (1922).

<sup>162</sup> *Division of Traffic G. & N. Ry. and Connections*, *supra*, p. 446.

<sup>163</sup> *Ibid.*

<sup>164</sup> *Ibid.* The contract was to run for nine years from September 23, 1921 (its actual operation awaiting the approval of the Commission), and thereafter until terminated upon notice as specified; but provision was also made "for termination before or after the expiration of the nine years' period in case one or more of the parties becomes unable to comply with its terms for routing traffic."

<sup>165</sup> As a continuing safeguard, however, the Commission's order approving the proposed contract was made subject "to any orders and directions with respect to car service . . . in conflict therewith" which might be issued from time to time. *Ibid.*, p. 447.

the pooling by these roads of their inbound coal traffic and outbound ore traffic of this region.<sup>166</sup> The proposal, which had the united support of the mine operators, was calculated to expedite service and to effect material reductions in operating expenses and capital outlays. Said the Commission, after a review of the evidence: "The handling of the entire tonnage through one dock, one assembly yard, one grading yard, and the pooling of the ore cars will permit the elimination of duplicate facilities, and will expedite the switching, grading, and transportation of the ore from the mines to the dock and the accumulation in the dock of ship cargoes of the desired commercial grades. It will also eliminate delays and expense to the producers on account of shortage of the special type of cars required for handling ore. The applicants estimate that the savings from the proposed joint operation will approximate \$350,000 a year."<sup>167</sup> On this showing of advantage both to the roads and to the shipping public, the Commission approved the project and the terms upon which' the applicants had agreed, not only as satisfying the requirements of convenience and necessity in the matter of joint operation, but as meeting all the statutory stipulations upon which the authorization of pooling of traffic is conditioned.<sup>168</sup> Both of the above proceedings disclose very clearly the

<sup>166</sup> *Joint Operation by Northern Pac. and Soo Ry. Cos.*, 154 I.C.C. 279 (1929). The joint operation was authorized under paragraph (18) of section 1; the pooling of traffic, which was dependent upon, and constituted an integral part of, the proposal for joint operation, was authorized under paragraph (1) of section 5. All the trackage on the range, with some eliminations made possible by the pooling arrangement, was to be jointly owned and operated; and other facilities—such as yards, docks, and ore cars—were likewise to be curtailed and jointly used. The ore tonnage was to be divided as follows: 1929 to 1931, inclusive, 40 per cent to the Northern Pacific and 60 per cent to the Soo; 1932 to 1936, inclusive, 45 per cent to the Northern Pacific and 55 per cent to the Soo; and thereafter, equally. The coal tonnage was to be divided as follows: 1929 to 1931, inclusive, 58 per cent to the Northern Pacific and 42 per cent to the Soo; 1932 to 1936, inclusive, 53 per cent to the Northern Pacific and 47 per cent to the Soo; and thereafter, equally. Earnings were not to be pooled, each road retaining all revenues collected on the portion of the pooled traffic transported by it.

<sup>167</sup> *Ibid.*, p. 283.

<sup>168</sup> The Commission's formal conclusion was stated as follows: "Upon the facts presented we find (1) that the present and future public convenience and necessity require (a) the operation by the Soo over the line of the Northern Pacific . . . and (b) the joint operation by the Northern Pacific and Soo of tracks serving the mining operations on the Cuyuna Range . . . ; (2) that the pooling by the applicants of ore tonnage moving from, and coal tonnage moving to, mining operations on the Cuyuna Range . . . in accordance with the terms of the contract . . . will be in the interest of better service to the public, will effect economies in operation, and will not unduly restrain com-

great potentialities of the pooling device, as applied to the freight service, and the Commission's ready acquiescence in arrangements calculated to realize them.

But the opportunities for improving service and achieving economy through resort to pooling arrangements are not confined to the freight traffic; there is especial need of coöperative activity in connection with the passenger service, which has been recognized as presenting the "foremost among the problems to be solved" in the railroad field.<sup>169</sup> With respect to passenger traffic also, however, only two distinct proceedings came before the Commission during the 1920's involving the establishment of joint service and the division of earnings produced thereby. In 1924 the Northern Pacific, the Great Northern, and the Oregon-Washington Railroad & Navigation Company applied for approval of a contract providing for joint passenger-train service between Seattle and Tacoma, in Washington, and Portland, Oregon, and for the pooling of the earnings derived from this traffic.<sup>170</sup> This step was taken because of the decline in passenger revenues resulting from rail and bus-line competition, and because the carriers were confronted with a public demand for fast service, which no one of them could inaugurate without inviting duplication by the others.<sup>171</sup> Ori-

petition; that the division of such traffic has been assented to by all the carriers involved; and that the consideration between the applicants, and the terms and conditions of the contract under which such division of traffic is to be effected, are just and reasonable." *Ibid.*, pp. 283-284. For a very recent approval of a similar arrangement for the pooling of iron-ore traffic and the earnings therefrom between the Chicago & North Western and the Wisconsin Central, see *Pooling of Ore Traffic in Wisconsin and Michigan*, 201 I.C.C. 13 (1934). In *Union Belt of Detroit Pooling of Revenues*, 201 I.C.C. 577 (1934), a joint application of the Union Belt, the Wabash, the Pere Marquette, and the Pennsylvania for the pooling of certain revenues was denied, but because of technical considerations rather than the merits.

<sup>169</sup> *Fifteen Per Cent Case*, 1931, 178 I.C.C. 539 (1931), at p. 584. Note, also, the following comments upon the passenger service from the Commission's report to Congress of the same year: "It is that service, rather than the freight service, which under normal conditions is the greatest contributing factor to decline in earnings. Even now, with freight traffic at a minimum, the railroads would be earning enough to stabilize their credit, if they were able to conduct the passenger business as profitably as the freight business. Much has been done to meet this situation, particularly by curtailment in passenger service. A little has been done in the way of pooling competitive train service by rival lines, although the opportunities in this direction are very far from being exhausted." *Annual Report*, 1931, at pp. 117-118.

<sup>170</sup> *Puget Sound-Portland Joins Passenger-Train Service*, 96 I.C.C. 116 (1925).

<sup>171</sup> More concretely: "Commercial organizations and others in Portland, Tacoma, and Seattle have been endeavoring for several years to obtain a fast-train service be-

nally only the Northern Pacific served these points, operating four trains a day in each direction; in 1910, as a result of its extending trackage rights to the Great Northern and the Oregon-Washington, eleven trains were run daily in each direction; in 1912 the number was reduced to nine, and during the war it was further reduced to six. The proposed contract provided for the operation of five trains daily in each direction, one of which was to run on fast schedule with limited stops; and equipment was to be furnished and revenues were to be divided on the basis of an agreed test period. It was manifest that this arrangement would improve service and promote economy. In the words of Chairman Aitchison, speaking for a unanimous Commission: "The operation of passenger trains between Portland and Puget Sound points as a joint effort will enable carriers to arrange their schedules so as to result in greater convenience to the public. In addition to the fast train, it will also be possible to operate the other trains on a somewhat shorter time schedule than is now done. The proposed schedule of pool trains will result in a saving of approximately 1,632 passenger car-miles per day, or 595,680 passenger car-miles per year. In reality the economy that will result is much greater. As has been indicated, the alternative of a pooling of operations and the putting on of one fast train is the establishment of such service by each of the three carriers."<sup>172</sup> Accordingly, the Commission approved the proposed contract, "reserving the right to modify such approval by

tween the points named, but without results. Each carrier recognized that if it put on a fast train the others would likewise do so. The available traffic would not warrant this, and the result would be a waste of transportation, since the service furnished would be greatly in excess of the needs of the traveling public. Various plans were devised by the applicants in an effort to overcome the difficulties that were encountered, but there were insurmountable objections to all of them. Finally, because of the insistence of the public served, applicants decided that the most reasonable and economical thing to be done under the circumstances was to pool the earnings of all of the Portland-Tacoma-Seattle passenger trains and to operate them as a joint effort. The contract which we are asked to approve would carry into effect that plan." *Ibid.*, p. 118.

<sup>172</sup> *Ibid.*, pp. 119-120. The Commission also made the required finding that the arrangement would not unduly restrain competition. On this issue it declared: "While the pooling arrangement will of necessity lessen the competition of carriers for traffic between points local to the tracks hereinbefore described, there will remain the same incentive for each carrier to strive for through business as now exists, because only the portion of the traffic which travels over the pool tracks will be subject to division of earnings. Nor will there be a likelihood of any carrier furnishing shabby equipment for the pool operations, because to do so would undoubtedly reflect to its disadvantage at other points not included in the pool" (p. 120).

imposing additional or different terms as a condition of its continuance, or to revoke it entirely if in the future that course seems proper."<sup>173</sup> In 1926, under somewhat similar circumstances, the Northern Pacific and the Minneapolis, St. Paul & Sault Ste. Marie were authorized to reduce the number and coordinate the schedules of their passenger trains between Minneapolis and St. Paul, in Minnesota, and the head of the Great Lakes, at Duluth, Minnesota, and Superior, Wisconsin, by establishing joint service and pooling the earnings therefrom.<sup>174</sup> Because of keen competition, actual and in prospect, services were duplicated and returns were inadequate; and the projected joint operation promised substantial savings. Not only was the immediate proposal approved, therefore, as being in the interest of better service and more economical operation, but the pooling arrangement was later extended to the Great Northern,<sup>175</sup> with further elimination of unnecessary services and the achievement of additional operating economies. Such cooperative activity, though confined in practice to only a few instances, has proved itself clearly beneficial to the passenger service.<sup>176</sup>

Somewhat allied to the foregoing cooperative arrangements in the movement both of persons and of property, though not concerned with the pooling of traffic or revenues, are the situations involving the common use of terminals. Because these situations, as frequently hap-

<sup>173</sup> *Ibid.*, p. 120. By its terms the contract was to continue in effect for a period of two years from April 1, 1925, when it became operative. In subsequent proceedings approval of the contract, as amended in minor respects, was affirmed, and the period of its operation was progressively extended. See 128 I.C.C. 149 (1927), 167 I.C.C. 308 (1930), 169 I.C.C. 244 (1930).

<sup>174</sup> *Joint Passenger-Train Service*, 107 I.C.C. 493 (1926). The contract provided for the elimination of the Soo's night trains and for the discontinuance of the recently added afternoon trains on the Northern Pacific. Revenues were to be divided according to the shares of the two roads during a test period; and the savings realized from the discontinuance of trains, as well as the increased costs of hauling additional equipment on the remaining trains, were to be estimated and divided equally. For approval of minor modifications of these arrangements, which were unopposed, see 112 I.C.C. 403 (1926).

<sup>175</sup> 132 I.C.C. 413 (1927).

<sup>176</sup> In 161 I.C.C. 1 (1930), the tripartite arrangement for joint service and pooling of earnings, which had expired by its terms on November 26, 1929, was permitted to be continued, with minor modifications, for an indefinite period. For a very recent approval of an arrangement for the pooling of passenger service and the earnings therefrom between the Canadian National, the Canadian Pacific, and the Boston & Maine, see *Pooling Passenger-Train Revenues and Service*, 201 I.C.C. 699 (1934).

pens in the case of pooling arrangements, involve the joint use of facilities, and because the terminal problem is intimately related to the more comprehensive unions of interest to be presently considered in connection with acquisitions of control and consolidations, the nature of the Commission's power and the character of its performance with respect to the common use of terminals will be briefly surveyed at this juncture.

The problem of compelling carriers owning terminal properties to share their use with other roads had early confronted the Commission; but prior to 1920 its power was restricted to the prevention of discrimination as between different lines. In the original Act to Regulate Commerce the carriers subject to its provisions were directed to "afford all reasonable, proper, and equal facilities for the interchange of traffic between their respective lines, and for the receiving, forwarding, and delivering of passengers and property to and from their several lines and those connecting therewith," without discrimination in rates and charges between such connecting lines; but it was expressly provided that this stipulation was not to be construed "as requiring any such common carrier to give the use of its tracks or terminal facilities to another carrier engaged in like business."<sup>177</sup> Accordingly, only when a road voluntarily opened up its terminals to the use of some lines while denying the same privilege to others, by entering into interchange and switching arrangements with some carriers which it declined to extend to other carriers under substantially similar circumstances and conditions, did the Commission find itself possessed of authority with respect to terminal facilities and services, and then only by way of removing the discrimination.<sup>178</sup> With this end in view it distinguished between "open" and "closed" terminals, holding that the former, under like conditions, must be made equally

<sup>177</sup> This was part of the original section 3 of the Act; not until the amendments of 1920 were enacted was the concluding restriction eliminated from this provision. See Interstate Commerce Act, as amended, sec. 3, par. (3).

<sup>178</sup> See *Buffalo, Rochester & Pittsburgh Ry. v. Pennsylvania Co.*, 29 I.C.C. 114 (1913); upheld in *Pennsylvania Co. v. U.S.*, 236 U.S. 351 (1915). But where the terminal properties are jointly owned by the carriers using them, refusal to switch traffic for an outside line has been judicially held not to constitute unlawful discrimination. See *Louisville & Nash. R. R. v. U.S.*, 242 U.S. 60 (1916), reversing the Commission's determination on this point in *City of Nashville v. L. & N. R. R. Co.*, 33 I.C.C. 76 (1915).

available to all, despite the restriction of the statute, and that only the latter were shielded by that restriction.<sup>179</sup> But the larger problem of the coöperative use of terminal facilities for improving service, promoting efficiency, and rationalizing competitive relations was without the scope of the Commission's authority; and in connection with the reconstitution of the statutory structure at the end of the war period, it explicitly recommended for legislative consideration "a more liberal use of terminal facilities in the interest of proper movement of commerce."<sup>180</sup> The response of the Transportation Act, apparently by way of departure from the controlling method of relying upon voluntary action by the carriers, was to endow the Commission with power to require the joint use of terminals and to prescribe the terms of the use and the compensation therefor. By the addition of a new

<sup>179</sup> See, for example: *St. Louis, Springfield & Peoria R. R. v. P. & P. U. Ry. Co.*, 26 I.C.C. 226 (1913); *Traffic Bureau of Nashville, Tenn. v. L. & N. R. R. Co.*, 28 I.C.C. 533 (1913); *Waverly Oil Works v. P. R. R. Co.*, 28 I.C.C. 621 (1913); *Switching at Galesburg, Ill.*, 31 I.C.C. 294 (1914); *Kansas City & Memphis Ry. Co. v. St. L. & S. F. R. R. Co.*, 46 I.C.C. 464 (1917); *Aurora, Elgin & Chicago R. R. Co. v. I. H. B. R. R. Co.*, 51 I.C.C. 331 (1918); *Chicago, Lake Shore & S. B. Ry. Co. v. Director General*, 58 I.C.C. 647 (1920). This approach received express judicial approval. Note the following from *Louis. & Nash. R. R. v. U.S.*, 238 U.S. 1, 19 (1915), affirming the Commission's determination in *Traffic Bureau of Nashville, Tenn. v. L. & N. R. R. Co.*, *supra*: "Under the provisions of the commerce act . . . the reciprocal arrangement between the two appellants would not give them a right to discriminate against any person or 'particular description of traffic'; for section 3 requires railroad companies to furnish equal facilities for the interchange of traffic between their respective lines . . . 'provided that this should not be construed as requiring any such common carrier to give the use of its tracks or terminal facilities to another carrier engaged in like business.' If the carrier, however, does not rest behind that statutory shield, but chooses voluntarily to throw the terminals open to many branches of traffic, it to that extent makes the yard public. Having made the yard a facility for many purposes and to many patrons, such railroad facility is within the provisions of section 3 of the statute, which prohibits the facility from being used in such manner as to discriminate against patrons and commodities. The carriers can not say that the yard is a facility open for the switching of cotton and wheat and lumber but can not be used as a facility for the switching of coal. Whatever may have been the rights of the carriers in the first instance, whatever may be the case if the yard was put back under the protection of the proviso to section 3, the appellants can not open the yard for most switching purposes and then debar a particular shipper from a privilege granted the great mass of the public. In substance that would be to discriminate not only against the tendering railroad, but also against the commodity which is excluded from a service performed for others." For a more recent finding of discrimination, under the amended section 3, paragraph (3), because of the failure of the New Haven to accord joint rates via its New York Harbor facilities to the Central of New Jersey while contemporaneously according such rates to the Lehigh Valley and the Pennsylvania, see *Central R. R. Co. of N. J. v. N. Y., N. H. & H. R. R. Co.*, 122 I.C.C. 661 (1927), at pp. 673-675.

<sup>180</sup> *Annual Report*, 1919, p. 6.

paragraph, provision to this end was made as follows: "If the Commission finds it to be in the public interest and to be practicable, without substantially impairing the ability of a carrier owning or entitled to the enjoyment of terminal facilities to handle its own business, it shall have power to require the use of any such terminal facilities, including main-line track or tracks for a reasonable distance outside of such terminal, of any carrier, by another carrier or other carriers, on such terms and for such compensation as the carriers affected may agree upon, or, in the event of a failure to agree, as the Commission may fix as just and reasonable for the use so required, to be ascertained on the principle controlling compensation in condemnation proceedings." And for the further protection of the interests of the proprietary carriers, the following was added: "Such compensation shall be paid or adequately secured before the enjoyment of the use may be commenced. If . . . the use of such terminal facilities of any carrier is required to be given to another carrier or other carriers, and the carrier whose terminal facilities are required to be so used is not satisfied with the terms fixed for such use, or if the amount of compensation so fixed is not duly and promptly paid, the carrier whose terminal facilities have thus been required to be given to another carrier or other carriers shall be entitled to recover, by suit or action against such other carrier or carriers, proper damages for any injuries sustained by it as the result of compliance with such requirement, or just compensation for such use, or both, as the case may be."<sup>181</sup>

While on its face the Commission's authority with respect to the joint use of terminal facilities is mandatory in character, as contrasted with the permissive power applicable in the case of pooling arrangements, the fact that compensation fixed by the Commission must be ascertained on the principle governing its determination in condemnation proceedings tends to render such use unacceptable to the roads nominally benefiting thereby, and hence to obstruct, if not to defeat

<sup>181</sup> Sec. 3, par. (4). It should be noted, also, that under the emergency service provisions the Commission was authorized "to require such joint or common use of terminals, including main-line track or tracks for a reasonable distance outside of such terminals, as in its opinion will best meet the emergency and serve the public interest, and upon such terms as between the carriers as they may agree upon, or, in the event of their disagreement, as the Commission may after subsequent hearing find to be just and reasonable." Sec. 1, par. (15) (c). For the Commission's execution of its emergency service powers, see pp. 62-66, *supra*.



altogether, the effective utilization of this cooperative expedient on a mandatory basis. In other words, although the Commission may conclude that the joint use of terminal facilities will be in the public interest, its finding may merely be tantamount to a declaration that such use would be desirable and practicable, assuming agreement as to terms by the carriers affected; objection by the proprietary road, inevitably leading to disagreement as to terms, may necessitate the requirement of such liberal compensation as to eliminate the advantages of the proposed use and render the projected cooperative arrangement ineffectual. Under such circumstances the Commission can accomplish little more than determine whether the proposals of the carriers, or those to which they are willing to assent, shall have its approval. The scope of the Commission's performance in the exercise of this power has thus been sharply restricted. Two types of situations have received its principal attention: first, situations in which shippers, relying not only upon the provisions as to terminal facilities, but upon those relating to the extension of service, the establishment of through routes, and the removal of discrimination, have petitioned the Commission to require one road to perform switching services for, or interchange traffic with, another road; and second, situations in which carriers have endeavored to enlist the aid of the Commission in the settlement of disputes as to terms upon which their existing joint use of terminal facilities should be continued. Neither of these types of proceedings, it will be observed, has emerged from the attempts of carriers to gain access to the terminals of other carriers not theretofore available to them; and even in these situations, as will appear, the problem of compensation has given rise to serious difficulty in the furtherance of public ends.

The Commission has definitely held that it may require one road to extend switching facilities to, or perform switching services for, another road. Commercial and industrial interests at Hastings, Minnesota, for example, sought an order requiring the utilization by the Burlington of the terminal facilities of the Milwaukee to reach a section of the city not on the line of the Burlington, the switching service to be performed by the Milwaukee.<sup>182</sup> The underlying issue was

<sup>182</sup> *Hastings Commercial Club v. C., M. & St. P. Ry. Co.*, 69 I.C.C. 489 (1922).

whether a switching service so performed would constitute part of the terminal facilities the joint use of which might be required.<sup>188</sup> After a careful consideration of judicial pronouncements concerning the nature of terminals, the Commission concluded "that the terminal switching service of the Milwaukee at Hastings is a part of its terminal facilities, and that we may require the use of such terminal facilities by another carrier or carriers under the conditions prescribed in the act."<sup>184</sup> With "terminal facilities" thus broadly construed, the Commission proceeded to determine, as required by statute, whether the service would be in the public interest and whether it would be

<sup>188</sup> The complainants insisted that the Commission's power "to require the use by one carrier of 'terminal facilities' of another carrier is not confined to the physical operation by one carrier over the terminal tracks of another carrier, but that it covers also the use of all the other instrumentalities that go to make up a practical operating terminal capable of handling traffic." That the Commission accepted this contention is evidenced by the rhetorical question which concluded its discussion of whether "terminal facilities" include such use: "If the Milwaukee with its own power switches a Burlington car over the former's terminal tracks at Hastings, is not that a use of the terminal facilities of the Milwaukee by the Burlington in the fullest sense?" In dealing with this issue the Commission sought to give effect to the object of the 1920 legislation, in the light of "the occasion and necessity of its enactment, the defects in the former law, and the remedy provided by the new one." This basis of its approach was stated as follows: "Prior to its amendment by the transportation act, 1920, that part of section 3 which relates to the interchange of traffic between connecting carriers specifically provided that it should not be construed as requiring any common carrier to give the use of its 'tracks or terminal facilities' to another carrier engaged in like business. As amended by the transportation act this provision of the law gives us a direct and explicit power to require the use by one carrier of the 'terminal facilities' of another carrier upon certain conditions. It is apparent that the policy of Congress was thus reversed. Where it had formerly safeguarded the carrier in the exclusive use of its terminals, it now recognized that there is a broader interest than that of the individual carrier whose property rights happened to be involved, viz., that of the public. The object of the statute was to make more flexible the use of existing terminal facilities, and while the power thus granted to us is to be exercised upon careful consideration of each situation, it is but an extension of the general principle that in many instances, and from the very nature of the business of a common carrier, the interest of the public imposes important qualifications on the manner of use of the property employed in the carrier service." *Ibid.*, pp. 493-494.

<sup>184</sup> *Ibid.*, p. 496. It was on this issue that Commissioner Hall, with the concurrence of Commissioner Daniels and Commissioner Potter, dissented. *Inter alia*, he said (pp. 499-500): "Plainly the Burlington can not be required to condemn the use of property which it does not want. Plainly the Milwaukee can not be required to afford 'enjoyment of the use' until the compensation to it, 'ascertained on the principle controlling compensation in condemnation proceedings,' shall have been paid or adequately secured by the Burlington. . . . And plainly the use contemplated is use 'by' the Burlington, with its engines and crews and not those of the Milwaukee, unless the carriers can otherwise agree. . . . To my mind the plain wording of the statute negatives the existence of any such power as is claimed by the majority. . . ."

practicable. On both matters, in the first instance, the findings were favorable to the position of the complainants.<sup>186</sup> No order was entered, however, the carriers being expected to arrange promptly for the use of the Milwaukee's terminal facilities by the Burlington, and the record being held open to enable the roads to agree upon compensation for the use. On further hearing, following failure of the carriers to agree upon terms, the Commission's finding as to "public interest" was reversed and the complaint dismissed.<sup>186</sup> The problem of compensation was an influential factor in this result.<sup>187</sup> The Milwaukee contended that its compensation should be based on the aggregate value of the terminal facilities in question; the complainants argued that the charges should be apportioned on the basis of use; the Commission took an intermediate position—"that in determining the amount of the just compensation, we must confine ourselves to the loss to be suffered by the Milwaukee."<sup>188</sup> While the record was not adequate for fixing the amount of compensation with exactitude, it was apparent "that the sum would be substantial," and the problem was further complicated by the fact "that the Burlington is [was] opposed to the use required."<sup>189</sup> In the light of these facts, and upon the

<sup>186</sup> The record indicated "that it would be to the decided interest of Hastings to have the Burlington traffic handled over the Milwaukee's terminals," and "on the whole, that the switching service of the Milwaukee could be so arranged as to be practicable without substantially impairing the Milwaukee's ability to handle its own traffic." *Ibid.*, pp. 492-493.

<sup>187</sup> 107 I.C.C. 208 (1926).

<sup>188</sup> This clearly appears from the dissenting expression of Commissioner Meyer, in which Commissioners Esch, Campbell, and McManamy joined: "The public interest requires the fullest utilization of existing terminal facilities in the interest of all the railroads which the industries located upon the terminals desire to use. . . . In its simplest aspect, what should here be done is to fix a reasonable switching charge, based on the record and the law that controls. If, upon consideration, this charge would seem to be higher than the Burlington could reasonably be expected to absorb, the Hastings shippers would no doubt be willing to pay the unabsorbed portion. More or less technical legal views based upon condemnation proceedings in other fields should not prevent a common-sense measure of compensation for the use by one railroad of property owned by another railroad, based upon the extent of the property necessarily employed in connection with that use. A liberalization of the use of terminal properties is in the interest of all railroad owners and users. It is the spirit of the transportation act." *Ibid.*, p. 218.

<sup>189</sup> *Ibid.*, pp. 213-214.

<sup>189</sup> *Ibid.*, p. 215. "That carrier contends," added the Commission, "that we may not order and require it against its will and the judgment of its traffic officials to make expenditures of the nature herein referred to without considering at the same time whether or not such order would take the property of the Burlington without just compensa-

showing that the proposed arrangement would benefit primarily a single industry, the Commission reversed itself on the question of "public interest."<sup>190</sup> But despite this outcome on the merits, the right of control under such circumstances was clearly recognized.<sup>191</sup>

When carriers have been petitioners for the exercise of this power, they have generally requested the Commission to prescribe the terms under which existing joint use of terminal facilities should be con-

tion." And upon a review of the evidence as to the probable extent of the use, the Commission itself concluded that "it is difficult to see how the handling of so small a portion of the Hastings traffic by the Burlington would be of such material benefit to Hastings as to outweigh the other considerations herein recited" (p. 216).

<sup>190</sup> The dominant influence exerted by financial considerations, from the standpoint of the carriers, upon this reversal on the question of "public interest," appears from the following: "In the instant case any traffic gained by the Burlington would be at the expense of a corresponding loss to the Milwaukee, and although this is not controlling, we should consider it in arriving at our conclusion as to the public interest. The cost to be met by the user carrier, as compared with the traffic served, is an important element. We must also consider the financial consequences to the carriers involved and the inconveniences that may result to the shipping and traveling public in general. The record upon which our former report was based contained no evidence as to the compensation on the principles controlling in condemnation proceedings. Fairness demands that the whole question of 'public interest' be now reconsidered on the more complete record before us, especially as no order was entered by us, and the record was expressly held open, and we are considering what order is appropriate upon the whole record." *Ibid.*, pp. 216-217. Note, also, the following from *York Mfrs. Assn. v. P. R. R. Co.*, 73 I.C.C. 40 (1922), at pp. 49-50: "In determining what is 'in the public interest' in a given case, as antecedent to the affirmative exercise of this broad grant of power, we must take into consideration not only the interests of the particular shippers located at or near the terminal involved but also the interests of the carriers and of the general public. In this case to require the Pennsylvania to afford use of its terminal facilities by another carrier would be tantamount in practical effect to requiring a division between such carriers of traffic naturally tributary to the Pennsylvania. The loss to the Pennsylvania and the gain to the Western Maryland would each be considerable. There is no showing that the shippers are so inadequately served at present that we are warranted, from the standpoint of the public interest, in depriving the carrier first on the ground of an important volume of the traffic originating along its line, by the direct and affirmative exercise of the power to require the Pennsylvania to share its terminal facilities with the Western Maryland, and it is therefore unnecessary to decide as to the practicability of such an arrangement." In this proceeding the Commission did find, however, that the practice of the Pennsylvania and the Western Maryland of extending switching and interchange facilities to each other within a limited zone in York was unduly prejudicial to York shippers outside that zone; and the Commission's order requiring the railroads to remove this unlawful discrimination was upheld in *United States v. Pennsylvania R. R.*, 266 U.S. 191 (1924). See, also, the report of the Commission on further hearing in 107 I.C.C. 219 (1926).

<sup>191</sup> The compensation difficulty has not always operated as an obstacle to administrative action requiring the performance of switching service by one carrier for another. Upon complaint of local interests in Port Arthur, Texas, for example, the Commission ordered the Kansas City Southern, through its subsidiary, the Texarkana & Fort Smith,

tinued. In these proceedings the Commission has held that its jurisdiction extends to such situations<sup>192</sup> and cannot be defeated because of the ownership and operation of the properties by a separate terminal company,<sup>193</sup> but little of an effective character has been accomplished through its invocation.<sup>194</sup> The Commission has been uniformly unwilling to use its authority to prescribe terms except as a last

to open its Port Arthur terminals to the export and import traffic of the Southern Pacific, which had no terminal facilities of its own at this port, by performing the switching service at a reasonable charge, which was designed to take into account "the cost of the service, the value of the property used, and the circumstance that defendant would be deprived of the line haul." *Port Arthur Chamber of Commerce v. T. & F. S. Ry. Co.*, 136 I.C.C. 597, 599 (1928), reversing the earlier dismissal of this complaint by Division 2 in 73 I.C.C. 361 (1922). The practicability of joint use, without substantial impairment of the ability of the owning road to handle its own traffic, has generally presented no serious issue. But see *Use of Northern Pac. Tracks at Seattle by Great Northern*, 161 I.C.C. 699 (1930). Even in this proceeding, however, the Commission found the proposed use practicable as well as in the public interest.

<sup>192</sup> In *Peoria & Pekin Union Ry. Co.*, 93 I.C.C. 3 (1924), the Commission was requested to prescribe terms for the use of the terminal properties of the Peoria & Pekin Union by various lines which were already using them under contracts and leases. Disputes had been particularly serious in the case of the Chicago & Alton, which was negotiating a new contract. The Commission promulgated certain general principles designed to remove the unjust discrimination and undue prejudice which it found to result from the switching charges, rates, and practices of the Peoria & Pekin Union, but no affirmative action was deemed to be justified on the record.

<sup>193</sup> Note the following, for example, from *Missouri-Kansas-Texas R. R. Co. v. K. C. T. Ry. Co.*, 104 I.C.C. 203 (1925), at p. 228: "The objection raised in the plea to our jurisdiction and in the motion to dismiss that sections 1 (15) and 3 (4) apply to trunk-line railroads only and do not comprehend the facilities of a terminal company, has not been discussed on briefs or orally and may have been abandoned. In any event, it is difficult to conceive upon what reasoning the objection could be supported. Certainly, respondent is a carrier owning or entitled to the enjoyment of the terminals in question, and it and each of the proprietary lines is a common carrier subject to the act. While the provision of section 3 (4) relating to 'main-line track or tracks for a reasonable distance outside' a terminal might possibly suggest that in framing it Congress had in mind, as the more common situation, trunk lines as terminal owners, yet Congress could hardly have been unaware of the practice of creating and operating joint terminals through subsidiary terminal companies. At least, the provision is not limited to trunk-line terminals; nor is the authorized relief limited in any case to a terminal use in connection with an outside main-line use, which latter a petitioner might not desire or be in position to make."

<sup>194</sup> See, for example, *Chicago & Alton R. R. Co. v. T., P. & W. Ry. Co.*, 146 I.C.C. 171 (1928). The following situation was disclosed in this proceeding. Beginning in 1895, the Chicago & Alton had operated over some 12 miles of the main tracks of the Toledo, Peoria & Western, from Washington to Peoria, both in Illinois, under a continuing agreement which could be terminated by either party on 12 months' notice. The original rental of \$20,000, subsequently reduced to \$16,000, was raised in 1917 to \$20,500; and in 1925 and 1926 the receivers of the T., P. & W. had endeavored, without success, to secure a further increase. In 1927, on sale of the road under foreclosure and in conformity with the decree under which the property was sold, the defendant

resort. The leading illustration of this procedure is provided by the controversy involving the Missouri-Kansas-Texas Railroad, which, as virtual co-proprietor of the freight and passenger terminals in Kansas City, sought to substitute for its existing status a joint-use arrangement with compensation fixed on a user basis. In the first instance the Commission held itself without power to relieve the road of its admittedly burdensome contractual obligations; and when the required relief had been afforded through judicial decree, it ordered the admission of the road to certain specified terminal facilities, but with agreement as to compensation to be determined by the parties. Only upon their failure to agree was the proceeding reopened; and subsequently, after thorough investigation, compensation was prescribed. On the basic issue whether payment should be fixed according to use or in strict conformity with condemnation principles, the Commission declared for the latter in its requirement that such costs as interest on

served formal notice of the cancellation of the agreement, but later offered to renew it "at a minimum annual rental of \$50,000, which it declared to be the nuisance value" (p. 172). Thereupon the Alton, regarding this rental as excessive, petitioned the Commission to order the continued use of the tracks upon reasonable terms under section 3, paragraph (4); and, pending the determination of these issues, to require the continuance of operation under its emergency powers conferred by section 1, paragraph (15). The requested emergency order (Service Order No. 46 of August 9, 1927) was issued by Division 5; and almost a year later the majority of the Commission, speaking through Commissioner Porter, found that it had "power under section 3 (4) to require use by the Alton of main-line tracks of the T., P. & W. to a connection . . . at Peoria, that such use is in the public interest, is practicable, and will not substantially impair the ability of the T., P. & W. to handle its own business" (p. 179). But no action was taken in reliance upon these findings, because the Commission held that it had authority to prevent the discontinuance of the existing arrangement under the provisions of paragraph (18) of section 1, requiring certificates of public convenience and necessity for extensions and abandonments. Since, in this view, the arrangement could not lawfully be discontinued without the Commission's certificate—unauthorized discontinuance being subject to prevention by injunction and to the penalties provided by the act—no order was deemed necessary. The Commission merely vacated its emergency service order, which had been issued under provisions inapplicable "to the permanent arrangement sought by the complainant" (p. 177), and which it deemed "unnecessary, if not ineffective" (p. 182). In view of this disposition of the proceeding, the Commission concluded: "We express no opinion as to the adequacy of the rental or the propriety of the other terms and conditions under which the Alton is now operating over the track of the T., P. & W. We have no authority to adjust that matter in this proceeding. The law, no doubt, provides a remedy for any injustice in that regard" (p. 182). It should be noted, however, that Commissioners Eastman, Farrell, Brainerd, and Aitchison dissented. Since Commissioner Meyer and Commissioner Woodlock did not participate in the disposition of the proceeding, the determination was in fact made by less than a majority of the entire Commission. For the subsequent treatment of similar issues, see *Long Island R. Co. Trackage*, 162 I.C.C. 218 (1930).

property values and taxes should be apportioned on a numerical basis—one-twelfth to one of twelve carriers; but it held, contrary to condemnation procedure, that payment should be in the form of a rental rather than a lump sum.<sup>195</sup> The Commission's power to determine compensation has thus been held by it to be incidental to the require-

<sup>195</sup> *Missouri-Kansas-Texas R. R. Co. v. K. C. T. Ry. Co.* 104 I.C.C. 203 (1925); *Missouri-K.-T. R. Co. v. Kansas City Term. Ry. Co.*, 198 I.C.C. 4 (1933). The following situation was disclosed. In 1906 ten lines serving Kansas City had organized a terminal company which constructed and owned the union terminals at that point. Under an operating agreement of June 12, 1909, terms were fixed under which, among other things, these roads using the terminals shared equally the interest charges and taxes on the property. This agreement was to run for 200 years. In 1910 the agreement was modified to include two additional lines, bringing the proprietary companies to a total of twelve. The terms had long been a subject of controversy, the roads which made relatively slight use of the terminals contending for the revision of the agreement so that costs be apportioned according to use. In 1924 the Missouri-Kansas-Texas, successor by purchase at judicial sale to two of the roads which had been parties to the operating agreement, being a small user of the terminal facilities, sought entry into the union terminals by order of the Commission under section 3, paragraph (4), with compensation to be fixed upon a user basis. The carrier, in conformity with a judicial decree then pending on appeal, had elected not to adopt the operating agreement which bound its predecessors, but the Commission concluded that it must await final judicial determination of that company's obligations, although it found the use of the terminal properties to be in the public interest and practicable, and the prescription of terms and compensation, under a required use of the facilities, to be subject to its jurisdiction. When a federal court had adjudged that the Missouri-Kansas-Texas was not bound by the operating agreement, the Commission required the Kansas City Terminal Railway Company to admit it to designated portions of the terminal facilities, upon terms to be arranged between them, or in case of their failure to agree, as fixed by the Commission. When no agreement resulted the Commission reopened the proceeding for further hearing entirely with reference to the matter of compensation, and after extended consideration both of the theoretical issues and value facts, specified the payment to be made. Respondent claimed that, according to established condemnation principles, the measure of its loss through admitting the Missouri-Kansas-Texas was \$5,000,000—one-twelfth of the \$60,000,000 value imputed to the terminal zones whose use was shared; but that, if an annual payment were decided upon instead of a lump sum, 8 per cent, or \$400,000, would constitute a fair rental. That corollary of condemnation procedure which would call for payment in a lump sum was first rejected by the Commission: "To our minds the very language of the statute shows that what is acquired is not a permanent right, maintainable as long as petitioner continues to operate its railroad, as in a condemnation proceeding, but a right to be exercised only so long as it may be exercised 'without substantially impairing the ability of a carrier owning or entitled to the enjoyment of terminal facilities to handle its own business.' . . . To all intents and purposes petitioner, by operation of the statute and action of this Commission thereunder, has become a tenant of respondent, and the just and reasonable compensation which it is required to pay is in effect a rental" (198 I.C.C., pp. 7-8). But the petitioner, in its contention that in calculating the rental "the numerical basis is grossly inequitable" and should be replaced by a measure of actual use, was definitely overruled: "When analyzed, its position amounts to this, that respondent must hold its property in readiness at all times for the joint and equal use of petitioner, but that petitioner should

ment of joint use, and then only upon disagreement as to terms by the carriers affected, with a recognition that in fixing such compensation account must be taken of the condemnation value of the facilities involved and not merely of their use value to the non-proprietary carrier. Under these circumstances the Commission has generally recommended coöperation and negotiation between the carriers, instead of adjusting disputes as to terms on a basis which might render joint use unacceptable or impracticable.

With respect to both pooling arrangements and the joint use of terminals, the Commission's authority, in light of the safeguards provided for the managerial freedom and financial interests of the carriers, has in practical effect failed to furnish a mandatory basis for promoting the coöperative utilization of existing railroad facilities. The fact, therefore, that the legislative changes introduced by the Transportation Act have not issued in the anticipated amelioration of conditions must be attributed, in controlling measure, to the unwillingness of the roads on their own initiative to unite upon coöperative

be permitted to use the various zones if and when it may choose to do so, or not at all if it should so choose as to any particular zone, and to pay only for such use as it may actually make of the property" (p. 9). And, after reviewing the law on this issue: "The user basis as a method for determining the portion of the interest charge to be imposed upon petitioner finds no support in the principles governing compensation in condemnation cases, and in our opinion does not afford a just and reasonable basis. We conclude that the numerical basis in the circumstances of this case affords the just and reasonable method to be applied" (p. 11). The Commission held that taxes, additions and betterments, and retirements should be handled in the same way, but that operating charges and maintenance, "including such depreciation as is properly includible in the maintenance accounts," should be allocated on a user basis. To the petitioner's contention that compensation should be readjusted from time to time, as general economic changes affected property values, the Commission's reply was likewise unfavorable: "It is clear that in a condemnation proceeding no such readjustment of basic value as is here proposed would be made. In respect of this basic value, it is possible for us to adhere strictly to those principles of law. Hence, as we see it, the only grounds upon which we could construe it as being the intent of the Congress that those principles of law should not be adhered to in the respect now under consideration, would be upon a showing that the public interest requires a departure therefrom. There is here no such showing" (p. 13). In arriving at the property values on which the rental should be based, the Commission proceeded as in valuation cases to consider separately reproduction cost, depreciation, land values, working capital, original cost, and going-concern value, and fixed a single-sum value of \$36,800,000 for the property involved in the proceeding; the rate of interest prescribed was 6 per cent. Two of the commissioners dissented. Commissioner Mahaffie expressed the view that prescription of the rental basis of compensation involved a departure from the express requirement of the statute; Commissioner Miller objected to the numerical basis of allocating costs (pp. 37-38).



expedients for the improvement of service and the achievement of economy.<sup>196</sup> The Commission, both in its general comments on the railroad situation and in the exercise of its powers over other phases of organization and finance, has frequently urged upon the carriers the need and feasibility of a greater degree of coöperative effort. In discussing the railroad future, in face of shrinking revenues and growing competition by alternative transportation agencies, it emphasized the unusual opportunities available to the carriers "for the exercise of initiative and enterprise in railroad operation and management," through the pooling of competitive train service, the joint pursuit of research and experimentation, and coördination of rail and motor facilities, and, more generally, concert of action in the reduction of waste in revenues and expenses, believed to be of very large proportions, "resulting from undue and unwise competition of the railroads with each other." "Such reduction of waste," said the Commission, "is in entire harmony with the spirit of the Transportation Act, 1920. Congress there looked beyond the individual railroad to the concept of a national transportation system. It pointed the way to the better realization of that concept in the consolidation provisions. It went to the extreme of removing the barriers of restrictive Federal and State anti-trust legislation which might otherwise stand in the way. Short of consolidations, it opened wide the door to agreements for the pooling of traffic and of revenues, whenever it could be shown to our satisfaction that such agreements were in the public interest. Progress in unifications and greater use of the pooling provisions will help in improvement of the general situation."<sup>197</sup> But the Commission has not confined its concern over competitive wastes to general pronouncements of this character. While its lack of power to require one road to grant to another the right to operate over existing main-line tracks has occasionally led to the authorization of extensions, involving duplication of facilities, which might have been avoided under more adequate authority,<sup>198</sup> its orders approving new construction

<sup>196</sup> It should be noted, however, that many of the acquisitions of control proposed by the carriers under paragraph (2) of section 5 have been designed to effect economies through joint use and have provided for the extension of trackage rights and for joint operation.

<sup>197</sup> *Annual Report, 1931*, pp. 114-119, at p. 119; see, also, *Fifteen Per Cent Case, 1931*, 178 I.C.C. 539 (1931), at pp. 580-586.

<sup>198</sup> Note, for example, the Commission's conclusion in *Construction by Alabama*,

have frequently been so shaped as to encourage the joint use of existing plant in the interest of curtailing capital costs and reducing operating expenses.<sup>199</sup> The same approach, furthermore, has characterized the Commission's performance in connection with the more far-reaching acquisitions of control and consolidations. Its power to authorize acquisitions of control, through stock purchase or by lease, has been so exercised, wherever feasible, as to exert pressure toward joint utilization of facilities;<sup>200</sup> and in its consolidation plans it has made provision, not only for outright merger of properties, but for joint

*Tennessee & Northern R. R.*, 124 I.C.C. 114 (1927), at pp. 115-116: "While the proposed extension represents a duplication of railroad facilities which ought to be unnecessary, the Southern Railway by its refusal to grant trackage rights over its light-traffic line between Calvert and Mobile has, in effect, assumed the responsibility for such duplication. Under the circumstances, therefore, and in the absence of any power in this commission to require such trackage rights to be granted, we find that the present and future public convenience and necessity require the construction by the applicant of the extension of its line of railroad . . . described in the appended and supplemental application."

<sup>199</sup> Note the following, for example, from *Construction of Lines in Eastern Oregon*, 111 I.C.C. 3 (1926), at p. 46: "Here the conclusion is inescapable that the system proposed by the six finance applications is in the public interest, and is of public convenience and necessity. But it is clear that the public necessity can be met with equal convenience, if a large amount of expenditure be avoided by utilization, on fair and lawful terms, of existing facilities of the applicants, or those to be constructed, in such manner as to give substantially the same service as if all the lines involved were constructed. The duty of the carriers is plain, under a more pronounced policy of cooperation and coordination, to give interior Oregon railroad access to both the north and the south and the benefits of reasonable competition, in such manner as to afford the greatest service consistent with the minimum of expenditure to accomplish such purpose. This will reduce the operating and carrying charges of all of the applicant railroads, and will not materially impair the service any of them affords, or deprive any carrier of substantial rights or rewards for its enterprise and investment. We shall endeavor to attach conditions to the certificates to be issued herein to accomplish such result, as required by the public convenience and necessity. The heretofore existing policy of the western carriers is in marked contrast with that which obtains in other sections of the country, and should be revised with a view to more intensive use of the transportation machine existing and the avoidance of unnecessary expenditures in future development." For the subsequent course of this proceeding, involving modification of terms but no departure from the principle of joint use, see 117 I.C.C. 737 (1927), 124 I.C.C. 475 (1927), and 138 I.C.C. 99 (1928); for proceedings in which the authorization was conditioned upon inability to secure the necessary trackage rights, see *Construction of Line by W., B., T. & S. Ry.*, 94 I.C.C. 591, 610 (1925); *Northern Pac. Ry. Co. Acquisition*, 175 I.C.C. 253, 261 (1931).

<sup>200</sup> In *Great Northern Pac. Ry. Co. Acquisition*, 162 I.C.C. 37, 70 (1930), for example, the authorized acquisitions of control were conditioned, *inter alia*, upon the submission of "a comprehensive program and statement of proposed policy in the matter of unified operation of terminals, or its equivalent," and the provision of "suitable assurance that the Chicago, Milwaukee, St. Paul & Pacific Railroad Company, upon fair terms, may have access from Spokane to Portland and intervening points, over the lines

ownership, joint use, and operation under trackage rights.<sup>201</sup> But before we enter upon a detailed analysis of the Commission's administrative policies with respect to these closer and more permanent forms of combination, it should be noted that an unprecedented range of coöperative activities, under the supervision of a governmental coördinator and ultimately subject to his mandatory power, was made possible by the Emergency Railroad Transportation Act of June 16, 1933.<sup>202</sup>

This measure, the emergency provisions of which were to remain operative for one year from its effective date unless extended for another year or less by proclamation of the President,<sup>203</sup> provided for a Federal Coördinator of Transportation, to be appointed by the President by and with the advice and consent of the Senate or to be designated by the President from the membership of the Commission.<sup>204</sup> The Coördinator was directed to divide the railroads into three groups—eastern, southern, and western—and the carriers were re-

of the Spokane, Portland & Seattle Railway Company," which, along with the Great Northern and the Northern Pacific, was to be brought under the control of the Great Northern Pacific Railway Company. It was the additional conditions requiring complete separation of the Burlington from the new system and feasible provision for the so-called short lines in the territory, rather than the proposals for joint use of terminals and trackage, that were chiefly responsible for the abandonment of this projected unification.

<sup>201</sup> See *Consolidation of Railroads*, 63 I.C.C. 455 (1921), 159 I.C.C. 522 (1929), 185 I.C.C. 403 (1932).

<sup>202</sup> Public No. 68, 73d Congress. We are here concerned with Title I, Emergency Powers, sections 1-17. Title II, sections 201-209, amended sections 5, 15a, and 19a of the Interstate Commerce Act. These amendments are dealt with, respectively, in connection with acquisitions of control and consolidations, the rule of rate-making and the recapture clause, and valuations of carrier property.

<sup>203</sup> Sec. 17. But it was provided that "orders of the Coordinator or of the Commission made thereunder shall continue in effect until vacated by the Commission or set aside by other lawful authority," except that "no such order shall operate to relieve any carrier from the effect of any State law or of any order of a State commission enacted or made after this title ceases to have effect." The operation of these provisions was subsequently extended for a full year.

<sup>204</sup> Sec. 2. The office of Coördinator was created "in order to foster and protect interstate commerce in relation to railroad transportation by preventing and relieving obstructions and burdens thereon resulting from the present acute economic emergency, and in order to safeguard and maintain an adequate national system of transportation." In the event that the Coördinator were designated from the membership of the Commission, he was to be relieved from his duties as Commissioner to such extent as the President might direct; but it was expressly provided "that the Coordinator shall not sit as a member of the Commission in any proceedings for the review or suspension of any order issued by him as Coordinator."

quired to create three regional coordinating committees, one for each group, in accordance with a specified procedure.<sup>205</sup> The purposes of the emergency provisions were stated as follows: *first*, "to encourage and promote or require action on the part of the carriers . . . which will (a) avoid unnecessary duplication of services and facilities of whatsoever nature and permit the joint use of terminals and trackage incident thereto or requisite to such joint use . . . (b) control allowances, accessorial services and the charges therefor, and other practices affecting service or operation, to the end that undue impairment of net earnings may be prevented, and (c) avoid other wastes and preventable expense"; *second*, "to promote financial reorganization of the carriers, with due regard to legal rights, so as to reduce fixed charges to the extent required by the public interest and improve carrier credit"; and *third*, "to provide for the immediate study of other means of improving conditions surrounding transportation in all its forms and the preparation of plans therefor."<sup>206</sup> It was made the duty

<sup>205</sup> Sec. 3. Each committee was to consist of five regular members and two special members. The five regular members were to be selected by the carriers in the respective groups, each carrier having a vote in proportion to its mileage within the group, but no railroad system was to have more than one representative. The two special members were to be selected in such manner as the Coördinator might approve; and they were to represent, respectively, the steam railroads within the group whose operating revenues for 1932 were less than \$1,000,000, and the electric railways within the group which were not owned by a steam railroad or operated as part of a general steam railroad system. These special members were to be given notice of all meetings of their committees at which any matter affecting the carriers they represent was to be considered, and they were authorized to "participate in the consideration and disposition of such matter."

<sup>206</sup> Sec. 4. In connection with the avoidance of unnecessary duplication of services and facilities, the express proviso was included "that no routes now existing shall be eliminated except with the consent of all participating lines or upon order of the Coördinator"; by way of supplement to the provision for financial reorganizations, section 15 directed the Commission not to approve a loan to a carrier, other than a receiver or trustee, under the Reconstruction Finance Corporation Act, "if it is of the opinion that such carrier is in need of financial reorganization in the public interest"; and by way of supplement to the provision for study of additional ways and means of improving transportation conditions, section 13 stipulated as follows: "It shall further be the duty of the Coördinator, and he is hereby authorized and directed, forthwith to investigate and consider means, not provided for in this title, of improving transportation conditions throughout the country, including cost finding in rail transportation and the ability, financial or otherwise, of the carriers to improve their properties and furnish service and charge rates which will promote the commerce and industry of the country and including, also, the stability of railroad labor employment and other improvement of railroad labor conditions and relations; and from time to time he shall submit to the Commission such recommendations calling for further legislation to these ends as he may deem nec-

of the coördinating committees to carry out the first group of purposes—the elimination of waste and the achievement of economy through coöperative effort—by voluntary action as far as possible; but in the event of inability to do so, for legal or other reasons, they were to recommend to the Coördinator that he issue appropriate orders.<sup>207</sup> The Coördinator was authorized and directed to issue and enforce such orders upon finding them to be consistent with the public interest and in furtherance of the purposes of the legislation; and he was clothed with like power upon failure of the coördinating committees to act with respect to any such matter brought to their attention by him as requiring action.<sup>208</sup> Before taking action pursuant to these powers which would affect the interests of employees, both the carrier committees and the Coördinator were required to confer with labor committees for each regional group of roads; and special safeguards were provided against reduction of employment or compensation, with authority vested in the Coördinator to establish regional boards of adjustment for the settlement of controversies between carriers and employees.<sup>209</sup> Orders issued by the Coördinator—which “may include provision for the creation and administration of such just pooling arrangements or for such just compensation for the use of property or for carrier services as he may deem necessary or desir-

essary or desirable in the public interest. The Commission shall promptly transmit such recommendations, together with its comments thereon, to the President and to the Congress.” It should be noted that the second of the principal purposes of the legislation, dealing with financial reorganizations, is not reflected in any duty expressly imposed upon the Coördinator toward this specific end.

<sup>207</sup> Sec. 5.

<sup>208</sup> Secs. 5 and 6.

<sup>209</sup> Sec. 7. Two of the labor provisions may be noted more concretely: first, it was provided that “the number of employees in the service of a carrier shall not be reduced by reason of any action taken pursuant to the authority of this title below the number as shown by the pay rolls of employees in service during the month of May, 1933, after deducting the number who have been removed from the pay rolls after the effective date of this Act by reason of death, normal retirements, or resignation, but not more in any one year than 5 per centum of said number in service during May, 1933; nor shall any employee in such service be deprived of employment such as he had during said month of May or be in a worse position with respect to his compensation for such employment, by reason of any action taken pursuant to the authority conferred by this title”; and second, the Coördinator was authorized and directed “to provide means for determining the amount of, and to require the carriers to make just compensation for, property losses and expenses imposed upon employees by reason of transfers of work from one locality to another in carrying out the purposes of this title.”

able and in furtherance of the purposes of this title"—were to remain in effect until vacated by him or suspended or set aside by the Commission or other lawful authority;<sup>210</sup> but any interested party dissatisfied with an order of the Coördinator was authorized to petition the Commission for its suspension and review, and the Commission, guided by the purposes of the legislation and the requirements of public interest, was empowered, in its discretion, to suspend the order, and upon review, after notice and hearing, to set it aside, or to confirm it, or to reissue it in modified form.<sup>211</sup> In the event of such confirmation or reissuance, the order was to remain in effect until vacated or modified by the Commission, subject only to judicial review under established procedure.<sup>212</sup> In complying with the orders of the Coördinator or the Commission under these emergency provisions, the carriers were relieved from the operation of the anti-trust laws and of all

<sup>210</sup> Sec. 8. It was also provided that "any order issued by the Coordinator pursuant to this title shall be made public in such reasonable manner as he may determine and shall become effective as of such date, not less than twenty days from the date of such publication, as the Coordinator shall prescribe in the order."

<sup>211</sup> Sec. 9. The nature of the Commission's authority with respect to the orders of the Coördinator, by way of safeguarding all relevant interests, was set forth as follows: "Any interested party, including, among others, any carrier, subsidiary, shipper, or employee, or any group of carriers, shippers, or employees, or any State commission, or the Governor of any State, or the official representative or representatives of any political subdivision thereof, dissatisfied with any order of the Coordinator may, at any time prior to the effective date of the order, file a petition with the Commission asking that such order be reviewed and suspended pending such review, and stating fully the reasons therefor. Such petitions shall be governed by such general rules as the Commission may establish. If the Commission, upon considering such petition and any answer or answers thereto, finds reason to believe that the order may be unjust to the petitioner or inconsistent with the public interest, the Commission is hereby authorized to grant such review and, in its discretion, the Commission may suspend the order if it finds immediate enforcement thereof would result in irreparable damage to the petitioner or work grave injury to the public interest, but if the Commission suspends an order, it shall expedite the hearing and decision on that order as much as possible. Thereupon the Commission shall, after due notice and a public hearing, review the order and take such action in accord with the purposes of this title as it finds to be just and consistent with the public interest, either confirming the order or setting it aside or reissuing it in modified form, and any order so confirmed or reissued shall thereafter remain in effect until vacated or modified by the Commission."

<sup>212</sup> Sec. 16. All final orders under these provisions, whether issued by the Commission or by the Coördinator, were made subject "to the same right of relief in court by any party in interest as is now provided in respect to orders of the Commission made under the Interstate Commerce Act, as amended"; and the provisions of the Urgent Deficiencies Appropriation Act of October 22, 1913 (38 Stat. 219) were made applicable to any such proceeding.

other restraints and prohibitions of state and federal law not enacted for the protection of the public health or safety;<sup>213</sup> but for wilful failure or refusal to comply with any such order heavy fines were provided, and it was made the duty of any United States district attorney, upon application of the Coördinator or the Commission, to institute and prosecute the necessary proceedings for the enforcement of these provisions and for the punishment of all violations.<sup>214</sup>

This extraordinary piece of legislation, though induced by a grave emergency and limited to its duration, bears striking witness to the widespread belief that the railroads of the country, as well as the users of their service, can derive very substantial benefits from the coördination of facilities and activities through coöperative effort. So strong was this belief that provision was made for use, in case of need, of the whiplash of compulsion, instead of having sole reliance placed upon the voluntary action of the carriers. Just what wastes will be currently eliminated and what economies effected, particularly in face of the specific safeguards for the protection of railroad labor and under the practices of the general recovery program designed to enhance consumer purchasing power, cannot of course be foretold; nor is it pos-

<sup>213</sup> Sec. 10. But two specific safeguards were provided against the broad sweep of these exemptions. For the protection of the interests of labor it was stipulated that they were not to be construed "to repeal, amend, suspend, or modify any of the requirements of the Railway Labor Act or the duties and obligations imposed thereunder or through contracts entered into in accordance with the provisions of said Act." For the protection of the interests of the states it was stipulated that "the Coördinator shall issue no order which shall have the effect of relieving any carrier or subsidiary from the operation of the law of any State or of any order of any State commission until he has advised the State commission of said State, or the Governor of said State if there be no such commission, that such order is in contemplation, and shall afford the State commission or Governor so notified reasonable opportunity to present views and information bearing upon such contemplated order, nor unless such order is necessary, in his opinion, to prevent or remove an obstruction to or a burden upon interstate commerce." In addition, section 11 provided that nothing in the emergency provisions "shall be construed to relieve any carrier from any contractual obligation which it may have assumed, prior to the enactment of this Act, with regard to the location or maintenance of offices, shops, or roundhouses at any point."

<sup>214</sup> Sec. 12. It should be noted, finally, that this legislation broke federal precedent for meeting the costs of regulatory activity, by providing that "the expenses of the Coördinator except so far as they are borne by the Commission . . . but not including the expenses of the coordinating committees, shall be allowed and paid . . . out of a fund obtained from assessments on the carriers," each carrier to contribute for the first year of the operation of the enactment "one and one-half dollars for every mile of road operated by it on December 31, 1932," and a proportional amount for any period for which its operation might be extended by the President. Sec. 14.

sible to predict the precise character of the long-run influence of this emergency measure upon national railroad policy. But that material gains in both directions will be realized can be anticipated with reasonable assurance. When the bill was pending before Congress, Commissioner Eastman, who was designated Federal Coördinator of Transportation upon enactment of the legislation, gave restrained but significant utterance to the potentialities of the measure.<sup>215</sup> His emphasis was upon the future rather than the immediate present. Although he concluded that "the results are problematical," he added the following: "The possibilities are impressive and I believe that they justify much hope. . . . It is not unlikely that more time will be required in working out positive and practicable plans for improvement than some anticipate. In any event, however, I am confident that the thorough exploration of this field for which the bill provides will fully justify itself."<sup>216</sup> And in speaking of the provisions requiring investigation of ways and means of improving transportation conditions and the submission of recommendations for further enactments deemed to be necessary or desirable in the public interest, he declared: "Personally I regard this portion of the bill as perhaps the most important of all. The transportation of the country is in a period of grave unsettlement pending important changes. New transportation agencies have appeared on the scene in great force. It is a period of strife, confusion, and instability. The proper place for each of these agencies must be found, and in some way they must be coordinated and welded into a well-knit whole, into a transportation system operating much more nearly as a unit, without cross purposes and all manner of lost motion."<sup>217</sup> There can be little question that real and important advantages, in the long run as well as in the emergency,

<sup>215</sup> *Hearings before the Senate Committee on Interstate Commerce on S. 1580*, 73d Cong., 1st Sess. (May 9, 1933).

<sup>216</sup> *Ibid.*, pp. 35-36.

<sup>217</sup> *Ibid.*, pp. 52-53. At time of writing two reports, submitted by the Coördinator to the Commission, had been transmitted to Congress: *Regulation of Railroads*, 73d Cong., 2d Sess., Sen. Doc. No. 119 (January 20, 1934), dealing with the question, "Is there need for a radical or major change in the organization, conduct, and regulation of the railroad industry which can be accomplished by Federal legislation?"; and *Regulation of Transportation Agencies*, 73d Cong., 2d Sess., Sen. Doc. No. 152 (March 10, 1934), dealing with the question, "Is there need for Federal legislation to regulate other transportation agencies and to promote the proper coordination of all means of transport?" and with the question, "Is there need for amendments to Federal statutes to im-



can be made to flow from a policy of carrier coöperation under governmental control, and that the public interest would be advanced rather than retarded by the substitution, in this field, of regulated concert of action for unrestrained competitive rivalry.

### *Acquisitions of Control*

The Commission's powers over the intercorporate relations of the railroads, under the 1920 legislation, embraced not only the relatively loose and temporary associations effected through interlocking directorates, pooling arrangements, and joint use of facilities, but the more intimate, complete, and permanent unions of interest resulting from the acquisition by one carrier of the control of any other carrier or carriers.<sup>218</sup> Such acquisitions of control, whether accomplished through lease, or by purchase of stock, or in any other manner not involving consolidation of the roads into a single system for ownership and operation, might be approved and authorized by the Commission whenever it was of opinion, upon application and after hearing, that they would be in the public interest; and the Commission was empowered to indicate the extent of the authorized control and to prescribe the rules and regulations, consideration, and terms and conditions which it found to be just and reasonable. Furthermore, by way of removal of legal obstacles to compliance with the Commission's determinations, the carriers affected by its orders were expressly relieved from the operation of the anti-trust laws and of all other state or federal restraints and prohibitions in so far as might be necessary to enable them to execute the provisions of such orders. The authority thus conferred apparently subjected all acquisitions of control to the Commission's approval, with power to mold in full detail the character of the unifications which might lawfully be effectuated. Nor were any express limitations imposed upon the Commission's exercise of

prove details of the present system of regulating the railroads?" The first of these reports also contained a description of the work of the Coördinator for the period of June 16, 1933, to December 31, 1933 (Appendix I, pp. 38-82). The Coördinator's report on *Transportation Legislation*, with specific recommendations, was submitted January 21, 1935.

<sup>218</sup> Sec. 5, par. (2). While the emergency act of 1933 effected important permanent amendments to section 5, to be noted in due course, the Commission's administrative performance, until very recently, was necessarily based upon the 1920 legislation. In this discussion of acquisitions of control we shall confine ourselves to the relevant provisions of the earlier legislation and their interpretation and enforcement.

discretion; as far as this type of combination was concerned, a blanket finding of public interest was all that was provided for the Commission's guidance. But provision was also made for the merger of properties into single systems for ownership and operation, under a comprehensive plan to be formulated by the Commission for the consolidation of all the railroads of the country into a limited number of such systems.<sup>219</sup> In the preparation of its consolidation plan the Commission was enjoined to preserve competition as fully as possible, to maintain existing routes and channels of trade wherever practicable, and, as nearly as may be, to equalize transportation costs and rates of return among competitive systems; and approval of a proposed consolidation was conditioned, not only upon a finding that it would promote the public interest, but upon fulfillment of two specific requirements: first, that it is in harmony with the complete plan promulgated by the Commission; and second, that its securities at par do not exceed the value of its constituent properties as determined by the Commission. Since these consolidations, designed to effect economies, improve credit, and facilitate solution of the strong-and-weak-road problem, constituted the major objective of Congressional action, and since acquisitions of control, though not involving technical merger of the properties for ownership and operation, might promote or obstruct the general consolidation program contemplated by the Commission, administrative performance in the instant sphere was necessarily influenced, both in matters of jurisdiction and with respect to substantive policy, by the status and character of the comprehensive consolidation plan.

There is ample evidence that the Commission viewed its power to approve acquisitions of control against the background of the national railroad policy in its entirety, and attempted to interpret the public interest which guided its disposition of applications in terms consistent with the general purposes of Congress. At this juncture two illustrations will suffice. In finding a proposed Nickel Plate unification, to be effected through lease and stock ownership, to be in the public interest from a transportation standpoint, the Commission declared: "It seems clear that the proposed unification is a step along the right lines in carrying out the policy of Congress, as expressed in section 5 of the act, of encouraging the formation of a limited number

<sup>219</sup> Sec. 5, para. (4), (5), and (6).

of systems, which, as it affects the eastern territory, outside of New England, and considering the railway situation in that district today, dominated as it is by three long-established systems, would result in nearly all of the principal producing and consuming centers of the territory being served by two or more and in many instances by all of the limited number of systems. Each system would ramify throughout the territory. Each would have adequate access to sources of fuel supply as well as participation to a large extent in the commercial distribution of coal. Each would serve at least two of the five North Atlantic ports and have adequate access to lower lake ports. Mileage, property investment, gross earnings, and net railway operating income would be more nearly equalized than is possible in the case of the present number of systems, or even the number proposed in the tentative plan. The systems would more nearly approach an equality of opportunity to serve the public throughout the territory, to provide adequate facilities and to make necessary extensions from time to time with reasonable expectation of securing additional traffic. A greater amount of actual and effective competition in service may be assured by a limited number of well-articulated systems than by a greater number of systems less complete."<sup>220</sup> And not only did the Commission thus recognize the need of preserving railroad competition and balancing the railroad systems in conformity with the standards set up by the consolidation provisions, but it specifically sought to provide for the inclusion of so-called weak roads in combinations accomplished through acquisitions of control. In finding a proposed New York Central unification, to be effected through lease, to be in the public interest, but only upon express condition that certain short lines be acquired, the Commission declared: "A major purpose of the transportation act, 1920, by which paragraph (2) of section 5 and related provisions were enacted and inserted in the interstate commerce act, is to preserve 'substantially the whole transportation system.' . . . Short lines as well as trunk lines are parts of the national transportation system. In order that effect may be given to the intention of Congress it is essential that remedies calculated to avoid loss of transporta-

<sup>220</sup> *Nickel Plate Unification*, 105 I.C.C. 425 (1926), at pp. 439-440. The application was denied, however, because the terms and conditions of the acquisition were found not to be just and reasonable and the general financial structure fundamentally objectionable.

tion facilities be applied where and as possible. With respect to these remedies we have heretofore said that union of weak with strong lines is one of the ends which Congress apparently had most definitely in mind and given notice that every carrier proposing unification of railroad properties in advance of eventual consolidation should assume the burden of making reasonable provision in its plan for the possible incorporation of connecting short lines unless omission from the plan or abandonment of any such line or lines be justified."<sup>221</sup>

But in pursuing this general approach the Commission was compelled to struggle with a variety of controversial issues, affecting its jurisdictional authority as well as its substantive determinations, both because of the close relationship between many acquisitions of control and actual consolidations, and because of its own delay in adopting a consolidation plan. Its tentative plan, formulated in 1921, was permitted to remain in abeyance for a period of more than eight years; no final plan was promulgated till the end of 1929, and then only with hesitancy and subject to modification.<sup>222</sup> In the meantime, despite the absence of a consolidation plan and the uncertain status of consolidation policy,<sup>223</sup> numerous applications for authority to acquire control, often by methods operating in practical effect to achieve complete and permanent unification of the properties involved, had come before the Commission; and by October 31, 1929, shortly before the publication of its final plan, 298 of these applications, involving approximately 51,000 miles of line, had received its approval.<sup>224</sup> In these proceedings the question repeatedly arose as to whether virtual consolidations were not being prematurely accomplished, contrary to the stipulations of the statute, by nominal reliance upon the Commis-

<sup>221</sup> *New York Central Unification*, 150 I.C.C. 278 (1929), at p. 321.

<sup>222</sup> See *Consolidation of Railroads*, 63 I.C.C. 455 (1921), 159 I.C.C. 522 (1929).

<sup>223</sup> Early in 1925 the Commission requested that it be relieved of the duty of preparing and publishing a complete plan of consolidation, and recommended to Congress such amendment of the consolidation provisions, including those dealing with acquisitions of control, as would permit the process of consolidation "to develop, under the guidance of the Commission, in a more normal way." The recommendations were repeated for a number of years, and resulted in the submission of a number of bills embodying them. See *Annual Reports*: 1925, pp. 13-14, 72; 1926, pp. 76-77; 1927, p. 65; 1928, pp. 60-61. For a brief survey of these developments, see Part I, chap. v, note 27.

<sup>224</sup> In addition, between 1923 and 1929, the Commission had issued 273 certificates of convenience and necessity, involving almost 26,000 miles of line, to acquire and/or

sion's authority over acquisitions of control; and, under the prevailing circumstances, the problem of public interest in these acquisition cases was largely referable to the purposes of the consolidation provisions rather than to actual groupings established in furtherance thereof. Accordingly, while due recognition must be accorded to the influence exerted by the consolidation provisions upon the Commission's exercise of its authority over acquisitions of control, the problems and policies incident to the performance of the instant task, which has furnished the principal channel for effecting close combinations since the passage of the Transportation Act, must receive independent and somewhat detailed analysis.

In determining whether it should approve or disapprove of projected acquisitions of control, the Commission was called upon to pass upon three fairly distinct questions: first, whether the proposal fell within the scope of its statutory authority; second, whether the proposal was in the public interest from the standpoint of the transportation service; and third, whether the terms and other financial aspects of the proposal, as between the parties and in the interest of sound organization, were just and reasonable and conducive to the furtherance of public ends. Upon assumption of jurisdiction, moreover, the Commission was faced with the ancillary problem, in connection with matters of both transportation and finance, as to whether it should limit its findings to mere approval or disapproval of the applications, relying entirely upon managerial initiative for constructive action, or impose conditions and mold the arrangements in conformity with its views as to the public interest. We shall examine the Commission's policies and practices with respect to each of the major issues indicated above, noting, incidentally, the pervasive struggle within the Commission as to whether it should merely safeguard the public in-

operate roads, under paragraphs (18) to (20) of section 1. In many instances, as will be noted in due course, these authorizations involved acquisitions of control not unlike those effected under paragraph (2) of section 5. In some cases, however, the certificates were issued to authorize the transfer of properties in connection with reorganizations. See, for example: *International-Great Northern Reorganization*, 72 I.C.C. 722 (1922); *Missouri-Kansas-Texas Reorganization*, 76 I.C.C. 84 (1922); *Reorganization of A., B. & A. Ry.*, 117 I.C.C. 181 (1926); *Denver & Salt Lake Reorganization*, 117 I.C.C. 397 (1926); *Gainesville Midland Reorganization*, 131 I.C.C. 355 (1927); *Chicago, Milwaukee & St. Paul Reorganization*, 131 I.C.C. 673 (1928); *Acquisition by Chester & Mt. Vernon R. R.*, 138 I.C.C. 313 (1928); *K. C., M. & O. Reorganization*, 145 I.C.C. 339 (1928); *Central Vermont Ry. Reorganization*, 158 I.C.C. 397 (1929).

terest against unsound or unwise carrier proposals or seek to further the course of combination along desirable lines through affirmative action.<sup>225</sup>

The jurisdictional issues with which the Commission grappled under paragraph (2) of section 5 and related provisions clustered about three problems: whether combinations might lawfully be effectuated without its approval; what types of combination might lawfully be accomplished in advance of the adoption of a consolidation plan; and how complete a control or union of interests might lawfully be approved independently of the consolidation plan. In other words, the legislative provisions, as contained in the Act, proved to be sufficiently uncertain in tenor to raise serious questions as to whether exclusive jurisdiction was conferred upon the Commission in this field, as to whether controlling weight had to be accorded to the technical forms of combination, and as to whether virtual consolidations might be authorized pending the adoption of, and action under, the comprehensive plan.

The first of these problems requires no great elaboration at this point, since we have already dealt with it at considerable length in connection with state and federal relationships in the regulation of

<sup>225</sup> In this field, as in case of the other aspects of its control of organization and finance, the Commission insisted upon having before it full and accurate information. In addition to the obviously necessary data describing the applicant and the carrier or carriers to be controlled, the applications were required to include such information as the following: the section and paragraph of the Act under which authority was sought, the methods to be employed in acquiring control, and the grounds upon which the acquisition was thought to be in the public interest; pertinent facts as to the laws governing the corporate organization of the roads; the character of the corporate action authorizing the filing of the application; the nature and extent of existing control, together with data as to any interlocking of officers or directors authorized by the Commission; the mileage and interchange points of the roads; whether, and to what extent, the roads were parallel or competing lines; if control was to be acquired through the purchase of stock, the consideration agreed upon and the market or estimated value of the stock; and various exhibits, chiefly of a legal character, together with income accounts for the preceding five years and the latest profit and loss statement and general balance sheet of the roads involved. On the basis of such data, supplemented by evidence submitted at the hearings, the Commission sought to determine both the jurisdictional and substantive issues raised by the application. See *In the Matter of Applications for Approval and Authorization of the Acquisition of Control by One Carrier of Another Carrier or Carriers, Not Involving Consolidation, under Paragraph (2), Section 5 of the Interstate Commerce Act, as Amended*, September 1, 1922. For an excellent analysis of the Commission's performance, with special reference to the legal problems involved, see Sidney P. Simpson, "The Interstate Commerce Commission and Railroad Consolidation," *Harvard Law Review*, vol. 43 (December, 1929), pp. 192-250.

matters of finance and management.<sup>226</sup> Whether or not combinations might lawfully be effected without the Commission's approval depended upon whether the statutory provisions were to be construed as enabling in character, merely providing relief against the operation of the anti-trust laws and other restrictive legislation, or as prohibitory in character, forbidding the accomplishment of acquisitions of control and consolidations except through resort to, and approval by, the Commission. That the Commission's approval of a combination confers immunity from attack under restrictive provisions of state and federal law, as expressly stipulated in the Act, was repeatedly recognized;<sup>227</sup> but where existing state authority was sufficient for the purpose and no violation of the anti-trust laws was involved, resort to the Commission for approval, at least in connection with mergers and consolidations, was not always held necessary.<sup>228</sup> In the leading case, for example, involving lines which had been consolidated under state

<sup>226</sup> See Part II, pp. 218-220, 250-258.

<sup>227</sup> Thus, in *Control of Central Pacific by Southern Pacific*, 76 I.C.C. 508 (1923), a combination through lease and stock ownership was authorized by the Commission which had been declared to be in violation of the Sherman Act and ordered dissolved in *United States v. Southern Pac. Co.*, 259 U.S. 214 (1922). In connection with the instant issue the Commission said (at p. 516): "While the Sherman law has not been repealed, carriers affected by any order made by us under paragraphs (1) to (7) of section 5 of the act are relieved from its operation. How far our discretion in any particular case should be influenced by consideration of the evils which the Sherman law was designed to prevent is a question necessarily involved in every case where a carrier seeks to acquire control of a competing line. There is nothing in section 5, however, indicating that the Congress intended that we should refuse to accept jurisdiction upon the ground, solely, that a proposed acquisition of control would violate the Sherman law. Full effect must be given to the provisions of paragraph (8). When by our order based upon broad considerations of the public interest we in effect grant relief against antitrust laws, and other restraints and prohibitions by law, we are exercising a power which the statute gives to us alone. Evidence as to public benefits to be derived from common control of competing carriers, which would be immaterial in a prosecution under the Sherman Act, might be entirely pertinent in a proceeding before us under paragraph (2). There is, therefore, an essential dissimilarity in the issues and in the nature of the proceeding which in our opinion makes it proper for us to pass upon the application, while giving full effect to the adjudication of the Supreme Court." The Commission's order in the premises was held to be valid and to relieve the roads from the operation of the anti-trust laws and other restrictive legislation. *United States v. Southern Pac. Co.*, 290 Fed. 443 (1923). Similarly, in *Control of D., S. & S. R. R. by Lehigh Valley R. R.*, 86 I.C.C. 567 (1924), the Commission authorized a combination through stock ownership which had been ordered terminated as in violation of the Sherman Act in *United States v. Lehigh Valley R. R. Co.*, 254 U.S. 255 (1920).

<sup>228</sup> At the outset the Commission, through Division 4, expressly recognized the dominant rôle assigned to it in molding all types of coöperation and combination, but without deciding whether its jurisdiction was exclusive. Thus, in *Lease of Valley Ter-*

laws without its approval, the Commission not only authorized the requisite issuance of securities, but issued a certificate of convenience and necessity for the operation of the constituent lines by the consolidated company.<sup>229</sup> In view of the affirmative purposes of the Transportation Act and the elaborate character of the consolidation provisions, this self-denying attitude on the part of the Commission, in derogation of its exclusive jurisdiction in this field, appears to be of questionable soundness, at least as a matter of policy, despite the absence in the statute of express words of prohibition.<sup>230</sup> The Commission was clearly entrusted with the task of furthering, in the public interest, the reorganization of the railroad net into a limited number

*minimal Ry.*, 65 I.C.C. 105 (1920), it was said (at p. 109): "It seems evident that Congress had in mind a complete scheme of regulation of contracts or other arrangements whereby one common carrier subject to the act might secure control of another such carrier, either by consolidation into one corporation, or in some manner not involving such consolidation, or whereby they might enter into an agreement for the pooling of freight or earnings with a competing railroad. In other words, Congress intended to permit unified operation, even if involving the elimination of competition, where this would be in the public interest, and provided for a modification of the antitrust laws to the extent necessary to effect this purpose, stating certain prerequisites, and imposing upon us the duty of determining, after hearing, whether or not the conditions of the section have been or will be fulfilled and the proposed arrangement is in the public interest. Without now passing on the question as to whether the provisions of section 5 are exclusive or whether in cases where the right and power to consolidate or lease existed prior to the passage of the act such right continues and it is not necessary to comply with section 5, we think in the case before us it is proper to take jurisdiction. The evidence shows that at the present time the operation of the property of the Valley Terminal by the Cotton Belt is in the public interest." Thereafter there was first an express recognition that the provisions were prohibitory, and then a reversal of this attitude. In *Securities Application of Pittsburgh & West Virginia Ry.*, 70 I.C.C. 682 (1921), Division 4, in denying authority for the issuance of securities, concluded "that the proposed issue of stock and the proposed assumption of obligation and liability are for an object, namely, the purchase by applicant and the sale by the Belt Company of the property and franchises of the latter, which can not lawfully be accomplished without our authority under the provisions of section 5," and that "until such authority is secured the application must be denied" (p. 688). Upon argument, in 76 I.C.C. 663 (1923), the full Commission again denied the application, but without finding it necessary to pass upon the issue as to the legality of combinations effected without its approval. In *Acquisition and Stock Issue by N. Y., C. & St. L. R. R.*, 79 I.C.C. 581 (1923), however, the full Commission definitely recognized as lawful a consolidation accomplished under state laws without its authorization. See, also, *Operation of Lines and Bond Issue by Reading Co.*, 86 I.C.C. 157 (1923); *Acquisition by L. S. & I. R. R.*, 86 I.C.C. 313 (1924); *Acquisition and Stock Issue by F., O. & D. R. R.*, 105 I.C.C. 189 (1925); *Grand Trunk W. R. Co. Unification and Securities*, 158 I.C.C. 117 (1929).

<sup>229</sup> *Acquisition and Stock Issue by N. Y., C. & St. L. R. R.*, 79 I.C.C. 581 (1923).

<sup>230</sup> In *Snyder v. New York, C. & St. L. R. R. Co.*, 278 U.S. 578 (1929), the Supreme Court apparently held that resort to the Commission for effecting consolidations was not mandatory prior to the promulgation of its final consolidation plan.



of well-articulated systems, and such determinations, permitting uncontrolled private initiative in the grouping of roads, were bound to complicate the task and to hamper the achievement of its full fruits.<sup>281</sup> In connection with acquisitions of control, however, with which we are primarily concerned at this juncture, the Commission appears to have construed the statutory provisions as prohibitory, declining to make findings in aid of combinations of this character consummated without its authority.<sup>282</sup>

A second jurisdictional problem arose from the inadequacy and diversity of the provisions under which combinations of various types might be accomplished. Acquisitions of control were expressly made subject to the Commission's jurisdiction when effected through lease or stock purchase or in any other manner not involving the consolidation of the carriers into a single system for ownership and operation. Such unifications were not required to conform to the complete grouping of the roads and could be accomplished in advance of the promulgation by the Commission of a final consolidation plan.<sup>283</sup> Ac-

<sup>281</sup> See dissenting opinion of Commissioner Eastman in *Acquisition and Stock Issue by N. Y., C. & St. L. R. R.*, *supra*, at pp. 587-595; and compare Sidney P. Simpson, *op. cit.*, at pp. 199-200.

<sup>282</sup> Note the following, for example, from *Bonds of Chesapeake & O. Ry. Co.*, 150 I.C.C. 257 (1929), at p. 260: "The stock of the Ashland, the Long Fork, and the Millers Creek not having been acquired in accordance with the provisions of paragraph (2) of section 5 of the interstate commerce act, the peculiar status of the C. & O. in relation to those companies and the stock and properties thereof is not such, in our opinion, as to justify the finding required by section 20a of the act as to the objects and purposes involved in the issue of bonds in reimbursement of expenditures amounting to \$6,246,646.67 made in respect to those companies and their properties for the purposes stated above." See, also, *Directors of Wheeling & Lake Erie*, 138 I.C.C. 643, 654-655 (1928), discussed at pp. 392-396, *supra*. For acceptance of this view by the Supreme Court, see *Chicago Junction Case*, 264 U.S. 258, 267, 271 (1924).

<sup>283</sup> In *Nickel Plate Unification*, 105 I.C.C. 425 (1926), for example, the Commission said (at pp. 435-436): "In compliance with the mandate of paragraph (4) of section 5 of the act, on August 3, 1921, we promulgated a tentative plan for the consolidation of the railway properties of the United States into a limited number of systems. . . . It will be noted that the carriers covered by the present application were placed in four separate systems. Since that time several changes have taken place in the corporate relationship of several of the carriers in the eastern group, with the approval of the Commission where necessary. . . . In many of the instances where we approved acquisition of control, such groupings were contrary to the tentative plan. We have never considered that plan as an inflexible guide to our actions under these provisions of the statute. On the contrary, although consolidations must be in conformity with our complete plan when promulgated, it is evident that it was not the intent of Congress that even the complete plan should be considered as an inflexible guide, as we are empowered at any time after its promulgation, upon our own motion or upon application, to reopen the

cordingly, the Commission often issued orders of approval in the case of applications involving acquisitions of control through leases,<sup>284</sup> stock purchases,<sup>285</sup> or a combination of the two expedients.<sup>286</sup> But its authority, as defined in the statute, was expressly made applicable only to acquisitions by "carriers." When, therefore, non-carrier holding companies were utilized for the unification of carrier properties, the Commission found itself without jurisdiction.<sup>287</sup> With the growth of such holding companies, and particularly upon emergence

subject for such changes or modifications as in our judgment will promote the public interest. As we stated at that time, the tentative plan was put forward in order to elicit a full record upon which the plan to be ultimately adopted can rest, and without prejudgment of any matters which may be presented upon that record. Furthermore, we are here dealing with acquisitions, not consolidations, although the latter are the ultimate ends sought."

<sup>284</sup> See, for example: *Lease of Pennsylvania-Detroit R. R.*, 82 I.C.C. 396 (1923); *Clinchfield Railway Lease*, 90 I.C.C. 113 (1924); *Control of A. & V. Ry. and V., S. & P. Ry.*, 111 I.C.C. 161 (1926); *Acquisition by K., O. & G. Ry.*, 145 I.C.C. 53 (1928); *St. Paul & K. C. S. L. R. Co. Control*, 175 I.C.C. 133 (1931).

<sup>285</sup> See, for example: *Control of Houston & Brazos Valley Ry.*, 86 I.C.C. 587 (1924); *Control of Lines by N. O., T. & M. Ry.*, 105 I.C.C. 79 (1925); *Control of Tavares & Gulf*, 105 I.C.C. 383 (1926); *Control of Island Creek R. R.*, 105 I.C.C. 804 (1926); *Reorganization of A., B. & A. Ry.*, 117 I.C.C. 181 (1926), 117 I.C.C. 439 (1926); *Control of New Orleans & Lower Coast R. R.*, 117 I.C.C. 213 (1926); *Control of Pecos Valley Southern Ry.*, 124 I.C.C. 749 (1927); *Acquisition by Western Maryland Ry.*, 131 I.C.C. 599 (1927), 138 I.C.C. 461 (1928); *Control of Texas S. L. Ry. Co.*, 150 I.C.C. 604 (1929); *Rio Grande & E. P. Ry. Co. Control*, 175 I.C.C. 216 (1931).

<sup>286</sup> See, for example: *Acquisition of Control of C. V. & M. R. R. by P. R. R.*, 70 I.C.C. 301 (1921); *Acquisition of P. A. & W. R. R. by P. R. R.*, 70 I.C.C. 303 (1921); *Acquisition of N. Y. B. R. R. by P. R. R.*, 70 I.C.C. 306 (1921); *Control of Big Four by New York Central*, 72 I.C.C. 96 (1922); *Lease of Grand Rapids & Indiana Ry.*, 72 I.C.C. 260 (1922); *Control of Central Pacific by Southern Pacific*, 76 I.C.C. 508 (1923); *Control of D., S. & S. R. R. by Lehigh Valley R. R.*, 86 I.C.C. 567 (1924); *Acquisition of Line by Salina & Santa Fe Ry.*, 90 I.C.C. 189 (1924); *Control of El Paso & Southwestern System*, 90 I.C.C. 732 (1924); *Control of M. H. & C. Ry. Co.*, 99 I.C.C. 193 (1925); *Control of J., L. C. & E. R. R.*, 99 I.C.C. 753 (1925); *Control of Pond Fork & Bald Knob R. R.*, 105 I.C.C. 800 (1926); *Control of Fresno Interurban*, 111 I.C.C. 69 (1926); *Control of New Mexico Central Ry.*, 111 I.C.C. 468 (1926); *Acquisition by Monongahela Ry.*, 117 I.C.C. 329 (1926); *Control of Sewell Valley R. R.*, 124 I.C.C. 195 (1927); *New York Central Unification*, 150 I.C.C. 278 (1929).

<sup>287</sup> In *Stock of Denver & Rio Grande Western R. R.*, 70 I.C.C. 102 (1921), in which a holding company owning all the stock of one operating carrier sought to acquire all the stock of the applicant, likewise an operating carrier, and thereby bring the two lines under a unified control, the Commission concluded "that the proposed acquisition of applicant's stock by the holding company does not constitute a consolidation of the property of two or more carriers by railroad subject to the act into one corporation for the ownership, management, and operation of properties theretofore in separate ownership, management, and operation within the meaning of paragraph (6) of section 5 of the act," and that "inasmuch as the holding company is not a carrier engaged in the transportation of passengers or property subject to the act, the acquisition of the control

of the intricate network of intercorporate relations sponsored by the Van Sweringen and Pennsylvania interests, the Commission expressed grave concern lest its consolidation plans be thwarted and effective financial control be undermined;<sup>288</sup> and after a comprehensive

of the applicant by the holding company is not within the scope of paragraph (2) of section 5" (p. 105). But note the following from the dissenting opinion of Commissioner Eastman, in which Commissioner Campbell concurred: "I am further persuaded that the acquisition by the holding company of the stock of applicant is subject to the provisions of paragraph (2) of section 5 of the interstate commerce act. That paragraph authorizes us to approve the acquisition by one carrier of the control of any other carrier 'either under a lease or by the purchase of stock or in any other manner not involving the consolidation of such carriers into a single system for ownership and operation.' The words 'in any other manner' are very broad. The holding company completely controls the Western Pacific. It now proposes to control the Denver & Rio Grande as completely. To hold that such a transaction is not covered by paragraph (2) is to regard form rather than substance and open the door to evasions wholly nullifying the intent and purpose of this provision of the act" (p. 108). Where, however, the holding company was a subsidiary of a carrier, the Commission asserted jurisdiction. Thus, in *Control of G. & S. I. R. R. Co.*, 99 I.C.C. 169 (1925), Division 4 disposed as follows of the contention of an intervening short line that the acquiring company was not a carrier and hence not subject to the Commission's jurisdiction: "Inasmuch as all the capital stock of the Mississippi Valley is owned by the Illinois Central, and as the latter company has joined in the application, we are of opinion that we have jurisdiction over the subject matter involved" (p. 172).

<sup>288</sup> In bringing the danger of these developments, as illustrated by the character of the Alleghany Corporation and the Pennroad Company, to the attention of Congress and recommending a thorough investigation as to the need of legislative action, the Commission said: "Both of these companies . . . are purely holding companies. That is to say, the property which they own is not physical property but consists solely of the stocks or securities of other companies. The Alleghany Corporation now owns various stocks of railroad companies. It is not controlled by any railroad company but is controlled, through a combination of direct and indirect means, by certain interests which control through similar means the New York, Chicago & St. Louis, the Erie, the Pere Marquette, and the Chesapeake & Ohio railroad companies. The Pennroad Co. also owns various stocks of railroad companies. It is not controlled by any railroad company as such, but its stock is held under a voting trust agreement, continuing until May 1, 1939, and the voting trustees are the president and two other directors of the Pennsylvania Railroad Co. If these facts are correct, the Alleghany Corporation can, by acquiring a controlling interest in the stock of a railroad company, bring it under common control with the railroad companies above mentioned which are controlled by the same interests as control the Alleghany Corporation, but without itself holding control or being controlled by any one of these railroad companies as such. In a similar manner the Pennroad Co., by acquiring stock control of a railroad company, can bring it under common control with the Pennsylvania Railroad without itself controlling or being controlled by the latter carrier as such. In other words, common control can be exercised in both instances by a chain, one vital link in which is made up of the control exercised, directly or indirectly, over two or more corporations by individuals. The process may, of course, be facilitated by reducing the control of the holding company or of one or all of the carriers involved to a relatively small if not insignificant financial interest through various devices, such as limitation of the voting power of certain classes of stocks, the superimposing or pyramiding of one holding company on top of another, and the like.

and thorough Congressional investigation,<sup>239</sup> followed by the introduction of a number of bills designed to subject railroad holding companies to the Commission's control,<sup>240</sup> this end was finally accom-

. . . Plainly . . . the subjection of the unification of carriers by railroad to the orderly processes of a carefully planned scheme of public regulation, which section 5 was designed to accomplish, is very likely to be partially or even wholly defeated, subject to the possibility that the Clayton Antitrust Act may in some measure, after protracted litigation, enable control over the situation to be maintained." *Annual Report, 1929*, at pp. 81-82. And two years later, in recommending to Congress that acquisitions of control effected through holding companies be brought within its jurisdiction, the Commission added: "We are also of the opinion that if a holding company is allowed to control a carrier by rail through ownership of stock, thereafter the accounts and capitalization of that holding company should be subject to regulation by the commission. The present financial depression has brought into clear relief the evils involved in permitting stock equities in railroad companies to be made the basis for the issue by holding companies of unsupervised securities, including funded debt and preferred stock." *Annual Report, 1931*, at pp. 85-86. For an illuminating analysis of the nature of railroad holding companies and of the need of subjecting them to regulation, see James C. Bonbright and Gardiner C. Means, *The Holding Company* (1932), at pp. 223-318.

<sup>239</sup> Under House Resolution No. 114 (1930), passed in response to the Commission's recommendation noted above. This extensive inquiry by the House Committee on Interstate and Foreign Commerce resulted in the publication of a voluminous report (in three parts, and comprising more than 1800 pages) on *Regulation of Stock Ownership in Railroads*, 71st Cong., 3d Sess., House Report No. 2789 (1931). This report contains a detailed analysis of the organization and activities of railroad holding companies, together with a consideration of matters of law and policy involved in their control. The Commission commented as follows upon this report: "At the last session of Congress the committee submitted an elaborate report . . . of its special counsel 'on the phases of the investigation pertaining to the control of railroads through stock ownership and the regulation of such control.' . . . In his report, special counsel stated that the investigation conducted under H. R. No. 114 had 'established that the commission was correct in its belief that certain railway systems are in desperate competition for strategic properties, particularly in eastern territory.' He mentioned the 'acquisitions of such holding companies as the Pennroad Corporation and the Alleghany Company' as notable instances. He also found that the commission was correct in its fear that the 'effect of these acquisitions of control by nonoperating companies not within its jurisdiction would be so to entrench particular interests in so far as particular properties are concerned that consolidation might perhaps in effect be accomplished without the approval of the Congress.' Certainly the difficulties would be so increased, he believed, 'as to make it well-nigh impossible to bring about the agreement necessary to an orderly and satisfactory unification of railway property in eastern territory,' and what had been done in the East 'could easily be duplicated where there might be provocation in any other part of the country.'" And the Commission found itself "in hearty agreement" with the principal recommendation—namely, "that paragraph (2) of section 5 of the interstate commerce act be amended so as to bring within the jurisdiction of the commission for approval or disapproval any acquisition of the control of a railroad which would result in bringing that road into affiliation with, in control of, or under the management of another railroad, whether the acquisition be by holding company or otherwise." *Annual Report, 1931*, at pp. 84-85. See, also, *Testimony before House Committee on Interstate and Foreign Commerce under H. Res. 114*, 71st Cong., 3d Sess. (1930).

<sup>240</sup> See, especially, H.R. 17226, 71st Cong., 3d Sess. (1931), and H.R. 9059 and

plished, in complete and thoroughgoing fashion, by the provisions of the Emergency Railroad Transportation Act of 1933.<sup>241</sup> But from the standpoint of administrative performance this new legislation merely provided a basis for future action; under the 1920 legislation there was ample opportunity, at least in so far as no relief from the anti-trust laws was required, to effect unifications through holding companies without the Commission's approval.<sup>242</sup> Furthermore, the Commission

11677, 72d Cong., 1st Sess. (1932). For the Commission's views with regard to the then pending legislation, see *Annual Report*, 1932, pp. 23-25. For an analysis of the constitutional issues involved in such legislation, see M. S. Breckenridge (assisted by Willard W. Gatchell and William H. Watts), "Legal Study on Constitutional Power of Congress to Regulate Stock Ownership in Railroads Engaged in Interstate Commerce," House Report No. 2789 (note 239, *supra*), Part I, pp. 1-62; and Bliss Ansnes, "Federal Regulation of Railroad Holding Companies," *Columbia Law Review*, vol. 32 (June, 1932), pp. 999-1016.

<sup>241</sup> Title II, sections 201-203, amending section 5 of the Interstate Commerce Act. Since these amendments not only subjected holding companies to the Commission's control, but overhauled all the provisions dealing with railroad combination—establishing a uniform policy, under strict regulation by the Commission and in required conformity with its consolidation plan, with respect to consolidations, mergers, purchases, leases, operating contracts, or acquisitions of control, and expressly prohibiting unions of interest without resort to the prescribed procedure—they will be analyzed at the conclusion of our discussion of consolidations, after a full disclosure of the shortcomings of the preëxisting legislative provisions and their administrative enforcement.

<sup>242</sup> It should be noted, however, that in some proceedings the Commission showed a disposition to disregard the fiction of separate corporate entities in connection with the relationship between operating carriers and their affiliated holding companies. Thus, in *Interstate Commerce Commission v. Pennsylvania R. Co.*, 169 I.C.C. 618 (1930), in which the Pennsylvania Railroad and the Pennsylvania Company (the latter being a subsidiary holding and investment company under complete control of the Pennsylvania Railroad) were found to have violated the Clayton Act through stock acquisitions in the Lehigh Valley and the Wabash, the Commission, in answering the question as to whether the stocks were acquired directly or indirectly by the Pennsylvania Railroad, concluded as follows: "The outstanding facts remain that the purchases were for the sole benefit of the Pennsylvania Railroad; that the Pennsylvania Railroad was in complete control of the Pennsylvania Company; that the power to act for both corporations resided in the same individuals; and that the acquired stocks are held in the name of the Pennsylvania Company for the benefit of the Pennsylvania Railroad. If these facts do not establish an implied agency, the alternative deduction must be that the relationship is still closer than that of principal and agent, the Pennsylvania Company being, in the language of the court, a mere 'department' of the Pennsylvania Railroad. Under these circumstances it must be held that, giving all possible recognition to the separate incorporation of the Pennsylvania Company, the stocks, if not directly acquired, were indirectly acquired by the Pennsylvania Railroad, within the meaning of the statute" (p. 633). Again, in *Consolidation of Railroads*, 185 I.C.C. 403 (1932), in which the Commission approved the four-system plan for eastern territory outside of New England, the conditions imposed in the case of the Pennsylvania were based upon that carrier's indirect as well as direct control of the New Haven and Boston & Maine. The Commission found that "the Pennsylvania Railroad Company owns 15.52 per cent and

itself appears to have granted questionable authorizations for the unification of railroad properties. Consolidations into single systems for ownership and operation were expressly required to conform to the Commission's complete plan of consolidation, and this requirement was properly held to preclude their approval in advance of its adoption.<sup>248</sup> But combinations effected through the purchase of assets,

the Pennroad Corporation 7.27 per cent, or a total of 22.79 per cent of the voting stock of the New Haven," and that "the Pennroad Corporation owns 19.25 per cent and the Boston Railroad Holding Company, all of the voting stock of which is owned by the New Haven, owns 26.18 per cent, or a total of 45.43 per cent, of the voting stock of the Boston & Maine"; and on this basis the Commission declared: "We cannot . . . give our approval to any application of the Pennsylvania Railroad Company designed and seeking to carry into effect any portion of so much of the proposed four-system plan as related to system No. 4 [the Pennsylvania System], unless and until that railroad company either has divested itself of all stock held by it both directly in the New Haven and indirectly (through the Pennroad Corporation, the Pennsylvania Company, or any similar instrumentality) in the New Haven and the Boston & Maine, or has placed all such stock in the hands of independent trustees approved by us as in the public interest, under suitable terms and conditions for voting and sale, consistent with the provisions of the act and with our modified final plan" (pp. 412, 414).

<sup>248</sup> Thus, in *Merger of Subsidiary Companies with Boston & Maine*, 76 I.C.C. 797 (1923), the Commission dismissed applications of the Boston & Maine Railroad to acquire by merger the corporate property, rights, credits, and franchises of certain of its subsidiaries. Since these applications involved consolidations for ownership and operation, they could not be approved as mere acquisitions of control; and since no complete consolidation plan had been adopted, their submission under the consolidation provisions was premature. In support of its conclusion that "there is . . . no provision of law pursuant to which we may at this time approve or authorize the proposed mergers" (p. 800), the Commission said: "If the applications be treated as having been filed under paragraph (2) of section 5 of the interstate commerce act, we are of the opinion that that paragraph does not confer upon us the power to approve or authorize the proposed transactions. The contemplated mergers would involve the consolidation of the applicant and the subsidiary companies into a single system for ownership and operation and, therefore, we are without jurisdiction under that paragraph to approve or authorize the same. If the applications be considered as having been presented under paragraph (6) of said section 5 they can not be entertained by us at the present time. That paragraph confers upon us jurisdiction to approve a proposed consolidation of the properties of two or more carriers into one corporation for ownership, management, and operation, but it provides that the proposed consolidation must be in harmony with, and in furtherance of, the complete plan of consolidation. . . . While we have agreed upon the tentative plan of consolidation . . . and given due publicity thereto, the hearings which we are required . . . to hold thereon have not yet been brought to a close and the complete plan of consolidation has not yet been adopted by us. We are of the opinion, therefore, that the filing of the application was premature . . ." (p. 799). Similarly, in *Consolidation of D. T. & I. and D. & I. R. R.*, 124 I.C.C. 145 (1927), in which an application of the Detroit & Ironton, under paragraph (2), to acquire control of the Detroit, Toledo & Ironton through stock ownership and by purchase of properties, franchises, and assets, and a joint application of the two carriers, under paragraph (6), to consolidate their properties for ownership, management, and operation were dismissed, the Commission found: *first*, "That the proposed acquisition by the D. & I. of

though not involving technical consolidations, likewise result in unification for ownership and operation, and there appears to be no valid ground for according approval to them in reliance upon any statutory authority other than that contained in the consolidation provisions.<sup>244</sup> Yet the Commission, under its power to approve applications for acquisition and operation of railroad lines,<sup>245</sup> after considerable waver-

control of the Ironton [the D., T. & I.] . . . by purchase of stock and other securities and by purchase of all railroad properties, franchises, and assets (except the franchise to be a corporation, and certain cash), involves consolidation of such carriers into a single system for ownership and operation within the meaning of paragraph (2) of section 5 of the interstate commerce act"; and *second*, "That the application by the D. & I. and the Ironton [the D., T. & I.] for authority under paragraph (6) of section 5 of the interstate commerce act to consolidate their properties . . . into one corporation for ownership, management, and operation is prematurely filed" (pp. 159-160).

<sup>244</sup> In *Consolidation of D., T. & I. and D. & I. R. R.* (note 243, *supra*), the Commission, through Division 4, so held in unqualified terms. The Detroit & Ironton and the Detroit, Toledo & Ironton, in addition to seeking to consolidate their properties under paragraph (2) and paragraph (6) of section 5, filed a joint application under paragraph (18) of section 1 for a certificate that public convenience and necessity require the acquisition and operation by the D. & I. of the lines of the D., T. & I. In dismissing this application, it was found that such acquisition of properties, franchises, and assets "does not fall within the purview of paragraph (18) of section 1 . . . and can not be accomplished thereunder." In view of the Commission's determinations on this issue in other proceedings, its supporting declarations in the instant case are highly significant: "Paragraph (18) of section 1, paragraph (2) of section 5, and paragraph (6) of section 5 . . . were simultaneously enacted in the transportation act, 1920, and by that statute inserted in the interstate commerce act. . . . Paragraph (6) is designed to enable the consolidation of railroad properties for common control, management, and operation in conformity to a comprehensive plan to be adopted and published by us. While we have agreed upon a tentative plan of consolidation . . . the complete plan has not yet been adopted. Pending adoption of the complete plan, paragraph (2) enables unions of railroad properties in ways not involving consolidation, subject to prior authorization from us. In paragraph (8) of section 5 it is provided that carriers affected by any order made by us under paragraph (2), or paragraph (6), are thereby relieved from the operation of the 'antitrust laws,' and of all other restraints or prohibitions by law, State or Federal, in so far as may be necessary to enable them to do anything authorized or required by such order. Paragraphs (18) to (22) of section 1 contain no reference to relief from the operation of antitrust laws, etc. This fact is sufficient to denote fundamental difference in the intent and purposes of the provisions of paragraph (18) from the provisions of paragraphs (2) and (6). We are of opinion that any proposed union of railroad properties capable of accomplishment neither under paragraph (2) of section 5, because involving consolidation within the meaning thereof, nor under paragraph (6) of section 5, because the requirements of paragraph (5) have not yet been fulfilled, can not be accomplished under the provisions of paragraph (18) of section 1 of the interstate commerce act because those provisions are inapplicable in the premises" (p. 159).

<sup>245</sup> Paragraphs (18) to (20) of section 1, which provide for certificates not only to abandon, extend, and construct railroad lines, but to acquire and/or operate them.

ing<sup>246</sup> issued numerous certificates of public convenience and necessity authorizing unifications to be accomplished through the purchase

<sup>246</sup> At the outset Division 4 approved combinations effected through the purchase of assets under paragraph (2) of section 5, without specific notice of the fact that such combinations result in unification for ownership as well as operation. See *Acquisition of Wis. & Nor. R. R. by M., St. P. & S. S. M. Ry.*, 70 I.C.C. 31 (1921); *Acquisition of Control of B. & C. M. Ry. by N. P. Ry.*, 70 I.C.C. 328 (1921); *Acquisition of C. & O. Northern by C. & O. Ry.*, 70 I.C.C. 550 (1921). In the same year, however, this position appears to have been reversed. In *Securities Application of Pittsburgh & West Virginia Ry.*, 70 I.C.C. 682 (1921), in which the principal holding of Division 4 was that the purchase of the properties and franchises of one carrier by another could not lawfully be made without the Commission's approval, it was also established that authority to effect such a combination must be secured under paragraph (6): "Paragraph (6) of section 5 uses the word 'consolidate.' Technically, a consolidation is sometimes defined as a union of companies where a new corporation is created to take over the powers and property of the consolidating corporations. We are of the opinion, however, that the word 'consolidate' is not used in paragraph (6) in a narrow sense, but that the language of the paragraph is broad enough to cover any form of union under which 'properties theretofore in separate ownership, management, and operation' pass into the possession of a single corporation for ownership, management, and operation" (p. 684). It should be noted, furthermore, that an application to acquire and operate the line involved in the above proceeding, under paragraph (18) of section 1, had been previously dismissed by Division 4 as not falling within the scope of that paragraph. *Public-Convenience Application of Pittsburgh & W. Va. Ry.*, 67 I.C.C. 786 (1921). Despite this fact, and the later declaration in *Merger of Subsidiary Companies with Boston & Maine*, 76 I.C.C. 797 (1923), that "there is . . . no provision of law" under which such mergers could be effectuated in advance of the promulgation of the complete consolidation plan (see note 243, *supra*), Division 4 came to authorize combinations through purchase of assets under paragraph (18) of section 1. The following from the separate expression of Commissioner Eastman in *South Georgia Ry. Capital Stock*, 82 I.C.C. 723 (1923), indicates both the change of policy and its questionable propriety: "In *Merger of Subsidiary Companies with Boston & Maine* . . . we held that we could not, under the provisions of section 5 of the interstate commerce act, authorize the consolidation of the Boston & Maine Railroad with certain subsidiary companies into a single system for ownership and operation prior to the adoption of the complete plan of consolidation required by . . . this section. In the instant case authority to effect a consolidation of precisely the same character is granted under paragraph (18) of section 1. While the application in the *Boston & Maine* case was made under section 5, there was no intimation in our report that the result desired could be accomplished by resort to paragraph (18) of section 1, although the Boston & Maine was fairly entitled to such an intimation, if we can do what is here proposed. In my judgment paragraph (18) of section 1 has to do with the acquisition and operation of new lines of railroad which are not now in operation as common carriers engaged in interstate commerce and can not lawfully be employed to authorize consolidations, our authority over which is specifically conferred and defined by section 5" (p. 726). While subsequently, in *Consolidation of D., T. & I. and D. & I. R. R.*, 124 I.C.C. 145 (1927), Division 4 again held paragraph (18) of section 1 to be inapplicable to combinations effected through purchase of assets (see note 244, *supra*), the contrary view now prevails in the determinations of both Division 4 and the full Commission. This latter view appears to have been rendered definitive by the full Commission (Commissioner Eastman and Commissioner McManamy dissenting) in *Acquisition by Pittsburgh & W. V. Ry. Co.*, 150 I.C.C. 81 (1928): "We have



of assets.<sup>247</sup> The technical forms of unification thus exerted a potent influence upon the course of the combination movement as it was permitted to develop under the operative statutory provisions.

Finally, the question arose, and created sharp conflict within the Commission, as to how complete a control or union of interests might lawfully be approved independently of the consolidation provisions—that is, whether virtual consolidations might properly be authorized under other sections of the Act. This issue was of outstanding importance because upon the character of its solution depended, on the one hand, whether close combinations deemed to be in the public interest might be effectively furthered without awaiting agreement upon the comprehensive grouping of roads, and, on the other, whether such preliminary authorizations might operate to complicate the problem of orderly reorganization of the railroad system and defeat the purposes of the consolidation plan. It arose not only in connection with combinations accomplished through the purchase of assets, but with respect to acquisitions of control effected through stock ownership, under lease, and by resort to both leases and stock purchases. In all these situations the Commission was largely guided by technical con-

considered and have given our approval to numerous applications involving, as here, the acquisition by the parent company of the physical property of a subsidiary operated as a part of its system. . . . This construction of the act has apparently not been questioned. The acquisitions authorized under it have been carried out. Nor do we think we would now be justified in departing from it" (p. 84).

<sup>247</sup> See, for example: *South Georgia Ry. Capital Stock*, 82 I.C.C. 723 (1923); *Acquisition and Stock Issue by P., O. & D. R. R.*, 105 I.C.C. 189 (1925); *Acquisition of Central New England Ry.*, 124 I.C.C. 165 (1927); *Acquisition by S., C. D. & P. Ry.*, 124 I.C.C. 355 (1927); *Acquisition by C., R. I. & P. Ry.*, 124 I.C.C. 610 (1927); *Acquisition of O. & C. R. R.*, 124 I.C.C. 614 (1927); *Acquisition by Southern Pacific Co.*, 131 I.C.C. 726 (1927); *Acquisition of Paris & Great Northern R. R.*, 131 I.C.C. 797 (1927); *Acquisition by N. Y. C. R. R.*, 138 I.C.C. 163 (1928); *Acquisition by D., L. & W. R. R.*, 138 I.C.C. 285 (1928); *Acquisition of M., O. & G. R. R.*, 138 I.C.C. 294 (1928); *Acquisition by St. L.-S. F. Ry.*, 145 I.C.C. 110 (1928); *Acquisition by Long Island R. Co.*, 145 I.C.C. 477 (1928); *Acquisition by Pittsburgh & W. V. Ry. Co.*, 150 I.C.C. 81 (1928); *Acquisition of Lines by Great Northern Ry. Co.*, 150 I.C.C. 451 (1929); *Abandonment of Line by Elwood, A. & L. R. Co.*, 150 I.C.C. 468 (1929); *Acquisition of Jacksonville & H. R. Co.*, 150 I.C.C. 551 (1929); *Acquisition of Line by Midland V. R. Co.*, 150 I.C.C. 584 (1929); *Acquisition of Lines by Gulf, M. & N. R. Co.*, 154 I.C.C. 479 (1929); *Chicago, M., St. P. & P. R. Co. Acquisition*, 158 I.C.C. 770 (1930); *Chesapeake & O. Ry. Co. Acquisition*, 162 I.C.C. 323 (1930); *Maine Central R. Co. Acquisition and Operation*, 175 I.C.C. 461 (1931); *Western New York & P. Ry. Co. Acquisition*, 180 I.C.C. 334 (1932); *Southern Pac. R. Co. Acquisition*, 184 I.C.C. 189 (1932).

siderations and authorized virtual consolidations. We have already noted its repeated approval of the acquisition by one carrier of the properties, franchises, and assets of another; and these holdings elicited vigorous dissent, as a matter of policy as well as for want of power.<sup>248</sup> Similar differences of judgment emerged in connection

<sup>248</sup> Commissioner Eastman consistently protested. In *Acquisition by Pittsburgh & W. V. Ry. Co.*, 150 L.C.C. 81 (1928), the first proceeding in which the full Commission considered the matter at length, he argued convincingly as follows: "Section 5 of the interstate commerce act specifies very definitely the conditions under which it shall be lawful for two or more carriers by railroad, subject to the act, 'to consolidate their properties or any part thereof, into one corporation for the ownership, management, and operation of the properties theretofore in separate ownership, management, and operation.' There are technical distinctions between a purchase and sale, a merger, or a consolidation, and the latter term is used, in this technical sense, to describe a form of union in which the consolidating corporations cease to exist and are superseded by a wholly different corporation. It is plain, however, that the word 'consolidation' is not used in this narrow sense in section 5, and that it includes all methods of bringing the properties of two or more carriers under the ownership and management of a single corporation. . . . In view of the fact that the manner and means by which railroad properties may be unified, either through the acquiring of control of one carrier by another or through consolidation into a single system for ownership and operation, are definitely and specifically covered in section 5, and in view of the well-settled principle of statutory construction ['that specific terms covering the given subject will prevail over general language of the same or another statute which might otherwise prove controlling'] . . . it seems to me clear beyond any doubt that we are not empowered to authorize such unifications under paragraph (18) of section 1, by reason of an incidental phrase of three words which was inserted in that paragraph. . . . A narrow construction of the word ['consolidation'] . . . would lead to the absurd conclusion that Congress intended . . . to limit and safeguard the union of two or more carrier properties under the ownership and management of a single corporation, when that corporation is not one of the previously existing corporations, but did not intend to so limit and safeguard the accomplishing of the same result through the medium of one of those corporations" (pp. 87-88, 90, 91). Prior to the decision in the *Pittsburgh & West Virginia* case, Commissioner Eastman had dissented in all the Division 4 proceedings involving this issue. In *Acquisition by Southern Pacific Co.*, 131 L.C.C. 726 (1927), for example, he declared: "Consolidations of the properties of carriers into a single system for ownership and operation are specifically provided for in section 5, and such specific provisions clearly have precedence over any general provision in another part of the act which may seem to deal with the same subject matter. Plainly, also, what is here proposed is a consolidation, in even a technical sense, of properties theretofore in separate ownership 'into one corporation for ownership, management, and operation.' The circumstances not being present under which such a consolidation can be authorized under the provisions of section 5, we are without power to authorize it under paragraph (18) of section 1. I may add that if we can authorize what is here proposed, we can authorize the consolidation into a single system for ownership and operation of the properties of any two or more carriers in the country, however large those properties may be" (pp. 728-729). After the decision in the *Pittsburgh & West Virginia* case, he generally concurred, but only, by express statement, on the authority of that decision. In one instance, however, he was constrained to dissent once more, despite that deci-

with the approval of acquisitions of control under paragraph (2) of section 5. The Commission soundly defined "control" as "the full and complete control which may be exercised by the owner of the majority of the capital stock of a carrier, or by the lessee of the property,"<sup>249</sup>

sion. Note the following from *Chesapeake & O. Ry. Co. Acquisition*, 162 I.C.C. 323 (1930), at p. 331: "What is here proposed is obviously the consolidation of the properties of two carriers into one corporation for the ownership, management, and operation of the properties theretofore in separate ownership, management, and operation, and the application should have been brought under section 5(6) rather than under section 1(18). While there is a precedent for something like this in the decision of the commission in *Acquisition by Pittsburgh & W. V. Ry.* . . . the fact of consolidation is so patent here that I can not bring myself to concur in the majority report even on the strength of that precedent" (p. 331).

<sup>249</sup> *Nickel Plate-Lake Erie & Western Contract*, 72 I.C.C. 151, 153 (1922). Accordingly, the acquisition of the bonds of a carrier authorized to acquire control through stock ownership was not deemed to fall within the Commission's jurisdiction. In *Control of Kansas & Missouri Ry. & Term. Co.*, 86 I.C.C. 631 (1924), for example, the Commission said: "So far as appears, the purchase of the Terminal Company first-mortgage bonds will not give either the Kaw Valley or the Kansas any other or further control over the Terminal Company than will be procured through the acquisition of the latter's stock. We are therefore of the opinion that the applications, in so far as authority is sought to acquire the bonds of the Terminal Company, are not within the scope of paragraph (2) of section 5 of the interstate commerce act" (p. 635). Where the applicant already owns a majority of the stock more of which is sought to be acquired, it would seem that the Commission is without jurisdiction. It was so held in *Control of Peoria & Eastern by Big Four*, 71 I.C.C. 747 (1922): "By paragraph (2), of section 5 of the interstate commerce act, we are authorized to approve the acquisition, to the extent indicated by us, by one carrier engaged in interstate commerce of the control of any other such carrier by the purchase of stock or in any other manner specified. In this case, however, so far as appears, the purchase of the remaining stock of the carrier will not give the applicant any other or further control over such carrier than that which it had acquired prior to the enactment of the paragraph. It can only be said that the applicant, in this proceeding, is seeking to acquire that which it admittedly has heretofore acquired. We are, therefore, of the opinion that the application is not within the scope of the paragraph above referred to" (pp. 647-648). See, also, *Securities of Colorado & Southern*, 86 I.C.C. 213, 218 (1924); *Securities of Chesapeake & H. Ry. Co.*, 150 I.C.C. 248, 249 (1929). But in *Control of C., St. P., M. & O. Ry.*, 105 I.C.C. 543 (1926), and in *Control of L. & J. Bridge & R. R.*, 145 I.C.C. 131 (1928), the prior ownership of a majority of the stock by the applicant did not inhibit the Commission from authorizing further acquisitions. Moreover, the Commission frequently assumed jurisdiction to approve control by lease where complete control through stock ownership already existed. Note, for example, the following from *Acquisition of Control of C. V. & M. R. R. by P. R. R.*, 70 I.C.C. 301 (1921), at p. 302: "The Pennsylvania owns all of the outstanding capital stock of the Cumberland, and so long as it continues to be the owner the payment of the rental will be no more than a matter of bookkeeping. . . . For many years the companies have been affiliated and have interchanged and moved traffic as one system, the Cumberland's railroad being, in effect, a continuation of the Cumberland Valley division of the Pennsylvania's railroad. It is claimed that the proposed arrangement will eliminate the operating organization of the lessor and substitute that of the lessee, which should result in added efficiency, and give the public the

and it properly assumed jurisdiction over joint acquisitions of such control.<sup>250</sup> But however complete the proposed control to be thus acquired—whether by purchase of the entire capital stock,<sup>251</sup> or by long-term lease,<sup>252</sup> or by both lease and stock ownership<sup>253</sup>—the Commission declined to view such unions of interest as involving consolidations into single systems for ownership and operation.<sup>254</sup> "It is not

full benefit of the Pennsylvania's organization and service. The transaction is expected to effect economies in the accounting department and to simplify the work of compiling reports required by State and Federal laws." See, also, *Acquisition of Control of P. A. & W. R. R. by P. R. R.*, 70 I.C.C. 303 (1921); *Acquisition of Control of N. Y. B. R. R. by P. R. R.*, 70 I.C.C. 306 (1921); *Lease of Grand Rapids & Indiana Ry.*, 72 I.C.C. 260 (1922); *Lease of Pennsylvania-Detroit R. R.*, 82 I.C.C. 396 (1923); *Lease of Island Creek R. R.*, 117 I.C.C. 670 (1927); *Control of Washington & Vandermere R. R.*, 124 I.C.C. 307 (1927). Generally the Commission has assumed jurisdiction where the applicant has sought to acquire at least a majority of the stock, or such amount, in view of existing holdings, even when they constituted *de facto* control, as would result in the ownership of a majority of the stock and enable the applicant to exercise control over all the activities of the acquired road. See, for example: *Control of Rockingham R. R. by A. C. L.*, 72 I.C.C. 85 (1922); *Control of Big Four by New York Central*, 72 I.C.C. 96 (1922); *Control of K. & M. Ry. & Term. Co.*, 94 I.C.C. 127 (1924); *Control of Gulf Coast Lines by M. P. R. R.*, 94 I.C.C. 191 (1924); *Control of Ann Arbor R. R. by Wabash Ry.*, 105 I.C.C. 43 (1925); *Control of Western Allegheny R. R.*, 105 I.C.C. 499 (1926); *Control of Columbia, Newberry & Laurens R. R.*, 117 I.C.C. 219 (1926); *Control of Northwestern P. R. Co.*, 150 I.C.C. 119 (1928).

<sup>250</sup> See, for example: *Control of Ironton R. R.*, 82 I.C.C. 665 (1923); *Control of Kansas & Missouri Ry. & Term. Co.*, 86 I.C.C. 631 (1924); *Clinchfield Railway Lease*, 90 I.C.C. 113 (1924); *Acquisition and Construction by Alameda Belt Line*, 105 I.C.C. 349 (1926); *Control of Texas City Terminal Ry.*, 111 I.C.C. 729 (1926). In *Control of Central California Traction Co.*, 131 I.C.C. 125 (1927), the Commission authorized acquisition of control by the Southern Pacific under paragraph (2) of section 5 "upon condition that the Southern Pacific promptly admit the Western Pacific and the Santa Fe, or either of them, as those carriers respectively thereto may consent, to participation equally with the Southern Pacific in joint control of the carrier upon payment of proportionate shares of the cost of the securities to be acquired" (p. 139). In *Northern Pac. Ry. Co. Acquisition*, 175 I.C.C. 253 (1931), the Commission issued a certificate under paragraph (18) of section 1 authorizing the acquisition by the Northern Pacific, the Oregon-Washington, the Great Northern, and the Milwaukee "of undivided one-fourth interests in the part of a line of railroad . . . described in the applications," and "the operation of such part of line jointly by the aforesaid carriers or by any of them for the benefit of all" (p. 260). See, also, note 142, *supra*, for position taken by the Commission in *Directors of Wheeling & Lake Erie*, 138 I.C.C. 643 (1928).

<sup>251</sup> See cases cited in note 235, *supra*.

<sup>252</sup> See cases cited in note 234, *supra*.

<sup>253</sup> See cases cited in note 236, *supra*.

<sup>254</sup> In view of this construction of the Commission's authority under paragraph (2) of section 5, most of the major unifications sought to be effectuated since the passage of the Transportation Act have utilized the expedients of lease and stock ownership, singly or in combination. See, for example: *Control of Big Four by New York Central*, 72 I.C.C. 96 (1922); *Control of Central Pacific by Southern Pacific*, 76 I.C.C. 508 (1923);

enough to constitute such a consolidation," the Commission has said, "that the carriers or their properties be consolidated into a single system for operation, or for management, or for management and operation, but it must also appear that they are consolidated for ownership. Since each of the carriers will retain its corporate identity and the legal title to its property, no consolidation of the kind defined by the statute will result."<sup>255</sup> As in the case of acquisitions effected through the purchase of assets, this emphasis upon form rather than substance evoked repeated protests from within the Commission.<sup>256</sup> The complete and enduring control accomplished through these means was not only deemed by the dissenting commissioners to produce virtual consolidations, and hence to be beyond the scope of the Commission's authority under paragraph (2) of section 5, but to subvert the constructive purposes of the consolidation program as a whole.<sup>257</sup> Be-

*Clinchfield Railway Lease*, 90 I.C.C. 113 (1924); *Control of Ann Arbor R. R. by Wabash Ry.*, 105 I.C.C. 43 (1925); *Nickel Plate Unification*, 105 I.C.C. 425 (1926); *Unification of Southwestern Lines*, 124 I.C.C. 401 (1927); *Control of B., R. & P. Ry.*, 131 I.C.C. 750 (1927); *Control of Erie R. R. and Pere Marquette Ry.*, 138 I.C.C. 517 (1928); *New York Central Unification*, 150 I.C.C. 278 (1929), 154 I.C.C. 489 (1929); *Great Northern Pac. Ry. Co. Acquisition*, 162 I.C.C. 37 (1930).

<sup>255</sup> *Control of Central Pacific by Southern Pacific*, 76 I.C.C. 508 (1923), at pp. 524-525. Note, also, the following from *Construction of Cus-Off for I. C. R. R.*, 86 I.C.C. 371 (1924), at p. 373: "Under the provisions of paragraph (2) of section 5 of the interstate commerce act, the commission has power to authorize the acquisition of control of one carrier by another 'by the purchase of stock or in any other manner not involving the consolidation of such carriers into a single system for ownership and operation.' There is no restriction as to the extent of the control, which therefore may be complete. Where control exists it is apparent that the operation and policy of the controlled carrier become subject to the will of the controlling carrier, and this effect must have been in contemplation by Congress when it enacted this provision. Assuming, therefore, that we have no power under present laws to authorize an absolute consolidation of carriers into a single system for ownership and operation, it is nevertheless clearly within our power to authorize the acquisition of such control as may result in unified operation."

<sup>256</sup> See numerous dissenting opinions, especially by Commissioner Eastman and Commissioner McManamy, in cases cited in notes 234, 235, and 236, *supra*.

<sup>257</sup> A few illustrations will suffice. In *Control of Big Four by New York Central*, 72 I.C.C. 96 (1922), Commissioner Eastman, with whose expression of dissent Commissioner Cox concurred, declared: "It is conceded that the New York Central and the Big Four are now a single system for operation. In my judgment they will also be a single system for ownership if the New York Central acquires 100 per cent of the Big Four stock, and virtual consolidation into one corporation for ownership, management, and operation will have taken place. No other conclusion can be reached, unless form be deemed of more significance than substance. It follows that what the New York Central is now seeking to do can not be authorized under paragraph (2) of section 5 and will be unlawful until we approve it under paragraph (6) as in harmony with the com-

cause these views did not prevail with the Commission, the course of piecemeal combination was substantially facilitated, but at the expense of the comprehensive and orderly reorganization of the railroad systems of the country which the complete plan of consolidation was designed to further.

But while much may be said by way of criticism of the Commission's rather narrow interpretation of its powers along jurisdictional lines, it would be an error to assume that the intimate relationship be-

plete plan of consolidation" (p. 100). In *Clinchfield Railway Lease*, 90 I.C.C. 113 (1924), three of the commissioners dissented, and each laid stress upon this issue. Commissioner Eastman declared that "the 999-year lease will effectually unite these properties into a 'single system for ownership and operation,'" and that "certainly the union here contemplated is of so permanent and enduring a character that it ought not to be consummated until these carriers have been given the thorough consideration which the act requires in connection with the preparation and adoption of the so-called consolidation plan" (p. 135); Commissioner Campbell withheld his assent "because it is likely that when the commission has consummated its complete plan of consolidation . . . it will be found that the control authorized by the majority will interfere with that plan" (p. 136); and Commissioner McManamy found that "the acquisition of control under a lease for a period of 999 years in effect amounts to a consolidation of the carriers concerned into a single system," which "may or may not be in harmony with" the complete plan of consolidation as finally formulated by the Commission (p. 137). In *Nickel Plate Unification*, 105 I.C.C. 425 (1926), in which control was to be acquired through 999-year leases coupled with stock ownership, Commissioner Eastman, joined by Commissioner Campbell and Commissioner McManamy, dissented from the finding "that the proposed plan of unification does not involve the consolidation of the carriers into a single system for ownership and operation and that it contemplates merely acquisitions of control which we have jurisdiction to approve under paragraph (2) of section 5 of the act" (p. 450). In *Control of A. & V. Ry. and V., S. & P. Ry.*, 111 I.C.C. 161 (1926), Commissioner McManamy, with whose expression of dissent on this point Commissioner Eastman concurred, declared: "Much can be said that is favorable to the consolidation here proposed. . . . But its approval is beyond our power under the law. The term of the lease is 357 years with a privilege of renewal for 999 years, making the total term 1,356 years. To hold that this is not actual ownership is to cling to form rather than substance. It is admitted on the record that it is a consolidation for operation, therefore it is a consolidation 'into a single system for ownership and operation' which is contrary to paragraph (2) of section 5, under which this application is filed. . . . Delay by this commission (no matter how caused) in bringing forward a plan for consolidation can not be a justification for permitting under paragraph (2) consolidations such as this, which in my opinion involve 'ownership and operation.' To approve such consolidations is in effect substituting paragraph (2) for paragraphs (4), (5), and (6). This we are without authority to do and I do not believe it was contemplated by Congress" (p. 181). Finally, in *Great Northern Pac. Ry. Co. Acquisition*, 162 I.C.C. 37 (1930), involving a unification through lease and stock ownership which was authorized under paragraph (2) of section 5 after the Commission's consolidation plan had been published, both Chairman McManamy and Commissioner Eastman dissented on this jurisdictional issue as well as on the merits. Chairman McManamy said: "Consolidations for ownership and operation are clearly not authorized under paragraph (2) of section 5. . . . As a matter of fact the word 'consolidation' appears in this para-

tween acquisitions of control and the ultimate consolidation program was ignored, or that a mere routine endorsement was accorded to the unification proposals of the carriers, independently of the standards prescribed in connection with consolidations. This will clearly appear from an analysis of the various considerations which guided its findings of public interest. Although, for defensible if not altogether convincing reasons, the Commission occasionally construed its authority as merely enabling in character and adopted a policy which permitted virtual consolidations to be effected, in advance of the promulgation of its complete plan, through purchase of assets, negotiation of leases, and ownership of securities, it in large measure approached the problem of public interest involved in such acquisitions of control in terms of the purposes and requirements of Congress, as well as of its own preliminary determinations in pursuance thereof, bearing upon the general objective of consolidating the railroads of the United States into a limited number of systems. The controlling issues upon the question of public interest thus centered about the achievement of economies and improvement of service, the preservation of competition and maintenance of existing channels of trade, the disposition to be made of the so-called weak roads, and the propriety of the contemplated financial arrangements.<sup>258</sup>

graph only for the purpose of specifically forbidding it" (p. 75). And Commissioner Eastman's declarations were to the same effect: "The unification proposed is not to my mind a mere acquisition of control within the purview of section 5(2). It is to all intents and purposes a consolidation of the railroad properties in question into one system for ownership and operation, and hence is within the purview of section 5(6). If this is not so, the distinction between the two forms of unification falls short of a difference and is a matter of form rather than substance. Obviously, the attempt to bring this unification under section 5(2) is pure subterfuge, such as we ought not to countenance. It trifles with the law" (p. 80).

<sup>258</sup> The public interest to be furthered was very broadly defined. Thus, in *Clinchfield Railway Lease*, 90 I.C.C. 113 (1924), the Commission said: "The public interest . . . is the aggregate of many individual and community interests, and where there is conflict as to the results which would follow the approval of a proposed transaction, it becomes necessary to examine the claims of the conflicting interests in order to determine the ultimate public interest" (p. 121). Again, in *Acquisition of D. & R. G. W. Common Stock*, 90 I.C.C. 161 (1924), the Commission said: "In so doing [determining the public interest] we have to consider the interests of the people of the State of Colorado, but the duty placed upon us by the interstate commerce act will not be fully performed unless we also consider the interests of the people of other States of the Union, including those States served by the railroads connecting with the lines of the Denver" (p. 166). Furthermore, the burden of proof in the matter of public interest was defi-

Perhaps the factor most frequently stressed by applicants in proposed acquisitions of control as an affirmative basis for approval in the public interest concerned the achievement of economies in capital costs and operating expenses. Such considerations were deemed to be relevant in numerous instances, although they were not accepted as conclusive.<sup>259</sup> The economies thus recognized were found to spring from a variety of sources. They included, among others, savings to be realized from the rerouting of traffic,<sup>260</sup> from the joint use of equip-

nately placed upon the applicant. Thus, in *Nickel Plate Unification*, 105 I.C.C. 425 (1926), the Commission said: "Great undertakings like this proposal should be supported by a strong and clear affirmative showing which will fairly meet in advance of rebuttal every substantial objection which reasonably can be anticipated" (pp. 442-443). Again, in *Control of Virginian Ry.*, 117 I.C.C. 67 (1926), the Commission said: "Applications for authority to acquire control of railroads under the interstate commerce act must be supported by a clear and strong showing of public gain. If serious doubt exists regarding the wisdom of the proposed grouping, that doubt must be resolved against the applications. Real and substantial advantages of railroad grouping are capable of reasonable proof. So are the disadvantages. There must be a record of a substantial preponderance of evidence in favor of an application before we are warranted in giving it favorable consideration" (p. 85).

<sup>259</sup> "Reduction in the cost of transportation is a matter of public interest. It is not, however, of controlling importance, but is to be considered and weighed in connection with all other matters affecting the public interest." *Control of Virginian Ry.*, 117 I.C.C. 67 (1926), at p. 75.

<sup>260</sup> Note the following, for example: "Under the proposed arrangement through traffic can be routed between Buffalo and Peoria as a single-line movement, affording in many instances a shorter route between those lines with which the Nickel Plate connects at Buffalo and Chicago and relieving the main line of that carrier for the benefit of business originating or terminating in the Chicago switching district." *Control of Lake Erie & Western by Nickel Plate*, 72 I.C.C. 459, 460 (1922). "One of the most important factors in the unified system will be the movement of traffic over the most economical routes, having regard to density of traffic, congestion at terminals, and grades. . . . Altogether it is estimated that the proposed unified operation would result in annual savings of more than \$6,000,000. Many, if not all, of the savings are not dependent upon unification in the exact manner proposed here but could be brought about if control were only by stock ownership, or in many cases by intercompany contracts providing for the use of such joint facilities as it is proposed the unified system will establish. But that is not to say that the things mentioned can not more certainly and easily be brought about when the lines are under one management and control." *Nickel Plate Unification*, 105 I.C.C. 425, 433-434 (1926). "The routing of traffic by shorter lines within the system would be made practicable, resulting in some cases in decreased transportation expense. . . . The use of these shorter routes would in some cases require one of the carriers to short-haul itself and would therefore be to its disadvantage as an independent carrier. It would, however, be to the advantage of the system, and the disadvantage to one of the companies might be obviated by suitable arrangements for dividing the resulting savings between the carriers involved." *Unification of Southwestern Lines*, 124 I.C.C. 401, 418 (1927).



ment and terminals,<sup>261</sup> from the fuller utilization of shops,<sup>262</sup> from improved distribution of the labor force.<sup>263</sup> While the Commission subjected the claims of the roads to careful scrutiny, and, in the absence of other persuasive considerations, declined to be swayed by

<sup>261</sup> Thus: "The acquisition by the applicant of the Terre Haute company will result in more efficient and economical operation, and will facilitate putting the road in a position where it will be able properly to care for the needs of the communities it serves. Large economies will be effected by the joint use of applicant's passenger and freight facilities at Terre Haute, its shops at Terre Haute and Indianapolis, its rolling stock, and in the administration of the property." *Stock Control of E., I. & T. H. Ry. by C., C., C. & St. L. Ry.*, 67 I.C.C. 513, 514 (1921). Again: "The applicant controls the American Refrigerator Transit Company, which owns 7,500 refrigerator cars and has authorized the purchase of 2,000 more. It appears that traffic from territory served by the New Orleans Company reaches its peak in the early months of the year, when traffic shipped in refrigerator cars is light on the applicant's system. Apparently the applicant would be able to supply refrigerator equipment for the expeditious movement of perishable products from the Rio Grande Valley." *Control of Gulf Coast Lines by M. P. R. R.*, 94 I.C.C. 191, 199 (1924).

<sup>262</sup> Note the following, for example: "The proposed system would be able to adopt joint arrangements for the use of excess shop and other facilities of one line for the benefit of other lines of the group. The shop facilities of the several lines are, on the whole, adequate for their normal needs; but in times of congestion the surplus facilities of one company could be made available to the others and thus capital expenditures otherwise needed to enlarge the shops of the individual lines could be postponed." *Unification of Southwestern Lines*, 124 I.C.C. 401, 420 (1927). "The major advantage of the proposed leases from the viewpoint of the repair of equipment would be in relation to main shops where general repairs are handled. It appears that main shop facilities are generally adequate except at [certain points] . . . where extensions estimated to cost \$7,000,000 are in contemplation. Through use of facilities available on the Big Four these expenditures can be indefinitely deferred, with a resulting saving in carrying charges. Other economies may be effected by the combination or closing of some smaller shops, and for the future it would be beneficial to consider any extensions or replacements of existing facilities from the viewpoint of a unit rather than from that of two or three carriers. Unified operation of the lines would permit increased flexibility in the repair of equipment and would facilitate the transfer of locomotives from one line to another for transportation purposes." *New York Central Unification*, 150 I.C.C. 278, 293 (1929).

<sup>263</sup> Thus: "The interest of employees of the Southern Pacific system was represented by the intervention of the four national train brotherhoods and the Order of Railway Telegraphers. These offered testimony tending to show that dismemberment would interfere with seniority rights and, by reason of dislocation of runs and positions, would harmfully affect the employees who had established their homes in localities affected. It was urged, further, that the present practice of shifting employees seasonally from the Southern Pacific to the Central Pacific lines, which permits continuity of employment to junior employees, would probably no longer continue." *Control of Central Pacific by Southern Pacific*, 76 I.C.C. 508, 513-514 (1923). Again: "The proposed grouping would make possible the use of any surplus labor force of one line on the lines or in the shops of the other lines, thus lessening the number of men required and ensuring more experienced labor." *Unification of Southwestern Lines*, 124 I.C.C. 401, 423 (1927).

mere conjectural savings,<sup>204</sup> the likelihood of effectuating economies of substantial amount exerted an important influence upon its approval of proposed acquisitions of control.<sup>205</sup> Recognition was also accorded to prospective advantages to carriers and shippers which, though not reducible to savings in capital costs and operating expenses, were none the less deemed to further like public interests. Thus, the probable strengthening of the position of carriers, particu-

<sup>204</sup> Such declarations as the following, in connection with proposed acquisitions of control not found to be in the public interest, are indicative of this approach: "The C. & O. introduced much testimony in an endeavor to refute the claims of the N. & W. with respect to the operating economies it would be able to effect. This testimony went into elaborate details, including grades, engine ratings, engine terminals, electrified zones, methods of operation, repair shops, use of facilities, etc. Considering the testimony as a whole it fails to establish that the N. & W. could effect the operating savings which it anticipates. Witnesses on behalf of the N. & W. admitted on cross-examination that they were unable to state how the Virginian would be operated, and that they could not know until after they had actually operated both properties. In the absence of a definite plan for operation, it would appear that the evidence relating to prospective operating economies is largely speculative." *Control of Virginian Ry.*, 117 I.C.C. 67, 75 (1926). "This ambitious program [for reduction of grades] suggests large economic possibilities. Its immediate importance, however, seems not to be great, because the traffic density on no one of the lines is sufficient to justify a program of this nature in the near future and the roads do not now compare unfavorably in grades with their competitors, and also because any very extensive program of joint road revision would have to be predicated on a union between the lines of a more definite and permanent nature than stock control. The program is presented as a future possibility only." *Unification of Southwestern Lines*, 124 I.C.C. 401, 420 (1927). But see *New York Central Unification*, 150 I.C.C. 278 (1929).

<sup>205</sup> In *Great Northern Pac. Ry. Co. Acquisition*, 162 I.C.C. 37 (1930), for example, the anticipated savings, estimated by the applicants to amount to more than \$10,000,000 annually, probably constituted the leading factor in the conditional approval of the proposed merger of the Great Northern and the Northern Pacific, in the face of vigorous opposition from many quarters. "Foremost among the considerations in favor of the proposed unification is the feasibility of making large operating economies" (p. 47), said the Commission; and after an analysis of the detailed estimates of the applicants, the Commission declared: "The applicants' proposal to reduce the expense of operation is entirely sound in principle, and is entitled to serious consideration as a step toward ultimately reducing the cost of transportation, thus tending to prevent increased rates if not to lower existing rates, and aiding in the development and prosperity of the territory" (p. 52). A like emphasis is found in the Commission's concluding summary of the grounds of its approval: "The applicants' proposal has, in our opinion, important advantages. The economies in operation from it are well assured and are large in aggregate amount. Such means of lowering the cost of rail transportation and of ultimately reducing rates should be adopted wherever possible. By the use of shorter routes, one-system movements, common terminals, and car supply, the public may confidently look for substantial benefits from this unification, notable among which are savings in time due to rerouting, elimination of interchange, and increased access to markets" (p. 69). But see dissenting opinions of Chairman McManamy and Commissioner Eastman (pp. 74-82).

larly through expanding or diversifying their command over traffic,<sup>286</sup> and the probable improvement of the position of shippers, particularly through bettering service or reducing rates,<sup>287</sup> received frequent consideration. But such economies and betterments, which are independent of the express mandates governing consolidations, generally served as a mere starting-point in determining whether proposed acquisitions of control were in the public interest. In the disposition of such proceedings, especially those of far-reaching scope, the Commission was also guided by the specific principles and general purposes underlying the contemplated consolidation of railroad properties into a limited number of systems.

The most important of these considerations, in their bearing upon the public interest, concerned the preservation of competition and the maintenance of existing channels of trade, in line with the specific requirements of the consolidation provisions. In some measure these factors were recognized indirectly, through the influence exerted by the Commission's consolidation plan.<sup>288</sup> While in view of the tentative character of this plan, even in its "final" form, the validity of objections to it, the absence of power of governmental compulsion, and the desirability of giving flexible scope to managerial initiative, the Commission did not insist that acquisitions of control must conform to its comprehensive grouping of roads,<sup>289</sup> the fact that proposals were

<sup>286</sup> See, for example: *Acquisition of C., T. H. & S. En. Ry. by C., M. & St. P. Ry.*, 70 I.C.C. 20, 23 (1921); *Acquisition of D. & R. G. W. Common Stock*, 90 I.C.C. 161, 167-168 (1924); *Control of C., St. P., M. & O. Ry.*, 105 I.C.C. 543, 544-545 (1926); *Control of Dayton-Goose Creek Ry.*, 105 I.C.C. 792, 796 (1926); *Control of Washington & Vandemere R. R.*, 124 I.C.C. 307, 309 (1927); *Acquisition by S., C. D. & P. Ry.*, 124 I.C.C. 355, 359 (1927); *Control of Erie R. R. and Pere Marquette Ry.*, 138 I.C.C. 517, 528-529 (1928).

<sup>287</sup> See, for example: *Lease of Texas State R. R. by T. & N. O. R. R.*, 70 I.C.C. 485, 486 (1921); *Clinchfield Railway Lease*, 90 I.C.C. 113, 122 (1924); *Control of International-Great Northern R. R.*, 90 I.C.C. 262, 268 (1924); *Control of Gulf Coast Lines by M. P. R. R.*, 94 I.C.C. 191, 199 (1924); *Control of J., L. C. & E. R. R.*, 99 I.C.C. 753, 756 (1925); *Control of Lines by N. O., T. & M. Ry.*, 105 I.C.C. 79, 83 (1925); *Acquisition by T. & P. Ry.*, 124 I.C.C. 369, 371-372 (1927); *Acquisition by St. L., K. & S. E. R. R.*, 131 I.C.C. 105, 109 (1927); *Acquisition by W. F. & S. R. R.*, 131 I.C.C. 117, 119 (1927); *Acquisition of Control by Panhandle & S. F. Ry. Co.*, 154 I.C.C. 342, 344-345 (1929); *Control of Texas State R.*, 154 I.C.C. 359, 360 (1929).

<sup>288</sup> *Consolidation of Railroads*, 63 I.C.C. 455 (1921), 159 I.C.C. 522 (1929).

<sup>289</sup> For the Commission's general pronouncement to this effect in *Nickel Plate Unification*, 105 I.C.C. 425, 435-436 (1926), see note 233, *supra*. For the approval of proposals which involved departures from the "tentative" consolidation plan (63 I.C.C.

in harmony with the consolidation plan tended to support their approval,<sup>270</sup> and the fact that they were in conflict with it tended to contribute to their rejection.<sup>271</sup> Thus, to the extent that the consolidation plan influenced the disposition of unification proposals, the preservation of competition and the maintenance of existing channels of trade played an important part in the determination of the public interest.<sup>272</sup> But the Commission was also swayed directly by these factors in connection with proposed acquisitions of control. When the issue as to their relevancy was sharply raised, the Commission, though

455 [1921]), see for example: *Acquisition of D. & R. G. W. Common Stock*, 90 I.C.C. 161, 163 (1924); *Control of San Antonio, Uvalde & Gulf Ry.*, 105 I.C.C. 35, 41 (1925); *Control of Ann Arbor R. R. by Wabash Ry.*, 105 I.C.C. 43, 47 (1925). For the approval of modifications of the "final" consolidation plan (159 I.C.C. 522 [1929]), see *St. Louis S. W. Ry. Co. Control*, 180 I.C.C. 175, 710 (1932); *Consolidation of Railroads*, 183 I.C.C. 663 (1932), 185 I.C.C. 403 (1932).

<sup>270</sup> See, for example: *Texas & Pacific Readjustment*, 86 I.C.C. 808, 810 (1924); *Control of International-Great Northern R. R.*, 90 I.C.C. 262, 268 (1924); *Control of El Paso & Southwestern System*, 90 I.C.C. 732, 736 (1924); *Control of Gulf Coast Lines by M. P. R. R.*, 94 I.C.C. 191, 199 (1924); *Control of C., St. P., M. & O. Ry.*, 105 I.C.C. 543, 545 (1926); *Control of C., I. & W. R. R.*, 111 I.C.C. 124, 126 (1926); *Buffalo, R. & P. Ry. Co. Control*, 158 I.C.C. 779, 789 (1930); *Alton R. Co. Acquisition and Stock Issue*, 175 I.C.C. 301, 306 (1931).

<sup>271</sup> See, for example: *Control of I.-G. N. by St. L.-S. F. Ry.*, 79 I.C.C. 435, 438 (1923); *Control of Virginian Ry.*, 117 I.C.C. 67, 68 (1926); *Lease of L. & N. E. R. R.*, 124 I.C.C. 81, 92-93 (1927); *Control of B., R. & P. Ry.*, 131 I.C.C. 750, 764 (1927); *Control of Erie R. R. and Pere Marquette Ry.*, 138 I.C.C. 517, 530 (1928); *Directors of Wheeling & Lake Erie*, 138 I.C.C. 643, 654 (1928).

<sup>272</sup> It should be noted, also, that in some instances the Commission expressly reserved the right to withdraw its approval, particularly where the authorization was at variance with the tentative consolidation plan, and to dispose of the road in question as its final plan of consolidation might require. Thus, in *Control of Central Pacific by Southern Pacific*, 76 I.C.C. 508 (1923), the order specified that "the aforesaid lease shall contain a provision that the same shall become null and void and of no effect whenever this commission shall find that the control, acquisition of which is herein approved and authorized, interferes with the consummation of the complete plan of consolidation adopted and published under the provisions of section 5," and that "the control herein authorized by lease and stock ownership shall be held subject to termination by order of this commission if and when found by this commission to interfere with the consummation of its complete plan of consolidation . . . and for this purpose the commission reserves full jurisdiction over the case to make such order or orders as, after hearing, it may deem to be necessary and appropriate" (p. 531). Again, both in *Control of San Antonio, Uvalde & Gulf Ry.*, 105 I.C.C. 35, 41 (1925), and in *Control of Ann Arbor R. R. by Wabash Ry.*, 105 I.C.C. 43, 47 (1925), the Commission, noting that the acquisition involved a departure from its tentative consolidation plan, conditioned its approval as follows: "Nothing in this report or in the order to be entered herein is to be construed as waiving or limiting our right to make disposition of the Ann Arbor [the San Antonio] under our final consolidation plan." But there is considerable doubt as to the efficacy of such conditions. Note the following, for ex-

conceding that only a finding of public interest was expressly required by statute, added unequivocally: ". . . but we consider competition and the preservation of established channels of trade in cases of this character and have not overlooked them here."<sup>273</sup> A showing that no destruction of competition would be involved tended to support the approval of proposals,<sup>274</sup> while a showing that competition would be seriously curtailed tended to justify their disapproval,<sup>275</sup> and

ample, from the concurring opinion of Commissioner Eastman in the *Ann Arbor* case: "It is quite true that we can give the Ann Arbor such place in our final consolidation plan as may please our fancy. But as a practical matter, once the Wabash acquires a majority of the stock of the Ann Arbor, any separation of that road from the Wabash in the final consolidation plan will be a wholly empty gesture, unless the Wabash consents to separation or the power of eminent domain is used to pry the two roads apart" (p. 47).

<sup>273</sup> *Control of A. & V. Ry. and V., S. & P. Ry.*, 111 I.C.C. 161 (1926), at p. 170.

<sup>274</sup> The Commission's emphasis upon this factor is illustrated by the following: "The Terre Haute runs in the same general north-and-south direction as applicant's line . . . the lines being from 25 to 35 miles apart and on opposite sides of the Wabash River. There is no substantial competition, actual or potential, between the two. The applicant's line furnishes a natural outlet for the products transported by the Terre Haute, the two forming a continuous route." *Stock Control of E., I. & T. H. Ry. by C., C., C. & St. L. Ry.*, 67 I.C.C. 513, 514 (1921). "The Norfolk's railroad does not parallel or compete with that of the Pennsylvania. For many years the companies have been affiliated and have interchanged and moved traffic as one system." *Acquisition of Control of N. Y., P. & N. R. R. by P. R. R.*, 70 I.C.C. 299, 300 (1921). "It was testified that during the Federal Control period there was some competition between the Santa Fe and the New Mexico Central for Colorado traffic . . . but there is very little competition between the lines at present." *Control of New Mexico Central Ry.*, 111 I.C.C. 468, 470 (1926). "There is no substantial competition between the Chesapeake & Ohio and the Pere Marquette; on the contrary, the supplemental nature of their transportation functions is evident. Regarded as a single system, the Chesapeake & Ohio, Hocking Valley, and Pere Marquette would operate in competition with the Pennsylvania, New York Central, and, to a considerable extent, with the Baltimore & Ohio, between the Atlantic seaboard on the east and the Great Lakes and Michigan points on the west." *Control of Erie R. R. and Pere Marquette Ry.*, 138 I.C.C. 517, 528 (1928).

<sup>275</sup> In *Control of Virginian Ry.*, 117 I.C.C. 67 (1926), for example, the elimination of competition between the Norfolk & Western, the applicant carrier, and the Virginian, the control of which was sought to be acquired by a long-term lease, appears to have exerted great influence upon the denial of the application. In support of the denial the Commission concluded with respect to competitive relationships: "Under the proposed lease all competition between the lines of the two companies would be eliminated. Important shipping points would be deprived of competitive service. The president of the Virginian testified that the elimination of competition in rates and service would injure any town through which the two roads pass, and this conclusion is corroborated by the testimony of the protestants" (p. 85). But this factor may well be offset by other considerations. Thus: "If it be conceded that the two railroads are, to some extent, parallel and competing, we are of opinion that fact should not control our action in this proceeding." *Control of International-Great Northern R. R.*, 90 I.C.C.

like consideration, with similar results, was accorded to evidence of probable disruption or preservation of existing channels of trade.<sup>276</sup> Nor was the influence of these factors restricted to their bearing upon outright approval or disapproval of applications. In a considerable number of instances the Commission also utilized its power to pre-

262, 267 (1924). Again: "While there is admitted to be some competition between sections of the lines of the L. & A. and of the L. R. & N. . . . it is believed that it is not so extensive as to offset the advantages which will result from the proposed unification." *Control of Louisiana & A. Ry. Co.*, 150 I.C.C. 477, 487 (1929). Indeed, proposals were approved which involved such suppression of competition as had previously been condemned under the anti-trust laws. See note 227, *supra*, for the Commission's determinations in *Control of Central Pacific by Southern Pacific*, 76 I.C.C. 508 (1923), and in *Control of D., S. & S. R. R. by Lehigh Valley R. R.*, 86 I.C.C. 567 (1924). Where the general competitive situation was likely to be maintained or improved, the mere lessening of local competition was not deemed to be controlling. See, for example: *Clinchfield Railway Lease*, 90 I.C.C. 113 (1924); *Control of Gulf Coast Lines by M. P. R. R.*, 94 I.C.C. 191 (1924); *Control of Louisiana & A. Ry. Co.*, 150 I.C.C. 477 (1929); *Great Northern Pac. Ry. Co. Acquisition*, 162 I.C.C. 37 (1930); and note the following from *Nickel Plate Unification*, 105 I.C.C. 425, 440 (1926): "A greater amount of actual and effective competition in service may be assured by a limited number of well-articulated systems than by a greater number of systems less complete."

<sup>276</sup> The following declarations illustrate the express recognition of this factor in the denial of applications: "The conclusion that the proposed lease would result in eliminating existing routes and channels of trade appears warranted by the record. The chief traffic official of the N. & W. testified that under unified operation of the Virginian and N. & W. the use of the Deepwater route would be discouraged, but that it would be kept open if found to be an efficient route. No reason appears why the N. & W. would be interested in maintaining a competitive through route via Deepwater, which would short haul its own traffic." *Control of Virginian Ry.*, 117 I.C.C. 67, 84-85 (1926). "We do not consider that the relationship of the Chesapeake & Ohio and the Erie is complementary or supplementary. The Erie constitutes an east-and-west connection in contrast with the northerly extension provided by the Pere Marquette. The Chesapeake-Hocking lines reaching from the seaboard to Lake Erie make contact with practically every important trunk line in eastern and central territory and are thus in position to distribute their coal both east and west over many connecting lines. Control of the Erie by the applicant would tend to disturb this structure and to disrupt existing channels of traffic to a much greater extent than would its control of the Pere Marquette." *Control of Erie R. R. and Pere Marquette Ry.*, 138 I.C.C. 517, 529-530 (1928). The maintenance of existing routes and channels of trade also exerted a distinct influence upon the approval of applications. Thus, in *Control of Central Pacific by Southern Pacific*, 76 I.C.C. 508, 518-519 (1923), in which a unification was authorized which had previously been held to be in violation of the Sherman Act, the Commission said: "The record justifies the conclusion that separate operation of the Central Pacific lines will disrupt existing routes and service in California and between that State and adjacent States, and except to the extent that the rupture may be mitigated by apportionment of particular lines and provision for the joint or coordinated use of others by the respective carriers, will render impossible the continuance of much valuable transportation service now conducted over the Central Pacific and Southern Pacific lines without regard to corporate ownership. Such separation will result to an indeterminate extent in increased cost of operation and duplica-

scribe conditions for the purpose of fashioning competitive relationships and protecting established interests. Thus, in connection with the approval of acquisitions of control of both terminal properties<sup>277</sup> and line carriers,<sup>278</sup> conditions were imposed requiring that existing routes and gateways be kept open and that neutrality in the movement of traffic be maintained.<sup>279</sup> Through these various policies and expedients, the course of piecemeal unification was molded in considerable measure from the standpoint of the railroad system as a whole, with special reference to the specific consolidation standards of preserving competition and preventing the precipitate disruption of established commercial relationships.

In conformity with the general objective of the consolidation provisions, furthermore, the Commission accorded consideration, in pass-

tion of capital investment in railroad facilities and increased cost of transportation" (pp. 518-519). Again, in *Control of Gulf Coast Lines by M. P. R. R.*, 94 I.C.C. 191 (1924), the Commission included the following among the reasons for approval: "Control of the International Company will insure the maintenance of the through route from St. Louis to Laredo, which has been established for more than 40 years" (p. 199).

<sup>277</sup> See, for example: *Chicago Junction Case*, 71 I.C.C. 631, 639-641 (1922); *Control of Chicago Heights Terminal Transfer R. R.*, 124 I.C.C. 753, 760-761 (1927); *Control by Illinois Terminal Co.*, 138 I.C.C. 487, 497-498 (1928); *Acquisition by Wabash Ry. Co.*, 154 I.C.C. 155, 162-163 (1929).

<sup>278</sup> See, for example: *Clinchfield Railway Lease*, 90 I.C.C. 113, 133-134 (1924); *Control of A. & V. Ry. and V. S. & P. Ry.*, 111 I.C.C. 161, 178-179 (1926); *Control of Columbia, Newberry & Laurens R. R.*, 117 I.C.C. 219, 227 (1926).

<sup>279</sup> The following conditions, prescribed in *Clinchfield Railway Lease*, *supra*, are typical: "3. So far as lies within the power of the applicants, existing routes and channels of trade and commerce heretofore established by other carriers in connection with the Clinchfield shall be preserved, existing gateways for the interchange of traffic with such other carriers shall be maintained, and the present neutrality of handling traffic inbound and outbound . . . shall be continued so as to permit equal opportunity for service and routing or movement of traffic which is competitive with traffic of the applicants, or either of them, to and from all connecting lines reached by the line of the Clinchfield companies, without discrimination in service against such competitive traffic. 4. The applicants shall permit the line of the Clinchfield and its subsidiaries to be used as a link for through traffic . . . equally available to such other carriers . . . as may desire to participate in through routes and joint rates . . . and shall not discriminate as to rates, fares, and charges against such participating carrier or carriers as compared with the applicants, or either of them; the intention of this provision being that the line of the Clinchfield and its subsidiaries shall be maintained as an open route equally available to all carriers connecting with the Clinchfield for traffic between the points designated" (pp. 133-134). In *Restriction in Routing between Greenwood and Augusta*, 165 I.C.C. 3 (1930), certain restrictive schedules were ordered cancelled on the ground that they violated these conditions; and in *Atlantic Coast Line R. Co. v. U.S.*, 284 U.S. 288 (1932), the Supreme Court upheld the validity of the conditions and of the Commission's order in pursuance thereof.

ing upon acquisitions of control, to the disposition to be made of short and weak roads. There can be no question that one of the major purposes of the reorganization of the railroad net contemplated by the Transportation Act was the preservation of "substantially the whole transportation system,"<sup>280</sup> the union of weak with strong lines being "one of the ends which Congress apparently had most definitely in mind";<sup>281</sup> and in accordance with this aim the problem of allocating the short and weak roads among the limited number of systems held in view has received explicit attention in the formulation of the Commission's comprehensive consolidation plan.<sup>282</sup> But this factor has also been operative in connection with the authorization of proposed acquisitions of control, despite the fact that no express power was conferred upon the Commission to make such allocations. The requirement that acquisitions must be found to be in the public interest constituted the substantive source of authority for this purpose, and the right to prescribe conditions afforded the necessary instrument for carrying this policy into effect. When the issue was first raised, the Commission, through Division 4, did not deem itself to possess the power to order the inclusion of a weak road in a projected combination as a condition of approval,<sup>283</sup> but in due course it not

<sup>280</sup> *Dayton-Goose Creek Ry. v. U.S.*, 263 U.S. 456, 478 (1924).

<sup>281</sup> *New York Central Unification*, 150 I.C.C. 278, 321 (1929); *Nickel Plate Unification*, 105 I.C.C. 425, 449 (1926). See, also, John E. Oldham, "The Problem of Railroad Consolidations," *Harvard Business Review*, vol. 1 (January, 1923), pp. 139-153; Winthrop M. Daniels, "Economic Purposes and Limitations of Consolidation," *American Economic Review*, vol. 14 (Supplement, March, 1924), pp. 43-51; Lewis H. Haney, "Advantages and Disadvantages of Railway Consolidation," *ibid.*, pp. 88-99; Bird M. Robinson, "The Relation of the Short Lines to Railroad Consolidation," *Proceedings of the Academy of Political Science*, vol. 13 (June, 1929), pp. 90-98; Walter M. W. Splawn, *The Consolidation of Railroads* (1925); James M. Herring, *The Problem of the Weak Railroads* (1929).

<sup>282</sup> *Consolidation of Railroads*, 63 I.C.C. 455 (1921), 159 I.C.C. 522 (1929).

<sup>283</sup> *Control of G. & S. I. R. R. Co.*, 99 I.C.C. 169 (1925). In this proceeding the Illinois Central, through a subsidiary, applied for authority to acquire control of the Gulf & Ship Island Railroad Company by purchasing its entire capital stock. The Fernwood, Columbia & Gulf Railroad Company, a connecting line serving in the same general territory, intervened, alleging that it was a necessary carrier dependent upon the Illinois Central and its connections for maintenance and support, and requesting "that if the proposed acquisition is authorized, provision be made in the order for the inclusion of the Columbia line and the continued maintenance of the present service" (p. 171), in order to prevent the elimination of competition and the abandonment of its line. In denying this request, the Commission said: "We have authority, and have heretofore exercised it, to impose just and reasonable conditions in connection with



only recognized the relevancy of making provision for such roads in the public interest,<sup>284</sup> but actually conditioned its approval of unifications upon compliance with the requirement that short and weak

orders issued under paragraph (2) of section 5. Even if we accept the view of the Fernwood that the provisions of the paragraphs relating to consolidation must be considered in connection with the authority granted us in paragraph (2) of section 5, in the absence of legislation authorizing or requiring compulsory consolidation we are not inclined to assert that we have authority under an application of this nature to compel an applicant to acquire and maintain a connecting road. This conclusion makes it unnecessary to consider whether such a condition would be a just and reasonable one" (pp. 172-173). It should be noted, however, that even in this proceeding conditions were imposed which were calculated to meet the situation stressed by the intervening road. After pointing out the advantages of the proposed acquisition from the standpoint of the public interest, the Commission added: "However, the public interest in this case seems to require that those shippers on the road of the Fernwood Company, who might be without means of transportation by railroad if the line of that company should cease to operate, should be given such protection as is within our power to afford in this proceeding to assure the continued operation of that line. Our order will therefore be issued upon condition that existing through routes and joint rates shall be preserved and that divisions of joint rates allowed to the Fernwood Company by the Illinois Central and the Gulf & Ship Island shall not be decreased except upon our order. It is alleged, but not proven, upon this record that the granting of this application will result in the ultimate extinction of the Fernwood as a common carrier. However, in order to meet such a possible contingency we will attach the further condition that if the operating revenues of the Fernwood Company shall at any time become insufficient to pay its operating expenses the Illinois Central, upon the request of the Fernwood Company, shall establish and maintain reasonable and adequate service over the line of the Fernwood Company, upon such terms and conditions as may be agreed upon between the parties, until such time as the Commission shall, under appropriate proceedings, authorize abandonment of such service on the railroad of the Fernwood Company" (p. 173).

<sup>284</sup> Thus in *Unification of Southwestern Lines*, 124 I.C.C. 401 (1927), in which the applications were denied, the Commission declared: "As above noted, the proposed system includes all the larger independent lines of railroad in the Southwestern-Gulf region. If this combination is made, no other major system apparently can be organized in that territory. Therefore, if we were to approve these applications it would be necessary to consider most carefully the disposition to be made of the lesser lines therein, to the end that the major systems be fully articulated and that the economic needs of the region in all its parts for transportation service be effectively met. In view, however, of the disposition which we find it necessary to make of these applications, it is deemed unnecessary to discuss further in this report the situation and contentions of the short lines" (p. 427). See, also, *Nickel Plate Unification*, 105 I.C.C. 425, 449 (1926); *Control of Erie R. R. and Pere Marquette Ry.*, 138 I.C.C. 517, 535-537 (1928); *Buffalo, R. & P. Ry. Co. Control*, 158 I.C.C. 779, 790 (1930). In the last of these proceedings the Commission's approval of the proposed acquisition of control was actually conditioned upon agreement by the applicant to accept such findings as the Commission might subsequently make with respect to the treatment to be accorded to an intervening short line: "The record does not justify any conclusion regarding the retention or disposition of any portion of the intervener's line. It raises the presumption, however, that if the circumstances warrant continued operation of the intervener's line or any part thereof, such operation should be conducted by the B., R. & P. . . . Our

lines be acquired by the applicant carrier.<sup>285</sup> As a guiding standard in this sphere the Commission declared that "every applicant should assume the burden of making reasonable provision in its plan for the possible incorporation of every connecting short line now in operation in the territory covered or to be covered by the proposed grouping or unification," and that "no branch line or short line now in operation within the territory in question should be left out of the consideration unless by affirmative testimony the abandonment of operation of such line or its omission from the plan has been justified."<sup>286</sup> While the

approval of the application will therefore carry as a condition precedent that the applicant shall agree and undertake to abide by such findings as we may hereafter make with respect to the taking over or operation of the intervener's line, or both, or such findings as may be made in an ancillary proceeding or arbitration, if that course shall be found by us to be suitable, and the record will be held open for such supplementary proceedings as may be found necessary to that end. Our order will accordingly not become effective until such agreement and undertaking is filed with us" (p. 790).

<sup>285</sup> The most definite exercise of this power, for the purpose of securing the inclusion of intervening short lines in proposed acquisitions of control, is to be found in *New York Central Unification*, 150 I.C.C. 278 (1929). In this proceeding the proposal of the applicants was held to be in the public interest only upon compliance with a condition looking to the acquisition of certain specified short lines found to be "required by public convenience and necessity and for the maintenance of an adequate transportation system" and shown "to be complementary to and properly apportionable to the New York Central system." Said the Commission: "We . . . find that our authorization of the unification herein proposed should be upon the express condition that before said leases become effective, the New York Central shall offer to acquire the lines of the Alpena, the lines of the Attica, the line of the Federal Valley, the steam railroads of the Fonda, that part of the Owasco's properties hereinbefore referred to as the southern segment, and the lines of the Ulster, for considerations equal to the commercial value of the respective properties as determined by agreement between the parties, or by arbitration in the manner prescribed in said leases for valuation of minority shares of stock of the lessors, and hereafter approved by us . . ." (p. 322). The entry of an order of approval and authorization was deferred until a proper showing of compliance with this condition should be made, the Commission expressly reserving the right to determine the question of *bona fide* compliance; and such showing having been made, the acquisitions of control originally found to be in the public interest were approved and authorized. 154 I.C.C. 489 (1929). Of similar tenor, though less concrete in character, was the requirement, in *Great Northern Pac. Ry. Co. Acquisition*, 162 I.C.C. 37 (1930), that as one of the conditions precedent to the findings of public interest in that proceeding, the applicants submit "a bona fide and feasible plan for the acquisition and operation of the so-called short lines of railroad named in system No. 12 of the consolidation plan, except such thereof as may be found . . . upon this record or from a subsequent showing, not to be required by the present or future public convenience and necessity" (pp. 69-70).

<sup>286</sup> *Nickel Plate Unification*, 105 I.C.C. 425 (1926), at p. 449. See, also, *Control of Erie R. R. and Pere Marquette Ry.*, 138 I.C.C. 517, 535 (1928); *New York Central Unification*, 150 I.C.C. 278, 321 (1929).

conditions imposed were confined to the inclusion of intervening short lines found to be necessary,<sup>287</sup> and while the hesitancy of the Commission to take positive action toward fashioning the course of unification along desirable channels, through a more liberal resort to conditional authorizations, evoked criticism and dissent from within its own ranks,<sup>288</sup> it is questionable whether there was sufficient war-

<sup>287</sup> In *New York Central Unification*, *supra*, for example, only 9 of the 71 short-line connections of the New York Central system intervened, and the Commission's consideration and subsequent action were restricted to these intervening lines. In disposing of the general short-line situation, the Commission said: "We assume that the 62 short-line carriers whose railroads connect with the New York Central lines, but which have not intervened herein, and those parts of the public served by those carriers, are content, for the present at least, with existing conditions. These carriers will therefore be dismissed from further consideration at this time" (p. 295). The only declaration affecting these other carriers looked to the future. The conditional approval of the unification (see note 285, *supra*) was accompanied by the added proviso "that acceptance of and compliance with the conditions precedent herein prescribed shall not be interpreted as relieving the New York Central from the further operation of the law respecting consolidations or as excusing that carrier from further responsibility for the representation made on its behalf that on appropriate occasion for considering the inclusion of so-called short-line railroads, these matters will be approached by the New York Central in a spirit of cooperation looking to their solution with all due regard to the public interest" (p. 322). It should be observed, furthermore, that the method of conditional authorization was not followed in all instances even with respect to connecting short lines which intervened and made a showing of need for their service and of benefit to be derived from their inclusion. Note the following, for example, from *Control of C., I. & W. R. R.*, 124 I.C.C. 476 (1927), at pp. 479-480: "The petition of intervention of the Chicago, Attica & Southern Railroad Company . . . which was filed at the hearing, recites that one of the purposes if not the main purpose and intent of Congress in the enactment of section 5 of the act was to bring about the absorption of the small and weak railroads of the country into the large and powerful railroad systems in order that adequate transportation facilities might be furnished to the people of the United States as a whole, that it is of the type of railroad generally classed as a small and weak line, and that it connects with the C., I. & W., and is directly and vitally interested in any plans or proposals to unify or consolidate the C., I. & W. with any other railroad or system. Evidence was submitted to show the benefits that would accrue to the carriers and shippers directly involved, and to the public generally, if the Attica were included within the Baltimore & Ohio system. The intervener contends that the applicant has failed to sustain the burden of proof cast upon it in this proceeding by reason of its failure to make provision for the inclusion in its plan, under fair and reasonable terms, of the Attica and other short lines and request is made that either the application be denied because of this fact or the record be held open for a reasonable time to afford the applicant an opportunity to amend its application so as to provide for inclusion of the short lines. The acquisition of control of the C., I. & W. would seem to be in line with the purpose of the law as stated by the intervener. It does not necessarily follow, however, that we should withhold our approval of this acquisition, which we find to be in the public interest, in order to require the applicant to take over an additional weak line."

<sup>288</sup> In *Unification of Southwestern Lines*, 124 I.C.C. 401 (1927), for example, both Commissioner Meyer and Commissioner Lewis based their dissents, in part, upon the

rant for a more sweeping policy. A more vigorous insistence upon the disposition of short lines in connection with acquisitions of control would probably have been premature and futile. Not only was the general allocation of them dependent upon the complete plan of consolidation which was not yet available, but the power to compel the acquisition of weak roads or to require acceptance by them of terms which they might deem objectionable was entirely lacking. Since the Commission desired to permit and encourage proposed unifications

undesirable effect of the outright denial of the applications upon solution of the weak road problem in the territory involved. Commissioner Meyer said: "The basis for treatment of weak lines as proposed by applicants in their final submission is adequate. The public interest in this feature of the case is fully protected. Every weak line connecting with the proposed system can be fairly dealt with on the basis of applicants' undertaking. One of the chief advantages of the grouping of railroads is to provide means of preserving those weak lines which in the public interest should be kept in service. In fact, one of the regrettable features of the complete rejection of these applications is the resulting inability to bring immediate relief to the Missouri & North Arkansas Railway. These applicants . . . have bound themselves to assume the obligation to continue the operation of this and all similarly situated weak lines assignable to them. . . . Facts like these are sufficient to suggest that the proposed treatment of weak lines by the applicants can not be a valid reason for denying the applications" (p. 443). And even more pointedly, Commissioner Lewis said: "If there were no other reasons for keeping hold of this situation, now that it is in our hands, we should do so to avail ourselves of the stipulation of applicants that they are willing to assume their part of the weak line burden by accepting and bringing into their group those roads which we may allocate to them. Forty of the 58 short and weak lines enumerated above connect with the three roads involved in these applications. Why, when we have this offer and also the expressed willingness of the applicants to listen to our advices on any defects which our considerations may reveal, should we do the negative thing?" (p. 446). Note the following, also, from the dissenting opinion of Commissioner McManamy in *New York Central Unification*, 150 I.C.C. 278 (1929), even in face of the fact that the authorization was conditioned upon affording certain intervening lines an opportunity to be included in the combination: "My third objection is to the complete disregard which is shown throughout this record for the welfare of the short-line connections. The applicants contend that this is not an appropriate occasion for considering the inclusion of any so-called short-line railroads, and nowhere in the record is it indicated when such an appropriate occasion might arise. . . . My conception of what the Congress had in mind when it included in the transportation act the provision for the consolidation of railroads is that systems of railroads should be created which would adequately serve all of the territory properly tributary to each system which would necessarily include connecting short lines. Certainly Congress did not reverse public policy to the extraordinary extent of exempting railroads from the provisions of the antitrust laws and other restrictive laws merely to make it possible for the large and strong systems to consolidate, thereby making the strong stronger and the weak helpless. . . . The record shows that connected with the New York Central Lines are 72 short-line railroads in varying degrees of prosperity, yet their welfare has been disregarded, and consideration is not to be given them until some time in the very indefinite future. It is true the majority have required that consideration be given to certain short-line interveners, but, to my mind, that does not meet the needs of this situation" (pp. 327-328).

which, without substantial destruction of competitive processes or serious disruption of trade relationships, promised to result in the achievement of economies and the improvement of service, it was reluctant, except in very clear cases, to introduce restrictions which might jeopardize progress in this direction. On the whole, in light of the problematical character of the ultimate consolidations and the questionable need for many of the short lines, the Commission's attitude of restraint was not without adequate justification.

Finally, because they affect the public interest, the financial arrangements accompanying proposals for control were deemed relevant to the disposition of applications, under the statutory authority to approve acquisitions for such consideration and on such terms and conditions as are found to be just and reasonable. In asserting this jurisdiction, the Commission not only passed upon the propriety of the consideration from the standpoint of the burden placed thereby on the applicant, but upon the reasonableness of the adjustment as between the parties involved and the effect of the resulting financial structure upon the exercise of control of the unified system. The consideration approved, whether in the form of rentals for leased lines or of prices paid for stock, was not measured by property valuations determined under section 19a; while excessive rentals and unduly high prices contributed to the denial of applications for acquisitions of control through lease<sup>289</sup> or stock ownership,<sup>290</sup> the guiding standard was

<sup>289</sup> Note, for example, the following: "Although, by reason of economies in capital and operating costs, and by reason of traffic accessions resulting from unification, the Reading might, and probably would, be able to increase its net income, we do not regard the payment of such a high price for control of the Lehigh & New England as in the public interest. It is proposed to surrender to the owners of the leased property a large proportion of the financial benefit which the consolidation plan contemplates should accrue to the carriers for the benefit of the public through reduced rates and improved service. The adoption of similar standards in future transactions of the kind would impose upon the carriers too heavy a burden of fixed charges." *Lease of L. & N. E. R. R.*, 124 I.C.C. 81, 94 (1927). "It will be noted that by this lease the applicant obligates itself to pay fixed charges on more than \$52,000,000 of capital obligations, thus increasing its fixed charges nearly \$2,700,000 a year, although about \$1,700,000 of this amount is now a fixed interest charge of the lessor. It may well be doubted whether this large increase in fixed charges, involving substitution of an annual fixed dividend charge of \$990,000 for a contingent dividend distribution, is in the public interest." *Control of B., R. & P. Ry.*, 131 I.C.C. 750, 753 (1927). See, also, *Acquisition by S. A. L. Ry.*, 138 I.C.C. 665, 670-671 (1928).

<sup>290</sup> Thus, in *Control of Dayton-Goose Creek Ry. by N. O., T. & M. Ry.*, 72 I.C.C. 377 (1922), where the proposed consideration of \$925,000 for the purchase of the

not the value of the property for rate-making purposes, but rather, in most instances, the market value to the lessee of the facilities acquired,<sup>291</sup> or some reasonable approximation to the market value of the securities purchased.<sup>292</sup> In this way, by recognizing that voluntary combinations can be effectuated only by flexible adherence to a com-

stock exceeded the book value of the property by more than \$400,000, Division 4 concluded: "Aside from the question whether a carrier, in the public interest, should be permitted, in order to secure traffic from a competitor, to buy control of another at a price greatly in excess of the value of the physical property involved, the commission must be convinced that the price to be paid is a reasonable one. On this record that conclusion is not justified" (pp. 380-381). See, also, 82 I.C.C. 27 (1923), where, upon further hearing, the denial of the application was affirmed by the full Commission. But in *Control of Sewell Valley R. R.*, 138 I.C.C. 85 (1928), the Commission approved an application despite the payment of an excessive purchase price, but with restrictions upon the amount to be charged to the investment account of the applicant. This procedure appears to be entirely without justification.

<sup>291</sup> In *Chicago Junction Case*, 71 I.C.C. 631 (1922), for example, the Commission concluded "that for the purpose of this proceeding only we may accept the position of the Central that the market value of the properties to the Central and its affiliated companies at this time is such as to justify the payment of a rental based on something more than the value for capitalization or rate-making purposes" (p. 637). See, also, *Control of A. & V. Ry. and V., S. & P. Ry.*, 111 I.C.C. 161 (1926), and *New York Central Unification*, 150 I.C.C. 278 (1929), and note the following from the dissenting opinions of Commissioner Eastman in these proceedings: "The rental proposed in the case of the Alabama & Vicksburg is too high and contrary to the public interest. It amounts to 36 per cent per year upon the actual cash investment of the stockholders of that company. . . . The property has been built up out of surplus earnings remaining after the payment of generous cash dividends, and these surplus earnings have in large measure been capitalized by the declaration of successive stock dividends of 50, 100, and 100 per cent." 111 I.C.C., at p. 180. "Stating it baldly, it seems to me an indefensible anomaly that the public served should be required to pay 50 per cent dividends annually upon the stock of a road like the Michigan Central. It means requiring the public to pay 6 per cent, or some such return, upon property acquired or constructed out of surplus earnings provided by the users of the road in addition to dividends upon stock which have far exceeded limits of reasonable liberality. . . . All that the public served should in reason be required to pay the private owners of railroad and other public-utility properties is sufficient compensation to insure the faithful and efficient performance of the public service which they undertake to render, including the supply of capital necessary for the extension of the service. If, however, in times of prosperity the public is able and willing to provide earnings which are in excess of what is needed for such compensation, it ought in reason to be possible to use such earnings, either for the retirement of debt or for the extension of the plant, in such a way that the burden upon the public for the future will be decreased or in any event will not be increased." 150 I.C.C., at pp. 324, 325. It should be noted that these strictures were really directed to the character of the Commission's valuation standards, rather than to the use of market value, in the absence of adequate valuation data.

<sup>292</sup> See, for example, *Control of Gulf Coast Lines by M. P. R. R.*, 94 I.C.C. 191 (1924); *Control of Ann Arbor R. R. by Wabash Ry.*, 105 I.C.C. 43 (1925). Note, also, the following from *Unification of Southwestern Lines*, 124 I.C.C. 401, 431-432 (1927): "As the prices paid for the several blocks of stock . . . were close to the prices

mercial basis of interchange of rights,<sup>293</sup> the Commission facilitated acquisitions of control which appeared, on the whole, to promise public advantage. But in judging the propriety of the financial arrangements, attention was also directed to the character of the adjustments as between the parties concerned, and particularly to the treatment accorded to minority holdings. The Commission declared that the terms and conditions which it finds to be just and reasonable must "include proper provisions for the protection of minority interests."<sup>294</sup> Where the dealings were consummated at arm's length, there was no disposition to question the proposed terms;<sup>295</sup> similarly, the applicant's willingness to hold its offer open to minority interests on the same terms as those accepted by the majority,<sup>296</sup> or the inclusion of provisions for

current at the times of purchase, and it is well known that large blocks of stock carrying a measure of corporate control usually sell somewhat above the market, we do not regard these prices as necessarily excessive."

<sup>293</sup> While the Commission was critical of excessive payments to bankers and the realization of large private profits in connection with the acquisition of stock for purposes of control, these factors did not result in the denial of applications. See, for example, *Control of Gulf Coast Lines by M. P. R. R.*, 94 I.C.C. 191, 199-201 (1924); *Control of Erie R. R. and Pere Marquette Ry.*, 138 I.C.C. 517, 531-532 (1928); 150 I.C.C. 751, 754-755 (1929).

<sup>294</sup> *Unification of Southwestern Lines*, 124 I.C.C. 401, 434 (1927).

<sup>295</sup> At an early date the Commission's approach was explicitly set forth as follows: "In passing upon an application by a carrier for authority to acquire control of another carrier by the purchase of its stock, we are called upon to consider whether the transaction is one into which the applicant should be permitted to enter, having in mind the terms and conditions of the proposed bargain and their effect upon the ability of the carrier to serve the public. We may inquire whether the consideration to be paid by the applicant is fair and reasonable, to the end that the assets of the applicant be not wasted or its credit impaired so as to jeopardize its ability to perform its public functions. In a case involving dealings between two corporations under common control, we may even, perhaps, scrutinize the proposed transaction to determine whether the bargain is fair from the standpoint of protesting minorities. But where the transaction is between a carrier and individuals who are dealing with the carrier at arm's length and are presumably capable of determining their own best interests, we do not think that the interstate commerce act requires us to do more than to determine whether the transaction will be in the public interest, having in mind, as above indicated, the consideration to be paid by the carrier and the terms and conditions of the transaction. So here, we are not called upon to decide any question as between the applicant and stockholders of the Big Four, except whether the former may, consistently with its obligations to the public, pay the price proposed to be paid to such of the latter as may be willing to sell at that price." *Control of Big Four by New York Central*, 72 I.C.C. 96, 97-98 (1922). See, also, *Proposed Control of S. N. by W. P. R. R.*, 99 I.C.C. 382, 383-384 (1925).

<sup>296</sup> Thus: "Whether all stockholders of the carrier were afforded an opportunity to participate in the contract with the applicant does not affirmatively appear, but the applicant states that it proposes to acquire additional stock from time to time at not exceeding par [the price stipulated in the contract] and there has been filed with us a

the acquisition of minority interests upon terms to be determined by impartial arbitration,<sup>297</sup> was recognized as evidence of fair dealing.<sup>298</sup> When, however, by reason of interlocking directorates or other communities of interest, the terms were largely set by the group seeking to acquire control, without independent negotiation by those representing the lines to be acquired, the Commission subjected the proposals to careful scrutiny, and, even upon finding the projected unification to be in the public interest from the standpoint of the transportation service, denied the application.<sup>299</sup> Such denial was grounded, furthermore, in improper distribution of controlling au-

verified copy of a resolution of the applicant's executive committee authorizing the purchase, at par, of any stock of the carrier tendered to the applicant within 60 days after favorable action by us herein." *Control of Cisco & Northeastern Ry.*, 117 I.C.C. 447, 448-449 (1926). See, also, *Consolidation of D., T. & I. and D. & I. R. R.*, 124 I.C.C. 145, 157-158 (1927).

<sup>297</sup> Thus: "The provisions of the proposed leases for the purchase of minority stock at values determined by bona fide arbitration appear to furnish adequate means for equitable adjustment of grievances of dissatisfied minority stock holders." *New York Central Unification*, 150 I.C.C. 278, 320 (1929). See, also, *Great Northern Pac. Ry. Co. Acquisition*, 162 I.C.C. 37, 45 (1930).

<sup>298</sup> It should be noted that the Commission itself sometimes provided such safeguards. In *Acquisition by Central R. R. Co. of N. J.*, 145 I.C.C. 279, 280 (1928), for example, the Commission declared: "The acquisition of 1,707 shares of stock by the applicant as sought herein will leave outstanding a small minority, concerning which the applicant now has no definite plans. Our order herein will provide that within 30 days from the date thereof the applicant shall notify the minority stockholders that it will purchase their stock at any time within six months after said date at the same price paid for the stock herein authorized to be acquired, namely \$60 per share."

<sup>299</sup> The outstanding proceeding of this character is *Nickel Plate Unification*, 105 I.C.C. 425 (1926). The fact that, because of interlocking directorates and perfunctory corporate procedure, "the boards of the Chesapeake and the Hocking appear to have acted as boards of ratification rather than authorization and direction" (p. 446) in approving the proposed ratios of stock exchange was a leading factor in the denial of the application. For the details as to this community of interest and absence of independent action, see note 155, *supra*. Said the Commission: "With respect to the reasonableness of the proposed terms of stock exchange, the applicants state that 'those considerations, terms and conditions, were not arrived at, nor could they have been arrived at, by the use of a mathematical formula. Nor may the justness and reasonableness thereof be made the subject of any process of exact demonstration.' But it is evident from the record that inadequate consideration was given to the terms from the viewpoint of the stockholders of the Chesapeake and Hocking. The president of those two companies was not asked to submit any information or figures bearing on the matter while the plan was under consideration, and had no part in fixing the terms beyond a few general suggestions as to the factors to be considered. He first learned of the proposal from the newspapers and voted to approve it without change. Other directors acted principally on the basis of the balance sheet and income account annexed to the plan and a general inspection of railway and financial manuals and annual reports. They could produce no memoranda or data actually considered by them or by the re-



thority among the interested parties—that is, it was based upon disapproval of the concentration of control of vast properties in the hands of those responsible for but a small proportion of the aggregate investment.<sup>800</sup> In this way the course of combination was pro-

spective boards although data used by the Erie and Pere Marquette boards were produced" (pp. 445-446). Again, in *Unification of Southwestern Lines*, 124 I.C.C. 401 (1927), the fact of existing control and its relationship to the treatment of minority interests were likewise influential in the denial of the application. On the matter of control the Commission concluded: "It thus appears that the K. C. Southern dominated the other carriers of the proposed system before its application was filed. We doubt that such preliminary ascendancy was necessary or conducive to the fixing of equitable terms of union. If a project to unite two or more carriers is fair in its provisions and appears to be to the advantage of all of them it should not be necessary that one be put in a dominant position before applying to us for authority to acquire control of the others. It would also seem that whether a project of this kind is fair and of mutual advantage ought to be considered both by the directors and by the stockholders of the corporations concerned unaffected by any relation of control or ownership possessed by one of those corporations" (pp. 429-430). And more concretely, on the matter of minority interests, the Commission said: "The proposed plan of control affords no proper protection to the minority stockholders of the M-K-T and Cotton Belt. If the applications are approved it will be in the power and to the interest of the K. C. Southern to discriminate against the other two carriers. . . . The danger to minority stockholders from the effective control of one carrier by a competing carrier through ownership of voting stock of the controlled company is a very real danger, especially if the holdings of minority stockholders are large, as in this case. The K. C. Southern having control of the M-K-T can divert traffic from that road to its own, as hereinbefore indicated. If it owns only a little over half of the outstanding voting stock of the M-K-T, it will be greatly to its advantage to draw business away from the latter at all junction points and in other territories where the roads compete. In like manner the M-K-T, if it obtains control of the Cotton Belt, can divert traffic from that road to its own, and if it owns less than the entire capital stock of the Cotton Belt it will be to its advantage, and to the advantage of the K. C. Southern, as the owner of the majority of its stock, to divert business from the Cotton Belt. These diversions of traffic may be greatly to the detriment of the minority holders of stock of the M-K-T and of the Cotton Belt who do not have large holdings of the stock of the respective controlling corporations. It is also within the power of a controlling company to injure a controlled carrier by permitting the deterioration of its property or service. By these methods the price of stock of the controlled carrier can be depressed and its acquisition by the controlling carrier or its stockholders facilitated" (pp. 432, 433). See, also, *Consolidation of D., T. & I. and D. & I. R. R.*, 124 I.C.C. 145, 151, 157 (1927); and compare *Control of Erie R. R. and Pere Marquette Ry.*, 138 I.C.C. 517, 531-534 (1928).

<sup>800</sup> Thus: "We can not escape the conclusion that the plan was arranged with the intention of keeping control in the hands of its proponents even though their interest is a minority one in fact. Such an arrangement is not in accord with sound railroad practice. The Nickel Plate is the only railroad of importance in the country in which preferred stockholders do not have the right to vote, and now it is proposed to extend this feature to over \$155,000,000 of new stock of a company comparable with the New York Central, Pennsylvania, and Baltimore & Ohio. The common stock of the new company will not greatly exceed \$174,000,000 out of a total capitalization of over \$950,000,000. We believe it to be self-evident that the public interest requires that the

tected against unsound practices in organization and finance, at least in their more flagrant forms. But even these factors—the protection of minority interests against exploitation, and the protection of the transportation systems against minority domination—merely operated to prevent undesirable unifications, instead of leading to the prescription of such terms and conditions as might be deemed to be in the public interest. Affirmative action, particularly in the adjustment of conflicts between various groups of stockholders, would have involved such onerous tasks in the delimitation of private rights as to

entire body of stockholders of a railroad which is bonded in excess of one-half of its investment, and not a powerful few, shall be responsible for its management. This can be done only by giving them the power to control the management. The lethargy of ordinary stockholders in exercising their power to control the management of these large corporations has often been commented on, but nevertheless the power should be in their hands to use as they see fit. It is inimical to the public interest to strip stockholders of their voting power, thus rendering it so much easier to control a great transportation system by a comparatively limited amount of investment." *Nickel Plate Unification*, 105 I.C.C. 425, 444 (1926). Again: "If one carrier is to control another there should be a reasonable and proper proportion between them. The burden assumed by the dominant corporation should be commensurate with its resources. There is something incongruous in the control by one carrier of another having more than three times its mileage and more than twice its resources, and when there is added indirect control of a third carrier, also larger than the controlling corporation, the incongruity and lack of proportion is accentuated. We can not look with favor upon such control, especially when effected largely by the use of the credit of the controlled carriers and when the preexisting obligations of the controlling carriers are such as to suggest the impropriety of its assuming additional financial burdens. . . . But even if the K. C. Southern were financially able to acquire and maintain control of the M-K-T and through the latter of the Cotton Belt, the control of properties so large by such a relatively small amount of capital is not in the public interest. . . . About \$25,500,000 par of its common stock could effectively control the company, and the market value of this amount of stock [on the day of the close of the hearing] . . . was less than \$11,000,000, or less than 11 per cent of the market value of all the stock of the three companies, about 7.2 per cent of the total value of the stock if the M-K-T adjustment bonds should be converted, and less than 2 per cent of the aggregate amount of their book assets. This seems too small a base upon which to build such a financial pyramid. Concentration of control within proper limits may be a necessary incident of the grouping of railroads into a limited number of systems. There is, however, a limit to the extent to which it properly may be carried. As we view it, that limit is reached before the concentration has progressed to the extent of 1 to 50. There are too many possibilities of the misuse of power lodged in the hands of a small group of stockholders whose financial interest in the enterprise may be very small in comparison with the enormous assets under their control. However worthy of trust the persons now seeking to acquire this control may be, their successors may not be so worthy. The possibilities of exploitation of the carrier and the use of its resources for the personal benefit of those controlling it is obviously increased as the disparity between the investment representing control and the aggregate assets controlled increases." *Unification of Southwestern Lines*, 124 I.C.C. 401, 437-439 (1927).

divert the Commission unduly from the performance of its public duties;<sup>801</sup> and this practical consideration, coupled with the importance of flexibility in the furtherance of voluntary combinations, was properly deemed controlling, despite the vigorous protests of some members of the Commission.<sup>802</sup>

Viewing the complex of administrative activities as a whole in this

<sup>801</sup> The most striking expression of this negative attitude is to be found in *Nickel Plate Unification*, 105 I.C.C. 425 (1926). Although the applicants not only conceded that the Commission possessed authority to pass upon the financial arrangements, but requested that it indicate, particularly with references to the ratios for exchange of stock, what it deemed to be just and reasonable, the Commission declined to do so. Nor was it content to point to the inadequacy of the record for this purpose; it declared unequivocally that "the burden of ascertaining or determining proper ratios of exchange" should not be cast upon it: "If all the stockholders are impartially represented in the preliminary discussions they should be able to reach an agreement which can secure the approval of substantially all of the stockholders. If all the stockholders of the Chesapeake and Hocking had been represented by independent negotiators, the transcript of these hearings would read differently and our findings would be different. The burden is upon applicants to justify the justness and reasonableness of the ratios of exchange. We should not be expected to do more than ascertain that fact upon the record. We should not be expected to arbitrate to the fraction of a share just what each stockholder should receive. Many similar applications will probably be filed in the future and if all of these applicants, like the instant one, should request us to adjudicate their differences in the commercial aspects of buying and selling railroad properties, the law would probably become unworkable. We can not undertake, at the request of parties, virtually to trade in several hundred thousand miles of railroads and at the same time perform our legitimate duties under the law" (p. 448). See, also, *Unification of Southwestern Lines*, 124 I.C.C. 401, 434 (1927).

<sup>802</sup> Note the following, for example, from the dissenting opinion of Commissioner Lewis in *Nickel Plate Unification*, 105 I.C.C. 425 (1926), at pp. 451-452: "This proceeding is brought under paragraph (2) of section 5. That section provides that the commission shall be authorized by order, to approve and authorize such acquisition as is found to be in the public interest 'under such rules and regulations and for such consideration and on such terms and conditions as shall be found by the commission to be just and reasonable.' Have we gone thus far? There certainly arise grave doubts as to whether this administrative body, having at most only quasi-judicial power, should attempt to set itself up as a court of equity to pass on various individual claims that arise in consolidation proceedings. But this body is competent and equipped to appraise, and to indicate what it would consider to be 'just and reasonable terms and conditions' even as between various groups of security holders. It would certainly be within the scope of its proper activity to indicate what would bring the proposal, found to be in the public interest, into line for its approval. . . . Proponents of the consolidation will be entirely free to renew their petition after such revision as they may think meets the objections on which denial is based. It would, however, be much better, it seems to me, for us to retain control of the matter and to lead the way to the realization of those things which we find meet the definitions of public interest set up by Congress in its declaration of a national railroad policy." See, also, the dissenting opinions of Commissioners Meyer, Lewis, and Woodlock in *Unification of Southwestern Lines*, 124 I.C.C. 401 (1927), at pp. 441-447.

sphere, it appears that while the Commission proceeded with undue liberality in acquiescing in consolidations effectuated independently of its authority and in approving of acquisitions of control which amounted to virtual consolidations in advance of the maturation of its comprehensive plan for the distribution of the roads into a limited number of systems, it consistently sought to safeguard the public interest in such unifications, largely along the lines contemplated by the consolidation provisions and in general furtherance of the purposes of its tentative determinations in execution thereof. It was impressed with the importance of achieving economies and improving service, and was willing to accede to such sacrifice of local competition as appeared necessary for attaining these ends; it was guided by the Congressional purpose of maintaining competition as fully as possible and existing channels of trade wherever practicable, and imposed conditions designed to safeguard established commercial and transportation relationships of significant character; it denied applications which ignored the preservation of needed short and weak lines, and approved others, when feasible, upon condition that reasonable provision be made for such lines; it scrutinized the financial arrangements incident to the execution of proposed combinations—approving those which imposed no undue burdens upon the transportation system and accorded equitable treatment to all the parties concerned, modifying others by conditional authorizations, and condemning such terms and expedients as clearly jeopardized minority interests and involved unsound corporate structures. The Commission's frequent failure to resort to affirmative action by prescribing specific arrangements in lieu of those which it found objectionable—that is, its practice, in connection with the denial of applications, of enunciating general principles and relying upon the initiative and ingenuity of the proponents of unifications to translate these principles into workable arrangements with respect to weak roads, dissenting stockholders, and financial organization—was grounded in the practical necessities of the situation, as influenced both by administrative difficulties and the demands of flexibility in furthering the program of voluntary combinations. These circumstances, coupled with the separate statutory provision for consolidations into single systems for ownership and operation and the Commission's own delay in promulgating a

comprehensive plan for effectuating such consolidations, were largely responsible for the absence of a greater measure of positive governmental direction in the field of acquisitions of control.

### *Consolidations*

The statutory provisions for the consolidation of railroad properties into a limited number of systems on the basis of a predetermined plan were regarded, at the time of their enactment in 1920, as a very important part of the new national transportation policy; yet, in the long interval which has elapsed since the passage of the Transportation Act, practically no consolidations have been effected under these provisions. While many carriers have unified their properties, through purchase of assets and acquisitions of control, into what have been virtually single systems for ownership and operation, both without the Commission's sanction and with its approval under other sections of the statute, the authorization of technical consolidations, in furtherance of the contemplated complete plan and in conformity with the expressly prescribed standards, still remains a matter largely for future consideration. Under these circumstances our analysis and appraisal of the Commission's activities in connection with "consolidations" must necessarily be restricted to a survey of its policies and processes in the preparation of the comprehensive plan which it was directed to formulate.<sup>808</sup>

That this plan was intended to contribute to the preservation of weak roads, the simplification of rate making, and the improvement of credit conditions, as well as to the achievement of economies, is clearly indicated by the legislative standards prescribed for the Commission's guidance. Thus, it was stipulated that "the several systems shall be so arranged that the cost of transportation as between competitive systems and as related to the values of the properties through which the service is rendered shall be the same, so far as practicable, so that these systems can employ uniform rates in the movement of competitive traffic and under efficient management earn substantially the same rate of return upon the value of their respective railway properties." Furthermore, no abandonment of the competitive principle

<sup>808</sup> Sec. 5, pars. (4) and (5).

was contemplated, nor were vested interests and prevailing relationships to be ignored; it was provided that not one system, but a limited number of systems, be established, that competition be preserved as fully as possible, and that wherever practicable existing routes and channels of trade and commerce be maintained. After agreement by the Commission upon a tentative plan conforming to these standards it was required to "give the same due publicity," and upon reasonable notice, to "hear all persons who may file or present objections thereto"; and upon conclusion of these hearings it was to adopt and publish a consolidation plan, but with authority "at any time thereafter, upon its own motion or upon application, [to] reopen the subject for such changes or modifications as in its judgment will promote the public interest."

To facilitate the preparation of the tentative consolidation plan, the Commission directed Professor William Z. Ripley of Harvard University to determine and propose to it a grouping of the roads by way of execution of the statutory requirements; and on August 3, 1921, upon completion of his report, the Commission published its tentative plan for consolidation of the railroads into nineteen systems.<sup>304</sup> It is beyond the scope of this study to undertake an analysis of the specific groupings proposed, but the general principles followed in interpreting and applying the legislative mandate constitute a significant expression of the controlling considerations. Although the Commission's plan departed in some particulars from Professor Ripley's proposals, it was accompanied by no independent declaration of policy;<sup>305</sup> accordingly, the nature of the Commission's approach in this initial step toward furthering consolidations must be gathered from the analysis contained in the Ripley Report.<sup>306</sup>

Professor Ripley, properly viewing his efforts merely as a preliminary step in the formulation of a consolidation plan, confined his attention to the larger steam roads; although he recognized the impor-

<sup>304</sup> *Consolidation of Railroads*, 63 I.C.C. 455 (1921).

<sup>305</sup> In referring to Professor Ripley's report, the Commission merely said: "In some respects our tentative plan does not follow his recommendations, but presents alternatives thereto for like consideration. We indicate the main differences. We have sought to minimize dismemberment of existing lines or systems." *Ibid.*, p. 455.

<sup>306</sup> This report, comprising some 200 pages and including statistical tables and maps, was added as an appendix to the Commission's report. *Ibid.*, pp. 465-660.

tance of the lesser properties which were left unassigned, he felt that further study, based on more adequate data, would be necessary for their eventual allocation.<sup>807</sup> Similarly, although he regarded "the adoption of a comprehensive policy as to terminal ownership, operation, or both" as indispensable to effective consolidation, he made no recommendations "as to particular terminal remedies," merely assuming that free and untrammelled utilization of terminals, on the basis of due compensation, "will be somehow provided."<sup>808</sup> With the scope of the undertaking thus delimited, he conceived of the task as affording "a unique opportunity for the evolution of a comprehensive plan for the development of national resources," unhampered by the "purely temporary or personal considerations of advantage or profit" which had so often in the past determined the location of the railroads.<sup>809</sup> But his approach was predominantly realistic, despite the fact that he deemed himself free to suggest "an ideal layout," disregarding adverse judicial decisions under preëxisting legislation, assuming the feasibility of effecting necessary readjustments in capitalization, and encouraging the development of alternative routes and gateways in order that concentration and congestion might be reduced.<sup>810</sup> He recognized that statistical data and "seductive maps" might give an appearance of symmetry which would be grossly misleading, that the effects of dismemberment and realignment of properties and of disturbance of existing traffic relationships could not be predicted with accuracy, and that the distinction between financially strong and financially weak roads, under the dynamic conditions of the post-war milieu and the impact of the new governmental policies, was highly uncertain.<sup>811</sup> To this practical view of the situation may be attributed his unwillingness to estimate the savings which would result from an increase in the scale of operations or a more intensive use of investment, as well as his desire to minimize the dismemberment of established systems, with its resulting difficulties in corporate organization and finance and in the utilization of existing physical instrumentalities.<sup>812</sup> The creation of systems of continental scope—"reaching, that is to say, clear across the country,

<sup>807</sup> *Ibid.*, p. 479.

<sup>809</sup> *Ibid.*, p. 484.

<sup>811</sup> *Ibid.*, pp. 478-479, 481-482.

<sup>808</sup> *Ibid.*, pp. 483-484.

<sup>810</sup> *Ibid.*, pp. 482-483, 484.

<sup>812</sup> *Ibid.*, pp. 644-645, 635.

from east to west, and from Canada to the Gulf"—which had been suggested as a means of providing the required competitive balance, was rejected in favor of the establishment of systems which would compete within defined territories. The latter policy was adopted because of the greater operating and administrative efficiency of the smaller and more compact systems, especially in view of the peculiar characteristics of particular regions and the need "that correspondence be maintained between the scope of these railroad systems and the long-standing rate-making areas and statistical divisions which have commended themselves upon the basis of long experience to the parties concerned."<sup>813</sup> Although this approach gave rise to the problem of strict or loose application when established systems had extended their lines beyond their appropriate territories, an attempt was made "to find for them, so far as may be, a natural alignment with the other properties within each of the great territorial subdivisions"—it being kept in mind, however, that "precision must at all times be tempered by practicability," and that "an occasional lapse from system" must be deemed preferable "to corporate or traffic dismemberment."<sup>814</sup> Throughout the analysis is discernible a willingness to depart from strict adherence to the theoretical ideal and to effect practical compromises, particularly in fulfillment of some of the "discordant requirements" of the statute.<sup>815</sup>

<sup>813</sup> *Ibid.*, p. 480.

<sup>814</sup> *Ibid.*, p. 481.

<sup>815</sup> Note the following, for example: "A peculiar difficulty in effecting consolidation of strong with weak roads and of reconciling such merger with existing operating and traffic relationships, arises from the tendency of the weak roads to link up in series and to form thereby through routes extending sometimes clear across the country. . . . These various properties . . . tend to exchange more freely with one another than with the standard or strong lines. From these strong lines, which have their own routes from end to end of each territory, they are naturally excluded, so that they are more or less compelled to associate with one another in the formation of what may be called substandard routes. . . . Furthermore, these smaller subnormal properties oftentimes serve as the natural arms or extensions of the larger companies, which by reason of a paucity of feeders, are forced to rely upon such association. . . . Under such conditions, the mandate of the statute, to preserve 'as fully as possible and wherever practicable' such traffic associations, impels one of necessity toward consolidation of a number of equally substandard roads. Conformity with the other mandate of the statute by seeking to ally strong and weak properties to a like degree, thus threatens to upset the traffic relationships which have become customarily established by force of circumstances. It is because of the clash between these at times discordant requirements, that the emergent result is so often a piebald compromise." *Ibid.*, p. 482.



The three fundamental requirements—that competition be preserved, that existing routes be maintained, and that earning capacity be equalized—were treated as of parallel importance, but the traffic and operating phase of the problem, grounded in basic economic factors, was recognized as a more fruitful starting-point than primary emphasis upon financial considerations.<sup>816</sup> On this basis, twenty-one systems were proposed, developed along regional lines,<sup>817</sup> but with

<sup>816</sup> The nature and significance of this approach appear from the following: "Without having regard to the fundamental principle involved, both in consolidation and the new statutory rule of rate making, it might appear that these several requirements were stated in the order of their importance; in other words, that the element of financial strength was less significant than the preservation of competition and of the existing traffic routes. But having due regard to the matter in its larger practical aspects, it is evident that any plan adopted will not only be a mere paper plan, ineffectual and futile, but that it will fail to conform to the spirit of the act, unless the financial requirements be given equal weight with those of operation and traffic. For the plan will never be put into effect unless a financial motive for consolidation be afforded; and unless it is put into effect, a positive bar to the attainment of uniform reasonable rates, under which all the carriers alike may thrive, will continue to exist, if the underlying principle of the legislation is in reality sound. . . . [But] two quite distinct methods of approach might be adopted according as one began at the operating and traffic end, or, on the other hand, began with the financial aspects of the matter. . . . One might, presumably, first ascertain the relative financial standing of the corporations; and thereafter check up the alliances thus indicated, by applying the test of operating efficiency and satisfaction of the traffic needs of the territories concerned. Or, contrariwise, one might first seek the natural alignment of these properties as operating and traffic units, before inquiry as to whether such alignment contained an effective invitation to merger, based upon considerations of earning power and financial stability. The former method appeals particularly to financial students of the subject. It has resulted in the formulation of several significant proposals. The latter calls for a somewhat wider range of information, dealing not alone, as it does, with the operating and traffic characteristics of the carrier companies, but also looking to the broader considerations of the traffic needs of the entire communities served. For it is held that the maintenance of the 'existing routes and channels of trade and commerce' implies not the preservation of merely artificial currents and conditions, but that the statute contains an invitation to consider these carrier corporations in their basic relationship to the welfare, present and prospective, of the country. Viewed in this larger sense the act is at once an invitation and an opportunity. It calls for an analysis of the commercial geography of the United States, in its relation to the layout of its railway net. For, unless the location of its railways conforms to the commercial requirements of the country, there can be no permanent prosperity for either." *Ibid.*, p. 477.

<sup>817</sup> *Trunk line region*: 1. Pennsylvania; 2. New York Central; 3. Baltimore & Ohio-Reading; 4. Erie-Lehigh Valley-Wabash; 5. Lackawanna-Nickel Plate. *Chesapeake Bay region*: 6. Chesapeake & Ohio; 7. Norfolk & Western-Virginian; 8. New England regional; 9. Michigan peninsula. *Southeastern region*: 10. Southern Railway; 11. Atlantic Coast Line-Louisville & Nashville; 12. Illinois Central; 13. Seaboard Air Line; 14. Florida East Coast. *Western transcontinental region*: 15. Union Pacific-North Western; 16. Burlington-Northern Pacific; 17. St. Paul-Great Northern; 18. Rock Island-Southern Pacific; 19. Santa Fe. *Southwestern-Gulf region*: 20. Frisco; 21. Missouri Pacific. *Ibid.*, p. 640.

"each considerable city all over the United States tapped by at least two railways," and with "all of the great competitive routes . . . so arranged that there is a matching for competitive purposes everywhere."<sup>818</sup> This grouping of roads was not only deemed to conform to the requirements of the statute with respect to competition, but to provide, as a broad matter of policy, such a measure of competitive rivalry as was believed to be indispensable to the maintenance of efficiency;<sup>819</sup> and the magnitude and scope of the proposed systems were also thus limited in the interest of administrative effectiveness.<sup>820</sup>

<sup>818</sup> In point of fact the competitive set-up in important communities was a much more intensive one: "The foregoing description of competitive routes, matched in pairs, does not, of course, preclude the possibility of competition between a larger number of roads than two. At most nodal points, for example, it will be found that from three to five are as likely to compete as two. Thus at Seattle, San Francisco, Savannah, Atlanta, or the twin cities, one discovers three systems in competition. At Galveston four systems enter. New Orleans has three systems from the southeast and four from west of the Mississippi. Kansas City will be touched by at least four of the transcontinental lines, with the two Southwestern-Gulf systems in addition. In short, as a city rises in the scale from third to second or first place, as a strategic center, the number of systems which independently seek to provide competition increases. This, it is submitted, conforms to the spirit of the act. It is inevitable, in any event, that competition becomes keener the greater the commercial importance of the city. But the progression under a well-ordered system seems to be more nearly an expression of the natural geographical fitness of that center, rather than, as sometimes heretofore, because of a fortuitous or artificial, and to that degree, less deserved advantage." *Ibid.*, pp. 637-638.

<sup>819</sup> That the entire pattern of the proposed plan was influenced by this emphasis upon the competitive principle appears from the following: "No impartial student can deny the force of the contention that unified operation in and of itself is advantageous both as regards cost and expedition in service. But it is equally incontrovertible that the cessation of competition under a system of complete regional monopoly . . . is destructive of one of the great incentives to efficiency. That was perhaps one reason why the cost of operation mounted so phenomenally during the war. The instrumentalities may be present; but the vigor and initiative which are commonly set on foot through rivalry are bound to be lessened. One of the larger aspects, then, of this proposed consolidation plan is that it offers a third choice, in place either of completely unified regional ownership and operation with its lack of incentive, on the one hand; or of the economic wastes which are incident to helter-skelter competition between a heterogeneous congeries of more or less imperfectly developed properties, on the other. One alternative threatens stagnation; the other has driven our railroads to the verge of bankruptcy. May not a well-ordered consolidation program offer a way out, without resorting to the ultimate expedient of government ownership from which, once adopted, there can be no withdrawal. It is believed that an opportunity presents itself to seek the advantages of each of the other arrangements, with some chance of escape from their several inherent defects. Such, at least, is the underlying principle contemplated in this plan." *Ibid.*, p. 636.

<sup>820</sup> The objective, apparently, was to impose at least no more extensive managerial tasks upon the proposed systems than those involved in the administration of the largest of the existing systems: "The really significant feature of the exhibits respecting size . . . and one which has been kept in mind throughout the evolution of this plan, is

and for the protection of local communities.<sup>321</sup> Furthermore, while the proposed systems varied widely in both mileage and volume of traffic, the ratio of net operating income to recorded investment, as tested by reference to such valuation data as were available, disclosed a high degree of uniformity of return among the respective systems, particularly in each of the territorial groups, as contemplated by the provisions of the statute.<sup>322</sup> The objects sought (and measurably attained) by the proposed grouping of roads were summarized as follows: "An inherently natural geographic scope for each system; a sound operating adaptation of each unit to its surroundings, due consideration being given to the nature of its traffic; administrative

the fact that the load thrown upon any single system for administrative purposes is kept well below the existing standards. The criterion for administration must necessarily be found in the revenue ton-miles; that is to say, in the density and the total movement of traffic. The attainment of the Pennsylvania in 1917 to 47,871,000,000 revenue ton-miles, followed next in order by the New York Central standing at 38,477,000,000 revenue ton-miles, is not elsewhere approached by any of the other proposed systems. And these two great groups, above named, represent in this plan not additions to the existing corporate business handled, but at least in the case of the New York Central, a substantial subtraction therefrom. The only proposed systems which approach within hailing distance of either the New York Central or the Pennsylvania in volume of business are the Baltimore & Ohio-Reading, the Erie-Lehigh Valley-Wabash, the Burlington, and the Union Pacific systems. In fine, if it lie within the bounds of human capacity to operate the Pennsylvania and the New York Central systems as at present constituted, there is no reason to suppose that these newly suggested systems are too big to be properly managed. This consideration is indeed a very vital one. Its significance could perhaps be better appreciated were it possible to outline all of the comprehensive proposals which have been in turn rejected, largely because of the undue magnitude of their operating units. This plan, it is confidently submitted, has been fashioned with a view to withstanding this test." *Ibid.*, p. 639.

<sup>321</sup> Thus: "The question is often raised why more than two competing through systems are necessary, inasmuch as two are adequate to provide the competition in service called for by the transportation act. . . . It is submitted in answer to this contention that more and more do the little local communities along the lines of these primary railroads need encouragement and support in face of the commercial and industrial rivalry of the great centers of population. Too comprehensive a scheme of consolidation would unquestionably operate to lessen the number of trunk lines between competitive centers, over each of which there would be provided a main-line quality of transportation. The cities of the intermediate class, Des Moines, Iowa, for example, cannot expect all of the rivalry which would arise between carriers at a primary center like Kansas City or St. Louis. But the chances for development attendant upon first-class main-line service will be considerably increased if there are, for example, three or four competing trunk lines of large systems across the state of Iowa, rather than a smaller number. It is also true that each main stem of a system may discover such an advantage due to its location or connections as will encourage it to specialize in certain classes of business. Upon such foundations are reputations as a reward of merit based." *Ibid.*

<sup>322</sup> *Ibid.*, pp. 640-644.

practicability, that is to say, a size under each particular set of circumstances, commensurate with human capacity in management; an ever-present competition between rival roads, in order to insure the continuance of an alert and accelerated service to the public, assuming that the foregoing physical arrangements have already provided economical carriage by each competitor; and such an equalization of earning capacity between these competitors, as to perpetuate such rivalry in service on an even-handed and wholesome basis.<sup>823</sup>

Without comment upon this analysis and largely on the basis of the groupings thus made, the Commission announced its tentative consolidation plan. It was put forward "in order to elicit a full record upon which the plan ultimately to be adopted can rest, and without prejudgment of any matters which may be presented upon that record."<sup>824</sup> In its expectation that this plan would be regarded merely as a point of departure, and that a great diversity of views would be forthcoming, the Commission was not to be disappointed. As a result of extensive hearings, held between April 24, 1922, and December 4, 1923, a record of almost 12,000 pages of conflicting testimony, including more than 700 exhibits, was developed. The general tenor of the views thus expressed was one of disapproval: because of skepticism, particularly in the face of improving transportation conditions, as to the necessity or desirability of consolidation as such; because of fear that the formulation of a plan would introduce an element of rigidity into a situation which required flexible treatment, and would enhance the costs and increase the difficulties of effectuating combinations; and because of numerous alleged defects of particular groupings suggested by the tentative plan.<sup>825</sup>

<sup>823</sup> *Ibid.*, p. 635.

<sup>824</sup> *Ibid.*, p. 455. Not only were alternative groupings suggested by the Commission in many instances, but very few Class II and Class III roads were allocated. "Those not so included," said the Commission, "whether industrial common carriers, terminal carriers, interurban electric railways operated as a part of general steam railroad systems of transportation or engaged in the general transportation of freight, 'short lines,' or others, will be considered at the hearings to be hereafter assigned so that in the plan to be ultimately adopted provision can be made for their inclusion in the systems." *Ibid.*, p. 464.

<sup>825</sup> See Record, *Consolidation of Railroads*, No. 12964; and compare the following, most of which bring the analysis forward to later years: Walker D. Hines, "The Relationship of the Burlington-Great Northern-Northern Pacific Group to the Federal Railroad Consolidation Laws," *Harvard Business Review*, vol. 1 (1923), pp. 398-413;

Impressed by the objections to the general policy of fashioning consolidations on the basis of a predetermined grouping of roads, as well as to its own particular proposals, and doubtful of its ability to reconcile the diverse interests involved and the various points of view which had been presented to it, the Commission, for a period of six years after the conclusion of its hearings, failed to adopt a final consolidation plan. Although the publication of such a plan was clearly intended and required by law, and although the tentative allocations had been announced for the express purpose of eliciting a full record "upon which the plan ultimately to be adopted can rest," the Commission chose to disregard both the statutory mandate and its own pronouncement. In extenuation, it may freely be conceded that the encouragement of planned consolidations, in the direction tentatively indicated, was being subjected to severe criticism, especially as the traffic, earnings, and credit of the roads improved; and that the incomplete status of the valuation project, together with the provision restricting the capitalization of consolidated systems to the rate-making value of their constituent properties, interposed obstacles to the speedy furtherance of consolidation policy. Moreover, while the Commission declined to sanction technical consolidations pending the promulgation of its complete plan, considerable progress was being made, as we have seen, toward the achievement of unifications, amounting in many instances to virtual consolidations, which were calculated to effect economies and improve service. Despite these circumstances, however, the Commission's apparent sidetracking of the consolidation plan suggested a deliberate disregard of the legislative will. Whatever the difficulties, the fact remains that Congress had declared for a policy of ordered consolidation, and, in the public

A. J. County, "Consolidation of Railroads into Systems," *American Economic Review*, vol. 14 (March, 1924, Supplement), pp. 73-85; Eliot Jones, "Railroad Consolidation," *North American Review*, vol. 221 (March, 1925), pp. 440-453; Walter M. W. Splawn, *Consolidation of Railroads* (1925); "Railroad Consolidation," *Proceedings of the Academy of Political Science*, vol. 13 (June, 1929); James B. McDonough, "Consolidation of Railroads," *Virginia Law Review*, vol. 16 (December, 1929), pp. 149-163; Howard C. Kidd, "Railroad Consolidations and the State of Pennsylvania," *Report to the Public Service Commission of the Commonwealth of Pennsylvania* (1930); T. W. Van Metre, "Railroad Consolidation," *Appendix to Report of Special Committee on Railroad Consolidation, Chamber of Commerce of the State of New York* (1930); *Report of the New England Railroad Committee to the Governors of the New England States* (1931).

interest, had imposed upon the Commission the duty of preparing a comprehensive plan. While it is true that the probable economies of consolidation have often been exaggerated, that the merging of roads on a large scale would inevitably involve sharp reductions in railroad employment, and that far-flung combinations would necessarily restrict the operation of competitive forces, it is not unreasonable to assume that such factors had been taken into account when Congress directed the Commission to proceed. Furthermore, the publication of a "final" plan, like the announcement of the tentative plan, was conceived by the lawmakers merely as a procedural step; and, as will appear in due course, the Commission itself came to regard its consolidation plan, as finally adopted at the end of 1929, in just this light: permitting such modifications as seemed warranted in the light of convincing representations or changing conditions, insisting that a finding of public interest is a prerequisite to its approval of any specific consolidation proposal, and asserting its authority to impose conditions in order to safeguard essential public ends. It is difficult, therefore, to find adequate justification for the Commission's long delay in promulgating a consolidation plan, particularly since its rather liberal attitude with respect to acquisitions of control, far from facilitating the solution of the problem as a whole, tended to confuse the situation, to encourage competitive purchases for strategic purposes, and, at least indirectly, to stimulate the development of railroad holding companies outside its jurisdiction.

It is not to be presumed, however, that the Commission remained altogether silent during the long interval between the announcement of its tentative plan in the summer of 1921 and the appearance of its complete, or final, plan in the winter of 1929. On February 4, 1925, about a year after the consolidation proceeding had been submitted for decision, the Commission addressed a letter to the Senate Committee on Interstate Commerce in which, expressing doubt as to the wisdom of the requirement that a complete plan be adopted to which all future consolidations must conform, it asked to be relieved of the duty of preparing a comprehensive consolidation plan. Being "impelled to the belief that results as good, and perhaps better, are likely to be accomplished with less loss of time if the process of consolidation is permitted to develop, under the guidance of the commission,

in a more normal way," it proposed that section 5 be so amended that, in addition to omitting the requirement for a consolidation plan, it expressly make unlawful all consolidations or acquisitions of control except upon the Commission's approval and authorization under broadly discretionary powers, and that it specifically authorize the Commission to disapprove of any consolidation or acquisition of control on the ground that it does not include a carrier, or the whole or any part of its property, which ought to be included in the public interest and which it is possible to include upon reasonable terms.<sup>826</sup> While the Commission's proposal was received sympathetically in many quarters, both because of appreciation of the great difficulties

<sup>826</sup> See *Annual Report*, 1925, pp. 13-14, 72. These provisions, it will be observed, were designed to make resort to the Commission mandatory, to safeguard every aspect of the public interest, and, specifically, to provide an express basis for the inclusion of weak roads in proposed combinations. In supporting the express prohibition of consolidations or acquisitions of control except upon its own authorization, the Commission said: "The purpose of this provision is to make certain that the process of consolidation will in all respects be subject to the control and guidance of Federal authority. Without such a prohibition it will be claimed that such consolidations or acquisitions of control as are not in conflict with the Federal antitrust laws may be effected, as was done in the Nickel Plate case, under State authority and without Federal approval. Whatever the merits of the Nickel Plate consolidation, it must be obvious that the possibility of consolidations or acquisitions of control thus consummated means a division of authority and responsibility which is likely to be destructive of any well-ordered and consistent control of the process of consolidation in the public interest." In supporting the broad powers of approval or disapproval which it recommended—requiring, for approval, a finding that the proposed consolidation or acquisition of control will be in the interest of better service to the public or economy in operation, will not unduly restrain competition or be in any other material respect inconsistent with the public interest, and will conform to the provisions which prohibit a capitalization of the consolidated company in excess of property value—the Commission said: "It may seem unduly drastic to require a finding that the consolidation or acquisition will not be inconsistent with the public interest in any material respect, but it will be noted that the commission is not restricted to the approval or disapproval of the consolidation or acquisition as proposed, but is authorized to approve 'with such modifications and upon such terms and conditions' as it shall find just and reasonable. If what is proposed will promote the public interest in certain respects but not in others, it need not be wholly rejected but may be approved in a modified form which will eliminate the objectionable features." Finally, in connection with the recommendation that it be specifically authorized to disapprove of consolidations or acquisitions which do not include particular carriers, the Commission said: "One of the criticisms of such consolidations or acquisitions as have been proposed or suggested has been that they do not take care of the weak lines, although the merger of strong with weak lines is one of the ends which Congress has apparently had in mind. The specific provision above described will, it is thought, enable the commission to require attention to be directed to this phase of the matter, which otherwise might be neglected."

involved in formulating a complete consolidation plan and because of belief that the publication of such a plan would result in undue rigidity and tend to increase the costs of effecting combinations, it did not prove convincing to those who deemed a carefully drawn plan for the entire country indispensable to the realization, in the public interest, of the full fruits of consolidation policy. This latter view apparently prevailed in Congress; for, despite the Commission's repeated recommendations<sup>327</sup> and the introduction of a considerable number of bills designed to incorporate them into law,<sup>328</sup> no action was taken.<sup>329</sup> In the meantime, as has already appeared, the Commission approved many close combinations and saw others independently consummated, with effects upon the railroad map which diverged considerably from the lines drawn by its tentative grouping of roads and without the guidance of any other comprehensive consolidation plan. There can be little question that the Commission's long delay in complying with its statutory duty contributed in no small measure to the sterilization of Congressional policy as enacted in 1920.

At length, evidently despairing of achieving a change in the law and under pressure of those who believed that consolidations should be encouraged, the Commission, on December 9, 1929, adopted a plan for consolidating the railroad properties of the continental United States into a limited number of systems.<sup>330</sup> This plan, which was

<sup>327</sup> See *Annual Reports*: 1926, pp. 13, 76-77; 1927, pp. 65, 80; 1928, pp. 60-61, 81-82.

<sup>328</sup> See, for example: 69th Congress, S. 1870 (1925), S. 3840 (1926), S. 4892 (1926), H.R. 11212 (1926), H.R. 17403 (1927); 70th Congress, S. 1175 (1927), S. 5817 (1928), H.R. 5641 (1927), H.R. 12620 (1928); 71st Congress, S. 668 (1929), H.R. 3208 (1929). For a synopsis of these bills and others of like character, see *Report to the Committee on Interstate Commerce on Railroad Consolidations and Unifications under S. Res. 290, 71st Cong., 3d Sess., Part I, pp. 32-38 (1931)*.

<sup>329</sup> As of November 30, 1929, the Commission reported as follows: "Commencing with our annual report of 1925, and in each succeeding annual report to and including that of 1928, we have suggested an amendment to section 5 of the interstate commerce act, which would relieve the commission of the duty of formulating a plan for the consolidation of the railway properties of the continental United States into a limited number of systems. While hearings have been held by appropriate committees of both Houses of Congress and bills have been reported to the respective Houses, the Congress has not amended section 5 as suggested. We believe, under these circumstances, it was our duty to proceed to comply, as far as possible, with the mandate of the law." *Annual Report, 1929, p. 87*.

<sup>330</sup> *Consolidation of Railroads*, 159 I.C.C. 522. The main stems of the twenty-one systems into which the roads were grouped were as follows: System No. 1—Boston &



based on the old record, differed from the tentative plan chiefly in the fact that it recognized, and for the most part left undisturbed, the new alliances and system interrelationships which had been established, in the interim, through acquisitions of control and other coöperative arrangements. The Commission thus displayed a willingness to accept and to deal with the existing situation, at least as a starting-point; but it carefully avoided a discussion of guiding principles, except for brief declarations as to the need of unifying terminal properties<sup>881</sup> and maintaining the independence of the consolidated systems.<sup>882</sup> Individual commissioners, disagreeing with the majority as to specific al-

Maine; System No. 2—New Haven; System No. 3—New York Central; System No. 4—Pennsylvania; System No. 5—Baltimore & Ohio; System No. 6—Chesapeake & Ohio-Nickel Plate; System No. 7—Wabash-Seaboard; System No. 8—Atlantic Coast Line; System No. 9—Southern; System No. 10—Illinois Central; System No. 11—Chicago & North Western; System No. 12—Great Northern-Northern Pacific; System No. 13—Milwaukee; System No. 14—Burlington; System No. 15—Union Pacific; System No. 16—Southern Pacific; System No. 17—Santa Fe; System No. 18—Missouri Pacific; System No. 19—Rock Island-Frisco; System No. 20—Canadian National; System No. 21—Canadian Pacific. *Ibid.*, pp. 524-547.

<sup>881</sup> "We think," said the Commission, "that consolidations should be accompanied by the unification of all terminal lines in the respective terminals. All terminal properties should be thrown open to all users on fair and equal terms so that every industry on whatever rails located shall have access to all lines radiating from that terminal, and every line carrier reaching that terminal shall similarly have access to all terminal tracks within the terminal area. . . . In the interest of efficient and economical operation and the free movement of traffic, restrictions in service and discriminations in charges which have arisen from differences in local terminal situations should cease to be a feature of railroad operation." But with these pronouncements as a declaration of general policy, the Commission postponed specific action with respect to most terminal properties: "In the face of such a great variety in circumstances and conditions, it is impracticable to prescribe in advance a universal rule for terminal railroad unification and operation. Each terminal and the properties serving it must be studied in the light of its particular facts and a practical solution worked out with due regard to the property and other rights of all owners and users. This is the duty in the first instance of the carriers serving each terminal. We expect to deal with these situations to the extent that they are connected with respective applicants when we shall have occasion to consider particular applications to consolidate, and therefore refrain from allocating in the present plan the various terminal properties not specifically mentioned herein. For present purposes they may be treated as independent systems, subject to later grouping as shown to be in the public interest." *Ibid.*, pp. 522-523.

<sup>882</sup> This declaration was designed to forestall requests by the carriers calculated, through various means, to establish communities of interest as between consolidated systems: "Under the act any plan of consolidation which may be adopted shall preserve competition as fully as possible. In order that the systems herein proposed, or any others that may be formed, may properly perform the functions intended by Congress and that competition may be preserved as required, they must be independent in fact as well as in name. The continuation or acquisition of inter-system interests directly or indirectly through holding companies, stock ownership, or otherwise, will be in-

locations, set forth at some length their views as to the requirements of the statute and their bearing upon the proposed consolidations.<sup>888</sup> More significant, however, is the fact that both the Commission as a whole and those who gave voice to separate expressions concurred in regarding the published plan merely as a point of departure, made necessary by the statutory mandate, but freely subject to subsequent modification. This approach received explicit emphasis in the Commission's report: "In a matter of this magnitude in scope and complexity in detail, even after the most careful study and the fullest and freest interchange of views by those charged with the duty of preparing this plan, there must remain many differences of opinion as to the several component parts, both large and small, comprised in the final result. Such is here the case. While a clear majority of us, although not always the same majority, have agreed as to each part of the plan proposed, not all of us have agreed as to all its parts, but all concur in the result. Some of us deem it helpful now to express individual views as to parts of the plan. Others feel that their individual expressions may usefully be deferred until the time for action looking toward the ultimate effectuation of actual consolidations as provided by the act. Section 5(5) provides that after we have adopted a plan, as we here do, we may, either upon our own motion or upon application, reopen the matter for such changes or modifications as in our judgment will promote the public interest. Such applications will afford opportunity for further consideration upon adequate and recent records of the various parts of the plan."<sup>884</sup> And in the individual concurrences, this point of view was stressed even more sharply. Commissioner Eastman, for example, who, in addition to making a critical survey of the proposed groupings in major territories, directed attention to the wide discretion allowed by the requirements of the statute, the absence of current information in the record, and the need of exercising caution in providing for consolidations "on a grandiose scale," both because of doubt as to the reality of their net advantages

consistent with the independence necessary to true competition. Carriers will, therefore, be expected to observe this requirement in submitting proposals for consolidations and to cooperate in establishing the desired status." *Ibid.*, p. 523.

<sup>888</sup> See the separate expressions, concurring in whole or in part, of Commissioners Eastman, McManamy, Taylor, and Porter. *Ibid.*, pp. 551-589.

<sup>884</sup> *Ibid.*, p. 524.

and because of skepticism as to the wisdom of effectuating undue concentration of control, introduced his separate expression as follows: "Although I do not approve of it in important respects, I concur in the adoption of the consolidation plan above outlined because it has many good features, because it is necessary under the law to adopt some plan, and because it is not very important, after all, whether or not it is the best plan that could be devised. We may modify it at any time hereafter, and no consolidation for which it provides can be accomplished until we have found, after full hearing, that the public interest will be promoted thereby. There is, I think, much misunderstanding on this point. The plan is very little more than a procedural step. There is nothing compulsory about it, nor even any assurance that authority will be sought to carry out the consolidations which it proposes."<sup>885</sup> Under this approach, the Commission has been chiefly concerned, thus far, in modifying its consolidation plan.<sup>886</sup>

The outstanding example of the Commission's willingness to modify its plan, largely in conformity with the wishes of the roads, is to be found in its treatment of the petition of the carriers that four instead of five systems be established in eastern territory, exclusive of

<sup>885</sup> *Ibid.*, p. 551. Similarly, Commissioner McManamy, who concurred "because under the law a plan is required before any consolidation may lawfully be made" (p. 568), concluded as follows: "I go along with this plan, therefore, only because it will cut the Gordian Knot and permit helpful consolidations, and not because I expect economy and efficiency of operation to be promoted by the gigantic systems here proposed" (p. 571). Commissioner Porter, who was the leading spirit in the preparation of the plan, likewise emphasized the legal requirement that a plan be adopted and published as a procedural step, rather than its substantive finality: "Congress has declared a policy for the nation in respect to the consolidation of railroads, and has issued an edict as to the manner in which it shall be carried out. . . . Irrespective of what I may think as to the wisdom of this policy and the method of its execution, I conceive it to be my duty, to execute in letter and in spirit, the mandate as promulgated" (p. 574). Although he took issue with the majority with respect to its proposals for New England and official and western territories, he presented his suggestions for consideration, "particularly when applications shall be made, looking to the effectuation of consolidation" (p. 589). Even Commissioner Taylor, who erroneously believed that the Commission possessed powers of compulsion in this sphere—that it was authorized "to require such groupings or consolidations as it may find to be in the public interest"—expressly recognized, in his general concurrence, that the requirements for the adoption and publication of a plan "were of such a mandatory character that compliance therewith could be neither avoided nor indefinitely delayed," and that the Commission was empowered "to change or modify the plan if, in its judgment, that is desirable" (pp. 571-572).

<sup>886</sup> *Consolidation of Railroads*, 163 I.C.C. 188 (1930), 183 I.C.C. 663 (1932), 185 I.C.C. 403 (1932).

New England, by the elimination of the proposed Wabash-Seaboard system and the reallocation of the properties assigned to that system among the remaining four systems.<sup>887</sup> This fifth system, which had elicited protest from within the Commission when it was originally included in the consolidation plan,<sup>888</sup> sprawled into both the southern and western districts, serving as a sort of catch-all for such loose ends as remained after the majority of the lines had been assigned, and the control of many of its important constituents had previously been acquired, largely without the Commission's sanction, by other eastern systems.<sup>889</sup> The executives of the four great existing systems in eastern territory—the New York Central, the Pennsylvania, the Baltimore & Ohio, and the Chesapeake & Ohio—while unable for some time to reach agreement as to specific conflicts of interest, were unanimous in opposing the creation of a new fifth system. Finally they managed to compose their major differences, and on December 30, 1930, it was announced from the White House that they had come to agreement upon a basis for consolidating the railroad properties in eastern territory. On October 3, 1931, their proposal, involving the elimination of the fifth system, was presented to the Commission as a request by the four systems that the consolidation plan be modified; and after extended hearings, on a voluminous record, the Commission, on July 13, 1932, entered an order effecting such modification. The general guid-

<sup>887</sup> 185 I.C.C. 403 (1932).

<sup>888</sup> See the partly concurring opinion of Commissioner Porter in 159 I.C.C. 522 (1929), at pp. 579-588, in which he objected to the proposed Wabash-Seaboard system as unwieldy, impractical, unnecessary, and likely to be independent only in name, and urged the adoption of the four-system plan for eastern territory.

<sup>889</sup> See, for example, the Clayton Act proceedings in *Interstate Commerce Commission v. Baltimore & O. R. Co.*, 152 I.C.C. 721 (1929), 156 I.C.C. 607 (1929), 160 I.C.C. 785 (1930), and in *Interstate Commerce Commission v. Pennsylvania R. Co.*, 169 I.C.C. 618 (1930). Note, also, the following from the dissenting opinion of Commissioner Eastman in *Consolidation of Railroads*, 185 I.C.C. 403 (1932), with respect to the control exercised over the major lines included in the Wabash-Seaboard system [No. 7]: "The Pennsylvania for many years has had a controlling interest in the Norfolk & Western. In violation of the Clayton Act, as we have found, it acquired controlling interests in the Wabash and the Lehigh Valley at extravagant cost. It also acquired, through the Pennroad Corporation, a controlling interest in the Pittsburgh & West Virginia and a substantial interest in the Seaboard Air Line. In violation of the Clayton Act, as we have found, the Baltimore & Ohio acquired a controlling interest in the Western Maryland. Likewise in violation of the Clayton Act, as we have found, the Nickel Plate acquired a controlling interest in the Wheeling & Lake Erie. Thus were the essential parts of the proposed system No. 7 seized, shackled, and kept out of mischief" (pp. 443-444).

ing principles in which its decision was grounded were disposed of in a single brief paragraph.<sup>840</sup> The Commission appeared to be moved primarily by the belief that the arrangement proposed by the carriers was a workable one, being largely the outcome of their own negotiations, and that upon approval it would be followed by advantageous consolidations.<sup>841</sup> With little apparent hesitation, therefore, it ac-

<sup>840</sup> Chairman Porter, speaking for the Commission, merely declared, after calling attention to the stipulations of the statute: "It is evident that the competition which the Congress desires to have preserved is healthful competition, because any other kind of competition can not be in the public interest, and that, since the public interest is paramount, any existing routes and channels of trade and commerce which promote unhealthful competition need not be maintained. Obviously, also, the costs of transportation as between competitive systems, their efficiency in management, and therefore the rates of transportation which they carry, are affected by the financial stability of the respective systems. These considerations weighed with us in the formulation of our final plan and, because of recent and very material changes in the nature of the competition which confronts the railroads, they must be given even greater weight in considering the application before us." *Consolidation of Railroads*, 185 I.C.C. 403 (1932), at pp. 407-408.

<sup>841</sup> Stress was placed not only upon the apparent futility of seeking to retain the fifth system as originally planned, but upon the fact that, since consolidation policy must proceed on a voluntary basis and most of the railroad properties in eastern territory were already controlled by four major systems, the proposal of the carriers was a highly practicable one. With respect to the original fifth system the Commission said: "The record now before us shows that no steps have been taken by any one with the object of carrying into effect system No. 7 as planned by us, and no one appeared at the further hearing in favor of that system. Since our plan was published the Wabash and the Seaboard Air Line, which form in large part the backbone of that system, have been placed in the hands of receivers. Aside from financial instability, there have arisen grave doubts whether in other respects system No. 7 would fulfill the requirements of the statute. The principal railroads included in the system appear to lack desirable coordination, important existing routes and channels of trade and commerce, particularly between the South and the North, would be quite certain to be displaced by circuitous and less efficient or desirable routes, over which the cost of transportation would be substantially greater than over competitive routes, and the total additional capital investments which would be necessary to insure adequate connections between the various properties and adequate track and terminal facilities for the principal routes upon which the system as planned would have to depend would be prohibitive." And in affirmatively supporting the four-system plan the Commission said: "Since the publication of our plan in 1929, and more especially in the consideration of the evidence upon this record, it has become increasingly apparent that no workable plan of consolidation in conformity with the law can be devised which calls for more than four systems in eastern territory, excluding New England. Two large and powerful systems, the Pennsylvania and the New York Central, already in existence, fairly equal to one another, own or control almost one-half of the entire railroad mileage in this territory. . . . Actual consolidation is voluntary, and if the fruits of consolidation are to be realized within the not too distant future, this condition must be taken into consideration in formulating a permanent plan. . . . In addition to those two major systems there are now in this territory two other systems which have shown considerable strength, the Baltimore & Ohio and the Chesapeake & Ohio-Nickel Plate. Those

ceded to the request of the applicants that the consolidation plan be modified in the general direction proposed, finding that the public interest would best be served by four systems instead of five in this territory. It should not be inferred, however, that the Commission merely endorsed the proposals submitted by the interested carriers, without careful scrutiny, or that its determinations were not based upon considerations of public importance. It is noteworthy that the new plan made the systems better balanced in size and earning power; that it involved a more extensive neutralization of terminals and use of trackage rights than had theretofore proved feasible; that it effected the allocation, for the most part, of both weak and strong lines; and that, in the public interest, the proposals of the carriers were altered by the Commission in a number of particulars. On the whole, then, despite the differences of opinion disclosed in four concurrences<sup>342</sup>

systems now own or control approximately 20,000 miles of road, and this record contains no serious suggestion that they should not be continued. . . . This leaves less than 7,000 miles of railway [the remaining 6,000 miles consisting of short lines, terminal lines, and New England bridge lines], most of which so lacks coordination that to build out of these remaining properties a fifth system which would have the necessary physical and financial strength to serve the public efficiently and economically in competition with the other four systems already wholly or partly in being is impossible. We believe that the public interest will be best served by grouping the railways in eastern territory, excluding New England, into four systems, each having adequate main stems between the Atlantic seaboard and the Middle West, reaching a majority of the large producing and consuming centers of the territory, having the necessary physical and financial strength to serve the public efficiently and economically and to coordinate their services with other modern means of transportation, and which will be so constructed as to preserve healthful competition and maintain, as far as practicable, the existing routes and channels of trade and commerce. We are of opinion that the four systems proposed by the applicants, modified in the respects herein-after noted, will achieve those objectives." *Ibid.*, pp. 406-407, 408-409.

<sup>342</sup> There were separate expressions, concurring in whole or in part, by Commissioners Lewis, Brainerd, Lee, and Mahaffie. Such disagreement as was voiced in these declarations was stated summarily and merely concerned the assignment of some of the individual lines. Only the concurring opinion of Commissioner Lewis dealt with the problem as a whole, and in this there was added emphasis upon the Commission's pragmatic approach, as appears from the following: "Though our plan for the eastern group has now been outstanding more than three years, nothing has resulted. It happened that our plan was issued two or three months after the first phases of the depression had been registered. The depression might have had some effect on some effort made to effectuate the five systems, but more deep-seated obstacles probably lay in ownership of certain properties whose transfer were [*sic*] essential to development of five systems. It must be realized that, in giving us the mandate to group the carriers of the country into a limited number of systems, Congress created or conferred no power of requirement on the carriers to buy, sell, lease, or transfer. Therefore, the will of Congress that the railroads of the country be brought into a limited number of

and two dissents,<sup>848</sup> the action of the Commission in modifying its consolidation plan, on the basis of realistic considerations, appears to merit approval.

systems can be realized, at least under present conferred powers, only by the adoption of a plan which the owners of the property can or will voluntarily carry forward. Such is the plan before us. . . . If I understand the background of the consolidation policy of Congress, it consists in the theory that by uniting strong and weak properties into a limited number of properly balanced systems, an adequate national system of transportation, preserving all needful lines, can be established and maintained; that such an arrangement will produce financially strong companies limited in number but sufficient to maintain established channels of trade and proper competition under regulation. In 1920 Congress was facing the fact that the future of the small, weak lines very vital to the territory served by them, was most uncertain under what were then newly created conditions. Then, generally speaking, only the short lines and the more obscure units were in the balance. Now, the entire rail transportation system is threatened; weak lines are not by any means limited to short lines. If it is still the policy of Congress to maintain an adequate system of transportation, the need for strengthening is greater now than ever in the past. The 4-system plan includes the allocation of all short and weak lines." *Ibid.*, p. 440.

<sup>848</sup> In a vigorous dissenting opinion, in which Commissioner McManamy joined, Commissioner Eastman, in addition to making many sharp strictures against particular allocations, voiced strong opposition to the whole proceeding. He directed attention to the artificial character of the support of the four-system plan, and to the improprieties, in both law and policy, which surrounded its development. "There is an epidemic of hope that some magic move will restore confidence and set the wheels of industry in motion. The promoters of this 4-system plan with most powerful aid [for a critique of the part played by President Hoover in this connection, see Part II, at pp. 457-458] have cultivated the hope that approval of the plan will be such a magic move. These circumstances have allayed much of the opposition which might otherwise have been voiced, although they have availed to produce of record no active public support." And as to circumstances which rendered the plan a "practical" one: "Congress directed the Commission to prepare a plan for the consolidation of the railroads of the country into a limited number of systems. Events suggest that it would have been simpler to have asked a few of the larger railroads to agree upon a plan for the distribution of the lesser railroads among them. The virtue most persistently urged in support of this 4-system plan is that it is a 'practical' plan which can be accomplished, because the four leading railroad executives of eastern territory have, after many conferences, agreed upon it. In fact, the plan has in large part already been accomplished. This has been done at great cost and mostly without our approval. We have found that to a very considerable extent it was done illegally, and we could with propriety have spread this finding over much more ground. The fact remains that many important and strategic parts of the plan have been accomplished. With these trump cards in hand the four executives went into conference. Their agreement was shaped accordingly, and upon it is now fixed the stamp of commission approval." Support for this position was found in a recital of the acquisition of lines without the Commission's sanction, through non-carrier holding companies and otherwise, by the Chesapeake & Ohio-Nickel Plate, the Pennsylvania, and the Baltimore & Ohio; and these system-making operations were deemed to have violated sound financial principles as well as the requirements of law. "The record contains startling comparisons of the prices paid for stocks with their present market values. . . . Much of the extraordinary shrinkage is due, of course, to the economic depression. More important

Following the adoption of the consolidation plan in 1929, and especially after its modification for eastern territory in 1932, it might have been expected that the process of consolidation in conformity with Congressional policy as enunciated in 1920 would at last go forward, particularly since the pressure of economic distress counseled that every source of economy be explored, that duplicate services be eliminated, that burdensome financial structures be reformed, and that embarrassed roads find support, if possible, in union with stronger lines. In point of fact, however, such expectation, if seriously entertained in any quarter, has not been realized. While some acquisitions of control, through lease and stock ownership, continued to be consummated, actual consolidations, by way of execution of the Commission's plan, have neither been sought nor effected. The impaired credit of the carriers and the depressed condition of the security markets rendered this period altogether unpropitious for such develop-

are the facts that in many instances the prices paid were very high even when measured by the inflated standards prevailing at the time when they were paid; that these purchases had the effect of accelerating the current inflation of security prices; that large debts were incurred in the acquisition of mere stock equities; that surplus funds were so used which ought to have been conserved; and that investors were enticed into the perilous holding-company field." These expressions constitute an accurate enough description of actual events, but they are directed against the propriety of past carrier policies, made possible in large measure by uncertainties and deficiencies in the scope of the Commission's authority, rather than against the soundness of the proposed consolidation plan as such. While there was some point to the contention that the difficulties of the economic situation made "peculiarly unwise any present attempt to determine a permanent alignment for carriers in eastern territory," and that there was no certainty that all of the four systems, "presumed to be of substantially equal earning power and financial stability," would be "financially able to hang together," it must be remembered that the proposed plan, even after approval, continued to be subject to modification, and still constituted little more than a procedural step. In the words of Commissioner Eastman himself: "Returning to the 4-system plan and its effect upon present conditions, it should be made clear that all that we are now asked to do is merely to modify our previous plan. Applicants have not sought authority to do a single thing. Before any part of the plan can legally be consummated, a new application for authority to act must be filed with us; and before we can grant such authority, it must be shown anew, notwithstanding that what is proposed is consistent with the plan, that it is in the public interest, including the terms and conditions, and that the latter are fair and reasonable. The law so provides specifically." Under these circumstances, also, the fact, as contended, "that the adoption of this 4-system plan has slaughtered the plan for the entire country which we set up in 1929, and that it must be made over again," is not as serious a stricture as might otherwise appear. Modification was expressly contemplated when the comprehensive plan was adopted, and if consolidations were to be encouraged, on the prevailing voluntary basis, piecemeal adjustments measurably conforming to the existing conditions of carrier ownership and control were inevitable. *Ibid.*, pp. 442-451.



ments, and the beginning of railroad consolidation into single units for ownership and operation, as part of the policy of effecting a comprehensive reorganization of the roads into a limited number of strong and balanced systems, still remains a matter for the future. But important progress has been made—in further defining the framework and procedure of consolidation policy, if not in its actual accomplishment. The legislative basis of future action has been very substantially modified, so that most of the statutory difficulties, in connection with both acquisitions of control and consolidations, to which attention has been previously directed, are no longer operative. Through the enactment of the Emergency Railroad Transportation Act of 1933, not only was the immediate need for operating economy met by requiring coöperative action among large groups of carriers under the supervision and ultimate control of a Federal Coördinator of Transportation,<sup>844</sup> but the permanent provisions of the Interstate Commerce Act dealing with combination in all its forms were completely recast.<sup>845</sup> These amendments, without departing from the underlying policy of furthering ordered consolidations on a voluntary basis, were designed to solve the major problems in this sphere encountered by the Commission in the course of its extended experience.

The provisions requiring the adoption and publication of a consolidation plan (in conformity with the prescribed standards as to preservation of competition, maintenance of existing channels of trade, and equalization of earning capacity) and authorizing its subsequent modification in such directions as are deemed to promote the public interest were retained intact—so that the Commission's plan as announced in 1929, as later modified, and as it might be further changed was to continue to provide the guiding chart of consolidation policy. But all provisions bearing upon the execution of the plan, or upon the accomplishment of unifications short of consolidations into single systems for ownership and operation, were drastically rewritten and expanded, in the interest both of strengthening the Commission's authority and of making possible greater flexibility in its exercise.<sup>846</sup> The principal objectives, as disclosed in the new provisions

<sup>844</sup> For an analysis of these emergency provisions, see pp. 424-430, *supra*.

<sup>845</sup> Title II, sections 201-204, inclusive, amending section 5 of the Interstate Commerce Act.

<sup>846</sup> Paragraphs (2) and (3) of section 5, dealing with acquisitions of control, were

themselves, were to provide a uniform and consistent basis for dealing with the great variety of forms of railroad combination; to extend governmental jurisdiction to holding companies and allied expedients for securing carrier control which had been used to effect numerous groupings of roads independently of the Commission's authority; to make resort to the Commission in all these situations, old and new, mandatory upon the interests seeking control, instead of merely being availed of as a means of securing exemption from the inhibitions of the anti-trust laws or other restrictive legislation; and to broaden the Commission's discretion in passing upon applications for unions of interest in furtherance of its consolidation plan.

First, the artificial distinction between acquisitions of control through lease and stock ownership and consolidations into single systems for ownership and operation, as embodied in the original legislation, was eliminated. It was made lawful, upon the Commission's approval and authorization, for two or more carriers to consolidate or merge their properties, theretofore in separate ownership, management, and operation; or for any carrier, or two or more carriers acting jointly, to purchase, lease, or contract to operate the properties of another; or for any carrier, or two or more carriers acting jointly, to acquire control of another through purchase of its stock; or for a non-carrier corporation to acquire control of two or more carriers through ownership of their stock, or, already possessing control of one or more carriers, to acquire control of another through ownership of its stock. It is clear that the Commission's authority was extended, without controlling differentiation, to all forms of combination. It applies on an identical basis to proposals for consolidations, mergers, purchases, leases, operating contracts, and acquisitions of control howsoever to be accomplished. The technical loopholes arising from the diffused approach of the original provisions as interpreted by the Commission were thus effectively removed.

Second, as already indicated by the earlier statement concerning non-carrier corporations, holding companies utilized to effect unions

struck out; paragraphs (4) and (5), dealing with the adoption of a consolidation plan, were renumbered paragraphs (2) and (3); paragraphs (6), (7), and (8), dealing with the accomplishment of consolidations under the plan (and with the consolidation of express companies which had already been accomplished), were struck out; and new paragraphs (4) to (17), inclusive, which will be presently analyzed, were inserted in lieu thereof.

of interest in the railroad field were for the first time expressly included within the scope of the Commission's jurisdiction. These holding companies were subjected to the Commission's authority as but one of the instrumentalities or devices through which control might be achieved, but in defining the character of this control specific reference was also made, by way of prohibition except on the Commission's authorization, to certain other expedients—such as interlocking personnel, investment companies, and voting trusts—which in the past have been frequently associated with holding companies in effecting communities of interest without public approval. Furthermore, non-carrier corporations, upon being authorized by the Commission to acquire control of any carrier or carriers, were to be subject to the provisions of section 20 with respect to accounts and reports, to the extent provided by the Commission, as well as to the provisions of section 20a for the regulation of the issuance of securities and assumption of obligations. The Commission was directed to approve of finance applications filed by these companies "only if it finds that such issue or assumption is consistent with the proper performance by each carrier which is under the control of such corporation of its service to the public as a common carrier, will not impair the ability of any such carrier to perform such service, and is otherwise compatible with the public interest."<sup>347</sup> This extension of jurisdiction to holding companies constitutes a highly significant development: at long last, in the federal sphere, railroad holding companies can no longer serve the unhampered ends of power and profit, without reference to the far-reaching effects upon the transportation agencies involved and in subversion of national plans sought to be fashioned by public authority.

Third, both holding-company control and all other forms of combination were expressly prohibited, unless sanctioned by public authority. Not only was provision made that authorization be secured for consolidations, mergers, purchases, leases, operating contracts, or acquisitions of control, but in the absence of such authorization, it was expressly declared to be unlawful "to accomplish or effectuate, or to participate in accomplishing or effectuating, the control or management in a common interest of any two or more carriers, however

<sup>347</sup> Par. (5).

such result is attained, whether directly or indirectly, by use of common directors, officers, or stockholders, a holding or investment company or companies, a voting trust or trusts, or in any other manner whatsoever."<sup>848</sup> Independent consummation of unification projects, as notoriously pursued under the original enactments, was thus explicitly outlawed; exemption from the anti-trust laws and from all other restrictive legislation, state or federal, was rendered a consequence of the Commission's orders authorizing action, instead of constituting a privilege to be sought, where deemed necessary, by way of enabling authority. Moreover, the transactions presumed to accomplish or effectuate control or management in the common interest of two carriers were, without limiting the scope of the general prohibition, concretely but sweepingly defined;<sup>849</sup> and the Commission was authorized, on complaint or on its own initiative, to investigate and determine, not only whether any person (including, wherever used, individuals, partnerships, associations, joint-stock companies, and corporations) is violating the statutory prohibition, but more specifically with respect to past transactions, for the proper protection and in furtherance of its consolidation plan, "whether the holding by any person of stock or other share capital of any carrier (unless acquired with the approval of the Commission) has the ef-

<sup>848</sup> Par. (6). It was also declared to be unlawful "to continue to maintain control or management accomplished or effectuated after the enactment of this amendatory paragraph and in violation of its provisions," the words "control or management" to be construed to include the power to exercise control or management.

<sup>849</sup> Paras. (7) and (8). Any transaction was to be deemed to be of this prohibited character: (a) "If such transaction is by a carrier, and if the effect of such transaction is to place such carrier and persons affiliated with it, taken together, in control of another carrier"; (b) "If such transaction is by a person affiliated with a carrier, and if the effect of such transaction is to place such carrier and persons affiliated with it, taken together, in control of another carrier"; and (c) "If such transaction is by two or more persons acting together, one of whom is a carrier or affiliated with a carrier, and if the effect of such transaction is to place such persons and carriers and persons affiliated with any one of them and persons affiliated with any such affiliated carrier, taken together, in control of another carrier." Furthermore, the nature of the circumstances constituting affiliation was very broadly defined. It was declared that "a person shall be held to be affiliated with a carrier if, by reason of the relationship of such person to such carrier (whether by reason of the method of, or circumstances surrounding organization or operation, or whether established through common directors, officers, or stockholders, a voting trust or trusts, a holding or investment company or companies, or any other direct or indirect means), it is reasonable to believe that the affairs of any carrier of which control may be acquired by such person will be managed in the interest of such other carrier."

fect (a) of subjecting such carrier to common control with another carrier, and (b) of preventing or hindering the carrying out of any part of such plan or of impairing the independence, one of another, of the systems provided for in such plan."<sup>850</sup> Upon finding a person to be violating the prohibition, the Commission was directed to "require such person to take such action as may be necessary," in its opinion, "to prevent continuance of such violation";<sup>851</sup> and upon finding a holding of securities to have the described effects, it was directed to "provide for restricting the exercise of the voting power of such person with respect to such stock or other share capital (by requiring the deposit thereof with a trustee, or by other appropriate means) to the extent necessary to prevent such holding from continuing to have such effects."<sup>852</sup> In unequivocal terms, therefore, resort to the Commission, with respect to the entire range of expedients calculated to effect unifications, was made mandatory; and ample power was conferred upon it, not alone to exercise its regulatory authority, but to scrutinize and alter actions and conditions deemed to be subversive of Congressional policy in this sphere.<sup>853</sup>

Finally, changes in the substantive standards prescribed for the Commission's guidance in passing upon proposed combinations were designed, not only to unify its authority in this field, but to render it a more flexible and effective instrument for the achievement of results. Under the old provisions only a blanket finding of public interest was required for approval of acquisitions of control, while for consolidations into single systems for ownership and operation more stringent and precise conditions, including, in addition to a finding of public interest, the requirement that they conform to the consolidation plan

<sup>850</sup> Pars. (10) and (11).

<sup>851</sup> Par. (10).

<sup>852</sup> Par. (11).

<sup>853</sup> Upon application by the Commission alleging violation of any of these statutory provisions or disobedience of any order issued thereunder, the district courts of the United States were to have jurisdiction "to issue such writs of injunction or other proper process, mandatory or otherwise, as may be necessary to restrain such person from violation of such provision or to compel obedience to such order." Par. (13). But if, in the course of any proceeding before the Commission or before a court in enforcement of an order entered by the Commission, it should appear that since the beginning of the proceeding the consolidation plan had been reopened for changes or modifications with respect to the allocation of properties to any carrier involved, then such proceeding might be suspended. Par. (12).

and that their securities at par do not exceed the value of the constituent properties, were prescribed; under the new provisions a single standard of decision was made applicable to all forms of combination, and this standard, embracing conformity to the consolidation plan and promotion of the public interest, eliminated the rigid financial requirement, dependent upon the availability of current valuation data, which had in the past hampered the consolidation process. "If after [public] hearing," it was provided, "the Commission finds that, subject to such terms and conditions and such modifications as it shall find to be just and reasonable, the proposed consolidation, merger, purchase, lease, operating contract, or acquisition of control will be in harmony with and in furtherance of the plan for the consolidation of railway properties established pursuant to paragraph (3), and will promote the public interest, it may enter an order approving and authorizing such consolidation, merger, purchase, lease, operating contract, or acquisition of control, upon the terms and conditions and with the modifications so found to be just and reasonable."<sup>864</sup> Since the circumstances surrounding particular unification proposals vary widely, since the task of fixing current property valuations is a prolonged and difficult one, since the finding of public interest and the prescription of terms and conditions necessarily comprehend the reasonableness of financial arrangements, and since, under another section of the Act, full authority exists for the regulation of security issues, the broadening of the Commission's discretion, through elimination of the rigid capitalization requirement, involves no threat to the public interest and is calculated to facilitate the accomplishment of desirable combinations.

There is no doubt that this thoroughgoing revision of the legislative basis for governmental guidance of the course of combination constitutes a very significant forward step. Since it was designed to meet difficulties actually encountered in numerous manifestations, it defined the duties of the carriers and the powers of the Commission along highly realistic lines; and since it was the expression of a determined purpose to have railroad organization molded in the national interest, it imposed a wide range of restraints upon private action and established a large reservoir of public authority. If, therefore, upon

<sup>864</sup> Par. 4(b).

measurable achievement of economic recovery, the combination movement should once more gain impetus in fulfilment of existing Congressional policy, its character and direction would doubtless be more largely and more effectively fashioned by the Commission's determinations than at any time in the history of the railroads. It is important to recognize, however, that this revision of the legislative structure, despite its far-reaching implications, retains the two basic elements of the old policy—namely, its insistence upon competition, and its reliance upon voluntary action. Because business rivalry provides strong incentives to efficiency and enterprise, much is clearly to be gained through the creation of balanced systems on a competitive basis; but a substantial body of opinion seriously questions whether the full fruits of consolidation, particularly in the way of eliminating waste and achieving economy, can be realized on such a basis. The depression years have greatly undermined faith in the competitive principle throughout the industrial field. Even ordinary business corporations, free from the impact of any great measure of public regulation, have been permitted to resort to concert of action on an unprecedented scale; the railroads, it is argued, being subject to the stringent control of the Commission in all important aspects of their activity, should be permitted to bring to the transportation service the full advantages of monopolistic operation. As a specific proposal it is most commonly urged that, like the British railroads, they be organized into a small number of regional systems. The persistence of such proposals and of efforts to effectuate them would, of course, seriously check, if not completely impede, the course of combination under existing policy. And of even greater importance, in its bearing upon the prospect of having unifications actually accomplished under the new statutory provisions, is the fact that the contemplated process is entirely voluntary. While the Commission is now vested with ample authority, not only to prevent undesirable carrier affiliations and groupings of roads inconsistent with its planned allocations, but to determine the nature of the combinations, whatever their form, which shall have its approval and authorization, it can exert no affirmative power to have such combinations effected. Since the initiation of proposals as well as their ultimate consummation, after receiving the Commission's sanction, rests in the will of the carriers, and since pri-

vate aims do not generally coincide with public ends, the outlook for extensive achievement of consolidations, particularly under the complete powers of control now vested in the Commission, is not an especially promising one. Under these circumstances there may well be a reversion, more vigorously pressed, to the proposals intermittently made since 1920 for the adoption, as was done in Great Britain as early as 1921, of a policy of compulsory consolidation. Both the establishment of non-competitive systems and the introduction of the element of compulsion would necessitate fundamental legislative changes, and it is problematical, of course, whether such changes are on the immediate horizon. But among the important purposes of the Emergency Railroad Transportation Act of 1933, in addition to encouraging coöperative action on the part of the carriers in the interest of operating economy and promoting financial reorganization of the railroads in the interest of reducing fixed charges, was "to provide for the immediate study of other means of improving conditions surrounding transportation in all its forms and the preparation of plans therefor." The Federal Coördinator of Transportation promptly proceeded with these studies, and the underlying problem of the organization of the railroad industry received his first attention. Not only was the character of desirable consolidation policy deemed relevant to these inquiries, but also the merit of the more extreme alternatives, first, of relying on informal railroad coöperation without special effort to further close combinations on a broad scale, and second, of making an outright transition to government ownership and operation on a completely unified basis. While his conclusions on these fundamental issues are now available, they but provide a guide, primarily, for future legislative action. After a decade and a half of crowded experience, then, the problem of railroad coöperation and combination still awaits solution.<sup>856</sup>

<sup>856</sup> Coördinator Eastman's conclusions on the various issues suggested above can be summarized briefly in his own words: "Theoretically and logically public ownership and operation meets the known ills of the present situation better than any other remedy. Public regulation of a privately owned and operated industry, reaching deeply into such matters as rates, service, capitalization, accounting, extensions and abandonments, mergers and consolidations, is a hybrid arrangement. When an industry becomes so public in character that such intimate regulation of its affairs becomes necessary, in strict logic it would seem that it should cease to masquerade as a private industry and the Government should assume complete responsibility, financial and



## §3. ISSUANCE OF SECURITIES AND ASSUMPTION OF OBLIGATIONS

The final major phase of the Commission's control of organization and finance concerns its functions and activities with respect to the issuance of securities and assumption of obligations by the carriers.<sup>866</sup> As is the case, for the most part, with reference to the regulation of extensions and abandonments and of coöperation and combination,

otherwise. . . . Nevertheless, I am not now prepared to recommend resort to public ownership and operation. This is for the principal reason that the country is not now financially in a condition to stand the strain of an acquisition of these great properties, imposing burdens which cannot be definitely foreseen and might well, in present circumstances, be disproportionately severe. The danger would be enhanced by the fact that there would be a comparatively long period before the new system could be got into smoothly running order, and by the further fact that the railroad industry is now in a stage of accelerated evolution. . . . Nor am I now prepared to recommend a grand consolidation plan. Any attempt to make such a plan effective speedily would require new legislation. It would precipitate a controversy in which many railroads, many communities, and labor would join with equal vigor and from which it would be difficult to emerge. Disregarding this practical difficulty, I am convinced that such a consolidation would have to be compelled and that it would not be wise, even if it be legally possible, to force so radical and far-reaching a change upon the country under present conditions. Nor am I persuaded of the merits of any plan of consolidating the railroads into a very few systems which would follow and emphasize regional lines, and retain, but at the same time vitally disrupt, competitive conditions. . . . It is possible that many of the objectives which are sought in grand consolidation plans or even in public ownership and operation can be attained through coordination, pooling arrangements, and a better organization of the industry. It now seems probable that rather extraordinary opportunities for better and cheaper service will be disclosed, through the pooling of important kinds of traffic, and that such arrangements are possible without consolidation of railroad systems and, if the preservation of competition be desired, without substantial increase in the number of non-competitive points. . . . That consolidations or other unifications of railroad properties, at least within certain limits, may often be desirable is conceded. I do not favor a grand plan of consolidation, to be accomplished either immediately or . . . gradually over a term of years. However, provision for compulsory consolidation under strict supervision merits a trial, both because it would permit such union of railroads to be accelerated where that may be desirable, and because it would . . . permit consolidations to be consummated by exchange of securities and without the use of cash. . . . Efforts toward coordination should not prevent the progress of consolidation, to the extent that it can be shown to be in the public interest. In my judgment, the Commission should be empowered, after full public hearing, to enforce such a consolidation on the terms which it decides to be just and reasonable, whenever the Coordinator requests that it initiate a proceeding for that purpose. I doubt, also, the necessity or desirability of requiring the Commission to adhere to any fixed plan of general railroad consolidation in this connection. Subject to such general standards as Congress may see fit to prescribe, a demonstration that what is proposed will be in the public interest should be the controlling factor." *Regulation of Railroads*, 73d Cong., 2d Sess., Sen. Doc. No. 119 (January 20, 1934), pp. 30, 32-33, 36-37. Coordinator Eastman's specific recommendations, covering the entire field of transportation, are contained in his report on *Transportation Legislation* of January 21, 1935.

<sup>866</sup> Sec. 20a.

the Commission's powers in this sphere are enabling rather than directing in character, both the initiation and execution of proposals resting entirely in the voluntary action of the roads. Within the limits of its permissive jurisdiction, however, sweeping authority was vested in the Commission. The basic provision of the enactment made it 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 . . . 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, even though permitted by the authority creating the carrier corporation, unless and until, and then only to the extent that, upon application of the carrier, and after investigation by the Commission of the purposes and uses of the proposed issue and the proceeds thereof, or of the proposed assumption of obligation or liability . . . the Commission by order authorizes such issue or assumption."<sup>857</sup> And for the exercise of this authority the Commission was clothed with a very broad discretion. The substantive considerations prescribed for its guidance were stated in most general terms, consisting only of the requirement that the issue of securities or assumption of obligations proposed by the carrier be found to be, first, "for some lawful object within its corporate purposes, and compatible with the public interest, which is necessary or appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier, and which will not impair its ability to perform that service," and second, "reasonably necessary and appropriate for such purpose."<sup>858</sup> Furthermore, the holding of hearings in aid of the disposition of applications was made optional with the Commission; and it was empowered "to grant or deny the application as made, or to grant it in part and deny it in part, or to grant it with such modifications and upon such terms and conditions" as it might deem necessary or appropriate in the premises, as well as to issue supplemental orders modifying the provisions of any previous order "as to the particular purposes, uses, and extent to which, or the conditions

<sup>857</sup> Par. (2). Only short-term notes, maturing within not more than two years and amounting in the aggregate to not more than five per cent of the carrier's outstanding securities, may be issued without approval by the Commission. Par. (9).

<sup>858</sup> Par. (2).

under which, any securities so theretofore authorized or the proceeds thereof may be applied."<sup>359</sup> The jurisdiction thus conferred upon the Commission was declared to be "exclusive and plenary," so that upon its order carriers might lawfully issue securities or assume obligations without obtaining approval from any other governmental authority;<sup>360</sup> and securities issued or obligations assumed without the required authorization of the Commission, which were declared to be void, subjected those responsible for them to civil and criminal liability.<sup>361</sup> It is clear that the financial organization of the carriers was placed under the close supervision of the Commission, and with but scant indication of the principles and policies to be applied in the exercise of its regulatory power.<sup>362</sup>

Under this authority, since 1920, all of the more important policies and expedients bearing upon the financial structure of the railroads have been passed upon by the Commission.<sup>363</sup> The large number of applications filed, involving the authorization of a vast aggregate of

<sup>359</sup> Par. (3). It should be noted that the Commission was directed to require all carriers issuing securities, including short-term notes, to submit periodical or special reports showing in such detail as may be prescribed "the disposition made of such securities and the application of the proceeds thereof." Par. (10).

<sup>360</sup> Par. (7).

<sup>361</sup> Par. (11).

<sup>362</sup> As throughout the field of organization and finance, the Commission requires the carriers to provide full and accurate information concerning their proposals for the issuance of securities or assumption of obligations. Applications must be filed sufficiently in advance of the date of the proposed issue or assumption to give the Commission not less than 30 days for the notices and investigations required by law; and the applications must show, in addition to formal data as to corporate organization and personnel, the purposes and uses of the proposed financing, the facts relied upon to support a finding that it satisfies the statutory requirements, at what prices and upon what terms or conditions the securities are proposed to be sold or disposed of, and how and by whom, or through whom, the securities are to be issued, with details of all contracts, underwritings, and other arrangements made or proposed to be made in connection with the financing. Furthermore, numerous specified exhibits must be filed, which set forth not only all essential sources of legal authority, but all relevant physical and financial details bearing upon the application; and the procedure to be followed and the forms to be used are also definitely prescribed. *Instructions to Carriers in Relation to the Issuance of Securities, etc., under Section 20a of the Interstate Commerce Act*, February 19, 1927.

<sup>363</sup> For detailed surveys of the Commission's administrative performance, see David P. Locklin, *Regulation of Security Issues by the Interstate Commerce Commission*, University of Illinois Studies in the Social Sciences, vol. 13, no. 4, December, 1925; John H. Frederick, "Federal Regulation of Railway Securities under the Transportation Act of 1920," *Journal of Political Economy*, vol. 37 (April, 1929), pp. 175-202. See, also, Harold G. Moulton and Associates, *op. cit.*, pp. 275-360.

security issues, have concerned a great variety of situations and have been handled with a high degree of flexibility. While the Commission's jurisdiction is restricted to common carriers by railroad,<sup>864</sup> practically the entire range of the financial transactions of these carriers has fallen within the scope of its authority;<sup>865</sup> and the disposition of proposals has been adjusted to the varying demands of public interest and to the requirements of changing conditions.<sup>866</sup> For the

<sup>864</sup> Sec. 202, par. (1). Thus, in the case of water carriers and of holding companies, the Commission has dismissed applications for want of jurisdiction. *Securities of Seaboard-Bay Line Company*, 71 I.C.C. 501, 502-503 (1922); *Guaranty of Bonds by Ann Arbor R. R.*, 90 I.C.C. 331, 332-333 (1924). The development of railroad holding companies, free from control, created concern on financial grounds as well as because of their bearing upon the course of combination. Note the following: "At the time when [our recommendation with respect to the control of holding companies] was first made, the main purpose which we had in view was to prevent evasion or defeat of the consolidation-plan provisions of the act, which were designed to subject the unification of railroads to the orderly processes of a carefully planned scheme of public regulation. This remains one of the chief purposes of the legislation which we recommend, but recent events have brought sharply into the foreground the need for curbing the operations of holding companies in the interest of the investor." *Annual Report*, 1932, p. 25. See, also, testimony of Commissioner Eastman in *Hearings before Senate Committee on Interstate Commerce on S. 843*, 73d Cong., 1st Sess. (April 5, 1933), p. 52. For an analysis of the powers of control over holding companies conferred upon the Commission by the Emergency Railroad Transportation Act of 1933, see pp. 495-496, *supra*.

<sup>865</sup> The great variety of transactions passed upon by the Commission, embracing numerous types of securities and obligations and a large diversity of details with respect to their issuance or assumption, will be amply illustrated in the pages following. Indeed, in the eagerness of the carriers to comply with the stipulations of the statute, applications have been filed with the Commission concerning matters which it did not deem to require its approval. See, for example: *Purchase-Contract Application of La. Ry. & Nav. Co.*, 67 I.C.C. 808 (1921); *Contract of Grand Trunk Western Ry. with L. C. R. R.*, 70 I.C.C. 554 (1921); *D., T. & I. Investment Certificates*, 82 I.C.C. 411 (1923); *Central of Georgia Railway Deposited Cash*, 90 I.C.C. 1 (1924).

<sup>866</sup> Not only has the method of conditional approval been widely utilized as a means of molding particular financial arrangements in the public interest, but through the issuance of supplemental orders the Commission has frequently modified its original findings in a variety of important respects by way of meeting the demands of altered situations. For conditional orders, see for example: *Bonds of New York Central R. R.*, 65 I.C.C. 172 (1920); *Notes of Indiana Harbor Belt R. R.*, 65 I.C.C. 362 (1920); *Stock of Leavenworth & Topeka R. R.*, 70 I.C.C. 632 (1921); *Rock Island Equipment Trust, Series M*, 94 I.C.C. 1 (1924); *Securities of National Coal Ry.*, 99 I.C.C. 787 (1925). For supplemental orders, see for example: *Securities of Chicago & Eastern Illinois Ry.*, 70 I.C.C. 589 (1921), modifying order in 67 I.C.C. 61 (1921); *Bonds of Ann Arbor R. R.*, 70 I.C.C. 631 (1921), modifying order in 70 I.C.C. 36 (1921); *Notes of Raritan River R. R.*, 71 I.C.C. 188 (1922), modifying order in 67 I.C.C. 260 (1921); *Bonds of New York Central R. R.*, 71 I.C.C. 334 (1922), modifying order in 65 I.C.C. 534 (1920); *Norfolk & Western Equipment Trust*, 1922, 72 I.C.C. 805 (1922), modifying order in 71 I.C.C. 749 (1922); *D. & R. G. W. Receiver's*

most part, however, the Commission has not been disposed to interfere unnecessarily with the freedom of the carriers. The vast bulk of applications, after being checked and investigated by the Bureau of Finance, are approved by Division 4 in more or less routine fashion, its brief reports setting forth the relevant facts summarily and concluding with the requisite findings and orders. Public hearings are held rather infrequently, and denials of applications, elaborately reasoned opinions, dissenting expressions, and determinations by the full Commission are relatively rare. This approach reflects the permissive character of the Commission's authority, and it has made possible prompt performance. But it is not to be inferred that, in deference to managerial independence or administrative efficiency, crucial issues have been ignored and the Commission has merely served as a ratifying agency. When proposed transactions are deemed to be incompatible with the public interest, the applications are denied, in whole or in part, or appropriate conditions are imposed; and when important questions of principle come to issue, extensive reports are prepared, individual commissioners express views diverging from those of the majority, and the controversies occasionally receive the attention of the Commission as a whole. The more significant matters of substantive policy which disclose the character and direction of the Commission's administrative record in this sphere center about its determinations with respect to the extent of capitalization, the types of instruments employed, the terms and conditions of issue, and the expedients adopted in connection with reorganizations. Each of these aspects of its performance will be analyzed and appraised.

#### *Extent of Capitalization*

Perhaps the most obvious purpose of Congress in empowering the Commission to regulate security issues was that of preventing excessive capitalization. The loose financial practices of some of the carriers, as notoriously pursued in the early days of railroad construction

*Certificates*, 79 I.C.C. 169 (1923), modifying order in 76 I.C.C. 411 (1922); *Fonds, Johnstown & Gloversville Bonds*, 86 I.C.C. 378 (1924), modifying order in 72 I.C.C. 462 (1922); *Bonds of Chicago Union Station Co.*, 94 I.C.C. 177 (1924), modifying order in 86 I.C.C. 529 (1924); *Bonds of Detroit, T. & I. R. Co.*, 145 I.C.C. 563 (1928), modifying order in 94 I.C.C. 706 (1925).

and intermittently continued into the second decade of the twentieth century, created a widespread popular belief that the railroads were grossly overcapitalized.<sup>867</sup> The passage of the Valuation Act of 1913 was induced in considerable measure by a desire to test the propriety of existing railroad capitalization, and the financial provisions of the 1920 legislation were designed to prevent for the future serious discrepancies between invested capital and capital issues. Although the results of the Commission's valuation project have largely dispelled the view that the face value of railroad securities exceeds the property values which these securities represent (leaving out of account, of course, the great shrinkage in the commercial value of the railroads springing from the sharp curtailment of earnings produced by the depression and in lesser degree by the competition of alternative transportation agencies), and although, under the rule of rate-making, the level of railroad charges and the extent of net operating income were made to depend upon property values rather than upon the amount of outstanding securities, the need of preventing overcapitalization continued to be operative. Even in face of a proper equivalence between capital and capitalization for the carriers as a whole, individual roads may well be burdened by unsound financial structures; and such structures unquestionably affect the credit of the lines, and thus, indirectly, the course of their rates and the adequacy of their service. As a practical matter, in other words, the fact of overcapitalization exerts a real influence upon the rate and service policies of both the carriers involved and the regulatory authorities, despite the general irrelevance of the amount of outstanding securities from a strictly legal standpoint.<sup>868</sup> For the protection of the public interest, therefore, the prevention of overcapitalization has constituted one of the Commission's major purposes in the exercise of its authority over the issuance of securities. To the extent that capital issues have been restricted to amounts covering capital assets acquired or to be acquired at reasonable cost this purpose has dominated its administrative performance.

While in reaching its determination on the particular facts of each

<sup>867</sup> For an analysis of the need of financial control, see Part I, pp. 86-94.

<sup>868</sup> See James C. Bonbright, *Railroad Capitalization* (1920), especially at pp. 13-63 and 156-168.

proceeding the Commission has occasionally encountered controlling needs for compromise,<sup>869</sup> it has insisted on the whole upon a reasonable equivalence between capital and capitalization.<sup>870</sup> This objective has been attained primarily through restricting security issues to the

<sup>869</sup> Since, prior to 1920, the railroads had enjoyed virtual freedom in matters of financial organization, applications for new financing, though sound in themselves, are sometimes filed by carriers already overcapitalized. Under such circumstances the Commission does not generally attempt to eliminate the excess securities incident to uncontrolled past transactions as a condition of approval of the proposed issues. To impede the consummation of proper financial arrangements because of such earlier overcapitalization would tend to prove damaging not only to innocent holders of securities but to those dependent upon the maintenance of adequate service. Accordingly, refunding operations have been approved, for example, despite the perpetuation thereby of an existing condition of overcapitalization. See *Bonds of Bullfrog Goldfield R. R.*, 70 I.C.C. 354 (1921); *Bonds of N. Y., L. E. & W. Coal & R. R. Co.*, 71 I.C.C. 541 (1922). Even where the proposed issue would itself produce an excess of capitalization over capital assets, or would increase the amount of existing overcapitalization, the Commission has sometimes accorded approval to the transaction, when it appeared that the projected financing was essential to the continuance of the service or the avoidance of receivership. Thus, in *Securities of Washington & Lincolnton R. R.*, 67 I.C.C. 774 (1921), an excess of securities over book investment was authorized, upon a finding that "the proposed expenditures are necessary to put the road in proper operating condition" and that "the proposed stock issue seems to offer the only practicable means of saving the road and insuring its continued operation" (p. 776); and in *Bonds of Bullfrog Goldfield R. R.*, *supra*, the Commission authorized a further increase in the capitalization of an overcapitalized property upon representations "that this is the best arrangement that can be made, and that unless it becomes effective it is probable that a receiver for the applicant will be appointed, with possible suspension of service" (p. 356). For other instances of approval of issues resulting in overcapitalization, induced by the special circumstances of the particular proceeding, see *Eastland, Wichita Falls & Gulf R. R. Stocks & Bonds*, 72 I.C.C. 181 (1922); *Electric Short Line Railway Bonds*, 76 I.C.C. 568 (1923). It should be noted, however, that in such circumstances the Commission often imposes conditions designed to eliminate or reduce the excess of capitalization. Thus, in *Stock of Leavenworth & Topeka R. R.*, 70 I.C.C. 632 (1921), it was provided "that before the applicant shall declare any dividends on its capital stock it shall establish out of future earnings a parity between its capital investment and capital liabilities" (p. 634); and in *Stock of Chicago & Illinois Western R. R.*, 70 I.C.C. 652 (1921), it was provided "that, before declaring any dividends, the applicant shall expend from income not less than \$309,000," the amount of the overcapitalization, for additions and betterments or for retirement of bonded indebtedness (p. 653).

<sup>870</sup> For the denial of applications, in whole or in part, and the imposition of restrictive conditions, primarily with a view to preventing excessive capitalization, see for example: *Securities of Cisco & Northeastern Ry.*, 70 I.C.C. 260 (1921); *Securities Application of D. & T. S. L. R. R.*, 70 I.C.C. 322 (1921); *Securities Application of Apache Ry.*, 71 I.C.C. 245 (1922); *Securities of St. Louis-San Francisco Ry.*, 79 I.C.C. 92 (1923), 79 I.C.C. 323 (1923), 86 I.C.C. 818 (1924); *Stock of Interstate R. R.*, 82 I.C.C. 359 (1923); *Wildwood & Delaware Bay Short Line Bonds*, 82 I.C.C. 825 (1923), 94 I.C.C. 682 (1925); *Stock of Alton & Southern R. R.*, 90 I.C.C. 363 (1924); *Bonds of K. & I. T. R. R.*, 99 I.C.C. 215 (1925); *Securities of National Coal Ry.*, 99

amount of capitalizable assets and through scrutinizing the values placed upon these capitalizable assets. Thus, as a general rule, the Commission permits "the capitalization of those assets of the carrier only which have been provided and which are intended for continuing productive use in the service of transportation,"<sup>871</sup> with the result that approved capital issues represent in large measure items properly chargeable to investment in road and equipment.<sup>872</sup> In conformity with this approach, it has been held that investments in non-carrier properties and securities are not capitalizable,<sup>873</sup> and that "ordinarily a carrier may properly capitalize investments in the stock of another corporation where, and only where, the latter is the owner of operated railway property and the carrier's holdings are sufficient and essential to give it control of that corporation and it appears that such

I.C.C. 787 (1925); *Bonds of New York Connecting R. R.*, 105 I.C.C. 402 (1926); *Bonds of Tennessee R. R.*, 111 I.C.C. 362 (1926).

<sup>871</sup> *Securities of Louisville & Nashville R. R.*, 76 I.C.C. 718, 720 (1923). See, also, *R. & P. Dividend Obligations*, 79 I.C.C. 465, 467-468 (1923).

<sup>872</sup> It should be noted, however, that the Commission does not always authorize securities to the full amount of the capitalizable assets. Where, because of the applicant's financial position, such authorization is not deemed to be in the public interest, the Commission has granted the application only in part and has prescribed the uses to which the proceeds of the issue might be put. For example: "The applicant desires to issue said \$200,000 of bonds against its uncanceled investment in road and equipment. Its financial condition is such, however, that it should be permitted to issue said bonds only to the amount necessary to enable it to make the proposed payments to the holders of said notes, and to pay the amount of its indebtedness to other creditors on open account by reason of the construction of said extension; and that it should be required to use the proceeds of said bonds solely for the purpose of making said payments." *Bonds of Fernwood, Columbia & Gulf R. R.*, 67 I.C.C. 418, 419 (1921).

<sup>873</sup> In referring to stocks of advertising, mining, timber, and land companies, and to United States government bonds and certificates of indebtedness, municipal bonds, and steel company bonds, held in the treasury of the applicant, the Commission said: "These are flexible assets which we deem it improper to permit applicant to capitalize. If it should be thought desirable to distribute the portion of surplus invested in such securities among the stockholders, the applicant would be able to apportion the securities themselves or distribute the proceeds thereof. They are neither property used or useful in rendering the public service, nor an assured part of any surplus." Similarly, the Commission declined to authorize the capitalization of investments in non-operating properties: "The reasons for acquiring and holding these properties are not stated, and no present or contemplated future use of them in connection with the applicant's transportation service is shown." *Stock of Delaware, Lackawanna & Western R. R.*, 67 I.C.C. 426, 433-434 (1921). Note, also, the following: "The applicant's miscellaneous physical property and investment in noncarrier companies and other investments do not appear to be held for and used in the service of transportation and are not recognized as of a capitalizable nature. . . ." *Stock Dividend of Oahu Railway & Land Co.*, 86 I.C.C. 137, 140 (1923).



control will probably be permanent.<sup>874</sup> A like purpose of restricting capitalization to the carrier's continuing capital investment in the transportation service has guided the Commission's treatment of other asset items, such as special deposits and reserve funds,<sup>875</sup> and

<sup>874</sup> Furthermore, in treating such securities as capitalizable assets, the Commission has imposed conditions prohibiting the applicant to sell, pledge, or otherwise dispose of them without first obtaining its consent. In the case of union-station projects and terminal lines, however, where joint enterprise is deemed desirable, actual investments are permitted to be capitalized, whether or not the holdings of securities carry control. *Securities of Louisville & Nashville R. R.*, 76 I.C.C. 718, 723 (1923); *R. F. & P. Dividend Obligations*, 79 I.C.C. 465, 469 (1923). Where the holdings of securities are deemed unnecessary, they are removed from the capitalization base. Thus, the Commission has declined to authorize the capitalization of stocks and bonds of leased lines held by the applicant: "The record discloses no intercorporate relations or other circumstances which bring these holdings within the sphere of securities which could properly be capitalized by a common carrier. It is not necessary for the applicant to hold securities of its leased lines in order to operate its system if, as it states, its leases are in perpetuity." *Stock of Delaware, Lackawanna & Western R. R.*, 67 I.C.C. 426, 433 (1921). But compare the following relevant considerations from the concurring opinion of Commissioner Daniels: "Assuming that the lease obligates the applicant to pay dividends on the stock and interest on the bonds, the acquisition of the stock out of applicant's surplus lessens the fixed charge to just the same degree as if that much additional property had been acquired outright. Applicant simply pays the guaranteed dividend to itself. The fact that the . . . stock will be outstanding and at the same time an equivalent amount of applicant's stock would have been issued is immaterial, inasmuch as there is no double return exacted from the users of the property represented thereby" (p. 436). Improvements on leased property are regarded "as capitalizable assets, if, but not unless, they have been made on property of which the applicant is the virtual owner." *Securities of Louisville & Nashville R. R.*, *supra*, at p. 721. Accordingly, an inadequate record as to the nature and length of the applicant's tenure has resulted in a refusal to authorize the capitalization of such improvements: "The applicant is not seeking to capitalize any equity in its leases of railroad property, but only the amount of earnings said to have been invested by it in the properties of such roads. The evidence is that most of these roads are leased in perpetuity, but that some are leased for the corporate life of the subsidiary line. Without the leases before us we are unable to determine the length or nature of the applicant's tenure, and can not on the present record authorize it to capitalize its total investment in such property." *Stock of Delaware, Lackawanna & Western R. R.*, *supra*, at p. 435. Similarly, in the case of operation under trackage rights, the applicant's estate in the line so operated was declared to be "of a nature that would not permit the capitalization of expenditures made in respect thereof." *Stock of Alabama & W. F. R. Co.*, 150 I.C.C. 243, 245 (1929).

<sup>875</sup> For example: "As it now appears that the funds represented by cash and special deposits set aside for the purchase of equipment are beyond the Frisco's control except for that purpose, they may properly be regarded as capitalizable assets." *Securities of S. L.-S. F. Ry.*, 79 I.C.C. 323, 324-325 (1923). "The items for depreciation are not regarded as forming proper bases for the issue of a stock dividend by a common carrier; and the same is true concerning the item of insurance and casualty reserves. The establishment of these reserves implies that they will be needed for replacements in the future." *Stock Dividend of Oahu Railway & Land Co.*, 86 I.C.C. 137, 138-139

working capital, materials, and supplies.<sup>876</sup> In limiting the issuance of securities to capitalizable assets as thus conceived, the Commission has sought to curb overcapitalization, with a view to the maintenance of a sound financial structure for the effective regulation of rates and earnings, and to harmonize its policies in this sphere with its accounting and valuation practices.

But the mere differentiation between capitalizable and non-capitalizable assets is not sufficient to achieve these ends; it is also neces-

(1923). "Assets held in insurance funds are for the purpose of restoring property damaged or destroyed by fire, or otherwise, which property undoubtedly already constitutes the basis for capitalization. Therefore Liberty Bonds in such funds will not be considered as a part of working capital." *Securities of St. Louis-San Francisco Ry.*, 86 I.C.C. 818, 821 (1924). The principles involved in the foregoing determinations are concretely illustrated, with reference to sinking funds, by the following: "On September 20, 1922, the book value of the assets in the applicant's sinking funds, excluding its own securities was \$446,907.52. This amount includes \$19,400 stock of the Louisville Property Company held by the applicant as trustee for the holders of outstanding scrip convertible into such stock; and \$114,372.52 deposited by the applicant with mortgage trustees to cover certain of its outstanding bonds and interest coupons, which are past due, and to secure the release of the mortgages securing those bonds. The obligations to be met by the stock and deposits are classified by the applicant as current or deferred liabilities. Obviously, these deposits and stock are not capitalizable assets. The other sinking-fund assets are United States Government Liberty bonds of the book value of \$299,977.06 and cash to the amount of \$127,530.46. Certain property was released from the lien of the Birmingham Mineral Railroad Company's first mortgage and sold by the applicant; and the proceeds thereof, \$299,997.13, were deposited with the mortgage trustee, which invested \$299,977.06 thereof in the Liberty bonds. These bonds and the remaining \$20.07 of the cash proceeds are held by the trustee in lieu of that property and will either be used to substitute under the lien of the mortgage additional property approved by the trustee, or applied to the payment of bonds secured by the mortgage. In the latter event, to the extent of the amount so applied, no refunding bonds will be issued. Under the circumstances, the Liberty bonds and the \$20.07 may be regarded as capitalizable assets. There is no sound economic principle, however, which would justify the capitalization by the applicant of the remaining \$127,530.46 of cash held in its sinking funds." *Securities of Louisville & Nashville R. R.*, 76 I.C.C. 718, 722-723 (1923).

<sup>876</sup> The Commission has consistently held that a carrier may properly capitalize a reasonable amount of working capital, including a sum sufficient to enable it to maintain an adequate stock of materials and supplies, but it has carefully scrutinized the claims of the applicants, from the standpoint of the propriety of both the assets included in the category of working capital and the sums assigned to such assets as are found to belong in that category. See, for example: *Securities of Louisville & Nashville R. R.*, 76 I.C.C. 718, 724-725 (1923); *Securities of St. Louis-San Francisco Ry.*, 79 I.C.C. 92, 96 (1923); *R. F. & P. Dividend Obligations*, 79 I.C.C. 465, 470 (1923); *Stock Dividend of Oahu Railway & Land Co.*, 86 I.C.C. 137, 139-140 (1923); *South Georgia Ry. Capital Stock*, 86 I.C.C. 713, 714 (1924); *Securities of St. Louis-San Francisco Ry.*, 86 I.C.C. 818, 821 (1924); *Stock of Alton & Southern R. R.*, 90 I.C.C. 363, 364-365 (1924).

sary that appropriate values be placed upon the capitalizable assets. In the performance of this aspect of its regulatory task, the Commission's determinations have been flexibly adjusted to the varying circumstances of each proceeding. The Commission has promulgated no single standard, such as actual cost or reproduction cost, for testing the propriety of railroad capitalization, nor has it uniformly restricted itself to physical valuations of carrier property, without reference to commercial considerations.<sup>877</sup> Furthermore, since the results of its valuation project, in final form, have been generally unavailable for use in these finance proceedings,<sup>878</sup> it has necessarily been forced to rely upon the book values reported by the carriers, despite their unreliability with respect to property acquired prior to the establishment of strict accounting control, and has merely checked these book values, wherever practicable, by reference to its tentative valuations

<sup>877</sup> Note the following, for example, from *Securities of La. Ry. & Nav. Co. of Tex.*, 99 I.C.C. 357 (1925), in which the whole Commission affirmed the report and order of Division 4 in 90 I.C.C. 229 (1924): "Counsel for the applicant argues that the requirement of compatibility with the public interest is fully met by a showing that the physical value of the property equals or exceeds the proposed capitalization; and that even though it appears certain that the capitalization proposed by a carrier will quickly result in a receivership, we are required by law to approve the application provided such showing is made. In other words, it is contended in substance that the law contemplates the consideration by us of the single element of physical value of property in determining what shall constitute proper capitalization and that such elements as commercial value, earning capacity, etc., must be disregarded. We believe that this contention is clearly refuted by the plain language of section 20a of the act" (p. 359). See, also, *Control of Erie R. R. and Pere Marquette Ry.*, 138 I.C.C. 517 (1928); *Proposed Control of Erie R. and Pere M. Ry. Cos.*, 150 I.C.C. 751 (1929).

<sup>878</sup> Thus: "As stated before, we have not yet established the final valuation of the properties which are to be included in the reorganization. It is therefore impracticable to compare the proposed capitalization with the underlying value. It appears, however, that the new capitalization will be substantially lower than the total capital liability of the companies comprising the present Missouri-Kansas-Texas system and that the fixed charges will be materially reduced, with a consequent improvement in credit. The evidence also indicates that the new capitalization will not be disproportionate to the earning power of the applicant. Under these circumstances and in view of the manifest desirability of ending the long period of receiverships, we think that approval of the proposed capitalization should not be withheld because of the fact that a final valuation has not been made of the properties which are to be included in the reorganization." *Missouri-Kansas-Texas Reorganization*, 76 I.C.C. 84, 104 (1922). Again: "Inasmuch as we have not yet established the final valuation of the Frisco's properties, it is impracticable to compare its capitalization with the underlying value; therefore, nothing contained herein is to be taken as an expression of opinion with respect to, or as a determination of, such value." *Securities of St. Louis-San Francisco Ry.*, 79 I.C.C. 92, 97 (1923).

and underlying valuation data.<sup>879</sup> But whatever the relationship between the aggregate securities of a carrier and the official valuation which may finally be placed upon its properties, the Commission generally restricts the capitalization of current investments for additions and betterments and the purchase of equipment to the reasonable costs of the properties involved,<sup>880</sup> and it similarly seeks to prevent the inflation of capitalization in connection with acquisitions of control<sup>881</sup> and conversion and refunding operations.<sup>882</sup> All these policies with respect to capitalizable assets and their valuation, which have been designed to safeguard the public interest in proper capitalization without undue encroachment upon managerial freedom, have generally been accepted as a matter of course by the carriers and have given rise to little disagreement within the Commission.

The controversial issues bearing upon the extent of capitalization have chiefly concerned the propriety of capitalizing corporate sur-

<sup>879</sup> See, for example: *Bonds of Bullfrog Goldfield R. R.*, 70 I.C.C. 354, 355 (1921); *Securities Application of Pittsburgh & W. Va. Ry.*, 76 I.C.C. 663, 668 (1923); *Denver & Rio Grande Western Reorganization*, 90 I.C.C. 141, 143-145 (1924).

<sup>880</sup> Thus, in authorizing the assumption of obligations with respect to \$270,000 of equipment-trust certificates, instead of \$396,000 as requested, it was said: "An increased operating efficiency from the use of such locomotives appears to reflect the wisdom of procuring, repairing, and modernizing them, but the conditions under which the rehabilitation was done resulted in a cost to applicant far beyond any reasonable valuation assignable to these locomotives when ready for service." The cost of purchasing, reconditioning, and improving the locomotives averaged about \$45,600, whereas at "about the time these locomotives were obtained new ones of a similar type were quoted to cost approximately \$40,000." *Akron, Canton & Youngstown Ry. Engine Trust*, 71 I.C.C. 237, 238 (1922). Again, in authorizing the issuance of \$253,920 of notes in payment for certain construction, instead of \$270,000 as requested, it was said: "It appears that \$280,000 [\$10,000 was to be paid in cash] was not representative of actual expenditures but was an amount agreed upon by the two parties and in the nature of a compromise. Of this total, the applicant has distributed \$11,300 to ballast and \$30,800 to track laying and surfacing. From a detailed analysis of these amounts, we are of the opinion that they exceed the fair cost of the construction represented thereby. And we are also of the opinion that cost for such work should not exceed \$6,700 and \$19,320, respectively. We will therefore limit the amount of the notes to \$253,920." *Sewell Valley R. R. Notes*, 79 I.C.C. 177, 177-178 (1923). There have been numerous proceedings in which issues and assumptions have been scaled down on this basis.

<sup>881</sup> See, for example: *Control of Sewell Valley R. R.*, 124 I.C.C. 195 (1927), 138 I.C.C. 85 (1928); *Acquisition of Lines by Gulf, M. & N. R. Co.*, 154 I.C.C. 479 (1929); *Chesapeake & O. Ry. Co. Acquisition*, 162 I.C.C. 323 (1930).

<sup>882</sup> See, for example: *Bonds of Union Pacific R. R.*, 65 I.C.C. 735 (1921); *Bonds of Chesapeake & Ohio Ry.*, 65 I.C.C. 743 (1921); *Bonds of New Orleans, Texas & Mexico Ry.*, 90 I.C.C. 84 (1924).

pluses, usually arising from reinvested earnings, through the issuance of stock dividends. The Commission has in many instances authorized such stock dividends,<sup>888</sup> and in doing so it has rejected the doctrine that reinvested earnings are impliedly held in trust for the public benefit and hence are not capitalizable.<sup>884</sup> The position of the majority of its membership has been stated as follows: "Where the public has found it expedient to adopt a *laissez-faire* policy to encourage utility development, it can not be said, in the absence of regulation, that profits have been illegally collected. The title to the surplus has vested without limitation or condition in the corporation, and benefits the shareholder. The doctrine of implied trust, sometimes applied to donated property by courts and commissions, has no application to excessive return, for the payment of rates carries with it no requirement that the funds be left in the business or used for the public benefit. Its strained application to carriers which have made additions and betterments from surplus would only penalize those who came nearest to benefiting the public. The surplus from income, in such cases, is unrestricted legal property of the company, and ceases to be funds of the public, before the decision to divert it to either dividends or additions and betterments is made."<sup>885</sup> But the Commission has not accorded the roads a free hand in such transactions; in other words, the distribution of surpluses as stock dividends, like the issuance of securities under other circumstances, is made to depend upon its authorization: "Authority to issue stock can not be claimed as a right. It

<sup>888</sup> *Stock of Chicago, Burlington & Quincy R. R.*, 67 I.C.C. 156 (1921); *Stock of Delaware, Lackawanna & Western R. R.*, 67 I.C.C. 426 (1921); *Securities of Louisville & Nashville R. R.*, 76 I.C.C. 718 (1923); *R. F. & P. Dividend Obligations*, 79 I.C.C. 465 (1923); *Stock Dividend of Kahului R. R.*, 86 I.C.C. 309 (1924); *South Georgia Ry. Capital Stock*, 86 I.C.C. 713 (1924), reversing the denial of authority in 82 I.C.C. 723 (1923); *Stock of New Jersey, Indiana & Illinois R. R.*, 94 I.C.C. 727 (1925), modifying original report and order in 86 I.C.C. 718 (1924), and 111 I.C.C. 749 (1926); *Stock of Alabama & Vicksburg Ry.*, 94 I.C.C. 732 (1925); *Stock of C., N. O. & T. P. Ry.*, 105 I.C.C. 683 (1926); *Stock of Glasgow Ry.*, 117 I.C.C. 578 (1927); *Stock of Lake Superior & Ishpeming R. R.*, 131 I.C.C. 331 (1927); *Stock of Missouri-Illinois R. R.*, 131 I.C.C. 467 (1927); *Pittsburgh & Lake Erie Stock Dividend*, 131 I.C.C. 584 (1927).

<sup>884</sup> In *Stock of Chicago, Burlington & Quincy R. R.*, 67 I.C.C. 156 (1921), the first of the stock-dividend cases, the Commission said unqualifiedly: "No one questions the right of owners to compensation for sacrifices made in foregoing dividends" (p. 163).

<sup>885</sup> *Stock of Delaware, Lackawanna & Western R. R.*, 67 I.C.C. 426 (1921), at p. 432.

is within our discretion, subject to the limitation that we shall grant authority only if we are able to make the necessary finding. If the applicant is lawfully entitled to earn a return upon the fair value of property acquired out of surplus this right will persist whether or not the stock issue is permitted.<sup>886</sup> Furthermore, while the advantages alleged by the carriers to spring from the issuance of stock dividends on the basis of uncanceled surpluses—by way of improving conditions for meeting their financial requirements,<sup>887</sup> removing the apparent unreasonableness of their nominal dividend rates,<sup>888</sup> facilitating desirable combinations by bringing par values and market values of outstanding shares closer together,<sup>889</sup> and making the policy of

<sup>886</sup> *Ibid.*, at p. 431. Note, also, the following from *Securities of Louisville & Nashville R. R.*, 76 I.C.C. 718, 720 (1923): "The applicant contends that it has the absolute legal right to distribute, in the form of a stock dividend, its entire surplus, regardless of the nature of the assets of which it consists. Section 20a of the interstate commerce act, however, makes it unlawful for any carrier to issue stock or other securities unless by order we authorize such issue . . ." and the following from *Proposed Control of Erie R. and Pere M. Ry. Cos.*, 150 I.C.C. 751, 756 (1929): "While we have recognized the right of stockholders to a distribution of corporate profits and to compensation for sacrifices made in the past, we have also pointed out the necessity for authority under section 20a of the act for the issuance of securities, including stock dividends."

<sup>887</sup> Thus: "The applicant seeks authority to issue \$60,000,000 additional capital stock [as a dividend] as a necessary basis for the proposed mortgage, under which the aggregate amount of such bonds can not exceed three times the outstanding capital stock." *Stock of Chicago, Burlington & Quincy R. R.*, 67 I.C.C. 156, 162 (1921). Again: "To justify the proposed stock dividend the applicant contends that a stock base of at least \$125,000,000 is necessary to enable it to meet its present and future financial requirements, including the refunding of outstanding bonds, without exceeding the 3 to 1 ratio prescribed in its first and refunding mortgage." *Securities of Louisville & Nashville R. R.*, 76 I.C.C. 718, 719 (1923).

<sup>888</sup> For example: "The applicant points out that the lawful declaration of dividends at a rate high in comparison with that of other railroads in the same territory has led the public to the unwarranted conclusion that it has received and is receiving an excessive return on its investment in property devoted to public use, and that the proposed increase in stock would tend to remove this source of distrust and suspicion." *Stock of Delaware, Lackawanna & Western R. R.*, 67 I.C.C. 426, 432 (1921). See, also, dissenting opinions of Commissioner Eastman in *Stock of El Paso & Southwestern Co.*, 70 I.C.C. 208, 209 (1921); *R., F. & P. Dividend Obligations*, 79 I.C.C. 465, 472 (1923); *Stock of Alabama & Vicksburg Ry.*, 94 I.C.C. 732, 734-735 (1925).

<sup>889</sup> In *Stock of Delaware, Lackawanna & Western R. R.*, 67 I.C.C. 426, 432 (1921), for example, it was suggested "that in case of consolidations with other lines the applicant could secure much better terms if its capital stock more nearly represented its value than as at present." And in *South Georgia Ry. Capital Stock*, 86 I.C.C. 713 (1924) the issue of a stock dividend of \$232,000 by the applicant was authorized, in connection with an acquisition of control, "for the purpose of more nearly equalizing its capitalization with its capitalizable assets." The following considerations appear to have been controlling: "The applicant contends that it would not be practicable for it to undertake

reinvestment of earnings attractive to stockholders<sup>890</sup>—have been sufficiently persuasive to support authorization in most instances, these authorizations have been grounded in the existence of conditions deemed to be essential for the protection of the public interest. In essence, assuming a reasonable need for the proposed issue, a two-fold showing must be made: first, that a real surplus of capitalizable assets over capital liabilities exists; and second, that a substantial uncapitalized surplus would remain after the authorized distribution has been made. Thus, the Commission has denied an application for the issuance of a stock dividend because the evidence failed to show satisfactorily “that the value of the applicant’s road and equipment,

the acquisition of the West Coast Railway under the conditions prescribed in our supplemental report and order. . . . While substantially all of the stock of the West Coast is owned by holders of the South Georgia stock, the ratio of such ownership is not uniform, and the exchange of stock as heretofore authorized would unduly benefit some stockholders and unduly prejudice others. It is pointed out that on the basis of book value South Georgia stock is worth approximately \$200 a share and West Coast stock is worth approximately \$100 a share. By exchanging on a par-for-par basis, those who hold more West Coast stock than South Georgia stock would benefit materially while those whose holdings are the reverse would lose. It is further alleged that by exchanging the stock on a par-for-par basis without first increasing the amount of South Georgia stock outstanding, it would be possible to deprive the present management of the South Georgia of its control of the company” (p. 715).

<sup>890</sup> The contentions of this character have been summarized by the Commission as follows: “The applicant contends that we should permit the capitalization of the full surplus of the company. It argues that refusal to grant the application would seriously discourage, if not entirely prevent, investment by the public in railway stocks. Some inducement, it says, must be offered investors in stock, to make up for the security and certainty both as to principal and interest afforded by mortgage bonds, and therefore that there must be a chance of more attractive return in the case of stock. It alleges that a refusal to grant this application would be public notice of a lack of advantage in investing in stock. And it suggests that in the event of denial of the application there would be no inducement in the future to use surplus earnings for additions and betterments, and that stockholders would insist each year upon the distribution of all available earnings.” *Stock of Delaware, Lackawanna & Western R. R.*, 67 I.C.C. 426, 431-432 (1921). Note, also, the following from the concurring opinion of Commissioner Potter in *Stock of New Jersey, Indiana & Illinois R. R.*, 86 I.C.C. 718, 720 (1924): “The public interest is served by encouraging stockholders to put earnings back into the property. To refuse permission to capitalize such earnings is to discourage a meritorious policy. Where, as in this case, earnings have been put into the property in the light of a long-established right to obtain securities therefor, denial savors of confiscation. The proprietary company is entitled to have reflected in its accounts the prosperity of its subsidiary. Since the earnings of the subsidiary have been invested in additions and betterments to its property, it is impossible to disburse them in cash dividends. The only way they can be reflected is by the payment of a stock dividend. To pay such a dividend is in accordance with the law and custom which we have no authority or right to repeal or condemn.”

plus a proper sum for working capital and for materials and supplies, exceeds or equals the present capitalization of the applicant";<sup>891</sup> and in scaling down the amount of stock to be issued as a dividend, it has established the doctrine that only those assets should be capitalized "which have been provided and which are intended for continuing productive use in the service of transportation,"<sup>892</sup> and that "a substantial surplus should remain uncanceled as a support for the applicant's credit, providing for emergency needs, offsetting obsolescence and necessary investments in nonrevenue-producing property, and serving as a general financial balance-wheel."<sup>893</sup> The administrative findings have been primarily directed to these considerations,<sup>894</sup> but in the exercise of the discretion inherent in this approach

<sup>891</sup> *Securities Application of D. & T. S. L. R. R.*, 70 I.C.C. 322, 323 (1921). Advance authority to issue stock dividends was also denied: "The applicant seeks authority also to issue stock dividends from time to time, as further expenditures shall be made from income for additions and betterments, thus capitalizing such expenditures. Authority therefor should be requested when the expenditures have been made." *Ibid.* For other denials of applications to issue stock dividends, see *South Georgia Ry. Capital Stock*, 82 I.C.C. 723 (1923), which was reversed in 86 I.C.C. 713 (1924); *Stock Dividend of Oahu Railway & Land Co.*, 86 I.C.C. 137 (1923); *Stock Issue by Pere Marquette Ry.*, 131 I.C.C. 304 (1927); *Securities of Alton & E. R. Co.*, 150 I.C.C. 519 (1929).

<sup>892</sup> *Securities of Louisville & Nashville R. R.*, 76 I.C.C. 718, 720 (1923). In this proceeding the amount requested was \$53,000,000, and the amount authorized was \$45,000,000. In *Stock of Delaware, Lackawanna & Western R. R.*, 67 I.C.C. 426 (1921), the applicant sought to capitalize its entire corporate surplus—\$90,461,776.03—but after an analysis of its capitalizable assets and its surplus requirements, only \$45,000,000 was authorized as a stock dividend.

<sup>893</sup> *Stock of Delaware, Lackawanna & Western R. R.*, 67 I.C.C. 426, 433 (1921). See, also, *Stock of Chicago, Burlington & Quincy R. R.*, 67 I.C.C. 156, 162 (1921); *Securities of Louisville & Nashville R. R.*, 76 I.C.C. 718, 720 (1923); *R. F. & P. Dividend Obligations*, 79 I.C.C. 465, 471 (1923); *Stock of Alabama & Vicksburg Ry.*, 94 I.C.C. 732, 733 (1925); *Stock of Missouri-Illinois R. R.*, 131 I.C.C. 467, 469 (1927).

<sup>894</sup> Note, for example, the following summary of the evidence in the first of the stock-dividend cases: "The evidence establishes (1) that the Chicago, Burlington & Quincy Railroad has a great uncanceled surplus; (2) that the present capitalization is far below the actual investment or any fair value for rate-making purposes which we may subsequently fix under the valuation act . . . ; (3) that the increase in capitalization which would follow the grant of this authority would still leave the total capitalization of the Burlington below the actual investment and the probable fair value of the property devoted to the public service; (4) that the remaining uncanceled surplus would be sufficient to serve the purposes for which a surplus should be accumulated; and (5) that the present financial structure of the Burlington is obsolete and inadequate and that a new form of mortgage and a larger stock base to meet the requirements of statutes governing investments by savings institutions in various states are necessary." *Stock of Chicago, Burlington & Quincy R. R.*, 67 I.C.C. 156, 162



the Commission has also differentiated between the types of securities sought to be issued.<sup>895</sup>

These policies and practices have not been marked by unanimity of opinion among the members of the Commission. In part, the differences in judgment have centered about whether and to what extent the requests of the carriers should be approved in light of the record; in part, they have concerned the propriety of authorizing the issuance of stock dividends under any circumstances. The first type of disagreement is of no crucial importance. While, on the basis of the facts of particular proceedings and in the exercise of administrative discretion within the flexible limits of public interest, a number of the commissioners have deemed specific determinations unduly restrictive,<sup>896</sup> they have generally accepted the guiding principles un-

(1921). See, also, *Stock of Delaware, Lachawanna & Western R. R.*, 67 I.C.C. 426, 435 (1921); *Securities of Louisville & Nashville R. R.*, 76 I.C.C. 718, 726-727 (1923); *R., F. & P. Dividend Obligations*, 79 I.C.C. 465, 471-472 (1923).

<sup>895</sup> Thus, in *Stock of Chicago, Burlington & Quincy R. R.*, 67 I.C.C. 156 (1921), in which authority was granted to issue \$60,000,000 of capital stock as a dividend, the application to issue \$109,000,000 of first and refunding mortgage bonds (\$29,000,000 to be used for future additions and betterments, and \$80,000,000 to be distributed as a dividend) was denied. Said the Commission: "The issuance of the proposed bonds at this time would materially increase the interest burden without apparent necessity. . . . Division of that part of the surplus not needed for ordinary surplus purposes by means of stock appears more in accord with the welfare of the applicant and the public. . . . The denial in this case extends only to the issuance of a bond dividend by a railroad which has no need for the bonds, and which can advantageously issue all the stock reasonably required for its needs. The more adaptable form of mortgage which the applicant desires can be provided without the issuance of a bond dividend" (pp. 161, 163). Practically all of the proposed issue of \$80,000,000 of bonds was to go to the Great Northern and Northern Pacific, the controlling stockholders of the Burlington, as a means of assisting them in refunding, at a near date, \$215,227,000 of their joint 4 per cent bonds which had been given in payment for the Burlington's stock. The Commission was not convinced, however, that the proposed bond dividend was necessary for this purpose. "While we do not minimize the advantages derived by the applicant from its connections with the northern lines, we are not convinced that the continuance of those connections is dependent upon the issuance of the proposed bond dividend. The general advantages of minimizing fixed charges in refunding the joint 4s are apparent, but we can not share applicant's apprehensions relative thereto. The northern lines enjoy a position relatively favorable to financing such a refunding. The value back of the applicant's stock renders it desirable collateral security. No evidence has been introduced which convinces us that the refunding could not be accomplished at a reasonable rate by the issuance of bonds of the Great Northern and Northern Pacific secured by mortgage and the pledge of the applicant's stock" (p. 161). For the refunding operations of the Great Northern and Northern Pacific, following the denial of the bond dividend to the Burlington, see *Securities of N. P. Ry. and G. N. Ry.*, 67 I.C.C. 458 (1921).

<sup>896</sup> See the concurring opinions of Commissioner Potter in *Stock of Delaware*,

derlying the Commission's action.<sup>397</sup> Commissioner Eastman, on the other hand, has consistently disapproved of all stock dividends, and has thus taken issue with the basic propriety of the Commission's policy. His views, as set forth at length in the first two stock-dividend cases,<sup>398</sup> have supported all his subsequent dissents.<sup>399</sup>

In the *Burlington* case,<sup>400</sup> starting with the proposition, agreed to by the majority, that authority to issue stock dividends must be obtained from the Commission, and that the denial of an application does not deprive the carrier of any right it may possess to earn a return upon the fair value of all its property, including that acquired through invested surplus, Commissioner Eastman concluded that it was not compatible with the public interest "to translate the invested surplus into shares of stock and mortgage bonds . . . because such translation may operate to enlarge the rights of applicant as against the public . . . and because it will weaken applicant's splendid financial strength."<sup>401</sup> Not only, as urged by carriers, is the possession of

*Lackawanna & Western R. R.*, 67 I.C.C. 426, 437 (1921); *Securities of Louisville & Nashville R. R.*, 76 I.C.C. 718, 727 (1923); *South Georgia Ry. Capital Stock*, 82 I.C.C. 723, 726-727 (1923); *Stock of New Jersey, Indiana & Illinois R. R.*, 86 I.C.C. 718, 719-720 (1924). See, also, concurring opinion of Commissioner Daniels in *Stock of Delaware, Lackawanna & Western R. R.*, *supra*, in which, disagreeing with the majority concerning the treatment of certain items, he concluded that he was "not persuaded that the entire remainder of the applicant's surplus not allowed to be capitalized is requisite for the necessary purposes of a surplus" (p. 437). In *Stock of Chicago, Burlington & Quincy R. R.*, 67 I.C.C. 156 (1921), both the concurring opinions of Chairman Clark (pp. 163-164) and Commissioner Potter (pp. 166-167), and the dissenting opinions of Commissioner Daniels (pp. 167-172) and Commissioner Ford (pp. 181-183) merely took issue, on practical grounds, with the Commission's denial of the \$80,000,000 bond dividend. See note 395, *supra*.

<sup>397</sup> But see the dissenting opinion of Commissioner Potter in *Stock Dividend of Oahu Railway & Land Co.*, 86 I.C.C. 137, 141-147 (1923), with respect to the Commission's treatment of appreciation and non-carrier property.

<sup>398</sup> *Stock of Chicago, Burlington & Quincy R. R.*, 67 I.C.C. 156, 172-181 (1921); *Stock of Delaware, Lackawanna & Western R. R.*, 67 I.C.C. 426, 437-441 (1921).

<sup>399</sup> *Securities of Louisville & Nashville R. R.*, 76 I.C.C. 718, 727 (1923); *R. F. & P. Dividend Obligations*, 79 I.C.C. 465, 472 (1923); *Stock Dividend of Kahului R. R.*, 86 I.C.C. 309, 311 (1924); *South Georgia Ry. Capital Stock*, 86 I.C.C. 713, 716 (1924); *Stock of New Jersey, Indiana & Illinois R. R.*, 94 I.C.C. 727, 730 (1925), 111 I.C.C. 749, 750 (1926); *Stock of Alabama & Vicksburg Ry.*, 94 I.C.C. 732, 733-735 (1925); *Stock of C., N. O. & T. P. Ry.*, 105 I.C.C. 683, 684 (1926); *Stock of Glasgow Ry.*, 117 I.C.C. 578, 579 (1927); *Stock of Lake Superior & Ishpeming R. R.*, 131 I.C.C. 331, 333 (1927); *Stock of Missouri-Illinois R. R.*, 131 I.C.C. 467, 470 (1927); *Pittsburgh & Lake Erie Stock Dividend*, 131 I.C.C. 584, 586 (1927).

<sup>400</sup> *Stock of Chicago, Burlington & Quincy R. R.*, 67 I.C.C. 156 (1921).

<sup>401</sup> *Ibid.*, p. 175.

large surplus reserves of great value,<sup>402</sup> but, as insisted upon by shippers, these reserves, derived from the public, are impressed with a trust in favor of the public.<sup>403</sup> "It is not a sufficient answer to this doctrine," he declared, "to say that the property acquired from surplus earnings is *owned* by the carrier, for the rights of ownership are not absolute, but limited by the dedication of the property to the public use and the circumstances of such dedication. Nor is it enough to say that the surplus might have been distributed to the stockholders at the time it was earned, for the public might well have declined to acquiesce in rates producing excess income if that income had not been used for the improvement of the property."<sup>404</sup> Deeming the legal validity of this doctrine, with its far-reaching importance in pending valuation and recapture controversies, still an open question, he argued that no action ought to be taken by the Commission "which will foreclose or impair the opportunity to bring this issue fairly be-

<sup>402</sup> The emphasis of the carriers upon the need of surplus accumulations was set forth as follows: "The carriers have again and again told us that sound policy demands that rates be high enough to permit not only the payment of reasonable dividends but the accumulation of large surplus reserves. Some have reduced this to the rule that for every dollar paid in dividends a dollar from earnings should be invested in the property. Financiers have been equally emphatic in favoring such a policy. Summarizing the arguments, we have been told that stockholders are interested quite as much in regularity and dependability of dividends as in their amount; that surplus reserves are necessary to maintain such regularity, and to protect against inevitable and wide fluctuations of earnings and financial disturbances; that they are needed for improvements which will not immediately yield revenue, or which will never do so but are required to enable a company to keep abreast of the times and furnish the best of services; and that they are equally necessary to enhance credit and enable financing upon favorable terms without disproportionate increases in funded debt. Before the Newlands committee in 1917 the carriers urged a need for earnings sufficient to pay regular dividends of 6 per cent with a surplus each year of 3 per cent besides. Stated in another way, it is claimed that to insure good credit surplus earnings should equal 25 per cent of the amount paid out in both dividends and interests." He also directed attention to the report of the Railroad Securities Commission, transmitted to Congress in 1911, which "favored the building up of surplus reserves, but disapproved and urged the prohibition of all 'script, bond, and stock dividends.'" *Ibid.*

<sup>403</sup> The doctrine thus urged by shippers was elaborated in these words: "They claim that when such earnings, over and above reasonable dividends, are invested in carrier property, the public, having provided the funds, has an interest in that property and can not fairly be asked to pay the same return upon it as upon property representing actual sacrifice by investors. They deem it unjust to ask the public to provide both capital and return. While such a surplus may be the property of the carrier, the claim is that the circumstances attending its accumulation impose a duty upon the carrier at least to share its advantages with the public, and that this duty may be considered in valuation for rate-making purposes." *Ibid.*, pp. 175-176.

<sup>404</sup> *Ibid.*, p. 176.

fore the Supreme Court.<sup>405</sup> But he also found that the issuance of the security dividends was not compatible with the public interest on financial grounds, entirely apart from the implied trust doctrine. Surplus reserves, as had already been pointed out, strengthen the position of carriers, and the capitalization of these reserves, especially with immediate and prospective increases in fixed charges, tends to impair their credit.<sup>406</sup> "The truth is," he declared, "that applicant, as it is now capitalized, is one of the fortunate carriers of the country. If all other carriers had been financed with equal conservatism and sound financial judgment our railroad problem would be far less serious. Its credit is unsurpassed, its stockholders seem assured of regular and dependable returns; for 20 years they have had dividends averaging more than 8 per cent, and if they should now wish to reap the reward of good management by increasing the regular dividend rate somewhat

<sup>405</sup> "Summing up this phase of the matter," he concluded, "applicant may have a right to a return upon its surplus, but whether or not the surplus shall be translated into stocks and bonds is subject to our determination under the law; and whatever right to a return it has can not be lost by the denial of the authority desired. On the other hand to grant the desired authority may prejudice and embarrass the decision of a question which has far-reaching importance." *Ibid.*, p. 178.

<sup>406</sup> In this instance, involving a proposal for the issuance of \$80,000,000 of bonds, as well as of \$60,000,000 of stock, as a dividend, primary stress was placed upon the element of fixed charges: "If its credit has thus been enhanced [that is, by surplus accumulations], will it not be impaired by the addition of \$4,800,000 per year to its fixed charges and by the capitalization of all but a comparatively small portion of its surplus? And has the public no interest in such impairment? . . . Our attention has repeatedly been called to the danger of a disproportionate increase in funded debt and we have been told that it is vital that the carriers should be able to finance their needs in part by the issue of stock. With its present capitalization applicant is one of the very few railroads in the country which could probably market stock—if not common, at least preferred—even under present conditions. Will not the distribution of \$60,000,000 of stock gratis impair this ability to some extent at least? The sole reason offered for this stock dividend seems to be the alleged necessity of affording a basis for the continual increase of funded debt under the new mortgage up to an ultimate ratio of \$3 of bonds for every \$1 of stock, a ratio far in excess of what we have been told is safe and proper. And if *stock* dividends are not open to question, what shall be said of *bond* dividends? After its stockholders have foregone extra dividends for years and approved the use of surplus earnings for improvements in times when money could have been borrowed at 4 per cent or better, can it be argued that it is sound financial policy to permit applicant to reverse this procedure and borrow money on the worst market in its history, for the purpose of reimbursing stockholders for their previous moderation? To ask this question is to answer it. The surplus has been invested in property. Even if the stockholders have a right to demand a return upon that property, they are certainly not entitled to ask that applicant now issue mortgage bonds for the sake of replacing in the treasury, for distribution in dividends, the cash which was so invested." *Ibid.*, pp. 178-179.

or by occasional extra dividends, there are few who would question the appropriateness of such action. Applicant ought not, I think, in the public interest or in its own interest, to be permitted to abandon this position of advantage in the absence of compelling need by greatly increasing the volume of its outstanding securities and the measure of its fixed charges. Rather, it ought to avoid unnecessary increase in capitalization and finance its own actual needs by the issue of stock, or if this is for the time being impracticable, by the issue of bonds and stock in equal proportions.<sup>407</sup> Moreover, the various reasons urged in support of the proposed dividend issues—the broadening of the stock base for the issuance of bonds,<sup>408</sup> the encouragement of investment in railroad securities,<sup>409</sup> the stimulation of reinvestment of earnings,<sup>410</sup> and the adjustment of capitalization to property values in the interest of consolidation policy<sup>411</sup>—were found to be without merit. Accordingly, the objections as between the stock divi-

<sup>407</sup> *Ibid.*, pp. 179-180.

<sup>408</sup> With respect to the suggestion that the stock dividend was necessary to provide a basis for the issuance of bonds under "a more modern and flexible mortgage," he said: "If applicant is right in its contention that this stock will add nothing to the value of the property upon which it is entitled to a return, the *real* foundation for the issuance of bonds will in no wise be enlarged by the stock dividend, but only the *apparent* foundation. It is the amount of property and its earning power which determine the debt which may safely be carried and not the par value of stock outstanding. Moreover, so long as applicant clings to the advantage of its present low capitalization, the stock basis for the issuance of bonds under the new mortgage can be enlarged from time to time by financing, in part at least, through new stock." *Ibid.*, p. 180.

<sup>409</sup> With respect to the suggestion that the authorization of stock and bond dividends would afford desirable encouragement to railroad investment, he said: "Apart from the fact that denial of the application can in no way deprive the applicant of whatever right it may have to a return upon its property, it is evident that if all carriers were now in the fortunate situation of applicant, with splendidly buttressed credit and assurance of regular and generous dividends, no further encouragement would be needed for investment in railroad securities. The best encouragement that can be offered is insistence upon the sound and conservative financial management which has so far characterized this carrier." *Ibid.*

<sup>410</sup> With respect to the suggestion that security dividends are necessary as an inducement to the use of surplus earnings for additions and betterments, as against the annual distribution, upon insistence of stockholders, of all available earnings, he said: "This argument is based upon an assumption plainly contrary to the fact, namely, that the creation of uncanceled surplus reserves, thus enhancing credit and the assurance of dependable dividends of liberal amount, is of no benefit to stockholders." *Ibid.*

<sup>411</sup> With respect to the suggestion, urged in view of the provision of paragraph (6) of section 5 that the capitalization of consolidated companies "shall not exceed the value of the consolidated properties," that the gradual adjustment of capital structures to property values ought to be encouraged, he said: "This argument is based on what I think is the mistaken assumption that the words 'shall not exceed' in the provision

dend and the bond dividend being found to differ only in degree, he concluded that the application should have been denied in its entirety.

Commissioner Eastman employed a similar line of attack in opposing the 100 per cent stock dividend authorized in the *Lackawanna* case.<sup>412</sup> After calling attention once more to the special public interest in property acquired through surplus earnings, he examined the various affirmative grounds urged in support of the application, and he found a "total lack of strong and compelling reasons in its favor."<sup>413</sup> He thus disposed of the claim that such distributions are necessary to induce investment in stock,<sup>414</sup> to remove the distrust and suspicion arising from high nominal dividend rates,<sup>415</sup> to facilitate consolida-

cited are equivalent to the words 'shall equal.' It is far from certain that consolidations of properties will necessitate capitalization of surplus reserves. The terms of future possible mergers are not now before us. They can be dealt with when the occasion arises." *Ibid.*, p. 181.

<sup>412</sup> *Stock of Delaware, Lackawanna & Western R. R.*, 67 I.C.C. 426 (1921).

<sup>413</sup> *Ibid.*, p. 438.

<sup>414</sup> "In the light of the facts the absurdity of the claim is clear. Since 1905 the dividends paid by the Lackawanna have averaged well over 20 per cent, and since 1853 the average rate has been about 12.8 per cent. In addition, a surplus of over \$90,000,000 has been accumulated. It is difficult to conceive what better encouragement for investing in stock could well be expected, or to grasp the thought that under such circumstances the denial of a 100 per cent stock dividend will cast a pall over the investment market. Stockholders who have received such dividends in the past, who have a prospect of such dividends in the future, and whose investment is now protected by such a surplus surely have no reason for complaint." *Ibid.*, p. 439.

<sup>415</sup> "Without pausing to consider whether or not the return has in fact been excessive, it is not made clear in what way this distrust and suspicion have been or are likely to be prejudicial to the Lackawanna. There is no evidence of injury. Nor, apparently, has thought been given to the distrust and suspicion which may be created in the public mind by the declaration, under present railroad conditions, of a stock dividend of 100 per cent." *Ibid.* On this issue note, also, the following from his dissenting expressions in other proceedings: "My understanding of the situation is that applicant wishes to distribute larger cash dividends to its stockholders. This could be done without an increase in the stock outstanding, but only through an increase in the dividend rate, which might influence the public mind. Through the device of a stock dividend, the larger cash dividends can be distributed without an increase in the rate. In other words, the actual profits of the stockholders will not so readily appear. In my judgment this is a good reason for denying the application rather than a good reason for granting it." *R., F. & P. Dividend Obligations*, 79 I.C.C. 465, 472 (1923). "It is further suggested that the 'larger capital,' following a stock dividend, may carry an annual cash dividend 'of say 6 per cent.' Six per cent upon the 'larger capital' would amount to 12 per cent upon the stock now outstanding. It is quite evident that a rental of 6 per cent would have a better superficial appearance than a rental of 12 per cent, and here, I think, is the real reason for the application. It does not appear to me as a reason 'compatible with the public interest.' On the contrary, I think it highly desirable and in the public

tions on terms contemplated by the statute,<sup>416</sup> to prevent the distribution of assets directly as dividends,<sup>417</sup> to discourage future insistence by stockholders that all available earnings be distributed as dividends,<sup>418</sup> and to further the establishment of the truth about values.<sup>419</sup> "These are the labored reasons," he concluded, "that have been urged upon us for the granting of the pending application, and it is manifest that they have neither strength nor weight. They offer no prom-

interest that the real earnings upon investment in railroad properties should not be disguised. . . . But the facts in regard to the generous treatment of this property by the public which it serves are already sufficiently disguised, and I am able to discover no good reason for carrying the process still further by an additional stock dividend of 100 per cent." *Stock of Alabama & Vicksburg Ry.*, 94 I.C.C. 732, 734-735 (1925).

<sup>416</sup> "Counsel has overlooked the fact that the provision quoted uses the words 'shall not exceed' and not the words 'shall equal.' Moreover, the valuation of applicant's property has not yet been completed. The terms of future possible consolidations or mergers can be dealt with when the need arises. The thought is staggering that they will be attended by 'immense issues of new securities.' I am unwilling to believe it." *Stock of Delaware, Lackawanna & Western R. R.*, 67 I.C.C. 426, 440 (1921). On this issue note, also, the following from his dissenting opinion, concurred in by Commissioners Campbell and McManamy, in *South Georgia Ry. Capital Stock*, 86 I.C.C. 713, 716 (1924): "The stock dividend apparently would not be contemplated by applicant except for this consolidation, which, in my opinion, has not been lawfully authorized. But in any event the stock dividend is not compatible with the public interest. The amount of stock outstanding does not determine or limit the earnings to which applicant is fairly entitled nor the distribution of its earnings among its stockholders, and refusal to approve a stock dividend can deprive it of no constitutional right. Applicant operates a so-called short-line railroad and has sought relief from the fourth section of the interstate commerce act upon the ground of financial weakness. The less stock it has outstanding the more likelihood that new issues can be marketed at par, and vice versa. Applicant will be a stronger company financially and better able to serve the public if it is not permitted to declare a stock dividend. The excuse is offered that the stock of the West Coast can not be exchanged on a par-for-par basis in the absence of a stock dividend. Assuming that the consolidation can now be lawfully accomplished . . . no necessity exists for a par-for-par basis of exchange."

<sup>417</sup> "It is true that not all of the surplus has been invested in physical property but that some of it is represented by securities of affiliated companies which might be distributed directly to the stockholders. It may be assumed, however, that the considerations which led applicant originally to use surplus cash for the acquisition of these securities, rather than for the declaration of still larger cash dividends to its stockholders, would continue to persuade it to hold these securities in its treasury. Certainly we ought not to assume the contrary. Moreover the partial capitalization of surplus which the majority have approved will not preclude their distribution." *Stock of Delaware, Lackawanna & Western R. R.*, 67 I.C.C. 426, 440 (1921).

<sup>418</sup> "Of this suggestion it is sufficient to say that if the stockholders should in the future deem such distribution wise and expedient, that situation can be dealt with then. My belief is that nothing of the sort would occur. Certainly it could not happen with regard for sound financial policy and the sanction of public opinion." *Ibid.*

<sup>419</sup> "Aside from the fact that the valuation of railroads which we are now conducting has for its purpose the ascertainment of the 'truth about values,' this argument rests

ise of public benefits outweighing the dangers involved. It is not even clear that they offer any promise of genuine private benefit. How can the finding be made, which the statute requires, that the issue is for a lawful object 'compatible with the public interest. . . .' ? It is, I think, a matter of regret that the exercise of our new powers of supervision over the issue of railroad securities should be marked in a period of financial depression by approval of the declaration of stock dividends by carriers which have refrained from declaring such dividends in past years of prosperity when such supervision did not exist. Without increasing the volume of railroad property it is proposed to increase the volume of railroad securities at a time when such securities are a drug upon the market. Undercapitalized railroad corporations are a source of strength to the nation, and they are all too few."<sup>420</sup>

If we recognize, as we must, that the dominant purpose in the regulation of security issues is to safeguard the financial strength and credit position of the carriers, the foregoing considerations in opposition to the authorization of stock dividends are amply persuasive. In the long series of proceedings involving problems of valuation and rate control little has emerged from the determinations of the Commission or the courts in support of the doctrine that property acquired through surplus reserves is held in trust for the public, and such a doctrine, even if sound in principle, would as a practical matter prejudice the interests of those carriers which have followed the conservative policy of reinvesting substantial portions of their earnings. But the mere fact that carriers are entitled to a return upon such property does not justify its capitalization. The authorization of stock dividends does not add to the equity of the shareholders in this property, nor does the denial of applications deprive them of such returns upon it as they may legally be entitled to earn. The crucial issue, in determining the question of compatibility with the public interest,

on the curious notion that property or wealth shown in the form of surplus accumulations is 'concealed,' and can only be brought to light by the declaration of stock dividends. The worth of the argument may be tested by its logical conclusion, namely, that those are wrong who have fancied that surplus reserves are a support and buttress to credit and that an important part of the wealth of the country will be 'lost or paralyzed' unless all corporations proceed to capitalization of surplus assets." *Ibid.*, p. 441.

<sup>420</sup> *Ibid.*



concerns the probable effect of the increase in the volume of securities, unsupported by new investment, upon the financial position and credit prospects of the carrier. The problem is one of dissolving the conflict between the immediate desires of the existing security holders and the long-run interests of the transportation service. It is generally conceded, on the basis of widespread experience, that the accumulation of corporate surpluses, whether maintained in liquid form or re-invested in necessary facilities, adds financial strength and improves carrier credit, and that the capitalization of these surpluses, through the distribution of securities as dividends, tends to impair the favorable status thus created. A bond dividend, by increasing fixed charges without corresponding additions to earning power, clearly operates in this direction; but even a stock dividend, by crystallizing a free surplus into a capital liability, is calculated to produce an adverse effect upon the financial position of the carrier and to detract from its ability to meet future financial needs. Only in rare instances is the capital set-up or other important stake of the carrier affirmatively served by stock dividends; for the most part the dominant motive is either to conceal the realization of liberal earnings on investment or to enable the shareholders to reap the benefit of enhanced prices in the speculative security markets. From the standpoint of the public interest, therefore, the Commission has probably shown an undue readiness to authorize the issuance of stock dividends. In point of fact, however, this policy has not been fraught with serious consequences. Although, in conformity with its general approach in the regulation of security issues, the Commission has usually sanctioned common corporate practice in this matter and has withheld interference with managerial initiative wherever possible, its careful scrutiny of the nature and value of the assets sought to be capitalized and its insistence upon the retention of substantial uncapitalized surpluses have largely served to keep railroad capitalization within reasonable bounds.<sup>421</sup>

<sup>421</sup> On the entire matter of overcapitalization, note the following from the first report of the Federal Coördinator of Transportation, as transmitted to the President and the Congress January 20, 1934: "Contrary to much popular impression, the railroads are not in the aggregate overcapitalized, in the sense that the par value of outstanding securities exceeds the money invested in the properties. The Bureau of Valuation of the Interstate Commerce Commission has estimated that the original cost of railroad carrier property, other than land, as it existed on December 31, 1932, plus land valued as of

*Types of Securities*

The financial structure of the railroads, even more than the extent of their capitalization, is of public concern, since both the relationship of capital investment to the exercise of corporate control and the ability of the roads to maintain flexible transportation charges and to avoid receiverships are dependent upon the types of outstanding securities. In the general field of corporation finance many kinds of securities have been evolved which, by combining the basic elements of income, risk, and control in varying proportions, have enabled those seeking to attract capital to meet the demands of different classes of investors; and in the field of railroad finance the types of securities have been still further differentiated because of the development of intercorporate relations over a long period of time and as a result of numerous financial reorganizations. Under these circumstances the proposals presented for the Commission's approval since 1920, for the refunding of existing capital issues, for the acquisition of new capital assets, to reimburse the treasury for expenditures incurred in additions and betterments, and to effectuate capital adjustments incident to reorganization, have necessarily reflected the complicated financial structure of the railroads, and have included a great variety of mortgage bonds, collateral trust bonds, income bonds, equipment obligations, and miscellaneous evidences of indebtedness, as well as preferred and common stocks of varying characteristics. On the whole,

June 1, 1933, and plus allowances for working capital, was in the neighborhood of \$26,232,000,000. Original cost of lands is not known, but it was probably materially less than the value as of June 1, 1933. Making all due allowance for this fact, however, the original cost of railroad carrier property would not fall below \$24,000,000,000. On December 31, 1932, the total railroad capital actually outstanding was \$23,573,556,588, made up of \$10,226,070,233 in stock and \$13,347,486,355 in funded debt. Allowing for intercorporate holdings, the net capitalization outstanding in the hands of the public was \$19,489,062,256, made up of \$7,150,374,952 in stock and \$12,338,687,304 in bonds. While there was much inflation of the original capitalization of many railroads, this has since been offset, in the aggregate, by two principal factors: (1) much investment of surplus earnings in carrier property by the more prosperous railroads, and (2) the scaling down of original capitalizations through reorganizations." He also pointed out that whereas in 1920 "the total outstanding capitalization amounted to 101 per cent of the book investment in road and equipment and the funded debt amounted to 56.7 per cent of that investment," in 1932 "the corresponding percentages were 86 and 49," this improvement being due "to the increase in corporate surplus, which in round figures aggregated \$2,905,000,000 in 1920 and \$4,656,000,000 at the end of 1932." *Regulation of Railroads*, 73d Cong., 2d Sess., Sen. Doc. No. 119, pp. 3, 5 (note).

however, few controversies have centered about the types of securities to be issued; in the vast majority of instances the judgment of the carrier has been accepted without question by the Commission. This more or less routine approval has been based, not upon lack of jurisdiction or want of public interest, but upon the persuasiveness of the controlling facts with respect to the existing financial structures and prevailing market conditions; and it has been furthered by the Commission's usual policy, in the absence of a clear showing of probable public injury, of allowing free play to managerial initiative in matters of financial organization. Occasions have none the less arisen when the Commission has found it necessary to withhold its authority, or to modify the plans submitted by the carriers, because the proposed types of securities were deemed incompatible with sound financial policy. For the most part this power has been exercised with reference to the issuance of bonds under particular circumstances, largely, though not exclusively, as a means of so controlling indebtedness as to keep the fixed charges of the carrier within the bounds of reasonably assured earning capacity; but in some proceedings an effort has also been made to prevent the issuance of non-voting stock, or of stock of limited voting power, as a means of mitigating the evils presumed to flow from the separation of ownership and control. Specific determinations along these lines have given rise to considerable conflict of opinion within the Commission, both because they were deemed to involve an undue interference with management and because they were regarded as an inadequate assertion of regulatory power. The Commission appears to have taken a conservative middle ground. While it has sought to safeguard the obvious and immediate interests of the public in its consideration of particular proposals, it has not undertaken to impose any far-reaching reforms upon prevailing financial practice. This approach is also illustrated by the Commission's attitude toward the issuance of no-par stock, which may well be noted briefly before we proceed to an analysis of the issues that have emerged in connection with its policies toward non-voting stock and bonded indebtedness.

In a considerable number of proceedings the carriers have applied for authority to issue no-par stock, and, when corporate power was found to exist, the necessary approval has been granted as a matter of

course.<sup>422</sup> Thus, at an early stage in this regulatory activity, in authorizing the issuance of 750,000 shares of capital stock without par value, to be exchanged on a three-for-one basis for 250,000 outstanding shares of \$100 par value, the Commission entirely refrained from discussing the desirability of the use of no-par stock by the carriers, merely referring to the fact that the proposal had been appropriately approved by the applicant's directors and stockholders and was within the authority of the law of the state of the applicant's incorporation.<sup>428</sup>

<sup>422</sup> No-par stock has been authorized for exchange for other outstanding securities, for acquisition of lines or payment for properties, and in connection with financial reorganizations. *Stock of Denver & Rio Grande Western R. R.*, 70 I.C.C. 102 (1921); *Stock of El Paso & Southwestern Co.*, 70 I.C.C. 208 (1921); *Securities of Fort Smith & Western Ry.*, 70 I.C.C. 777 (1921); *Missouri-Kansas-Texas Reorganization*, 76 I.C.C. 84 (1922); *Stock of Niagara Junction Ry.*, 76 I.C.C. 307 (1922); *Chicago, Attica & Southern Securities*, 79 I.C.C. 209 (1923); *Securities of Kansas & Missouri Ry. & Term. Co.*, 86 I.C.C. 559 (1924); *Acquisition and Stock Issue by N. C. & E. R. R.*, 86 I.C.C. 617 (1924); *Securities of Toledo, Angola & Western Ry.*, 105 I.C.C. 88 (1925); *Stock of Port Angeles Western R. R.*, 105 I.C.C. 224 (1925); *Securities of Tennessee Central Ry.*, 105 I.C.C. 609 (1926); *Denver & Salt Lake Reorganization*, 117 I.C.C. 397 (1926), 117 I.C.C. 749 (1927); *Reorganization of A., B. & A. Ry.*, 117 I.C.C. 439 (1926); *Stock of Trans-Florida Central R. R.*, 124 I.C.C. 699 (1927); *Chicago, Milwaukee & St. Paul Reorganization*, 131 I.C.C. 673 (1928); *K. C., M. & O. Reorganization*, 145 I.C.C. 339 (1928); *Securities and Acquisition of Control of Ry. Exp. Agency*, 150 I.C.C. 423 (1929); *Seaboard Air Line Ry. Co. Readjustment*, 158 I.C.C. 182 (1929); *Savannah & A. Ry. Co. Acquisition*, 162 I.C.C. 771 (1930), 166 I.C.C. 119 (1930); *Minneapolis, A. & C. R. R. Stock*, 170 I.C.C. 591 (1931).

<sup>428</sup> *Stock of El Paso & Southwestern Co.*, 70 I.C.C. 208 (1921). In *Fairport, P. & E. R. Co. Stock*, 175 I.C.C. 767, 768 (1931), in which a proposed issue of capital stock without par value to be exchanged for outstanding par-value stock was not found to be necessary or appropriate for the purpose intended, Division 4 took express notice of some of the alleged advantages of no-par stock: "In support of its proposal to issue no-par stock in exchange for its par-value stock, the applicant represents that it encountered considerable difficulty in disposing of the capital stock authorized by our order of November 22, 1930, and that it could more readily have disposed of the stock had it been able to sell shares of smaller unit price. The applicant further represents that, in its opinion, it would be in its interest and in the interest of the public for its stock to be held as widely as possible, and not concentrated in the hands of a comparatively small number of stockholders, and that future issues can be disposed of more readily and a broader market would be afforded such issues, with resulting wider ownership of its stock, if such issues could be marketed at a small unit price. The applicant states that it is its intention in the issue of any additional stock to ask authority to issue such stock as no-par stock, to be sold at a unit price of not less than \$20 a share. In order that its stock issues may be uniform and also to permit wider ownership of its present outstanding common stock, the applicant requests authority to issue no-par stock, as now proposed, in exchange for its par-value stock." The denial of the application, however, was not based upon want of merit in these contentions, but rather upon a finding that the request was prematurely made: "According to its own representations, the applicant may or may not find it necessary or appropriate to issue additional capital stock. Unless additional stock be issued there can be no necessity for

The problem of the substantive merit of the policy of issuing no-par stock was raised, however, in the dissenting opinion of Commissioner Eastman.<sup>424</sup> It appeared that the proposal was chiefly motivated by a fear that the outstanding par-value stock, which was deemed to be less in amount than the value of the property, might affect adversely the applicant's interest in the Commission's subsequent valuation findings, and by a desire to overcome the common popular prejudice against payment of high nominal dividend rates. Since no claim was made that the existing par-value stock had "hindered the development of the company or checked its prosperity," he found no substance in these considerations. Furthermore, positive reasons, based largely upon the desirability of maintaining an equivalence between capitalization and investment and avoiding the confusion and speculation incident to reliance upon the "value" concept, were found to support denial of the application. The argument was set forth as follows: "Of late a strong movement has developed in favor of the issue of stock without par value by railroads and public utilities. It is, I think, significant that this movement has coincided with the rapid growth of public regulation of security issues. Whether or not stock with no par value is desirable in the case of ordinary industrial enterprises I do not undertake to say, but I entertain little doubt that so far as public service corporations are concerned, it is the manifestation of an unsound tendency subversive of the public interest. Those who favor no par value are wont to say that stock with par value is misleading, because par value seldom, if ever, represents correctly the *actual* value of the property. But no one is misled, for it has been well and commonly known for many years that par value and actual value are not the same thing. The theory of par value is only that it represents cash or its equivalent that has been invested in the property. The trouble in the past has been that loose and pernicious cor-

changing the outstanding stock into stock having no par value. Under the circumstances we are unable to make the findings required under the provisions of section 202." It should be noted, also, that when, in *Savannah & A. Ry. Co. Acquisition*, 162 I.C.C. 771, 782 (1930), Division 4 scaled down a proposed issue of 30,000 shares of no-par stock to 23,500 shares, because "the issue of 6,500 shares of applicant's common stock as a bonus is not justified by the record and would not be compatible with the public interest," it did so, of course, without reference to the relative merits of *no-par* and *par-value* stock.

<sup>424</sup> *Stock of El Paso & Southwestern Co.*, 70 I.C.C. 208 (1921), at pp. 209-210.

poration laws have made this true merely in theory and not in practice. Now that these laws are being corrected, we have the movement in favor of stock with no par value. My conviction is that the doctrine of so-called 'value' is full of pitfalls, and that the path to soundness and stability in public service corporation finance under private management lies instead in the recognition and protection of investment honestly and prudently made. The distinguishing feature of a public service corporation is that it is monopolistic in nature and entitled to make only just and reasonable charges for its services. Those charges are just and reasonable which in the aggregate meet the reasonable cost of the services, including in that cost a sufficient return, fluctuating if need be with changing conditions, upon legitimate investment to induce a continuing influx of necessary capital. If such charges are permitted, no claim of confiscation can possibly be sustained. Under public regulation, investment is a thing definite, certain, and easily ascertained. So-called 'value,' as the word is now used in railroad and public-utility circles, is a thing of uncertainties, contradictions, artificialities, metaphysical subtleties, absurdities, and opportunities for public plunder. I am fully persuaded that it is desirable and in the public interest that outstanding capitalization should represent as nearly as practicable legitimate investment, and that the return upon that investment should clearly appear without disguise of any sort. We are a long distance from that now but can at least move in the right direction. Stock without par value in my opinion is a step in the wrong direction and toward speculation, instability, and confusion of the public mind.<sup>425</sup>

It is beyond our province to undertake an extended analysis of the merits and defects of no-par stock, but the chief conflicting contentions can be stated summarily.<sup>426</sup> On the one hand, it is argued that

<sup>425</sup> *Ibid.* Commissioner Eastman has dissented in practically all of the proceedings in which the issuance of no-par stock has been authorized by the Commission. See cases cited in note 422, *supra*. Generally, aside from the principal case, no comment has accompanied his dissents; but note the following from his dissenting opinion in *Acquisition and Stock Issue by N. C. & E. R. R.*, 86 I.C.C. 617, 621 (1924): "The device of eliminating par value introduces a speculative element and affords an opportunity, by multiplying the number of shares, to impose upon the credulity of investors. In my opinion it is an unsound financial device, akin to the old stock bonus plan, which we ought not to encourage. The multiplication of shares also makes it possible to give such stock a wholly unwarranted voting strength."

<sup>426</sup> For detailed studies of the problem of no-par stock and some of its special as-

the elimination of par value removes the possibility of discrepancies between capital and capitalization, prevents the deception of investors who assume the existence of an equivalence between par values and real values, and permits capital shares to be marketed on a flexible basis, particularly in meeting the difficulties of selling high priced stock or overcoming the statutory prohibitions against the sale of stock below par; on the other hand, it is argued that the elimination of par value tends to encourage the excessive issuance of securities, to promote speculation, to permit the avoidance of stockholders' liabilities to creditors, to facilitate the impairment of capital through payment of unearned dividends, to increase the likelihood of according unjustifiable rewards to promoters, and to further the exercise of control with limited investment. That the advantages of no-par stock have generally been deemed to outweigh its disadvantages is evidenced by the fact that statutory authorization of such stock, beginning in New York in 1912, has spread to practically all of the states, that special provisions are coming to be enacted to meet the various dangers of the practice as they come to light, and that such stock is now very widely used by industrial corporations. But these considerations do not necessarily justify the authorization of no-par stock in the railroad field, especially if the objective is pursued of restricting railroad earnings to reasonable returns upon actual investment. The goal of such a policy of financial control is to achieve an ultimate identity between capitalization and the rate base, each reflecting investment honestly and prudently made, and for this purpose the par-value device is a useful instrument. To the extent that the substitution of no-par for par-value stock constitutes an effort to make the financial structure reflect shifting values rather than certain investments, it is subject to the same frailties as those noted in our discussion of the valuation project; and to the extent that resort to no-par stock is motivated by a desire to conceal the realization of liberal earnings, it is subject to the same objections as those noted in connection with our

pects, see Carl B. Robbins, *No Par Stock* (1927); C. W. Wickersham, *A Treatise on Stock Without Par Value* (1927); James C. Bonbright, *Railroad Capitalization* (1920), chap. iv; William Z. Ripley, *Main Street and Wall Street* (1927), pp. 46-54; Adolph A. Berle, *Studies in the Law of Corporation Finance* (1928), chap. iv; James C. Bonbright, "The Dangers of Shares without Par Value," *Columbia Law Review*, vol. 24 (May, 1924), pp. 449-469; David P. Locklin, *op. cit.*, pp. 122-134.

discussion of the issuance of stock dividends. But there are doubtless countervailing considerations in support of the Commission's policy: the doctrine of "fair value," rather than of "prudent investment," is the prevailing law of the land with respect to the basis of railroad returns; and a carrier's ability to sell stock for what it will bring affords desirable flexibility in raising capital and may occasionally diminish forced reliance upon bonded indebtedness. Moreover, the Commission's control of the character and value of the capitalizable assets underlying security issues and of the disposition of their proceeds is applicable to no-par as well as to par-value stock. As long as such control is effective, and as long as rates and earnings are related primarily to the fair value of the property used in the public service rather than to the aggregate of outstanding securities, there is little of serious harm to be anticipated from the recognition of no-par stock as a proper constituent of the financial structure of the railroads, and possibly considerable benefit, especially under prevailing conditions of sharply restricted earnings.<sup>427</sup> The defect of the Commission's policy is to be found, not so much in the results to which it has led, as in its

<sup>427</sup> Note the following from Harold G. Moulton and Associates, *op. cit.*, at pp. 313-314, in support of the conclusion "that a considerable number of individual railroads would benefit by a scaling down of the par values of their common stocks or by a shift to no-par stock": "Par values of railroad stocks are in most cases fictions, accidents of the history of some half-forgotten reorganization or still more ancient original issuance of capital. When they are substantially above any reasonable prospective value as investments, they constitute a true overcapitalization. Common stocks make up about one-third of the total railroad capitalization, and roads which still have a margin of earnings beyond their fixed charges might gain and could not lose by a scaling down of this part of the capital. It is as easy to stop dividends in bad years on 5 million dollars of stock as it is on 10 millions, and if conditions justify the payment of some dividend it looks better to pay 3 per cent on 5 million dollars than to pay 1½ per cent on 10 millions. Moreover, under the laws of the states in which many of the railroads are incorporated, stock cannot be sold for less than its par value. Hence, in order to finance through the sale of common stock it is necessary that the number of shares be kept down to where the stock can be sold at or above par. While . . . a large number of railroads were able to sell stock during the period from 1923 through 1929, there was also a considerable number of roads which had a satisfactory rate of earning on the stockholders' equity but could not have sold common stock at par. In a number of cases the par value of stock was so high that in order to earn a return on a market value above par it would have been necessary for the road to earn an amount substantially greater than the statutory fair return on the tentative valuation of their properties. In industrial corporation finance it is not unusual to effect a reduction of par value, or a change to no-par stock of low book value, in order to legalize the sale of new stock at its market value. Such a decapitalization would improve the financial set-up of a number of roads."



unquestioning acceptance of general corporate practice in this matter, as early as 1921, without express analysis of the comparative advantages and disadvantages of no-par stock, particularly in relationship to the far-reaching valuation controversy which was yet in a highly fluid state.

Of greater importance is the Commission's attitude toward the problem of concentration of control arising from the issuance of non-voting stock or from the imposition of practical limitations upon the voting power of particular groups of shareholders. The widespread resort to such financial arrangements in recent years has been subjected to severe criticism, because of the general separation between ownership and control which the practice involves, and because of the resulting inability of stockholders to protect themselves against the powers and policies of directing and other inside personnel, the immediate interests of which may diverge widely from those of the large body of stockholders in the long-run prosperity of the enterprise.<sup>428</sup> Realizing that developments of this character in the field of railroad finance may jeopardize the credit of the carriers and impair the transportation service, the Commission has adopted the view that the factors bearing upon its determination of the public interest in connection with proposed security issues embrace the probable effects of the financial structure upon the relationship between capital investment and corporate control. The most striking manifestations of the Commission's purpose to protect minority interests and to prevent undue concentration of control are to be found in its disapproval of proposed unifications, under section 5, on financial grounds.<sup>429</sup> But the Commission has also followed this approach directly, under section 20a, in connection with the regulation of security issues. The most clear-cut pursuit of this purpose is to be found in the Commission's refusal to authorize the issuance of preferred stock with only contingent voting

<sup>428</sup> See, for example: Adolph A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (1933); James C. Bonbright and Gardiner C. Means, *The Holding Company* (1932); I. Maurice Wormser, *Frankenstein, Incorporated* (1931); John H. Sears, *The New Place of the Stockholder* (1929); William Z. Ripley, *Main Street and Wall Street* (1927); William H. S. Stevens, "Stockholders' Voting Rights and the Centralization of Voting Control," *Quarterly Journal of Economics*, vol. 40 (May, 1926), pp. 353-392.

<sup>429</sup> See pp. 468-472, *supra*; and note especially *Nickel Plate Unification*, 105 I.C.C. 425 (1926), and *Unification of Southwestern Lines*, 124 I.C.C. 401 (1927).

power and of common stock of reduced par value, in exchange for outstanding common stock, as a means of enabling the holders to recoup a large portion of their investment and still maintain control of the enterprise.<sup>480</sup> In the words of the Commission: "Control of the corporation is vested in a majority of the stock, that is, 151,176 shares, and the record indicates that this controlling interest is owned by F. E. Taplin, president of the applicant, and his associates. As above indicated, upon completion of the proposed plan, \$15,117,600 of preferred stock, represented by 151,176 shares of the par value of \$100 each, would be without general voting power. Control would then be vested in a majority of the \$15,117,500 of the new common stock, represented by 302,350 shares of the par value of \$50 each, or 151,176 shares of an aggregate par value of \$7,558,800. In other words, the present controlling stockholders could sell all of the preferred stock and a minority of the common stock received by them in exchange for their present holdings, and still retain control of the company with approximately one-fourth of its capital stock. The applicant attempts to justify this condition on the ground that it has no bonds outstanding and that if 50 per cent of its capitalization consisted of bonds, the control of the corporation would be vested in a majority of the stock, or approximately one-fourth of the capitalization; also, that the preferred stock will have preference as to dividends, and in the distribution of assets in the event of dissolution, and should not have

<sup>480</sup> *Stock of Pittsburgh & West Virginia Ry.*, 105 I.C.C. 552 (1926). Application was made for authority to issue \$15,117,500 of common stock, consisting of 302,350 shares of \$50 par value, and \$15,117,600 of preferred stock, consisting of 151,176 shares of \$100 par value, these securities to be exchanged for \$30,235,100 of outstanding common stock, consisting of 302,351 shares of the par value of \$100 each. For each share of the outstanding common one share of the new common and one-half share of the new preferred was to be given. Each share of the new common was to be entitled to one vote, but the preferred was not to have any voting power, "except in the event of a proposal to create and issue additional preferred stock of equal standing to that already outstanding, or in any proposed alteration of the rights or terms of the outstanding preferred, or unless the company shall be in default in the payment of quarterly dividends on the preferred for a period of one year" (p. 553). The Commission authorized, as in the public interest, the issuance "of \$15,117,550 of new common stock, consisting of 151,175.5 shares of the par value of \$100 each, and \$15,117,550 of 6 per cent cumulative preferred stock, consisting of 151,175.5 shares of the par value of \$100 each, said common and preferred stocks to have equal voting rights, and to be exchanged on the basis of one-half share of new common and one-half share of new preferred for one share of old common stock now outstanding" (pp. 555-556).

voting power in addition. We are of opinion, however, that the fact that a company has no bonds outstanding is not a valid reason, in itself, why it should issue either bonds or nonvoting preferred stock. In the instant case no new financing, corporate reorganization, nor change in property ownership or operations are [*sic*] involved. As the established capitalization of the applicant entitles the holder of each share of its capital stock to a vote, we are not convinced from the record that the conversion of one-half of the old common stock into nonvoting preferred stock is either necessary or compatible with the public interest. Further, there appears to be no sound reason of record, or otherwise, for the proposed reduction in the par value of the common stock from \$100 to \$50 per share."<sup>481</sup>

This determination, which subordinated common corporate practice to the public interest in matters of control, evoked vigorous protest from Commissioner Woodlock, who deemed it the duty of the Commission, under the established system of private ownership and operation of railroads, to accord the utmost freedom to the carriers in the adjustment of their financial structures. He declared the Commission to be "fundamentally in error" on both matters embraced in its findings.<sup>482</sup> Because his critical views provide a sharp contrast with those of Commissioner Eastman to be noted presently, they may be set forth with some fulness. With respect to limitations upon the voting power of preferred stock, he said: "Where do we find clear evidence that the issue of preferred stock, with contingent voting rights only, is 'contrary to public policy' or 'against public interest'? I am well aware that some people assert that it is. I do not find, however, that courts or legislatures have ever laid down the general principle that preferred stock is absolutely entitled to equal voting rights with common stock. I find, indeed, instances where both have either explicitly or implicitly quite definitely recognized the contrary view.

<sup>481</sup> *Ibid.*, p. 555. As a further reflection of the Commission's usual practice of requiring voting power to be accorded to preferred stock, note the following from *Securities of Tennessee Central Ry.*, 105 I.C.C. 609, 610 (1926): "The application as filed shows that the proposed preferred stock is to be issued without voting power. The applicant subsequently advised that it has no objection to the granting of voting power to the preferred equal per share to that accorded the common. Our order will provide that the preferred stock will have such voting power."

<sup>482</sup> *Stock of Pittsburgh & West Virginia Ry.*, 105 I.C.C. 552, 556 (1926). Commissioner Taylor joined in this dissenting expression.

The very nature of preferred stock, distinguishing it from common stock, is such that there is a fundamental difference between the two classes in the matter of management rights. Preferred stock enjoys certain privileges, advantages, and priorities against common stock, all by virtue of agreement with holders of common stock. A holder of preferred stock is in the position of a 'special partner' in a firm. 'Special partners' do not, as a rule, take part in management. Preferred stock is sheltered by its privileges from risks of the enterprise. These risks are all undertaken by common stock, and the most elementary principles of fairness would seem to indicate that as long as the common stock keeps the preferred-stock privileges intact, it should enjoy full management rights. I am utterly unable to divine in what respect 'the public interest' requires that this elementary principle should be set aside. Nobody is obliged to buy a preferred stock with limited voting rights. Whoever does so must be presumed to do so with full knowledge of what he is buying. Why should he not be allowed to do so? Every use can be converted into abuse. To point to possible abuse, however, is not to destroy the principle that I have described."<sup>438</sup> Similarly, on the propriety of the reduction in the par value of the stock, he said: "With respect to the conversion of the remaining common stock from \$100 par to \$50 par, the report disallows such conversion, presumably on two grounds. One is that by doubling the number of shares the voting power of the remaining common stock is doubled. The other is that it would enable 'control' of the property to be acquired or to be held by a much smaller investment of money than that which is required under the present capitalization. These reasons seem to me to have little weight. As a matter of fact, under the applicant's proposals 'control' of the Pittsburgh & West Virginia would cost about the same proportion of the total investment in the property as the average proportion necessary to 'control' all the railroads. With railroad bonded debt almost 60 per cent of the total investment, and capital stock 40 per cent, 21 per cent of the stock would give 'control.' Under the applicant's proposed capitalization 25 per cent of the present common stock would be needed for the same purpose. Nor is it our business whether or not present owners of the common stock may wish to withdraw some of the money that

<sup>438</sup> *Ibid.*, pp. 556-557.

they have invested in the property by sale of preferred stock, without loss of 'control.' Seemingly, according to the report, the suggestion that somebody may make a profit by the rehabilitation of this property is abhorrent. If we are to rely upon private enterprise and private capital for management of transportation, and if we are to rely upon voluntary enlistment of that capital, it is manifest that the utmost freedom of exchange should be provided for owners of that capital."<sup>484</sup>

Commissioner Eastman, on the other hand, has protested against a distribution of voting power in disregard of investment even where the approval was granted under very special circumstances. A carrier organized to acquire and rehabilitate a property which had been abandoned by another line was authorized by Division 4 to issue \$25,000 of common stock of a par value of \$5 per share and \$300,000 of 6 per cent non-cumulative preferred stock of a par value of \$100 per share. Both classes of stock were given one vote per share, but each dollar of investment in common stock had a voting power 20 times as great as a like investment in preferred stock, and as a practical matter the common shareholders could outvote the preferred shareholders 5 to 3, despite a preferred investment 12 times as great as that of the common. The common stock was subscribed for at par by the organizers of the line, and was to be deposited under a voting trust agreement for the purpose of assuring prompt action in the event of an opportunity to sell or lease the road; the preferred stock was to be sold at par to the patrons of the line located along its right of way.<sup>485</sup> It was this arrangement, defended by Commissioner Woodlock largely on the general ground that matters of control should be left undisturbed in the hands of management,<sup>486</sup> which evoked the dissenting expression of Commissioner Eastman: "It is said that hard cases

<sup>484</sup> *Ibid.*, p. 557.

<sup>485</sup> *Securities of Jacksonville & Havana R. R.*, 111 I.C.C. 107 (1926). The proposal was approved as in the public interest "in view of the importance of continued operation of the line to be acquired by the applicant" (p. 110).

<sup>486</sup> In his concurring opinion Commissioner Woodlock conceded that the proposed distribution of voting power was "very unusual," and that, despite the silence of the statute with reference to voting power, the Commission was "necessarily bound at all times by the generally accepted principles of equity and fair dealing." He argued, however, that he knew of no generally accepted principle "that voting power in corporations should always be directly proportionate to the amount of the investment," and

make bad law. This, in my opinion, is an illustration. It is a case in which there is natural and proper sympathy for those who, apparently with the best of motives, are trying to save this little line of railroad from abandonment. But such sympathy ought not to lead us to approve features of the proposed financial structure of the applicant which are unsound in principle and might, if the precedent were followed in other cases under other auspices, become positively vicious. . . . In the first place, it is proposed to issue \$25,000 par value of common stock and \$300,000 of preferred stock. However, there are to be 5,000 shares of common with a par value of \$5 each, and 3,000 shares of preferred with a par value of \$100 each. Moreover, each share, whether of common or preferred, is to have equal voting power. The

he directed attention once more to the fact "that almost 60 per cent of the investment in railroads is and always has been totally disfranchised." On this basis he concluded that neither law nor policy operated to prevent the Commission "from permitting distribution of voting power of the kind proposed in this application, unusual as is such distribution." But, as appears from the following, the more general basis of his views, which, in other proceedings, have come into conflict with those of the Commission, is to be found in his sponsorship of a laissez-faire approach in so-called matters of management: "Furthermore, when Congress, as it did in 1920, definitely elected to rely on private management, enterprise, and capital for the country's railroad transportation, it elected to take all those things that necessarily go with them. Among those things are a free public market for securities, opportunities for speculation in securities for private profit, opportunity for individual initiative and ambition in connection with transportation, and the consequences of all those things. . . . The presumption is that unless the public interest definitely blocks the road, or the law forbids, management should, by and large, have its way. Whenever we encroach upon the domain of management, except for definite legal reasons, or for reasons solidly founded upon a clear principle affecting the public interest, we are in effect using the letter of the law to defeat its spirit." *Ibid.*, pp. 110-111. Similar general views have been expressed from time to time by other commissioners. Note the following, for example, from the concurring opinion of Commissioner Potter in *Denver & Rio Grande Western Reorganization*, 82 I.C.C. 745 (1923), at p. 763: "To block the issuance of the Denver securities would, in my judgment, be to act beyond the law. Our function is administrative, not legislative. We are a governmental agency to apply law and not the people's representatives to make it. We must determine the public interest within the limits of existing law and have not been given power to reform according to our individual views. Business enterprises have liberty of action as long as they do not violate the law. They are not under restraint to function only as we please. We may not override their action merely because we think it unwise. The laws of all the States still provide for the organization of corporations and for their management by directors and officers chosen by their stockholders, whose investments are at stake. It is not our function to supplant them. . . . In our zeal we should not overlook the fact that our function is limited to the regulation of interstate transportation. It may be the function of Government to go to great extremes in regulating railways and other enterprises. It is not a function of Government to set up a system of regulation that places on us the power to determine purely business questions, and this has not been done."

result will be that the \$25,000 of common stock will strongly outvote the \$300,000 of preferred stock. The practical effect is much the same as if the preferred shares were deprived of voting power, a practice which we have condemned in other cases. In the second place, it is proposed to style \$300,000 of the stock 'preferred,' although the preference is only over \$25,000 of common. Such a preference amounts to little or nothing and the position of the holders would be practically as strong if all the stock were made common. If the company has real earning possibilities, their position in the latter event might even be stronger, for the preference operates to limit their maximum dividends to 6 per cent. The danger of such 'preferred' stock is that those to whom it is offered may be misled by the designation, and gain the impression that they are buying a security of strong and favored position. . . . I find myself unable to favor either that part of the plan which places the control of the property in the hands of those owning stock which represents but an insignificant portion of the investment sacrifice, or that part which creates preferred stock as to which the preference is but shadow rather than substance. I see no good reason why all the stock now issued should not be common stock of a uniform par value of \$100 per share. If the road develops any earning power in the future, this would improve its position by allowing opportunity for future financing through issues of preferred stock as well as through issues of bonds. It is not at all likely that under any set-up the company will be able to finance by new issues of common; nor is it likely that, under the proposed structure, it could finance by further issues of preferred. . . . Everything that we do, of course, encroaches upon the domain of management; but I agree . . . that we ought not to encroach 'except for definite legal reasons, or for reasons solidly founded upon a clear principle concerning the public interest.' In this case it seems to me clear that concentration of control of railroad properties in a relatively insignificant investment is opposed to the public interest, and it also seems to me clear that the public interest requires that railroad securities should conform in their designations and apparent attributes to the actual facts. As for our authority over such matters, it may be well to observe that . . . we are specifically empowered, in connection with an application for authority to issue securities, 'to grant it with such modifications and upon

such terms and conditions as the commission may deem necessary or appropriate in the premises.<sup>487</sup>

Regardless of the merits of the outcome of particular proceedings, it is apparent that the principal point of controversy, as reflected in the pronouncements of Commissioner Woodlock and Commissioner Eastman, concerns the lawful and desirable scope of the Commission's interference with the financial structures of the carriers, particularly in their bearing upon the control relations of different types of stockholders. The views expressed represent sharply divergent philosophies of regulation and concepts of public interest. Because reliance was placed upon private capital for the establishment and development of railroad service, Commissioner Woodlock deemed the matter of control to have been largely reserved to the free determination of the carrier corporations in the adjustment of investment contracts; on the other hand, because provision was made for the regulation of security issues under broad powers, Commissioner Eastman deemed the maintenance of reasonable relationships between investment and control, though necessarily involving encroachment upon the domain of management as conceived in unregulated industries, to have been both authorized by law and required in the public interest. In view of the purposes and methods of the regulatory process in the field of financial organization, the latter approach is clearly the more sound and appropriate. There can be little question that concentration of control in disregard of investment, however widespread in general corporate practice, is fraught with danger to the proper functioning of railroad enterprise, and that it is distinctly in the public interest to prevent such possibilities of abuse; nor can there be any doubt that ample authority was conferred upon the Commission for this purpose, and that there is no more justification for a laissez-faire attitude toward the problem of control than with respect to other aspects of the financial structure. And on the whole, it will be observed, the Commission has been guided by this approach. At least to the extent of insisting upon the possession of voting power by such stock as has been authorized, it has clearly recognized the persuasiveness of these considerations; and in connection with proposed unifications, as has

<sup>487</sup> *Securities of Jacksonville & Havana R. R.*, 111 L.C.C. 107 (1926), at pp. 112-113.



already appeared, it has scrutinized carefully the entire complex of relationships between investment and control. Its apparent disregard of the effect upon control relations of the issuance of varying amounts of different types of voting stock in the instant proceeding must be largely explained by the special circumstances surrounding the application.

Of final and predominant importance in the regulation of the types of securities to be issued is the Commission's control of indebtedness. The burden of funded debt bears most directly upon the credit of the carriers and their ability to serve the public; and if their financial requirements are to possess reasonable flexibility, so that rates may be readily adjusted to changing conditions and inevitable fluctuations in revenues may not produce the untoward consequences which generally flow from actual or threatened insolvency, it is necessary that an undue thinning of the stockholders' equities be avoided and a safe margin between fixed charges and normal earnings be preserved. Because of considerations of this character many of the states have imposed limitations upon the creation of indebtedness by railroad and public utility corporations, these limitations usually fixing definite maximum ratios of funded debt to capital stock or endowing the regulatory agencies with authority to maintain reasonable proportions between them. Under the federal statute, which virtually superseded the state regulatory activities as far as railroads are concerned, no standards are promulgated for the maintenance of fixed proportions between stocks and bonds, nor is specific mention made of the exercise of administrative jurisdiction over the relationship between total capitalization and the amount of interest-bearing obligations. It is clear, however, that the public interest to be served under the broad powers of security regulation established in 1920 must necessarily embrace this important matter of control of indebtedness; and the Commission has so construed its authority from the first. Moreover, the very absence of specific legislative standards has enabled it to deal with this problem on a flexible basis, in ways deemed appropriate to the peculiar circumstances of each proceeding. But despite the breadth of its discretionary authority, the Commission has by no means found itself entirely free to revamp the financial structures of the carriers, in the direction of reducing the proportion of funded debt and the burden

of fixed charges. Not only, as throughout the sphere of financial organization, has it sought to refrain from undue encroachment upon managerial initiative, but the position of the applicant carriers, in the light of prevailing money market conditions, has frequently interposed practical obstacles to desirable control of the amount of indebtedness. The fact, for example, that a given carrier is already subject to an overload of debt may render it virtually impossible to raise new capital, whether for refunding purposes or for additions and betterments, except through the further issuance of bonds; and the denial of the requested authority, however fully justified by defects of the existing capital structure, may not only produce financial embarrassment but impair necessary public service. In these circumstances the same types of difficulty which prevent the removal of past overcapitalization as a condition of authorizing new securities for proper purposes and in proper amounts tend to make past maladjustments in the proportions of stocks and bonds exert a continuing influence. But such factors are merely among the considerations relevant to the disposition of particular proceedings; the main objectives of regulation are not thereby abdicated. Just as the Commission has sought to limit the aggregate of new securities to the amount of properly valued capitalizable assets, so it has endeavored to restrict the issuance of bonds and other evidences of indebtedness to situations in which the authorization of such interest-bearing obligations would be appropriate and defensible.

In determining the compatibility of proposed bond issues with the public interest, the Commission has generally been guided, not by formulas as to proper proportions between stocks and bonds or between bonded indebtedness and property values, but more directly, by the relationship between fixed charges and earning capacity.<sup>488</sup> In some instances, when there appeared to be no prospect of sufficient earnings to support the proposed fixed charges, the Commission has

<sup>488</sup> Even in *Public-Convenience Certificate to W. F. & S. R. R.*, 67 I.C.C. 184, 187 (1921), where, in authorizing the construction of a line of railroad, it was specified "that in issuing bonds the applicant will be required to limit the amount to not more than 50 per cent of the total cost of road and equipment, exclusive of amounts donated," the percentage restriction was imposed "so that fixed charges will in no event exceed the estimate of net income from local traffic." Thus, \$688,000 of first mortgage bonds was authorized, in place of the \$874,000 requested by the applicant. *Securities of Wichita Falls & Southern R. R.*, 71 I.C.C. 694 (1922).

altogether denied the requested authority. Thus, where an exceptionally heavy bonded indebtedness existed and past revenues had been insufficient to pay operating expenses and fixed charges, authority to refund was denied as follows: "We are not convinced that the continuance of such heavy fixed charges is compatible with the interests of either the applicant or of the public, and the record discloses no facts tending to show that the prospective earnings or the operating ratio of the applicant will improve."<sup>439</sup> Again, where the construction of an extension was authorized, despite a lack of reasonable assurance that the project would be financially successful, because local interests were ready and willing to accept the risk, the Commission held that "in view of the uncertain future of the road, we do not think it would be proper for us to sanction at this time the issuance of bonds to finance its construction."<sup>440</sup> The more usual procedure, however, has been to prescribe such modifications of the proposed financing as to render the relationship between fixed charges and earning capacity more acceptable. Toward this end a variety of methods have been employed. The amounts of proposed bond issues have been cut down, with authorization of correspondingly larger amounts of stock;<sup>441</sup> the proposed rates of interest have been reduced, with the imposition

<sup>439</sup> *Bond Application of Texas Short Line Ry.*, 67 I.C.C. 400, 401 (1921).

<sup>440</sup> *Public-Convenience Certificate to Jackson & Eastern Ry.*, 70 I.C.C. 110, 113 (1921). See, also, *Securities Application of Apache Ry.*, 71 I.C.C. 245 (1922).

<sup>441</sup> In *Eastland, Wichita Falls & Gulf R. R. Stock and Bonds*, 72 I.C.C. 181 (1922), for example, the issuance of \$556,000 of stock and \$350,000 of bonds was authorized, instead of the \$355,000 of stock and \$551,000 of bonds requested by the applicant, to be used in payment for construction advances made to the carrier. Because it was found "that the applicant should be able to earn fixed charges upon \$350,000 of bonds," authority was granted to issue "that amount of bonds and \$556,000 of stock," but "without prejudice to the filing of other applications, from time to time, seeking the exchange of bonds for outstanding stock in an aggregate amount not to exceed \$201,000, upon a proper showing that future earnings of the road will justify the assumption of heavier fixed charges" (p. 182). Again, in *Securities of G., N. & A. R. R.*, 79 I.C.C. 289 (1923), the issuance of \$600,000 of stock and \$300,000 of first-mortgage bonds was authorized, instead of \$300,000 of stock, \$300,000 of first-mortgage bonds, and \$300,000 of second-mortgage bonds, as requested by the applicant, because of the finding, in light of the record of earnings, "that the burden of fixed charges assumed by applicant should be reduced to the minimum" (p. 290). See, also, *Securities of Louisiana Ry. & Navigation Co. of Texas*, 90 I.C.C. 229 (1924), 99 I.C.C. 357 (1925), in which authority was granted to issue \$400,000 of stock and \$750,000 of bonds, instead of the \$200,000 of stock and \$2,963,000 of bonds requested by the applicant.

of restrictions upon interest payments;<sup>442</sup> and bonds have been authorized on condition that interest be waived for a period of years and that available net income be used to meet accrued and unpaid interest on outstanding obligations.<sup>443</sup> In judging probable earning power, however, doubts have frequently been resolved in favor of the applicant. Where, for one reason or another, there appeared to be some likelihood of improvement in the traffic and financial position of the carrier, bonds have been authorized which increased fixed charges, despite the inadequacy of past earnings in relationship to the burden of outstanding obligations.<sup>444</sup> But in such circumstances, it must be recalled, the Commission does not deal *de novo* with ideal situations;

<sup>442</sup> In *Securities of Fort Smith & Western Ry.*, 70 I.C.C. 777 (1921), for example, the issuance of \$1,500,000 of first-mortgage bonds and \$3,744,000 of second-mortgage bonds was authorized, as requested by the applicant, but on condition that the first-mortgage bonds bear an interest rate of 6 instead of 7 per cent and that the second-mortgage bonds bear an interest rate of 5 instead of 6 per cent. It was also provided "that for 10 years from the date of issue the interest on the second-mortgage bonds should be noncumulative and payable only if earned" (p. 779).

<sup>443</sup> Thus, in *Electric Short Line Railway Bonds*, 76 I.C.C. 568 (1923), authority to issue \$367,000 of bonds, to be delivered in payment for past and future advances, was granted "on the condition, that, for a period of five years from the date of the issue of the bonds, the interest coupons shall be detached therefrom by the applicant before the bonds are issued, and deposited by it with the trustee, under the mortgage, and that these coupons, or any interest which they represent, shall not be paid by the applicant for such five-year period, except on further order of this commission upon application by the applicant therefor; and on the further condition that any excess earnings of the applicant over and above operating expenses, cost of maintenance, and upkeep of the property, including road and equipment, and interest charges on the now outstanding first-mortgage bonds, shall be used by the applicant to liquidate accrued and unpaid interest on the bonds, in the aggregate principal amount of \$840,000 heretofore issued and now outstanding" (p. 575).

<sup>444</sup> In *Bond Issue of Central Vermont Ry.*, 65 I.C.C. 126 (1920), the issuance of \$12,000,000 of 5 per cent bonds was authorized, for the purpose of refunding a like amount of 4 per cent bonds, despite the fact "that the applicant's earnings were barely sufficient to pay interest on its funded debt at the rate of 4 per cent; and that the increased interest charges would be approximately \$321,000." The authorization was influenced in large measure by the prospect of improvement: "The applicant submitted that the increased revenue from rate increases authorized by us, together with the increased tonnage which it has been receiving since the first of this year and would continue to receive from the Grand Trunk, due to the consolidation of the railways of Canada, thereby giving it access to some 18,000 miles of road in Canada, will produce sufficient revenue to justify the issue of the new bonds with interest at 5 per cent" (p. 127). In *Bonds of Manchester & Oneida Ry.*, 70 I.C.C. 672 (1921), the interest rate on a small issue of bonds was similarly increased (from 5 to 6 per cent), despite the inadequacy of earnings, upon a showing that, pending improvement in earnings, these charges could be met out of surplus: "The applicant's earnings for the last five

it finds itself compelled to face the fact that, however desirable it might be to avoid an overload of indebtedness, no other expedient than the issuance of bonds on rather unfavorable terms may be open to the carrier, when it must seek to meet maturing obligations under adverse market conditions, or to raise necessary new capital against a background of inadequate returns.<sup>445</sup> Even in these situations, moreover, reliance is generally placed upon prospects which appear sufficiently real to justify the new financing. On the whole, it is apparent, the Commission has sought so to restrict indebtedness as to bring fixed charges within the bounds of reasonably assured operating income.

But even in the case of strong carriers, where there can be no question as to the adequacy of normal earning power to meet the burden of fixed charges, there are sound reasons of public policy for curtail-

years have not been sufficient to meet its fixed charges, which have been paid in part out of surplus, and, from a statement filed with the amendment to the application, it appears that earnings for the current year will not be sufficient to pay fixed charges. The applicant has, however, submitted evidence tending to show that it will be able to meet its fixed charges out of surplus until its earnings are sufficient for that purpose" (p. 673). In *Knoxville & Carolina R. R. Bonds*, 79 I.C.C. 542 (1923), in which authority was granted to issue \$100,000 of 6 per cent bonds, partly for reimbursement of advances and partly for additions and betterments, despite inadequacy of past earnings, the authorization was influenced in large measure by the benefits to be derived from the new facilities: "The issue of the proposed bonds will increase the applicant's interest charges by \$6,000 per annum. From evidence submitted with the application it appears that the applicant has not earned its fixed charges since it began operation of the property, except in March, 1923, for which month the income account shows a small surplus in net income. The deficit resulting from operation has, however, not been large. It is represented by the applicant that its property and equipment facilities have been improved by the use of the cash advances and bank loans in the sum of \$49,000, and that they will be more greatly improved by the expenditure of the proceeds of the \$51,000 of bonds to be sold, which will enable it to increase its tonnage, develop new business, and thereby increase its net revenue to an amount more than sufficient to care for the interest charges on the bonds now outstanding and those proposed to be issued" (pp. 544-545). Compare, also, note 369, *supra*.

<sup>445</sup> Thus: "The applicant also submitted that unless the proposed issue be allowed, at least to the extent of \$12,000,000 to refund the bonds now past due, a receivership might result." *Bond Issue of Central Vermont Ry.*, 65 I.C.C. 126, 127 (1920). Again: "It is also represented by the applicant that it has no available means other than the issue of these bonds to pay and discharge the indebtedness represented by the cash advances and bank loans, and to finance the proposed additional improvements. In view of the representations made by the applicant, and the fact that it appears that this railroad is a public necessity and the operation of it should be continued, we think that it should be permitted to issue the proposed bonds for the purposes stated." *Knoxville & Carolina R. R. Bonds*, 79 I.C.C. 542, 545 (1923). For other factors operative in the disposition of these proceedings, see note 444, *supra*.

ing bonded indebtedness in favor of stock issues. With a large bonded debt, not only does the general credit of the carriers tend to be weakened, but serious difficulties in meeting both interest payments and capital maturities are bound to arise in the face of cyclical fluctuations and other uncontrollable developments, as has been amply demonstrated during the depression years.<sup>446</sup> The chief obstacle to authori-

<sup>446</sup> Note, for example, the following declarations from the discussion of the financial ills of the railroads by the Federal Coördinator of Transportation: "In 1932, the net railway operating income of class I railroads was \$326,000,000, in contrast with \$601,000,000 in the depression year of 1921 and with \$1,252,000,000 in 1929. In 1932, railroads operating nearly 74 per cent of the total class I mileage failed by \$250,000,000 to earn their fixed charges. The volume of freight and passenger business in 1932 was only about 50 per cent of that in 1926. At present, 75 railroads operating 42,340 miles are in receivership or in the hands of the court under the Bankruptcy Act. Except for loans from the Reconstruction Finance Corporation, many other railroads would be in similar difficulties. Business took an encouraging upturn in the last 9 months of 1933, particularly in the summer, but earnings are still very low, and the railroads are now faced by substantial increases in prices for materials and supplies. . . . At present few railroads would be able to place a new issue of securities in the private market on a satisfactory basis. . . . Important in this connection are the amount and character of railroad funded debt. It aggregates 56 per cent of the outstanding capitalization. This is a high percentage, particularly when it is borne in mind that it is only an average and that many railroads have a funded debt of much larger relative proportions. . . . From one point of view the using public is not concerned with the amount of railroad debt. So long as the railroads are privately owned, they have a constitutional right to obtain, if they can under reasonable rates, a fair return on the rate-making value of their property. This obligation of the public to pay is in no way affected by the ratio of debt to stock. The public, however, has a very practical interest in the matter, to the extent that an unduly high ratio impairs the credit of the carrier and its ability to provide the most economical and efficient service, or leads it to scrimp on maintenance and service in an endeavor to eke out earnings in times of depression. The great danger in a high percentage of funded debt is the inflexible burden of fixed charges which goes with it and which may bring financial disaster when earnings drop. . . . The extreme depression has demonstrated the dangers of a high percentage of funded debt in a way which has made a profound impression. The maturities which the railroads face are an added cause of alarm. For the next 5 years funded-debt maturities in excess of \$100,000, omitting debts to the Reconstruction Finance Corporation, total \$1,533,700,751. . . . With the funded debt at its present point, or anything like it, the opportunity is slim for further increase without at least corresponding increase in stock. Private railroad financing by bond issues alone has definite limitations at any time, and these limitations will be narrower in the future than they have been in the past. Ability to market new issues of stock is in the long run essential to private financing. . . . Practical experience has shown the need for adequate depreciation reserves to protect against obsolescence as well as wear and tear and the action of the elements, and investors appreciate this need as they have not heretofore. They have come to a similar appreciation of the need for paying off debt, and talk of adequate sinking funds is widespread—not mere book reserves but funds actually applied to debt retirement or invested in liquid assets." *Regulation of Railroads*, 73d Cong., 2d Sess., Sen. Doc. No. 119 (January 20, 1934), pp. 4-7.

tative control of indebtedness under conditions of carrier prosperity lies in its seeming interference with managerial freedom; but the Commission's powers over security issues are sufficiently broad to embrace such situations, and occasionally they have been so exercised.

As early as 1926, when the Chesapeake & Ohio, the credit position of which was outstanding among the railroads of the country, applied for authority to have \$10,621,000 of bonds delivered to it in reimbursement for additions and betterments made and to be made and for the cost of acquiring control of a subsidiary, the application was denied.<sup>447</sup> Referring to an earlier finance application of the same carrier, in which it had been contended that "increasing the amount of capital stock relative to funded debt increases safety," that "the effect of financing with stock should be to improve the credit of the railway and to enable it to borrow on more favorable terms in the future," and that its stock is "a high-grade security" and "readily salable,"<sup>448</sup> Division 4 concluded that these considerations should be made to apply to the instant proceeding: "Since the filing of that application the stocks of the applicant, according to market quotations, have not suffered from the standpoint of salability. It is our opinion that if the cost of acquisition of the Sandy Valley & Elkorn is to be capitalized by issue of securities, it should be by the issue of stock rather than bonds, and we are also of the opinion that when, as, and if the company's treasury is to be reimbursed for the expenditures made and to be made for additions and betterments as stated in the application, it should be by an issue and sale of stock rather than bonds."<sup>449</sup> The substantive grounds for restricting the issuance of bonds, at least as a policy of management, were suggestively set forth in the concurring opinion of Commissioner Woodlock: "The applicant is one of a comparatively small group of carriers which are in the enviable position of being able to sell common stock at par or better. Its earnings and its present dividend rate afford ample opportunity for doing this to a liberal

<sup>447</sup> *Bonds of Chesapeake & Ohio Ry.*, 105 I.C.C. 748 (1926).

<sup>448</sup> *Ibid.*, p. 749, referring to *Chesapeake & Ohio Railway Capital Stock*, 72 I.C.C. 658 (1922), in which authority was granted to issue and to sell at par \$12,558,500 of convertible preferred stock, the proceeds to be used for additions, betterments, and improvements, and to issue \$12,558,500 of common stock, to be used from time to time in conversion of the preferred stock.

<sup>449</sup> *Bonds of Chesapeake & Ohio Ry.*, 105 I.C.C. 748, 749 (1926).

amount at the present time, and there is every indication that this will continue to be true in the future, given capable management and prudent expenditure of capital. This being so it would be highly regrettable if so good an opportunity were neglected, in view of the serious objections that exist to the financing of railroads by terminable mortgage bonds with foreclosure rights. These objections are twofold, one being absolutely fundamental in its nature, and the other being of almost equal practical importance. The use of terminable mortgage bonds to secure railroad capital is an offense against the very nature of the case. A railroad does not naturally return capital once it has been invested; on the contrary, it is always engaging more capital as time goes on. When, therefore, it undertakes to pay a considerable sum of money at a fixed date under the terms of a mortgage, it can pay the maturing obligation only by raising new capital. . . . Granted that financing by terminable mortgage-bond issues may in the past have been forced upon the carriers by necessity, or seeming necessity, it is certain that any road that opens itself whereby the railroads can escape from a continuance of such a practice is a good road to take. . . . The second objection, arising from the fastening upon a railroad of a fixed-charge obligation with foreclosure penalties in the background, needs but to be mentioned. Two generations of this sort of financing have left most of the carriers in the United States with capital structures overweighted with terminable fixed obligations, carrying rights of foreclosure. About 60 per cent of railroad investment is represented by securities of this class. The extreme desirability of using for capital purposes a security which does not mature for repayment at a fixed date, and the return on which is not secured by foreclosure rights against the property, is so evidently desirable that dispute as to its merits is impossible.<sup>460</sup>

It is significant, however, that Commissioner Woodlock, despite this strong expression of sound principle with respect to the necessity for curtailing funded debt, concurred in the disposition of the proceeding "mainly because the application . . . did not involve the actual issue and sale of securities by the applicant corporation at this time"; though he deemed it "an unusually clear case so far as concerns the question of what is the wisest policy for the management to fol-

<sup>460</sup> *Ibid.*, pp. 750-751.



low," he expressed doubt, were the problem of actual issue and sale of securities presented for determination, as to whether it would be the duty of the Commission to substitute its decision for that of the managers of the corporation.<sup>461</sup> As in connection with the problem of regulating voting power in the adjustment of the financial structure<sup>462</sup> and of prescribing "competitive bidding" in the sale of securities,<sup>463</sup> this inclination of Commissioner Woodlock to urge a laissez-faire attitude on the part of the Commission was based, not upon a belief that its power was inadequate, but upon what he conceived to be the general spirit of the controlling Congressional legislation. His position is clearly disclosed by the following: "The terms of the transportation act, literally construed, give to this commission very broad powers with respect to the issue of securities by railroad corporations. In relying, however, as Congress deliberately did, upon private capital, management, and enterprise for efficient transportation service, Congress, by implication, instructed us in carrying out our regulatory task to leave to management all possible scope, subject to considerations clearly affecting the public welfare. So many of the activities of railroad carriers are now directly subject to definite control by this commission that the zone of free action available to management is considerably circumscribed. That portion of the zone wherein lie questions of finance is perhaps the largest part of the whole. In my judgment, it is our duty to avoid entering upon that zone save upon the clearest evidence of public necessity. Unless a course of action proposed to us by managers of a railroad corporation definitely threatens the public welfare it is, I think, our duty to refrain from interfering with managerial judgment, even though the law, literally construed, may give us the power to do so. That I believe to be the spirit of the transportation act. If Congress had not intended to leave to private management at least some substantial zone of activity it would not

<sup>461</sup> "The irony in the case," he added, "is that it is companies whose prosperity is so great as to make financing by common stock possible which can, in fact, most safely issue mortgage bonds." *Ibid.*, p. 752.

<sup>462</sup> See his dissenting opinion in *Stock of Pittsburgh & West Virginia Ry.*, 105 I.C.C. 552 (1926), at pp. 556-557; and his concurring opinion in *Securities of Jacksonville & Havana R. R.*, 111 I.C.C. 107 (1926), at pp. 110-112.

<sup>463</sup> See his concurring opinion in *Chicago, Milwaukee & St. Paul Equipments Trust*, 99 I.C.C. 682 (1925), at pp. 689-691.

have relied upon it for the kind of transportation that it was seeking.<sup>454</sup>

This philosophy has been appropriately rejected by the Commission, in the matter of regulating carrier indebtedness, as in other aspects of its control of financial organization. Reliance upon private management, under the 1920 legislation, was accompanied by the establishment of broad safeguards of the public interest, and these safeguards were made applicable to the financial policies of the carriers as well as to their transportation activities. The powers conferred upon the Commission in the premises are, it is true, of an enabling rather than a directing character, but they were designed to restrict the types of securities issued no less than their amount, and in the interest of maintaining a sound financial structure in the long run as well as of averting immediate threats of foreclosure penalties because of excessive fixed charges. Under these circumstances both law and policy fully justified the Commission in applying the brakes to the issuance of interest-bearing obligations by strong carriers. As a practical matter, however, the record of operating income and the character of money market conditions have been chiefly influential in determining the relative emphasis upon stocks and bonds in the financing of the railroads. Between 1925 and 1930, as net income and dividend payments rose,<sup>455</sup> the ratio of stock to the aggregate of securities authorized sharply increased;<sup>456</sup> in 1931 and 1932, with the precipitate

<sup>454</sup> *Bonds of Chesapeake & Ohio Ry.*, 105 I.C.C. 748 (1926), at p. 751.

<sup>455</sup> The ratio of net income to stock rose from 6.70 per cent for 1924 to 8.19 per cent for 1925 and 9.43 per cent for 1926; it fell to 7.78 per cent in 1927, but mounted again to 8.79 per cent in 1928 and 9.92 per cent in 1929. The course of dividend payments showed a similar development: the percentage of stock paying dividends was 64.97 in 1924, 66.70 in 1925, 69.12 in 1926, 70.25 in 1927, 73.65 in 1928, 76.23 in 1929, and 76.93 in 1930; the average rate on dividend-paying stock was 6.37 in 1924, 6.52 in 1925, 7.32 in 1926, 8.47 in 1927, 7.12 in 1928, 7.47 in 1929, and 7.83 in 1930; the average rate on all stock was 4.14 in 1924, 4.35 in 1925, 5.06 in 1926, 5.95 in 1927, 5.25 in 1928, 5.70 in 1929, and 6.02 in 1930. *Annual Reports*, 1933, p. 90.

<sup>456</sup> The figures were as follows: 5.0 per cent (\$45,217,499 of stock, out of \$907,777,854 of securities) for 1925; 14.5 per cent (\$124,650,103 of stock, out of \$862,628,862 of securities) for 1926; 29.4 per cent (\$359,853,584 of stock, out of \$1,157,368,222 of securities) for 1927; 28.9 per cent (\$540,695,464 of stock, out of \$1,871,200,314 of securities) for 1928; 27.1 per cent (\$314,133,446 of stock, out of \$1,160,383,991 of securities) for 1929; and 34.6 per cent (\$595,816,318 of stock, out of \$1,723,543,132 of securities) for 1930. No account is here taken of no-par stock. *Annual Reports*, 1925-1930.

decline in traffic and earnings,<sup>467</sup> this ratio shrank to negligible proportions.<sup>468</sup> But the record as a whole in this respect is a much more favorable one than is sometimes assumed. It is significant that, despite much new investment during the decade of the 1920's, the ratio of debt to capitalization was substantially the same at the end of 1932 as it was at the end of 1921.<sup>469</sup> This result, though largely achieved on the initiative of the carriers themselves, was in full harmony with the oft-expressed views of the Commission.<sup>460</sup> It is undoubtedly true that

<sup>467</sup> The ratio of net income to stock, which fell from 9.92 per cent in 1929 to 5.77 per cent in 1930, shrank to 1.69 per cent in 1931; and in 1932 net income failed by a very substantial margin to meet fixed charges. The proportion of stock paying dividends fell from 76.93 per cent in 1930 to 73.20 per cent in 1931 and 32.85 per cent in 1932; the average rate on dividend-paying stock fell from 7.83 per cent in 1930 to 5.48 per cent in 1931 and 4.57 per cent in 1932; and the average rate on all stock fell from 6.02 per cent in 1930 to 4.01 per cent in 1931 and 1.50 per cent in 1932. *Annual Report, 1933*, p. 90.

<sup>468</sup> From a post-war peak, in 1930, of \$595,816,318 of stock, constituting 34.6 per cent of the aggregate of securities authorized, the figure shrank to \$34,400,112 of stock out of \$750,092,636 of securities, or about 4.6 per cent, in 1931, and to \$78,105,401 of stock out of \$1,398,870,789 of securities, or about 5.6 per cent, in 1932. No account is here taken of no-par stock. *Annual Reports, 1930-1932*.

<sup>469</sup> This ratio was 56.1 per cent in 1921 and 56.0 per cent in 1932. By 1924 it had risen to 57.1, but with increasing reliance upon stock issues during the next five years, it reached a post-war low of 55.9 per cent in 1928 and 1929, rising again to 56.1 per cent in 1930 and standing at 56.0 per cent in 1931 and 1932. *Annual Report, 1933*, p. 90. See, also, notes 421 and 446, *supra*. For a suggestive analysis of the financial policies of the railroads since 1920, see Harold G. Moulton and Associates, *op. cit.*, pp. 298-320. The conclusions reached by this analysis, with special reference to the problem of bonded indebtedness, are stated as follows (p. 301): "(a) the railroads have actually done a much smaller proportion of their financing through bond issues since 1924 than is generally supposed; (b) they could have done a considerably larger volume of their financing by stock sales during the period since 1921 if their managements had considered it desirable to do so; (c) it would not have been a sound policy for the roads, viewed as private profitmaking corporations, to do a much larger proportion of their financing through the sale of stock; . . . (e) under the conditions which appear likely to prevail over the next decade a much greater proportionate use of stock is desirable."

<sup>460</sup> As early as 1922, for example, the Commission reported as follows: "The Illinois Central Railroad Co. and the Chesapeake & Ohio Railway Co. made applications for authority to issue preferred capital stock, the proceeds from sale of which are to be used in making additions and betterments to their properties. These applications constitute encouraging indications, inasmuch as of late years it has been generally the practice to finance additions and betterments through sale of bonds carrying fixed charges. Both applications have been granted." *Annual Report, 1922*, p. 32. A similar attitude has been taken toward the issuance of stock for a variety of other purposes, including the retirement of funded debt. See, for example, *Annual Reports: 1927*, pp. 9-10; 1928, pp. 9-10.

during the period of prosperity even greater advantage might have been taken of the favorable market for stocks, not only to meet new capital needs but to effect substantial reductions in bonded indebtedness, but the failure to do so was largely a reflection of the almost universal lack of awareness of the oncoming breakdown and of the basic significance of fixed obligations in the intensification of its hardships. That the experience of the depression will generate a stricter policy with reference to control of indebtedness is evidenced by the following pronouncement of the Commission concerning debt retirement in its latest report to Congress: "It has been the policy of railway companies to provide for their financial requirements largely through the issue of long-term bonds which at maturity are refunded. While the bonds are refunded the indebtedness evidenced by them is ordinarily regarded as perpetual and no provision is made for its ultimate liquidation. The result is that the funded debt of the railway companies is constantly increasing as their investment in railway properties is increased. . . . The expense of refunding in the manner heretofore usually followed is considerable. More important is the danger that the maturity, if it occurs at a time when new or junior bonds are difficult or impossible to market, will cause trouble. Recent experience sufficiently illustrates this. The strain caused by heavy fixed charges in such a time as this is detrimental to service furnished the public. . . . We are giving consideration to methods of bringing about a reversal of the present trend in railway financing. We believe that the desired results can be obtained, in part at least, through the provision of sinking funds to be set up by the railway companies out of net income for the purpose of retiring a part of their funded debt before maturity. If such funds are not voluntarily established by the railway companies, their establishment may be required as a condition to our authorization of further bond issues under the provisions of section 20a of the Interstate Commerce Act."<sup>461</sup>

<sup>461</sup> *Annual Report, 1933*, pp. 25-26. This attitude is in harmony with the mandate of the Emergency Railroad Transportation Act of 1933, whereby the Commission was directed not to approve loans under the Reconstruction Finance Corporation Act to carriers which, in its judgment, are in need of financial reorganization. The Commission's observance of this injunction should obviate the danger that governmental aid will preserve debt burdens that should be eliminated by drastic action.

*Terms and Conditions*

Effective control of the extent of capitalization and of the types of instruments employed renders it necessary that the scope of regulation embrace the terms and conditions under which securities may be issued. It is obvious that the sale of stock below par, without appropriate provision for the amortization of discounts, tends to produce a condition of overcapitalization; and that in the case of bonds so marketed, particularly when the discounts or fees and commissions are excessive, not only does overcapitalization tend to follow, but also an unreasonable inflation of capital costs. Since such consequences affect the credit of the carriers and the character of the transportation service, they are clearly related to the public interest sought to be safeguarded by the regulatory process; furthermore, the power to prescribe terms and conditions is expressly conferred upon the Commission. Accordingly, this aspect of the problem of financial activity has constituted an integral part of its regulation of security issues. Occasionally the requested authority has been denied because the proposed terms were deemed unduly burdensome to the applicant; for the most part the contemplated transactions have been so modified, as a condition of authorization, as to render their terms more favorable to the issuing carrier and more advantageous to the public dependent upon its service. Since the details of proposed security issues, including the prices at which they are to be sold, are usually determined in the first instance through negotiation between the issuing carrier and its bankers and underwriters, the relationships between railroads and their financial agents, particularly with reference to agreed prices, have frequently been subject to the scrutiny and control of the Commission. In so far as prices and other terms have merely been modified, on the basis of the special circumstances of particular proceedings, the Commission's determinations have generally been accepted as a matter of course; when, on the other hand, the public interest has been found to necessitate some alteration in long-standing practice with respect to the sale of securities, as through the policy of requiring competitive bidding, the question of unwarranted invasion of the domain of management has been sharply raised. But, as will appear presently, the record discloses no overreaching exercise of administrative discretion. The Commission's performance along these lines, as throughout

the sphere of finance, has avoided extremes in both directions: while in clear cases the Commission has not abdicated its function of protecting the public interest in deference to the maintenance of managerial freedom, it has proceeded cautiously and with marked restraint in substituting its judgment for that of the applicant carriers, both in its modification of specific adjustments and in its general requirements.

The treatment accorded to stock issues can be noted very briefly. While the Commission has respected the prohibitions of state laws against the sale of capital shares below par,<sup>462</sup> it has not invariably insisted upon such restrictions in the absence of state prohibitions. In thus permitting the issuance of stock below par when such authorization was found to be warranted, it has approved of the proposals of the carriers on the basis of sound policy. When the credit of a road is not sufficiently strong to permit the issuance of stock at par or better, the prevention of its issuance at a discount, for the purpose of meeting legitimate capital needs, would tend to necessitate the creation or perpetuation of indebtedness, with the possibility of more serious consequences than those flowing from a condition of technical overcapitalization; similarly, when a road finds it possible to convert interest-bearing obligations into stock, there is a likelihood that its financial position would be strengthened by the operation, even if the par value of the stock issued for this purpose exceeds the face value of the retired bonds. The realization that stock must be sold for what it will bring has been among the factors responsible for the growing use of no-par stock and the Commission's sanction of such use; and the authorization of the issuance of stock below its nominal or par value is likewise a realistic recognition of the demands of the financial situation surrounding the applicant carrier. Sufficient safeguards against deception of investors and inflation of asset values is provided by the accounting regulations, whereby appropriate charges must be made as discount on capital stock, and these entries must be carried until offset by premiums from the subsequent sale of stock of the same class, assessments levied on the stockholders, appropriations of income or surplus for that purpose, or charges to profit and loss upon

<sup>462</sup> See *Capital Stock of Pittsburgh & West Virginia Ry.*, 82 I.C.C. 704 (1923); *Stock of Castelman Valley R. R.*, 90 I.C.C. 521 (1924). For an analysis of state and federal relationships in the sphere of finance and management, see Part II, pp. 216-220, 247-258.

reacquisition of the stock. The Commission is thus concerned with scrutinizing the reasonableness of the proposed prices or interchange ratios under the prevailing circumstances of each proceeding, rather than with the enforcement of any rule designed to maintain an invariable equivalence between par values and market values.<sup>463</sup>

The matter of the price at which stock may properly be issued has also arisen in the case of strong carriers which have sought to accord to existing shareholders the right to subscribe at par for stock the market value of which was substantially above par. In such situations, too, the Commission has acceded to the wishes of the applicant carriers, though not without wavering and conflict of judgment among its members. When the Commission first authorized the Chesapeake & Ohio to acquire control of the Pere Marquette, it found "that the privilege proposed to be extended to registered holders of the applicant's stock to purchase the new stock at par . . . would result in imposing an unnecessary financial burden upon the applicant company"; and it therefore imposed the condition that the authorized stock "be offered to holders of common capital stock, pro rata, at \$150 a share."<sup>464</sup> This determination called forth sharp disagreement

<sup>463</sup> Thus, in *Bonds of Chesapeake & Ohio Ry.*, 65 I.C.C. 743 (1921), in which authority was granted to issue \$50,225,000 of common stock to be exchanged for \$40,180,000 of convertible bonds, the finding of compatibility with the public interest was supported as follows: "On December 31, 1919, applicant had outstanding capital stock of the par value of \$62,786,000 and funded debt of the principal amount of \$180,769,000. For every \$100 of stock outstanding it thus had a funded debt of about \$288, a ratio of nearly 3 to 1. If the bonds in question were exchanged for stock on the basis of \$100 of stock for every \$80 of bonds, the capital stock outstanding would have a value of \$113,011,000 and the funded debt would be reduced to \$140,589,000, or \$124 of bonds for every \$100 of stock. Fixed charges would also be reduced by \$2,009,000 annually. Manifestly the credit of the company would be materially improved. Moreover, on December 31, 1919, applicant had appropriated, according to its balance sheet, \$23,859,636.38 of surplus earnings for investment in additions to its property, and it appears that of this amount \$7,500,000 had been specifically appropriated by applicant under the provisions of the trust indenture of April 1, 1916, securing the bonds in question, 'as an offset to the difference between the price at which its said bonds are converted and the par amount of the stock in respect of any stock issued at less than par therefor'" (p. 744). See, also, *Stock of Erie R. R.*, 117 I.C.C. 752 (1927), in which authority was granted to issue \$39,254,200 of common stock to be exchanged for \$19,627,100 of convertible bonds, with a provision that the 50 per cent discount, which was found to be less than that reflected by the market price of the stock, be charged to the profit and loss account.

<sup>464</sup> *Control of Erie R. R. and Pere Marquette Ry.*, 138 I.C.C. 517 (1928), at pp. 534-535. In support of its conclusion the Commission said: "The fact that a corporation engaged in transportation has capitalizable assets in sufficient amount to sup-

within the Commission. Commissioner Woodlock, in conformity with his oft-expressed views concerning the scope of security regulation, contended that the extension of "rights" to existing stockholders involves no matter of public concern and is solely within the province of managerial policy;<sup>465</sup> Commissioner Eastman, though dissenting with respect to other aspects of the proceeding, found the denial of the carrier's application to issue stock to its existing shareholders at par to be within the express scope of the Commission's jurisdiction and clearly demanded by the public interest.<sup>466</sup> But upon further hearing the Commission modified the original order, authorizing the issu-

port an increase in securities does not, in itself, justify such increase, and the prospect of increased earnings, the improvement in ratio of stock to funded debt, and other considerations which may favor the proposal, are not to be taken as controlling factors. The necessity for the proposed issue must be demonstrated and the terms upon which it is to be sold must be found reasonable. With full respect to the rights of the applicant's stockholders to receive substantial benefits from the prosperity of the road, we do not believe that the offering of additional stock to them on the basis proposed would be consistent with the public interest" (p. 535).

<sup>465</sup> In dissenting from the Commission's denial of the carrier's application to issue stock to its shareholders at par, Commissioner Woodlock said: "The power of directors to determine what dividends shall be paid on a corporation's stock is as nearly plenary as any power can nowadays be. Its exercise is one of the most essential functions of management and has been uniformly so treated by the courts. Stock 'rights,' as they are commonly termed in the financial district, are by their nature the same things as dividends and directors have the same power with respect thereto. If a company has need for capital and if its directors determine to raise it by sale of new common stock to stockholders pro rata, they have the right to determine at what price stockholders shall have opportunity to subscribe thereto. The matter is one which concerns stockholders alone. As the law stands no question of 'public interest' arises. The price at which the new stock is sold does not affect rates or service nor, obviously, does it affect the solvency of the company. It is a matter of intracorporation policy pure and simple, and with such a matter we have no legitimate concern. We have stated more than once that regulation and management are two different things and that the law has not made us managers of the carriers. To the extent that we arrogate to ourselves the powers of management we are sabotaging the law that it is our duty to administer, and I can not readily imagine a greater offense by us against the real 'public interest' than this." *Ibid.*, p. 546.

<sup>466</sup> Commissioner Eastman's comment on this phase of the proceeding was expressly directed to Commissioner Woodlock's dissenting opinion: "Public regulation is in its very essence interference with private management, but such interference is founded upon the public interest and ought not to occur where no such interest is involved. Our power over stock issues under section 20a is plenary, and we are required by that section to make certain findings before we approve such issues. One finding is that the issue is 'reasonably necessary and appropriate for' a lawful object, and another is that the issue is 'necessary or appropriate for or consistent with the proper performance by the carrier of service to the public as a common carrier' and that it 'will not impair its ability to perform that service.' It is difficult to see, for example, how an issue of 300,000 shares of stock at par is 'reasonably necessary' when an issue of



ance of 300,000 instead of 200,000 shares of the par value of \$100, to be sold to the applicant's existing stockholders at par rather than at \$150.<sup>467</sup> Despite its rejection of the claim that the original order was legally indefensible<sup>468</sup> and its doubt as to the advantages of the proposed modification,<sup>469</sup> it concluded, apparently with no other basis for

200,000 shares at 150 can be made and will serve the same purpose. And manifestly it is not in the public interest that a carrier should issue more stock than is 'reasonably necessary,' for if it does, its further financing by issues of stock at not less than par is likely to be impaired to the detriment of the public which it serves. Nor is the ability of the carrier to declare whatever amounts in dividends its resources permit in any way interfered with by what is here done. We are following, under the plenary provisions of section 20a, what has been the public policy and practice in the Commonwealth of Massachusetts for a great many years, to the advantage, according to our observation, not only of the public but of the companies themselves." *Ibid.*, p. 545.

<sup>467</sup> *Proposed Control of Erie R. and Pere M. Ry. Cos.*, 150 I.C.C. 751 (1929).

<sup>468</sup> On this issue the Commission declared: "The petition . . . for a modification of our former order with respect to the amount and selling price of additional common stock, proposed to be issued by the applicant, is based upon the contentions that the price of \$150 per share fixed by us constitutes an error of law, that the requirement that stock be sold at a premium is a departure from our practice in all other cases where additional issues of stock are involved, that it unjustly discriminates against the applicant, infringes on the right of private management, and is generally unwarranted. . . . We need not discuss the question of law raised by the applicant. While we have recognized the right of stockholders to a distribution of corporate profits and to compensation for sacrifices made in the past, we have also pointed out the necessity for authority under section 20a of the act for the issuance of securities, including stock dividends. Our powers are plenary, and we conceive them to extend to jurisdiction over the terms and conditions under which stock may be issued by any carrier subject to the act." *Ibid.*, pp. 755-756.

<sup>469</sup> Thus: "We are not greatly impressed with the advantages described by the applicant, of issuing new stock at par rather than at \$150 per share. The issue of 300,000 additional shares now proposed will . . . provide for less than 33 per cent of control, and it will increase the applicant's outstanding stock by 25 per cent. The resulting dilution of value per share of the applicant's stock would be much further increased if the actual acquisition of majority stock control of the Pere Marquette were to be entirely financed by the issuance of additional stock at par. That the dilution presently to occur is considered a desirable thing by the applicant is shown by the statement made by counsel in the applicant's brief that 'the wider distribution of stock by reason of the issuance of 300,000 new shares at par instead of 200,000 new shares at \$150 would tend to increase the demand for the shares because the assets would be distributed over a larger number of shares, leaving each share somewhat more in reach of the pocketbook of the average investor.' While nothing appears in the testimony as to the applicant's ability to maintain its present dividend rate of 10 per cent per annum, it may be assumed either that there is confidence in such ability or belief in the soundness of increasing the amount of stock outstanding, even though the common-stock dividend rate may have to be reduced in consequence. With this policy, as applied to the railroads, we have not been entirely in accord. We realize, however, the latitude in action which must be preserved to private management." Similarly, while the Commission recognized the important influence upon the proposal exerted by the interest of the stockholders in the possibility of securing some distribution of their

the reversal than the carrier's improved financial condition,<sup>470</sup> that "in the light of the further showing made by the applicant and a re-consideration of all the circumstances affecting the case," the former order "should be modified as requested in the applicant's petition."<sup>471</sup> While there appears to be little logical connection between the conclusion and the reasoning which led up to it, this outcome as to the distribution of stock rights is consistent with, though subject to the same strictures as, the Commission's treatment of stock dividends;<sup>472</sup> and

equities, it did not deem this factor necessarily prejudicial to the public interest: "It is clear that the proposed issue at par may, within a reasonable probability, yield to present stockholders who sell their rights a money benefit of more than double the amount which would follow from an issue at \$150 per share. We can not escape the conclusion that the desire for the larger probable 'compensation' to the shareholders is a factor in the applicant's present request. This should, however, not confuse the merits of the case from the public standpoint." *Ibid.*, pp. 756-757, 758.

<sup>470</sup> After presenting a summary which showed that the applicant's financial position had improved, since the time of the earlier hearing, from the standpoint of capitalization, investment, current assets and liabilities, profit and loss, and corporate surplus, the Commission said: "The evidence introduced and the representations made by the applicant permit of no reasonable doubt as to the existence of a sound financial basis for the issuance of \$30,000,000 par value of additional stock, and as to the fact that the proportional interests of the stockholders in the property, its assets, and earnings, are unchanged, whether 200,000 or 300,000 new shares are distributed. In either case the assets would be increased by the payment of \$30,000,000 into the treasury. Under such circumstances our chief concern is with the test of public interest, and with a determination whether the proposed issue is reasonably necessary and appropriate." *Ibid.*, p. 757.

<sup>471</sup> *Ibid.*, p. 758. This reversal had been foreshadowed by the action of Division 4 in *Stock of New York Central R. R.*, 145 I.C.C. 95 (1928), authorizing the issuance of \$42,158,300 of capital stock, to be sold to the applicant's stockholders at par and the proceeds to be applied in payment of maturing bonds. Note the following from the partly concurring opinion of Commissioner Eastman: "I am in accord with the conclusions of the majority, except in so far as the issue of the stock at 'not less than par' is approved. This seems to me inconsistent with what was done by the entire commission in *Control of Erie R. R. and Pere Marquette Ry.*, 138 I.C.C. 517, 535, where the Chesapeake & Ohio was authorized to issue 200,000 shares of common stock at not less than \$150 per share. It is true that the reasons requiring issue at a premium were there stronger than they are here. There the stock was to be issued to provide funds for the purchase at a price above par of stock of another carrier, whereas here it is to be issued to provide funds to retire mortgage bonds. However, the common stock of the applicant is selling in the market at about \$170 per share, and it is clear that the new issue can without difficulty be sold at a price substantially in excess of par, although I recognize the desirability of a considerable margin between the issue price and the prevailing market value. . . . In my judgment it is eminently desirable, from the standpoint of the public interest, to keep the capitalization of carriers as low as is consistent with the proper performance of their service to the public. Not only is such a policy financially sound and conservative, but I believe that it will prove of increasing public advantage in other respects as time goes on" (p. 96).

<sup>472</sup> See pp. 513-527, *supra*.

it constitutes a further evidence of its disposition to accord approval to usual financial practice, in recognition of "the latitude in action which must be preserved to private management."<sup>478</sup>

But the problem of regulating the selling price of securities is most frequently concerned with the flotation, through bankers and underwriters, of bonds and other interest-bearing obligations. Compensation must of course be paid for the services of such financial middlemen, through fees and commissions or the spread between the price at which the securities are taken over and that at which they are offered to the public; and whatever the form of compensation, its amount becomes an element in the cost of capital to the carrier and hence a matter of public concern. The Commission's recognition of the relevancy of this consideration to the approval of security issues, and its consequent scrutiny of the operative arrangements, is illustrated by its disposition, in one of the earliest proceedings, of an application of the New York Central to issue \$25,000,000 of 7 per cent collateral-trust bonds.<sup>474</sup> It appeared that the sale was made, without competition, to

<sup>478</sup> See note 469, *supra*. The most substantial consideration in support of permitting strong carriers to issue shares at par, though below their prevailing market values, is that permanent financing through stock is thereby facilitated. Note the following criticism of the Commission's original decision in the *Chesapeake & Ohio* case: "We see no basis for the doctrine laid down by the Interstate Commerce Commission in 1928 in connection with the application of the Chesapeake and Ohio for permission to sell stock at par, to the effect that such action would 'place a burden on the carrier.' . . . The 'melon' distributed by issuing rights to subscribe at par was nothing but the equity of the stockholders in the undistributed past earnings, and anticipated future earnings of their property. The stockholder was given a convenient opportunity to sell part of his equity if he was not willing and able to make his pro rata contribution to the capital needs of the company. There is no sounder method of financing than this. Certainly if it is desired to encourage financing by stock issuance there is no sense in regulations which hamper such financing and obstruct the efforts of stockholders to withdraw from the business a part of the earnings which have accrued as part of their equity." Harold G. Moulton and Associates, *op. cit.*, pp. 315-316. These contentions are not entirely convincing. It is true, of course, that stock must be offered at such prices as will command a market, and hence, as an inducement, may properly be sold somewhat below prevailing prices. But neither the extent of the shareholders' returns nor the ability to withdraw part of their investments is dependent upon the issuance of stock dividends or stock rights. The argument for freedom in these respects rests on the assumption that capitalization possesses no relationship to rates and service. As a practical matter, however, because of the influence of capitalization on credit, the issuance of unnecessary securities through stock dividends or stock rights tends to affect the public interest in the maintenance of reasonable charges and adequate facilities; and even in the case of strong carriers, the dilution of the equity tends to make it more difficult, subsequently, to finance by means of stock issues.

<sup>474</sup> *Bonds of New York Central R. R.*, 65 I.C.C. 172 (1920).

J. P. Morgan & Company, under an agreement whereby the bonds were to be purchased at 96.5259, on a 7.5 per cent basis, to be taken over by a syndicate at 97, and to be sold to the public at par. Although the issue was promptly oversubscribed by more than 50 per cent, the cost to the carrier was \$868,525, plus small amounts of miscellaneous expenses. J. P. Morgan & Company received \$118,525 as syndicate manager, and in addition the syndicate received a gross profit of \$750,000, or 3 per cent, and a net profit, after deducting selling commissions and expenses, of \$274,870, or about 1.1 per cent. The terms proposed were approved, but the character of these relationships and adjustments was carefully examined, and the propriety and need of assuming jurisdiction over them clearly asserted. After directing attention to various factors which helped to explain the high cost of floating securities in the post-war investment market,<sup>475</sup> the Commission declared, through Division 4: "We have thought it necessary to set forth in detail the circumstances and cost attending the marketing of the proposed issue because the assurance of reasonable terms afforded by competitive bids was not present. In saying this we realize that, under the conditions prevailing in the financial world, applicant probably could not have obtained the advantage of open competition; but this fact merely emphasizes the necessity of our considering in this and all similar cases the terms of sale which we are asked to approve. In the present instance, in view of the small financial risk and the apparent ease with which the subscriptions were obtained, we think the discount at which the bonds were sold was liberal. The evidence, however, is not sufficient to justify a conclusion that the cost of

<sup>475</sup> The substantive considerations deemed to support the rather liberal terms of the present proceeding were set forth as follows: "Conditions arising out of the war have radically changed the character of the investment market. Evidence was offered to the effect that owing to the heavy income tax the tendency of large individual buyers is to purchase tax-free securities. High returns promised in competing lines of investment deter some investors from investing freely in railroad securities. Higher margins on the placement of certain competing investments also incline distributors to prefer the placement of the latter. The banks, moreover, find it necessary to use their funds chiefly for commercial purposes. To a much greater extent than heretofore railroad securities must, therefore, be sold to small buyers, and this makes necessary more comprehensive and expensive machinery of distribution. Applicant testified that it had no means of effecting such distribution upon its own account, and that it resorted to J. P. Morgan & Company because of that firm's prestige and experience and established connections with investment houses all over the country. In other words, Morgan & Company acted as middleman between the corporation and the distribution machinery

floating the issue was such that we ought, under all the circumstances, to withhold approval of the terms and conditions set forth in applicant's petition. The subject matter is plainly one deserving of attention, and it is desirable that carriers intending to present applications for the approval of security issues should appreciate that the proposed terms and conditions will be the subject of our careful consideration."<sup>476</sup>

In conformity with this enunciation of general policy concerning the terms and conditions of security issues, the Commission has not only insisted upon the submission of pertinent data, declining authorization where this requirement was not satisfactorily met, but has modified the proposed prices where they were found to impose undue burdens upon the carrier. In deferring action, for want of necessary evidence concerning terms, Division 4 has declared, for example: "As no information has been furnished by the applicant as to the terms of the note or notes which may be issued only upon our authorization, disposition of this portion of the application can not be made on the present record."<sup>477</sup> And in numerous instances its authorization has been conditioned upon the sale of the securities at prices considerably above those proposed by the carriers. Thus, in order to avoid excessive costs, authority has been granted to issue 6 per cent bonds at not less than 90, rather than at not less than 75 as proposed;<sup>478</sup> to issue 7 per cent bonds at not less than 90, rather than at not less than 80 as proposed;<sup>479</sup> to issue 6 per cent bonds at not less than 98, rather than at not less than 95 as proposed.<sup>480</sup> In passing upon the reasonableness

necessary to place so large an issue of securities, and in the opinion of the applicant the issue could not have been effected in any other way. Evidence was also offered by representatives of investment houses as to the greatly enhanced cost at the present time of distributing securities, because of increased salaries, higher rents, the necessity of appealing to a wider field of investors, and other factors entering into the conduct of the business." *Ibid.*, p. 175.

<sup>476</sup> *Ibid.*, pp. 175-176.

<sup>477</sup> *Pledge of Bonds by Pere Marquette Ry.*, 67 I.C.C. 690 (1921). See, also, *Acquisition of C., T. H. & S. En. Ry. by C., M. & St. P. Ry.*, 70 I.C.C. 20, 22 (1921); *Securities of St. Louis-San Francisco Ry.*, 79 I.C.C. 92, 99 (1923); *Bonds of Pere Marquette Ry.*, 94 I.C.C. 555 (1925).

<sup>478</sup> *Bonds of Wisconsin & Northern R. R.*, 65 I.C.C. 691 (1921).

<sup>479</sup> *Bonds of Alabama, Florida & Gulf R. R.*, 70 I.C.C. 238 (1921).

<sup>480</sup> "Upon the facts presented we are of opinion that under present conditions a minimum price of 95 per cent of par, with resulting cost of approximately 7.65 per cent per annum, is excessive. The bonds will mature in less than 3½ years, and the

of suggested terms, the Commission has weighed them against prevailing market prices. Thus, in authorizing the sale of  $4\frac{1}{2}$  per cent bonds at not less than  $92\frac{7}{8}$ , as proposed, Division 4 has declared: "It appears that the price at which it is proposed to sell the bonds is approximately the current market quotation for these bonds, which is no doubt as good a price as could be obtained by competitive bids."<sup>481</sup> And when the applicant shows that the suggested terms have been determined after consultation with several banking groups, and are the best obtainable, these considerations are deemed to provide strong grounds for approval. Thus, in authorizing the issue of 6 per cent notes at not less than 95, as proposed, Division 4 has declared: "The applicant states that efforts were made through negotiations with other bankers to obtain a better price, but because of the smallness of the issue and the present financial and market conditions, as well as its failure to pay dividends on its stock, the necessary funds could not be obtained upon any better terms."<sup>482</sup> Not only has the Commission

current market price is approximately 99 per cent of par. If sold at a minimum price of 98 per cent of par the cost of the proceeds to the applicant would be approximately 6.65 per cent per annum, which under the circumstances, appears to be more reasonable." *Bonds of New Orleans, Texas & Mexico Ry.*, 71 I.C.C. 562, 563 (1922). See, also, *New York Central Lines Equipment Trust of 1925*, 99 I.C.C. 121, 123 (1925); *Assumption of Obligation and Liability by G. N. Ry.*, 99 I.C.C. 227, 229 (1925); *Florida East Coast Line Equipment Trust, Series G*, 99 I.C.C. 741, 742 (1925); *Securities of N. Y., C. & St. L. R. R.*, 105 I.C.C. 144, 145 (1925); *Pennsylvania R. R. General Equipment Trust*, 111 I.C.C. 241, 243 (1926); *Bonds of M., N. & S. Ry.*, 111 I.C.C. 602, 603 (1926); *Bonds of Wheeling & Lake Erie Ry.*, 111 I.C.C. 681, 682 (1926).

<sup>481</sup> *Bonds of Chicago Union Station Co.*, 94 I.C.C. 177 (1924), modifying the order in 86 I.C.C. 529 (1924), in which the bonds were required to be sold to the highest bidder after public advertisement for competitive bids.

<sup>482</sup> *Securities of Ann Arbor Railroad*, 99 I.C.C. 52, 53 (1925). Note, also, the following: "Arrangements have been made to sell the proposed certificates to the Cleveland Trust Company at 95 per cent of par and accrued dividends. On that basis the average annual cost to the applicant will be approximately 7.1 per cent. The applicant represents that efforts have been made to secure a better price for the certificates but without success." *Fairport, Painesville & Eastern R. R. Equipment Trust*, 105 I.C.C. 297, 298 (1926). "The applicant proposes to sell the certificates to Dillon, Read & Company, of New York City, at 97.49 per cent of par and accrued dividends. Upon that basis the annual cost to the applicant will be approximately 4.9 per cent. It is stated on behalf of the applicant that negotiations were had with a number of banking firms in regard to the sale, that as a result of the negotiations a sale to Dillon, Read & Company at the figure mentioned was arranged for, and that this was the best price obtainable. It appears that the result[s] of the applicant's efforts are reflected in the price to be received for the certificates." *Pittsburgh & West Virginia Equipment Trust*, 105 I.C.C. 548, 549-550 (1926).

sought to protect the carriers against the sale of interest-bearing obligations at greater discounts than are necessary, but its accounting regulations provide for appropriate charges as discount on funded debt, which must be completely amortized by the time the discounted bond issues mature.<sup>483</sup> There is reason to believe that this regulatory activity has not been without substantial fruit. While the costs of railroad financing, as well as the total capital costs to the carriers, are dependent upon many fluctuating factors, reflected in the financial position of particular lines, the general state of railroad credit, and the course of money market conditions, which are beyond the Commission's control, its watchfulness of proposed terms has doubtless exerted an important influence upon the general decline, since 1920, of the spread between the average prices for securities paid to issuing carriers by their bankers and the average prices paid to the bankers by the investing public for the same securities.<sup>484</sup>

From the standpoint of general policy in this sphere, the most controversial issue has concerned the propriety and need of requiring

<sup>483</sup> Where there appeared to be no possibility of amortization, authority to issue bonds at a discount has been denied. Note the following, for example, from *Bonds of Arizona Eastern R. R.*, 105 I.C.C. 331, 332 (1926): "The sale of the bonds to the Southern Pacific Company on the basis proposed [at 87.25] would result in a substantial discount being suffered by the applicant. The rental payable under the lease . . . does not provide for the payment by the lessee of amounts sufficient to cover the discount which the applicant might sustain in the sale of its securities. Therefore, the applicant would not have any income available for the amortization of the discount on these bonds. The Southern Pacific Company, as lessee, will receive all revenues accruing from the operation of the lines of the applicant and as it will not pay as rental any amount which may be applied by the applicant to the discount on its securities we will authorize the sale of the bonds to the Southern Pacific Company at not less than par and accrued interest." It should be observed, also, that expenses incident to the issue and sale of bonds are treated as discounts and may not be capitalized. See *Seaboard Air Line Railway Bonds*, 79 I.C.C. 293, 294 (1923).

<sup>484</sup> See Herbert B. Dorau, "The Cost of Railway Capital under the Transportation Act of 1920," *Journal of Land & Public Utility Economics*, vol. 3 (1927), pp. 1-20, 219-221, 427-430, vol. 4 (1928), pp. 206-208, 427-428, vol. 5 (1929), pp. 203-204, vol. 6 (1930), pp. 98-101, vol. 7 (1931), pp. 94-97, 439-442; and Roy L. Reiersen and Ruth A. Foley, "Cost of Railway Capital," *ibid.*, vol. 8 (1932), pp. 435-438. In particular proceedings, however, various members of the Commission have expressed the view that the authorized capital costs were excessive. See, for example, the dissenting opinions of Commissioner McChord and Commissioner Eastman in *Securities of N. P. Ry. & G. N. Ry.*, 67 I.C.C. 458, 468-471 (1921); the dissenting opinions of Commissioner Eastman and Commissioner Campbell in *Control of Gulf Coast Lines by M. P. R. R.*, 94 I.C.C. 191, 201-204 (1924); and the dissenting opinions of Commissioner Eastman and Commissioner McManamy in *Missouri-Kansas-Texas Reorganization*, 99 I.C.C. 330, 332-343 (1925).

competitive bidding in the sale of railroad securities. As will appear in due course, the nature of this issue and the character of its disposition are indicative, not only of the "fostering guardianship" extended to the carriers, but of the marked restraint exercised by the Commission in its "control" of financial management.

As early as October, 1922, a public hearing had been held for a consideration of the following questions: first, "whether and to what extent the commission should . . . determine, limit, or restrict the price at which or the manner in which securities are to be sold and the cost to the carriers of the marketing of securities"; second, "whether it is within the province of the commission to require competitive bidding in the sale of securities . . . and whether competitive bidding should be required"; and third, "if competitive bidding is required, to what class or classes of securities it should be applicable and what regulations or conditions should be prescribed."<sup>485</sup> This inquiry resulted from the fact, disclosed in the Commission's own experience, "that carriers rarely, if ever, advertise for competitive bids when marketing new securities, and that they seldom approach or consult more than a single financial house."<sup>486</sup> It appeared, however, that the prevailing practice of dealing with a single financial house was strongly supported by both carriers and bankers, and that no one openly advocated competitive bidding. Many considerations were presented in justification of the existing procedure, including the necessity of expert advice, in view of the large variety of securities to be marketed and the great differences in credit position as between particular carriers, the importance of assuring prompt and successful flotations, the need of effecting wide distribution among investors, the protection afforded against speculative manipulation, and the assistance rendered available under adverse market conditions.<sup>487</sup> In these circumstances, and since the hearing was held when conditions were un-

<sup>485</sup> The nature and outcome of this hearing of October 26, 1922, are described in *Bonds of Chicago Union Station Co.*, 86 I.C.C. 529 (1924).

<sup>486</sup> "As a general rule," it was added, "each railroad company has a firm of bankers upon which it depends regularly and uniformly for financial advice, and in issuing securities it deals with no other. The two concerns which do most of this railroad financing are J. P. Morgan & Company and Kuhn, Loeb & Company." *Ibid.*, p. 531.

<sup>487</sup> More concretely: "Summarizing the view, it was argued that railroad securities are quite different from securities, such as State and municipal bonds, which are sold



favorable to experimentation—"at a time when the roads were recovering from a period of traffic depression and when more than normal uncertainty surrounded the marketing of their securities"—the Commission concluded that it was "unwise then to attempt to require any plan of competitive bidding, and felt that the public interest could be sufficiently protected for the time being by fixing . . . minimum prices consistent with market conditions below which the securities should not be sold."<sup>488</sup>

By March, 1924, however, in the very proceeding in which the initial disposition of the matter was thus surveyed, Division 4 declared that "while the arguments advanced in favor of present practice have force as applied to carriers of more or less uncertain financial status, they have less force in the case of carriers of assured earning power and favorable financial structure"; and, because in the instant proceeding authority was sought by a terminal company which owned lands in the heart of Chicago and was controlled by four large railroads which undertook to guarantee the bonds in question, it saw "no good reason why the applicant . . . should deal with a single financial house," selling the securities at the proposed price of not

on competitive bids. There are innumerable and wide variations in the kind and quality of railroad securities, dependent upon the earning power of the particular company, the relation between its stock and funded debt, the character of its outstanding mortgages, and similar factors. Expert advice in marketing such securities, resting upon intimate knowledge of the railroad's financial structure and of the likes and dislikes of investors is said to be necessary. The credit of a railroad is dependent upon the success with which it meets in selling its securities. Failure may work irreparable injury to credit, and in this respect a contrast is drawn between a railroad company and a State or a municipality. The continual fluctuations in market conditions often make time a most important element in the sale of securities. Competitive bidding is a process which consumes time, involving delay which may, under certain conditions, prove hazardous. Stress was laid upon the fact that it is necessary to distribute securities much more widely than was once the case. Sales to investors in large blocks are said to be rare and instead railroad securities are now sold in small lots to small investors scattered all over the country. The experience and organization which a large banking house favorably known to investors provides, is deemed necessary to such distribution. To guard against speculative attacks, it is said to be important that the announcement that securities have been underwritten should be made public simultaneously with the announcement of the proposed issue. This would be impossible if competitive bids were procured. Moreover, carriers deem it an advantage in times of financial stress or dullness to have the advice and support of a strong banking concern with intimate knowledge of their affairs, an advantage which can only be gained by regular banking connections." *Ibid.*, pp. 531-532.

<sup>488</sup> *Ibid.*, p. 532.

less than 86.5 per cent of par, and accordingly conditioned its authorization upon their being sold "to the highest bidder after public advertisement for competitive bids."<sup>489</sup> But before the end of the year this order was so modified as to authorize the sale of the bonds at not less than 92 $\frac{3}{8}$ , approximately the current market quotation, which was deemed to be as good a price as that obtainable through the procedure originally prescribed.<sup>490</sup> A considerable time elapsed before the notice served upon the carriers and their bankers that competitive bidding might be required in appropriate situations was translated into orders effectuating this policy, and even then their incidence was restricted to equipment obligations.<sup>491</sup> In the interim the Commission was content to note with satisfaction the voluntary resort of some of the carriers to competitive bidding in the marketing of such obligations, and to point out the appropriateness of that method of sale for this type of financing. Thus, in authorizing the assumption of liability with respect to \$12,000,000 of Norfolk & Western equipment-trust certificates the sale of which had been arranged as a result of advertising for competitive bids, the action of the carrier was commended and the hope expressed that "its example may be followed by others."<sup>492</sup> And in authorizing the assumption of liability with respect to \$3,000,000 of Union Pacific equipment-trust certificates, to be sold to Kuhn, Loeb & Company without securing bids from other houses, at a price which, judged by market conditions, was deemed favorable to the carrier, the occasion was utilized to emphasize the possibilities and advantages of competitive bidding in the marketing

<sup>489</sup> *Bonds of Chicago Union Station Co.*, 86 I.C.C. 529, 532-533 (1924). This ruling applied only to the sale of an authorized issue of \$850,000 of series-A bonds. With respect to the application for authority to issue and sell \$7,000,000 of series-B bonds, involving a marketing arrangement already completed for sale at 94.75, Division 4 said: "In view of the fact that the applicant prior to our decision herein has sold, subject to our approval, \$7,000,000 of the series-B bonds at a price which we believe not to be unreasonable, and which bonds have in turn been offered by the bankers to the public at a reasonable price, we will not in this case compel the applicant to secure competitive bids for that block of bonds."

<sup>490</sup> 94 I.C.C. 177 (1924).

<sup>491</sup> For a very able and comprehensive analysis of the character of these securities and their legal status, see Kenneth Duncan, *Equipment Obligations* (1924). For the Commission's first determination imposing the requirement of competitive bidding in the marketing of equipment-trust certificates, see *Western Maryland Equipment Trust*, 111 I.C.C. 434 (1926).

<sup>492</sup> *Norfolk & Western Equipment Trust*, 1924, 86 I.C.C. 553, 554 (1924).

of equipment obligations: "The method which the applicant proposes to follow in the sale of these securities calls attention again to the question as to whether carriers should endeavor to sell securities or certain classes of securities after something in the nature of a general invitation for bids, rather than to a particular banking house or distributor with which the carrier has established a continuing fiscal relation. . . . Small issues of bonds or equipment certificates might be handled in the open market and by independent bidding when such method would be inappropriate for large issues or securities of a different class. Equipment-trust obligations enjoy certain characteristics which make for stability in an exceptional degree. They enjoy direct lien on equipment purchased with the investors' money and find ready market among individuals and institutions which desire securities of particular maturities. They are not involved with other existing issues and do not require the determination of seniorities on account of prior mortgages. Rolling stock is usable not only on the lines of the particular railway purchasing it, but if need be, it finds use on other lines. There is little doubt but that any carrier of good credit can sell an issue amounting to several million dollars of equipment-trust certificates at desirable prices. Such certificates it would appear could frequently be sold direct in large blocks to important institutions. . . . One of the unfortunate impressions regarding the railroads at the present time is that they are unduly dependent upon financial institutions upon which they have been in the habit of relying. Anything that would result in removing this stigma, whether deserved or undeserved, would be a beneficial step for the carriers, the banking houses, and the public. It seems desirable that equipment-trust certificates in particular should receive consideration in this connection and that the carriers should give serious thought to the marketing of these, and perhaps other securities, on a competitive basis."<sup>498</sup>

Despite these pronouncements the Commission showed itself reluctant to require competitive bidding, even in the sale of equipment obligations, and continued for a period of more than two years merely to prescribe minimum prices.<sup>494</sup> This attitude produced sharp

<sup>498</sup> *Union Pacific Equipment Trust, Series D*, 86 I.C.C. 612, 614-615 (1924).

<sup>494</sup> See *New York Central Lines Equipment Trust of 1925*, 99 I.C.C. 121 (1925);

conflicts of judgment within its ranks. As in other aspects of the field of financial control, Commissioner Eastman was the chief proponent of the proposed policy, and Commissioner Woodlock was the principal supporter of existing practice. Commissioner Eastman directed attention to the virtual monopoly which prevailed in the marketing of railroad securities, and he argued that at least as far as equipment-trust certificates are concerned competitive bidding would provide the best evidence of the reasonableness of the prices at which they are sold;<sup>495</sup> Commissioner Woodlock took the position that the institution of such a "reform" in financial practice was beyond the scope of the Commission's authority, and he contended that no re-

*Northern Pacific Equipment Trust of 1925*, 99 I.C.C. 164 (1925); *Chicago, Milwaukee & St. Paul Equipment Trust*, 99 I.C.C. 682 (1925); *Pennsylvania R. R. General Equipment Trust*, 111 I.C.C. 241 (1926).

<sup>495</sup> See his dissenting opinions in *New York Central Lines Equipment Trust of 1925*, *supra*, at pp. 124-125, and *Northern Pacific Equipment Trust of 1925*, *supra*, at pp. 166-167. His position is summarized by the following declarations from his dissenting opinion in *Pennsylvania R. R. General Equipment Trust*, *supra*, at pp. 244-246: "In previous cases I have had occasion to refer to prevailing practices in the marketing of railroad securities. In the purchase of equipment the usual practice of railroad companies is to secure competitive prices from car and locomotive companies of recognized standing, and the same practice is ordinarily followed in the purchase of supplies and other items of property. There are exceptions, but that is the general rule. When it comes to the sale of their own securities, however, railroad companies follow quite a different policy. They throw competition into the discard and grant monopolies to particular banking houses. Ordinarily this monopoly is conferred upon either Kuhn, Loeb & Company or J. P. Morgan & Company. There are exceptions, but they prove the rule. . . . Such study and thought as I have been able to give to the question, utilizing various sources of information, have brought me to the conclusion that prevailing practices in the marketing of railroad securities are in many respects unsound and unhealthy. I am tempted to say that the preference of monopoly to competition is un-American, but refrain because of the widespread abuse of that word. I have been willing, however, that the change to better practices should be a process of evolution rather than revolution, and therefore have been content for the present to advocate a resort to some form of competition, in place of monopoly, only in the case of such comparatively standardized forms of railroad securities of assured investment standing as equipment-trust notes and certain classes of guaranteed terminal bonds. There is, in my judgment, clearly no good reason why the marketing of such securities, at least, should be monopolized. . . . We are entitled, and the public is entitled, to the best evidence that can be presented that maximum prices are being obtained, and that evidence is not being produced. Such evidence will only be before us when we know the prices that more than one, and preferably several, possible purchasers of recognized standing are willing to pay. In such cases I believe we are fully justified in presenting these alternatives to the applicant: (1) Sale to its chosen purchaser at a minimum price closely approximating the market level; or (2) if applicant is unwilling to adopt such an alternative, sale to the highest qualified bidder after competitive bids have been publicly advertised for and received."

duction in capital costs would result from the requirement of competitive bidding.<sup>496</sup> But the case for competitive bidding, as applied to the sale of equipment obligations, finally prevailed. When, in June, 1926, Division 4 authorized the assumption of liability with respect to \$2,278,000 of Western Maryland equipment-trust certificates which were sold to the highest of eight bidders, it generalized the method of

<sup>496</sup> Note the following from his concurring opinions: "When Congress passed the transportation act in 1920 it elected to rely upon private management and private capital for an adequate railroad transportation system. It was under no compulsion to do so. Government was, in fact, in control of the railroads, and it would have been an easy thing, had Congress wished it, to complete and perpetuate that control. Instead of doing this, Congress, after prolonged deliberation, provided by elaborate legislation for a return of the railroads to management by their owners. It is clearly the spirit of that legislation that owner-management shall have free play within the limits implied in the words 'honest, efficient, and economical' as used in section 15a. We have no right in the exercise of our regulatory powers to use the letter of the law in such a manner as to nullify its spirit. . . . It does not appear that there is anything in the letter of the law (and there is certainly nothing in its spirit) which requires us to invade the domain of management with the object of accomplishing a 'reform,' as such, of banking methods. We are concerned, under section 20a, mainly to see that railroad capital shall be economically raised, and that it shall not be wasted after it is raised. We have no right morally (and I think we have no right legally) to interfere with management on any other grounds or for any other purpose, so far as security issues are concerned. . . . As matters stand at present I have strong doubts that any system of public 'competitive bidding' would produce capital more cheaply to the railroads than the method which has been generally followed up to date. Between such a system, however, and the system commonly in use, whereby carriers have dealt with their own bankers, middle ground has been tentatively occupied in several cases. The carrier has invited bids from several banking houses for the securities that it wishes to sell, and has sold them to the highest bidder. . . . Carriers themselves have taken the initiative in the experiment and it is quite certain that if the experiment shall, as seems likely, prove successful, the method will come into common use. It is infinitely better that results come in this way than from the exercise of the powers possessed—if it does possess them—by this commission." *Chicago, Milwaukee & St. Paul Equipment Trust*, *supra*, at pp. 689-691. "In passing upon security issues by railroads, I conceive our main duty to be that of securing the lowest possible cost of capital to the issuing company. Whatever method of security sales will produce that result is, I take it, the method which should be approved by us. It is no part of our business under the law from which we derive our powers and responsibilities to undertake to regulate the distribution of railroad business among banking firms in the financial district, save in so far as such regulation may be clearly necessary to the main purpose in view. If there is any business in the world more highly competitive than the banking business in New York, I am unable at this moment to think of it. It is the essence of competition that somebody is successful as against somebody else. It is inevitably the result of competition that some are more continuously successful and upon a larger scale than others. Success of this sort does not necessarily imply unfairness on the part of a successful competitor, nor is the unsuccessful competitor necessarily the victim of injustice. Not merely have we no warrant under the law as it stands for an attempt to hinder such a process of competition or to interfere with the results, but to make such an attempt would be to run counter to the spirit and the principle upon which business

sale pursued in that proceeding into a requirement of competitive bidding.<sup>407</sup> Impressed by the advantages of competitive marketing of equipment obligations, particularly from the standpoint of cost to the carrier, it declared: "Recent experience in connection with the sale of equipment-trust certificates leads us to believe that conditions in the investment market are, and at least for some time to come are likely to be, such that railroad companies raising capital in this way may now profitably adopt a policy of offering such securities to public competitive bidding after the manner in which State, county, and municipal securities are commonly sold."<sup>408</sup>

An examination of the Commission's application of the policy of competitive bidding, as thus introduced in 1926, discloses that primary emphasis has been placed upon the achievement of possible reductions in costs, and that sufficient flexibility has characterized the

generally is conducted in this country. Whenever it shall clearly appear that competition is unfairly restricted in such a way as to involve a greater cost of money to the carriers issuing securities, or whenever it shall clearly appear that better results to the carriers will come from the imposition of a radical change upon issuing methods, then it will be our duty to give effect so far as lies in our power to the necessary changes. It is because I am not convinced that, taking the investment market as a whole, with all its fluctuations and changes in conditions of supply and demand, a radical change in methods would give cheaper money to the carriers, that I am opposed to any attempts to impose such change at the present time." *Pennsylvania R. R. General Equipment Trust, supra*, at pp. 243-244.

<sup>407</sup> *Western Maryland Equipment Trust*, 111 I.C.C. 434 (1926). This determination was made without dissent, although Commissioner Woodlock sat in the case.

<sup>408</sup> *Ibid.*, p. 436. The reasons in support of this declaration of policy were summarized as follows: "1. These securities are of virtually uniform character, they enjoy a high degree of safety as to payment of principal and interest, and the prices that they bring are very largely determined by interest rates current for the best class of security. The relative financial strength of the issuing carriers has ceased to be an important factor in determination of price. 2. While it is probably true that in former days equipment-trust securities were largely taken by investment institutions, such as insurance companies, savings banks, etc., it is evident that they are now growing in favor with individual investors who have at times, of late, been willing to pay more for them than these institutions. 3. The investment market as a whole has grown very greatly in size in the years following the war. It now absorbs annually some billions of securities other than those of railroads. While it is true that industries other than railroads have taken and are taking by far the largest part of the new capital, it is also true that there is an ever-growing demand for securities of the best class, in which railroad equipment trusts occupy a prominent place. It seems to us that the sale of these by public competitive bidding will tend to widen their market and thus produce capital more cheaply for the issuing railroads." But the new requirement was expressly restricted to equipment-trust certificates, and its applicability to other types of railroad securities was left open for future determination: "We propose for the present no change of selling methods in the case of other railroad securities and are fully mindful

record of performance to meet the distinctive demands of special circumstances. A few illustrations will suffice. In authorizing the assumption of liability with respect to \$4,665,000 of Illinois Central equipment-trust certificates, Division 4 declined to approve the sale of these securities to Kuhn, Loeb & Company at 98.43 as arranged, and ordered instead that they be sold either at 99.517, the prevailing market price, or at the highest obtainable price under competitive bidding, provided it was not less than the 98.43 originally offered by the applicant's bankers.<sup>490</sup> This prescription of terms in the alternative has served as the usual pattern in cases in which the propriety of resort to competitive bidding has been questioned. It is not designed or necessarily calculated to disrupt long-established banking relation-

of the considerations so frequently and forcefully urged in favor of the ordinarily existing relation of banker and railroad, and of the advantages to the latter which many believe result from a proper conduct of that relation by both parties thereto. We are concerned with the sale and distribution of railroad securities from the point of view of economy in the cost of capital to the railroads, to the end that the total burden of transportation shall be no larger than is absolutely necessary. It is our opinion, however, that the sale of equipment-trust certificates by public competitive bidding will be effective in so widening the market for these securities as to assist in the effective and economic financing of railroads by means of other securities. . . . Whether in the course of time it may come about that classes of railroad securities other than equipment trusts shall be susceptible of the same method of sale with economical results is a question that need not now be considered." *Ibid.*, pp. 436-437. This position as to other types of securities was affirmed in *Bonds of P., O. & D. R. R.*, 124 I.C.C. 315, 316-317 (1927). With respect to the disposition of equipment-trust certificates, it was provided that the procedure for competitive bidding established for transactions subject to section 10 of the Clayton Act be followed. See *Regulations Relative to Bids of Carriers*, 56 I.C.C. 847 (1920).

<sup>490</sup> *Illinois Central Equipment Trust*, 117 I.C.C. 15 (1926). In reply to the contentions of the applicant that it was to its best interest to sell the certificates to its regular bankers, and that the price offered was fair and advantageous and as high as could reasonably be expected from a responsible purchaser who planned to distribute them to permanent investors on fair terms, Division 4 declared: "We are not convinced that the method proposed by the applicant for marketing the certificates is in the best interest of either the applicant or the public. Our views as to the advantages of competitive bidding as a method of marketing such certificates are set forth in our report in *Western Maryland Equipment Trust*, 111 I.C.C. 434, decided June 23, 1926. In a recent application . . . equipment-trust certificates bearing the same rate of dividends and maturing in the same number of installments as those covered by the instant application had been offered for sale through competitive bidding, and as a result a price of 99.517 was realized. We will authorize the sale of these certificates at not less than 99.517 per cent of par and accrued dividends . . . or the applicant may offer them for sale through competitive bidding . . . such sale to be made to the highest bidder, but at not less than 98.43 and accrued dividends" (p. 17). The price of 99.517 was the highest of nine bids which had been accepted and approved in *C. of N. J. Equipment Certificates*, 111 I.C.C. 675 (1926).

ships; it is only utilized as a means of determining reasonable prices, with protection of the carrier against unduly depressed bids, and there is nothing to prevent the applicant's customary banking house from obtaining the business if it is willing to offer terms as advantageous as those which can be secured elsewhere. Furthermore, the requirement of competitive bidding has been relaxed somewhat when peculiar conditions have appeared to justify modification of the general rule. Thus, the disposition of a small issue at private sale was approved where the terms were found to be reasonably favorable to the issuing carrier;<sup>500</sup> and where bids had been invited from but four groups of bankers, which were advised that the applicant "desired to conserve its cash and wished to have bids made on a basis which would accomplish that result," the sale at the most advantageous price was approved, despite the absence of public competitive bidding.<sup>501</sup> Indeed, the issuing carriers have frequently been permitted to solicit bids from banking houses selected by themselves, as a means of assuring responsible offers, provided only those approached were deemed to be sufficiently representative to furnish the necessary element of competition.<sup>502</sup> But the mere failure to receive acceptable bids has been held not to justify relinquishment of the method of competitive bidding and substitution therefor of the method of private sale. Thus, where bids had been invited from forty banking houses, where but a single bid was actually received, where this bid was

<sup>500</sup> In authorizing the assumption of liability with respect to \$356,000 of Erie equipment-trust certificates, Division 4 said: "The applicant proposes to sell the certificates to Drexel & Company . . . at 98 per cent of par and accrued dividends, at which price the annual cost to the applicant will be approximately 4.83 per cent. In view of the small amount of the securities involved in the present application and of the fact that the bankers purchasing the securities agree to bear the cost of counsel and trustees' fees connected with the issue, it is unnecessary in our opinion to require competitive bidding in this case." *Erie R. R. Equipment Trust*, 111 I.C.C. 667, 668 (1926).

<sup>501</sup> *Seaboard Air Line Equipment Trust*, 117 I.C.C. 193 (1926), in which authority was granted to assume liability with respect to \$11,336,000 of certificates, of which \$9,060,000 of first-lien 4½ per cent obligations were to be sold at 95¼ and \$2,276,000 of second-lien 5½ per cent obligations were to be sold at 97. Approval was given for the sale of these certificates at not less than the above prices to Dillon, Read & Company as constituting the most advantageous tender made from the standpoint of the applicant.

<sup>502</sup> See, for example: *N. Y., N. H. & H. Equipment Trust*, 117 I.C.C. 365, 367 (1926); *Mobile & Ohio Equipment Trust*, 117 I.C.C. 621, 622 (1927). In such circumstances, although there is no public advertising for competitive bids, authority is granted to sell at the highest offer.



deemed excessive and hence rejected, and where an agreement was then reached with Kuhn, Loeb & Company for sale of the certificates at a somewhat higher price, but below that apparently prevailing in the market, the authority granted was conditioned upon resubmission of the issue to competitive bidding.<sup>608</sup> The position of the Commission, as expressed by Division 4, appears from the following: "Our views as to the advantages of competitive bidding are set forth in our report in *Western Maryland Equipment Trust*. . . . Since the date of that report, except in a few cases where we felt that the facts justified other disposition, we have required that carriers requesting authority to assume obligation and liability in respect of equipment obligations offer them for sale at competitive bidding. . . . Certain developments in the financial situation during the past few months have narrowed the investment market, with a resulting increase in rates on long-term securities, including equipment obligations. We feel, however, that this condition does not warrant a change in our policy with respect to the disposition of equipment obligations. Moreover, we are of the opinion that we should do nothing that would tend to discredit the method of disposing of equipment obligations that has been employed with success for the last two years or that would result in the withdrawal of the support of the investment houses that have participated in the sale of such securities. We can hardly expect bankers to continue to submit tenders for equipment obligations in invitation from carriers if the carriers may reject all bids and after thus testing the investment market place the obligations privately. We are of the opinion that if the offers received for the equipment obligations are not satisfactory the carriers should again call for tenders and accept the most favorable bid or should reject all bids and resort to temporary financing until there is such an improvement in the investment market as will enable a sale to be made on satisfactory terms. In accordance with these views, authority to assume obligation and liability in respect of the certificates under considera-

<sup>608</sup> *Chicago, St. P., M. & O. Ry. Co. Equipment Trust*, 145 I.C.C. 444 (1928). The single bid received specified a price of 98.815, involving an average annual cost to the applicant of 5.0075 per cent; the agreement with Kuhn, Loeb & Company called for a price of 99.42, involving an average annual cost to the applicant of 4.875 per cent; early in 1928 equipment obligations had been sold in some instances at prices which involved a cost to the carriers as low as 4.23 per cent.

tion will be granted upon condition that the certificates again be offered for sale at competitive bidding and sold to the highest bidder.<sup>504</sup>

That the requirement of competitive bidding in the sale of equipment-trust certificates has proved advantageous to the carriers appears to be clearly established by its effect upon the spread between the prices paid by bankers for these obligations and the prices at which they have been sold to the investing public.<sup>505</sup> This spread, computed as a weighted average, which stood at \$1.80 per \$100 in 1925, prior to the inauguration of competitive bidding, declined to \$1.47 in 1926, during the last six months of which competitive bidding was first required, fell sharply to \$0.66 and \$0.64 in 1927 and 1928, and while rising to \$0.89 and \$0.78 in 1929 and 1930, declined once more to a low point of \$0.43 during the first six months of 1931; and not only was this spread, reflecting marketing costs, much smaller for equipment obligations than for bonds throughout the period, but its decline was conspicuously more marked for the former than for the latter.<sup>506</sup> Despite this rather conclusive evidence of the merits of competitive bidding as applied to standardized equipment obligations, the Commission has continued to recognize the advantages to the carriers of relying upon their regular banking connections for the marketing of

<sup>504</sup> *Ibid.*, pp. 445-446. For the view that the Commission's requirement of competitive bidding in the marketing of equipment obligations is a mistaken policy, see John H. Frederick, "Federal Regulation of Railway Securities under the Transportation Act of 1920," *Journal of Political Economy*, vol. 37 (April, 1929), pp. 175-202, 197; Pierpont V. Davis, "The Effect of Railroad Consolidations on Railroad Securities," *Proceedings of Academy of Political Science*, vol. 13 (June, 1929), pp. 24-32, 30.

<sup>505</sup> For the relevant data, to be noted presently, see *Annual Reports: 1928*, p. 12; 1929, pp. 10-11; 1930, p. 11; 1931, pp. 9-10.

<sup>506</sup> In the case of bonds the corresponding figures of spread in price to the bankers and to the public, beginning in 1925, were \$2.95, \$2.62, \$2.60, \$2.33, \$2.46, \$2.43, and \$2.31. Prior to 1925 the figures of absolute spread for both types of securities were substantially higher, and the differences in spread as between equipment obligations and bonds were considerably smaller. These figures, in the case of equipment obligations, were \$1.91 for 1920 (seven months), \$2.29 for 1921, \$2.33 for 1922, \$2.33 for 1923, and \$1.86 for 1924; and in the case of bonds, \$3.47 for 1920 (seven months), \$4.54 for 1921, \$3.55 for 1922, \$2.81 for 1923, and \$3.17 for 1924. In 1927, the first full year of the operation of the method of competitive bidding, the spread of \$0.66 for equipment obligations was approximately 25 per cent of the spread of \$2.60 for bonds, as against an average of about 54 per cent during the preceding seven years; and during the first six months of 1931, the latest period for which data are available, the spread of \$0.43 for equipment obligations was less than 19 per cent of the spread of \$2.31 for bonds, as against a high of almost 83 per cent in 1923 (\$2.33 for equipment obligations and \$2.81 for bonds).

complex securities the terms of sale of which are dependent upon individualized credit and other distinctive factors, and hence it has not insisted upon the extension of the competitive method to the disposition of all high-grade offerings.<sup>507</sup> In at least one instance, by way of reversion to the policy which it had tentatively adopted as early as 1924,<sup>508</sup> it has required competitive bidding in the marketing of guaranteed terminal bonds,<sup>509</sup> but it has not yielded to representations that this method be applied under other circumstances.<sup>510</sup> In view of the fairly steady decline of marketing costs for the bond category as a whole, the mere establishment of minimum prices for these securities has been deemed to provide adequate protection of the public interest in the matter of capital costs. It may well be, furthermore,

<sup>507</sup> In *Western Maryland Equipment Trust*, 111 I.C.C. 434, 436-437 (1926), it was intimated that future consideration might lead to the adoption of the policy of competitive bidding in connection with the marketing of railroad securities other than equipment trusts.

<sup>508</sup> *Bonds of Chicago Union Station Co.*, 86 I.C.C. 529 (1924), which was so modified in 94 I.C.C. 177 (1924) as to remove the requirement of competitive bidding.

<sup>509</sup> *Indianapolis Union Ry. Co. Bonds*, 166 I.C.C. 723 (1930). In this proceeding authority was granted to the applicant to issue \$1,000,000 of refunding and improvement mortgage bonds, with respect to which the Pennsylvania, the New York Central, and the Big Four were authorized in the same proceeding to assume liability as guarantors and otherwise, on condition that the bonds be sold through the method of competitive bidding. By way of support for this determination Division 4 said: "The mortgage bonds of a terminal railroad company, guaranteed as to the payment of principal and interest by several strong trunk-line carriers controlling the former, and using its facilities, are a class of investment securities comparable in many respects with equipment-trust certificates. Current quotations for bonds of the Chicago Union Station Company, the Cleveland Union Terminal Company, and the Cincinnati Union Terminal Company, as well as for the bonds of the Indianapolis Union, indicate that the bonds of these terminal companies stand high in the railroad-bond market. We are of opinion that the proposed bonds of the Indianapolis Union constitute a class of security that may be marketed through competitive bidding as easily and as advantageously as equipment-trust certificates. Our order herein will require that they be offered for sale at competitive bidding and sold to the highest bidder . . ." (p. 727).

<sup>510</sup> See the dissenting opinion of Commissioner Eastman in *Control of Louisiana & A. Ry. Co.*, 150 I.C.C. 477, 491-493 (1929), in which he argued, among other things, that the \$12,000,000 of first-mortgage bonds authorized for the acquisition of control there involved be sold under competitive bidding, at a minimum price of \$10,000,000, instead of being sold to a syndicate at an agreed price of \$10,000,000, despite the absence of convincing evidence as to the real value of the bonds. "Under such a plan as this," he concluded, "if there were no bids for the bonds except from the syndicate, or if its bids were the best, the syndicate would be permitted to buy the bonds at the same price and pay for them in the same manner as now proposed; but we would find out by actual test whether or not the proposed terms are just and reasonable, and the possibility which now exists that the syndicate may profit unfairly at the expense of the carrier which it controls would be eliminated" (p. 493).

that this decline is partially attributable to the requirement of competitive bidding in the sale of equipment obligations—that is, a response arising sympathetically because of the possibility of further revision of prevailing practice; the fact that the door was plainly left open for a more comprehensive attack upon the maintenance of monopolistic marketing conditions has been calculated to exert a chastening influence and to render actual intervention, particularly under the precarious credit circumstances of the depression years, unnecessary as well as inexpedient. The Commission has thus been alert to safeguard the interests of the carriers and the public in the terms and conditions of security offerings, but without unjustifiable invasion of the domain of management.

#### *Reorganization Expedients*

Since railroad reorganizations invariably require the issuance of new securities, and since railroad securities may not be issued without authorization, the Commission is enabled to investigate the reorganization expedients employed and to exert some influence upon the character of the resulting financial adjustments. At first glance it might appear that in connection with the reorganization process, when entire capital structures are subject to revision, exceptional opportunities would be presented for molding financial arrangements in the public interest; in point of fact, as will appear in due course, freedom of regulatory action has been severely circumscribed by the procedures commonly pursued in effecting reorganizations and by the pressures of expediency which have resulted therefrom. The reorganization cases provide much striking evidence of the difficulties encountered by the Commission in seeking to develop and apply sound administrative policies with respect to extent of capitalization, types of securities, and terms and conditions of issue, despite the apparent leverage furnished by past financial embarrassment and the recognized need of reasonably assured relief for the future. Under the circumstances thus disclosed sharp differences of opinion have emerged among members of the Commission concerning the disposition of particular proceedings, as well as a common dissatisfaction, frequently expressed, with prevailing reorganization practice; and

this dissatisfaction, coupled with the impact of the emergency conditions created by the depression, resulted in the enactment early in 1933 of significant statutory provisions bearing upon the reorganization of railroads. While the principal financial problems with which the Commission is concerned in reorganizations, as in connection with normal capital operations, cluster about the amounts and kinds of securities to be issued and the terms of their disposition, the distinctive circumstances surrounding reorganization controversies, the conflicts of judgment which have characterized their settlement, and the procedural anomalies which have often inhibited sound results and finally led to the recent legislative enactments must receive special attention. But it is not essential to this purpose that the problem of reorganization be dealt with in all its many aspects, or that the numerous railroad reorganizations which have been effectuated since 1920 be fully analyzed and separately appraised. Extended consideration of the intricate questions of corporation finance which bear upon equitable dealing as between different groups of investors and of the issues raised by the dominance in reorganizations of the banking and management interests of the ill-fated corporations would carry us far beyond the scope of this study; since our concern is centered upon the character of the Commission's performance in the special sphere of security regulation as it affects the public interest in transportation, however unwisely this sphere may have been delimited as a practical matter by the traditional procedures of the reorganization process, we shall attempt primarily to discover and evaluate its major policies in reorganization cases from the standpoint of their relationship to the capital structures approved for the successor corporations.

Until very recently the Commission's relationship to reorganizations was a distinctly subordinate one, and its record of performance can be soundly appraised only in terms of its restricted functions. Both the initiation of receivership proceedings and the development of plans for rehabilitation of distressed carriers were pursued in complete independence of the Commission. The procedure, in brief, was this: receivers to operate the property during insolvency were generally appointed upon petition of those in control, and supervision of the receivership administration was vested in the federal judge appointing the receivers; the security holders' committees and reorgani-

zation managers created to work out expedients of rehabilitation were usually selected by the interests which initiated the receivership and comprised overlapping membership; these committees and managers obtained through deposit agreements and other contractual arrangements the necessary power to formulate a reorganization plan and put it into effect; the judge in charge of the receivership held hearings with reference to the propriety of the plan developed and agreed upon by the committees and managers, and on approval by him, after a judicial sale of the property had been made to provide a basis for determining the rights of non-assenting security holders, the reorganization was effectuated through the issuance of securities in the new corporation in amounts and kinds and on terms and conditions stipulated in the accepted plan, provided approval of the Commission was obtained for the issuance of these securities. Only at this stage did the Commission generally assume jurisdiction. The detailed arrangements of reorganizations, including the relative treatment accorded to the various parties in interest, were thus worked out under the aegis of the courts; the determinations of the Commission served primarily, as in all finance applications, to establish whether the new capital structures were in the public interest. These procedural processes have had a twofold consequence of importance: first, the Commission has generally been disinclined to concern itself with the equities of the settlement as between the different types of creditors and investors of the old company, reliance for the achievement of substantial justice being placed upon the safeguards provided by the courts; and second, in view of the fact that the plans placed before it were the outcome of a long process of negotiation and compromise, the Commission has shrunk from outright rejection of the matured proposals, contenting itself, even where it has indulged in severe criticism of some of their features, with the requirement of relatively minor changes in the resulting set-up. The effect of this approach has been to restrict its freedom of action even in matters of security regulation as such. In the main, where the proposed plan was accepted by the security holders and approved by the court, authorization for the issuance of securities has been rather readily forthcoming, provided only that the projected capital structure did not violate unduly the general standards of soundness which had been developed in the

field of financial control. In its consideration of reorganization expedients the Commission has been basically concerned with preventing, as far as possible, a recurrence of the conditions which had produced financial embarrassment or insolvency, and since these difficulties have generally been related to impaired credit resulting from excessive amounts of securities, and particularly to inability to meet fixed charges on overloads of indebtedness, the effects of the proposals along these lines have received primary attention; but the Commission's hesitancy to disturb the integrated plans which had been laboriously developed, coupled with its eagerness to prevent undue prolongation of receiverships, have led it for the most part to authorize the requested capital issues for the reorganized properties upon a showing that some measure of improvement would be effected in the volume of outstanding securities, or in the burden of fixed charges, or in both of these directions, and that the probable earning capacity of the new company would be reasonably adequate to meet its projected obligations. The character of the applications of these guiding factors, as well as the nature of the departures from even such minimum requirements, will appear from the survey and analysis which follow.

Most reorganizations have effectuated reductions in capitalization, and the Commission has often referred to the fact of such reduction by way of support for its authorization of the new securities. But there have been no uniform standards established for testing the propriety of the proposed capitalization, nor has there been strict adherence to such standards as have been employed from time to time.<sup>511</sup> The simplest basis for a finding of improvement with reference to the volume of securities rests upon a comparison of the old and the new

<sup>511</sup> In an early case, after noting that "the differences between the methods of reorganization have been so substantial as to suggest the inadvisability of attempting at this time to define a general policy with respect to reorganizations," Division 4 declared: "It is probable that in the future, as in the past, each case of reorganization will have to be considered and disposed of on its own merits and in the light of its own conditions." *Missouri-Kansas-Texas Reorganization*, 76 I.C.C. 84, 106 (1922). Note, also, the following: "Our decisions upon cases such as these shall not be taken as precedents for the reason that our findings in each case must necessarily be based upon the particular circumstances and facts presented therein, which may vary from those of every other case." *Securities of La. Ry. & Nav. Co. of Tex.*, 99 I.C.C. 357, 358 (1925).

capitalization,<sup>512</sup> but even on this basis increases in the aggregate of stocks and bonds have occasionally been approved.<sup>513</sup> Since, furthermore, this method of comparison disregards the absolute propriety of both the old and the new capitalization, other standards have received consideration, but also without conclusive or uniform effect. Perhaps the test most often invoked is that of investment—that is, the cost to the new company of the acquired capital assets.<sup>514</sup> The use of this

<sup>512</sup> See, for example: *Bonds, Stock, and Notes of Kansas, Oklahoma & Gulf Ry.*, 65 I.C.C. 672, 675 (1921); *Securities of Chicago & Eastern Illinois Ry.*, 67 I.C.C. 61, 63-64 (1921); *Securities of Missouri-Illinois R. R.*, 67 I.C.C. 651, 652 (1921); *Securities of Williamsport & North Branch Ry.*, 67 I.C.C. 766, 767 (1921); *Stock of Tennessee & North Carolina Ry.*, 70 I.C.C. 96, 97 (1921); *Securities of Fort Smith & Western Ry.*, 70 I.C.C. 777, 780 (1921); *Securities of Missouri & North Arkansas Ry.*, 71 I.C.C. 440, 443 (1922); *Tennessee Central Securities*, 72 I.C.C. 414, 419 (1922); *Missouri-Kansas-Texas Reorganization*, 76 I.C.C. 84, 100 (1922); *Missouri-Kansas-Texas R. R. of Texas Reorganization*, 76 I.C.C. 651, 659 (1923); *Securities of M. S., B. & P. Ry.*, 79 I.C.C. 509, 512 (1923); *Acquisition of Line by Minnesota Western*, 90 I.C.C. 637, 640 (1924).

<sup>513</sup> Thus in *International-Great Northern Reorganization*, 72 I.C.C. 722 (1922), the old capitalization of \$36,960,977 was increased to \$44,150,000, the larger capitalization being deemed reasonable "when compared with the book assets of the new company, aggregating over \$47,406,847.15" (p. 730). Increases in capitalization, though relatively slight, were also authorized in *Denver & Rio Grande Western Reorganization*, 82 I.C.C. 745, 759 (1923), 90 I.C.C. 141, 146-147 (1924), and in *Chicago, Milwaukee & St. Paul Reorganization*, 131 I.C.C. 673, 685 (1928). For similar results in connection with voluntary capital readjustments, see *Texas & Pacific Readjustment*, 86 I.C.C. 808, 813 (1924); *W. N. Y. & P. Readjustment*, 138 I.C.C. 235, 237 (1928); *St. Louis-San Francisco Readjustment*, 138 I.C.C. 505, 510 (1928); *Seaboard Air Line Ry. Co. Readjustment*, 158 I.C.C. 182 (1929), 162 I.C.C. 267, 269 (1930).

<sup>514</sup> In *Securities of Louisiana Ry. & Navigation Co. of Texas*, 90 I.C.C. 229 (1924), in which the applicant sought to issue an aggregate of \$3,163,000 of securities on the basis of the valuation in like amount placed upon the property by the Railroad Commission of Texas, Division 4 adhered strictly to the investment standard: "As stated above, the property involved was purchased . . . for \$750,000 cash. Allowing the maximum of \$100,000 for negotiations, expenses, etc., and the maximum of \$100,000 for equipment, materials, and supplies, together with \$52,500 received for subscriptions, which sum has been used for corporate purposes, there appears to be a total investment of \$1,002,500. For the purpose of this proceeding \$150,000 may be allowed for working capital, including materials and supplies. We will therefore authorize a capitalization of not exceeding \$1,150,000 . . ." (p. 232). These findings were affirmed in 99 I.C.C. 357 (1925). See, also, *Securities of D., C. & S. Ry.*, 99 I.C.C. 783 (1925); *Acquisition by T., P. & W. R. R.*, 124 I.C.C. 181 (1927); *Acquisition by San Luis Valley Southern Ry.*, 145 I.C.C. 71 (1928); *Stock of Santa Fe, S. J. & N. R.*, 154 I.C.C. 741 (1929). It should be noted that such proceedings involve relatively minor properties which are sold substantially for cash. In the more elaborate reorganizations the purchase price at forced sale, as fixed by the courts, exerts no influence upon the aggregate of securities to be issued. See, for example, *Chicago, Milwaukee & St. Paul Reorganization*, 131 I.C.C. 673 (1928).



standard of basing capitalization on purchase price has not only resulted in protest from within the Commission's ranks on the ground that property values rather than asset costs should be controlling,<sup>515</sup> but it has not been consistently applied to restrict capitalization to investment.<sup>516</sup> Finally, the valuation standard has also exerted an indefinite and uneven influence upon the extent of capitalization. In most instances the incomplete status of the valuation project has been deemed to justify resort to other tests;<sup>517</sup> tentative valuations and

<sup>515</sup> Thus, in *Securities of Louisiana Ry. & Navigation Co. of Texas*, *supra*, Commissioner Potter objected as follows to the restriction of capitalization to investment: "The limit of \$1,150,000 to securities authorized is applied because it represents the amount of cash paid by the present owner for the property, plus subsequent expenditures and plus necessary working capital. There is no warrant for arriving at authorized capitalization in this fashion. The question is what the property is worth, not what the owner paid for it. The buyer of a property is entitled to the benefit of his bargain. The majority report denies this to him" (p. 233). Other commissioners have also protested against the disregard of property values in reorganization cases, though with a view to decreasing rather than increasing the authorized capitalization, and without repudiating the investment principle as the chief determinant of value. Note the following from the dissenting opinion of Commissioner Eastman, concurred in by Commissioner Aitchison and Commissioner McManamy, in *Denver & Rio Grande Western Reorganization*, 90 I.C.C. 141, 159 (1924): "Such evidence as the record affords indicates that the new capitalization may be substantially in excess of the value of the property for rate-making purposes. Inasmuch as the right of the carrier to earnings is not determined or limited by capitalization, no sound reason can be offered for running any risk in this respect. A capitalization in excess of rate-making value is clearly contrary to the public interest, since it endangers the financial stability of the company." See, also, dissenting opinion of Commissioner Lewis in *Chicago, Milwaukee & St. Paul Reorganization*, 131 I.C.C. 673, 714 (1928).

<sup>516</sup> See *Securities of Missouri-Illinois R. R.*, 67 I.C.C. 651 (1921), *Tennessee, Alabama & Georgia Stock*, 72 I.C.C. 565 (1922), *Columbus & Greenville Ry. Stock*, 86 I.C.C. 153 (1923), in which the authorized securities far exceeded the purchase price of the properties, in recognition of a considerable variety of promoters' services of an intangible character.

<sup>517</sup> The Commission's approach, in the absence of valuation data, appears from the following: "The valuation of the property which will be taken over by applicant has not yet been completed, so that it is not practicable to compare this capitalization with underlying value. It is clear, however, that the proposed new capitalization will be relatively lower, even when allowance is made for the properties which are not to be taken over, than the outstanding capitalization of the old company, and that the fixed charges will very materially be reduced, with a consequent improvement in credit. The evidence also indicates that the new capitalization will not be disproportionate to the earning power of applicant. Under these circumstances, in view of the manifest desirability of ending the long period of receivership, we think that approval ought not to be withheld because of lack of complete information as to the value of the property to be taken over by applicant." *Securities of Chicago & Eastern Illinois Ry.*, 67 I.C.C. 61, 63-64 (1921). See, also, *International-Great Northern Reorganization*, 72 I.C.C. 722, 730 (1922); *Missouri-Kansas-Texas Reorganization*, 76 I.C.C. 84, 104 (1922). That the Commission contemplated according substantial weight to final single-

book values appear to have been accorded sharply varying weights in different proceedings,<sup>518</sup> and even when final valuation data began to become available, they were not held to establish a necessarily controlling basis for testing the propriety of the capitalization.<sup>519</sup> Under these circumstances, while the Commission's scrutiny of the agree-

sum values when ascertained appears from the following: "At the rehearing and upon the reargument, our attention was directed to what are known as the underlying land, engineering, and accounting reports of our Bureau of Valuation. . . . We, of course, have official knowledge of the making of the underlying reports and of the manner in which they were made and of the purpose for which they were made. We are unable, however, to attribute to them any more weight than that to which they are entitled by reason of their origin and purpose. Obviously, we can not upon an application for authority to issue securities give to those reports the force and effect of final valuation, because of the fact that they are subject to revision and correction before they become a tentative valuation of the property covered, and because such tentative valuation, when made, will be subject, by the express terms of section 192, to protest and change." *Denver & Rio Grande Western Reorganization*, 90 I.C.C. 141, 143-144 (1924). For proceedings, among others, in which no consideration was accorded to property values, see cases cited in notes 512 and 514, *supra*.<sup>1</sup>

<sup>518</sup> In at least one instance the tentative property valuation appears to have been definitely employed as the basis of the authorized capitalization: "Our tentative valuation report shows the cost of reproduction of the property, less depreciation and including land, at June 30, 1916, as \$380,440. There has been a net charge to the capital account through additions and betterments to road and equipment of \$2,774 up to December 31, 1920, and the applicant represents that it has spent approximately \$9,000 for similar purposes, making a total capitalizable value of \$392,214. On this basis we shall authorize the issue of \$260,200 of capital stock and \$132,000 of bonds." *Knoxville & Carolina Reorganization*, 72 I.C.C. 221, 222 (1922). But generally there has been no definite relationship between the tentative valuations and the amounts of securities authorized. For an authorization very substantially below the tentative valuation, see *Acquisition by T., P. & W. R. R.*, 124 I.C.C. 181 (1927); and compare *Stock of Poteau & Cavanal Mountain R. R.*, 86 I.C.C. 419 (1924), in which independent appraisals were submitted greatly in excess of the amount of securities authorized. For authorizations which exceeded probable property values, as disclosed in the underlying valuation reports, see *Missouri-Kansas-Texas Reorganization*, 76 I.C.C. 84, 103 (1922); *Denver & Rio Grande Western Reorganization*, 90 I.C.C. 141, 147-148 (1924). There has been similar divergence of treatment in the case of book values. In *Missouri-Kansas-Texas R. R. of Texas Reorganization*, 76 I.C.C. 651, 660 (1923), it was found that "the total capitalization of the applicant will be equal to the total of the book value of the properties and net value of the other assets to be acquired." See, also, *Acquisition by Arkansas R. R.*, 131 I.C.C. 299, 301 (1927). In *International-Great Northern Reorganization*, 72 I.C.C. 722, 730 (1922), the book value was found to justify an increase in the capitalization of the old company (see note 513, *supra*). In other proceedings there have been references to, and discussions of, book values, but without disclosure of the importance attached to them. See, for example: *Denver & Rio Grande Western Reorganization*, 90 I.C.C. 141, 145-147 (1924); *Securities of Jacksonville & Havana R. R.*, 111 I.C.C. 107, 109 (1926); *Acquisition by Chester & Mt. Vernon R. R.*, 138 I.C.C. 313, 314 (1928); *Stock of Burlington, Muscatine & Northwestern Ry.*, 138 I.C.C. 734, 735 (1928).

<sup>519</sup> Thus, in *Acquisition by J., G. & G. Ry.*, 124 I.C.C. 623, 628-629 (1927),

gate amounts of securities to be issued has served to keep flagrant proposals in check, it has not resulted in the enforcement of constructive policies or in the promulgation of principles providing guidance to the carriers with any degree of certainty. The rationale of this diffused approach is to be found in the circumstance that the proposed plans with respect to extent of capitalization were generally the outcome of elaborate negotiations, consummated independently of the Commission, which it was deemed inexpedient to disturb in any serious fashion, and in the further fact that the achievement of reductions in fixed charges, which was soundly recognized as constituting the most essential expedient of relief for the distressed carriers, was as a practical matter frequently dependent upon compromises which made possible only moderate improvements in the size of capitalization or even necessitated some increases in the aggregate of outstanding securities.<sup>520</sup>

As far as fixed charges are concerned, some reduction in amount has almost invariably been achieved—generally in the reorganization plans as submitted, occasionally through action of the Commission—as a means of improving the relationship between the burden of interest-bearing obligations and probable earning capacity.<sup>521</sup> This general result has conformed to the policy enunciated in the following declaration: “The public interests require that, before an issue of securities by a carrier is authorized, the probability of earnings sufficient to pay costs of operation and of fixed charges be reasonably estab-

\$455,000 of securities were authorized, despite a final valuation of \$523,193; and in *Stock of Ashland Ry.*, 145 I.C.C. 10, 11 (1928), \$6,000 of capital stock was authorized, despite a final valuation, as of an earlier date, of \$88,000. In the reorganization of such minor properties, involving outright sales for cash, the investment standard continued to be followed even after final valuation data became available. See note 514, *supra*.

<sup>520</sup> It should be noted, also, that the new capital structures often involved the issuance of no-par shares, which, while adding to the aggregate amount of securities, provided no definite basis for measuring the total capitalization. See, for example: *Stock of Denver & Rio Grande Western R. R.*, 70 I.C.C. 102 (1921), and *Denver & Rio Grande Western Reorganization*, 82 I.C.C. 745 (1923), 90 I.C.C. 141 (1924); *Missouri-Kansas-Texas Reorganization*, 76 I.C.C. 84 (1922); *Acquisition and Stock Issue by N. C. & E. R. R.*, 86 I.C.C. 617 (1924); *Reorganization of A., B. & A. Ry.*, 117 I.C.C. 181, 439 (1926); *Chicago, Milwaukee & St. Paul Reorganization*, 131 I.C.C. 673 (1928); *Savannah & A. Ry. Co. Acquisition*, 162 I.C.C. 771 (1930). For a consideration of the merits and defects of no-par stock, see pp. 528-534, *supra*.

<sup>521</sup> In all but a very few of the cases cited in the preceding notes of this section fixed charges were reduced.

lished, with some surplus for dividends and other purposes.<sup>522</sup> But in seeking to attain this objective in particular proceedings, the Commission has not always restricted its approval to adjustments which clearly merited support. While it has reduced or eliminated the proposed fixed charges in the case of some minor reorganizations,<sup>523</sup> it has also authorized additions to the old fixed charges in some instances.<sup>524</sup> For the most part, particularly in the more important re-

<sup>522</sup> *Denver & Rio Grande Western Reorganization*, 90 I.C.C. 141 (1924), at p. 148. After an examination of the fixed charges and earnings of the carrier for the preceding fourteen years, the Commission declared: "The results of the past strongly support the conclusion that the property may reasonably be expected to carry the burden of fixed charges according to the plan of reorganization; and that conclusion is strengthened by a consideration of the enhanced earning power that must result from the rehabilitation of the property" (p. 150).

<sup>523</sup> Note the following: "As stated above, the sale of the properties of the terminal company was made subject to the lien of its first mortgage, under which there are outstanding \$944,000 of 4 per cent bonds, with attendant interest charges of \$37,760 per annum. Should the new company be permitted to issue \$1,500,000 of general mortgage 5 per cent bonds as requested, with interest charges thereon of \$75,000 per annum, its annual fixed charges would amount to \$112,750. According to the estimates submitted it would be impossible for the new company to earn its fixed charges during the first five years of operation, if ever. Under the circumstances we are of the opinion that the issue of general-mortgage bonds should be limited to \$1,000,000. With this amount outstanding the total fixed charges would amount to \$87,560, which we believe to be the maximum the new company would have any reasonable expectation of earning." *Acquisition and Operation by Peoria Terminal Co.*, 117 I.C.C. 377, 382 (1926). "As the net annual earnings of the road for the past five years, of about \$1,978, do not indicate future ability to pay annual interest charges of \$3,600 on the proposed issue of notes, the applicant has not shown that the issue of such notes is an appropriate method of financing the proposed acquisition. Our authorization of securities for that purpose will be confined to an issue of capital stock." *Acquisition by Arkansas R. R.*, 131 I.C.C. 299, 301 (1927). "In view of the uncertainty as to the ability of the applicant to earn the interest on the proposed bonds, we will authorize the issue of capital stock only, and to preserve the relative rights and standing in the new company of those providing the money to purchase the railroad in relationship to those retaining an interest therein by virtue of ownership of the securities of the old company, we will require that the applicant issue prior-preference stock instead of proposed first-mortgage bonds." *Securities of Elkin & Alleghany R. R.*, 138 I.C.C. 341, 343 (1928). "As the road has been operated for the past five years with a net annual deficit of over \$22,000, approximately \$5,700 for the year 1927, we are not convinced that future earnings will be sufficient to pay annual interest charges of \$6,000 on the proposed income bonds and are further of the opinion that the applicant has not shown the issue of such bonds to be an appropriate method of financing the proposed acquisition. Our authorization of securities for that purpose will be limited to an issue of capital stock in the amount of \$44,550." *Acquisition by San Luis Valley Southern Ry.*, 145 I.C.C. 71, 74 (1928).

<sup>524</sup> Thus: "The reorganization would effect a reduction of \$69,900 in the total capitalization and an increase of \$1,000 in the fixed charges. Because of the Jacksonville's proposed relationship with the Seaboard . . . the Jacksonville expects to earn

organizations, the set-up presented to it has been approved. Since the burden of interest-bearing obligations which may safely be assumed by a carrier is dependent primarily upon its revenue outlook, the conservatism with which the relationship of fixed charges to probable earning capacity is viewed tends to determine the propriety of the adjustment. From this standpoint a number of proceedings have disclosed undue liberality, either because of the Commission's failure to insist upon sufficient proof of prospective earnings, or because of its disregard, in the immediate settlement, of contingent obligations embraced in the authorized capital structure. By way of example it may be noted that a reorganization plan reducing fixed charges was approved despite the expressed judgment that "the ability of the new company to carry its proposed indebtedness and to maintain adequate operation must be considered more than usually problematical";<sup>525</sup> and that in the largest of the railroad reorganizations approved by the Commission, in which fixed charges were reduced from \$21,544,066 to \$13,663,489, a decrease of \$7,880,577, it appeared that the contingent interest charges of \$9,143,685 on the adjustment bonds, beginning in 1930, and the contingent sinking-fund charges of \$1,139,368, beginning in 1936, made "a possible total charge against income of \$23,946,542 yearly, or an increase of \$2,402,476 over fixed charges prior

the interest on its bonds. . . . Beginning with estimated gross revenues of \$140,000 for 1927, the Jacksonville expects a yearly increase therein of 3 per cent. It is also of the belief that under the Seaboard's management and operation economies will result, such as a reduction in expenses for general officers, superintendence, traffic expenses, etc." *Acquisition by J. G. & G. Ry.*, 124 I.C.C. 623, 625-626 (1927). In connection with capital readjustments not involving judicial sales of the properties very substantial increases in fixed charges have been authorized. In *Texas & Pacific Readjustment*, 86 I.C.C. 808, 813-814 (1924), the fixed charges under the approved plan were increased from \$1,738,074 to \$2,268,509, upon representations that the average annual earnings for the three years following readjustment would be "sufficient to meet all fixed charges under the plan and full dividends upon preferred stock, and leave a surplus equal to more than 6 1/2 per cent on the common stock." Compare, also, *St. Louis-San Francisco Readjustment*, 138 I.C.C. 505 (1928).

<sup>525</sup> *Reorganization of Georgia & Florida Ry.*, 117 I.C.C. 473, 489 (1926). The fixed charges were reduced from \$621,020 to \$427,020. Division 4 declared: "The applicant's estimated earnings, after reorganization, if realized, indicate that it should be able to meet its fixed interest charges" (p. 484). For the very general character of the representations concerning prospective earnings, see, for example: *Bonds, Stock, and Notes of Kansas, Oklahoma & Gulf Ry.*, 65 I.C.C. 672, 675-676 (1921); *International-Great Northern Reorganization*, 72 I.C.C. 722, 729 (1922); *Securities of M. S., B. & P. Ry.*, 79 I.C.C. 509, 512 (1923); *Acquisition by Chester & Mt. Vernon R. R.*, 138 I.C.C. 313, 317 (1928).

to the reorganization.<sup>526</sup> Because of conflicts of judgment as to whether the goal of the Commission's policy was measurably achieved in particular proceedings, there have been numerous dissents bearing upon the propriety of the authorized fixed charges.<sup>527</sup>

<sup>526</sup> *Chicago, Milwaukee & St. Paul Reorganization*, 131 I.C.C. 673, 685 (1928). Similarly, in *Securities of Fort Smith & Western Ry.*, 70 I.C.C. 777, 780 (1921), non-cumulative income bonds were disregarded. The Commission found: "The evidence submitted tends to show that the fixed charges will be reduced for 10 years to an amount within the probable earning power of the applicant. Under these circumstances, we are of the opinion that the issuance of the new securities is warranted." But this finding was made despite the following: "In addition there will be annual interest charges on the 5 per cent second-mortgage bonds amounting to \$187,200 to be paid only if and when there are sufficient surplus earnings derived from operation, such interest to be noncumulative. Beginning 10 years after the date of issue, however, these bonds will cease to be income bonds, and the interest thereon will be added to the fixed annual interest charges."

<sup>527</sup> A few illustrations will suffice. Commissioner Eastman dissented in all three of the reorganizations of the Denver & Rio Grande Western, and in each case much of the emphasis was placed upon the matter of fixed charges. In the first, *Stock of Denver & Rio Grande Western R. R.*, 70 I.C.C. 102, 107-108 (1921), he said: "Applicant proposes to issue 300,000 shares of stock for property which is subject to outstanding debts totaling \$121,175,500. Not all the property of the old Denver company is to be acquired which it had when these debts were incurred, and upon such evidence as the record affords it is doubtful whether the earning power of the applicant will be sufficient to meet the interest charges." In the second, *Denver & Rio Grande Western Reorganization*, 82 I.C.C. 745, 766 (1923), where some reduction in fixed charges was achieved, he still found that "the evidence that the earnings over a period of years will be adequate to support fixed charges is not wholly convincing." And in the third, *Denver & Rio Grande Western Reorganization*, 90 I.C.C. 141, 156-157 (1924), his dissent, in which Commissioner Aitchison and Commissioner McManamy concurred, included the following: "Omitting the shares without par value, the funded debt will be 87.5 per cent of the total capitalization and the ratio of funded debt to stock will be 7 to 1. Figuring in the common stock at \$100 per share, a far higher figure than any one would claim, the funded debt will be 71.3 per cent of the total and the ratio of funded debt to stock will be 2.5 to 1. I realize that the general-mortgage bonds are, in effect, to be income bonds for a period of five years, but in 1929 the interest upon these bonds will become a fixed charge, and by that time the underlying debt will have grown much larger. . . . The new company begins business with a ratio of funded debt to stock far beyond the limit which we have repeatedly been told is safe and sound. That it is not anticipated that stock will ever be used as a means of financing is shown by the fact that no additional preferred or common stock can be issued without an amendment of the charter. . . . It is plain that the expectation is that the sole means of financing, apart from earnings and equipment trusts, will be the re-funding and improvement bonds, and it is equally plain that as more and more of these are issued the already disproportionate debt will become still more disproportionate." Similar strictures, vigorously urged, are to be found in the dissenting opinions of Commissioner Eastman (concurred in by Chairman Campbell and Commissioner McManamy) and Commissioner Lewis in the outstanding *Chicago, Milwaukee & St. Paul Reorganization*, 131 I.C.C. 673 (1928). Commissioner Eastman, with notable foresight, declared: "We must start, I think, with the premise that the new company should be prepared to face periods of business depression as well as periods of prosperity, and

But these conflicts of judgment have not been confined to specific applications of policy, either in the matter of fixed charges or with respect to other aspects of the financial structure; they have also concerned the more general and fundamental problem of regulatory approach: whether the Commission should content itself with approving any reorganization plan which provides a reasonable measure of improvement upon the preëxisting situation, in order that the difficulties of outright rejection or material alteration of proposals and the dangers of prolonging receiverships unduly may be avoided; or whether, despite these difficulties and dangers, the Commission should seek affirmative ends and require not merely improved set-ups but sound financial structures in reorganization cases. The determinations of the majority in practically all of the more important proceedings appear to have been characterized by the former attitude;

that there can be no certainty that it will enjoy better earnings in the future than it has labored under in the past. . . . The interest charges upon the new funded debt will amount to \$22,807,174 yearly as compared with \$21,544,066 upon the old funded debt, an increase of \$1,263,108. However, and this is the vital point relied upon in support of the plan, \$9,143,685 of the new interest charges, those upon the so-called adjustment-mortgage bonds, will not be fixed but will be payable each year only if earned. But beginning with 1930, only two years away, this \$9,143,685 will become cumulative, and all unpaid interest must be paid in full before any dividends can be declared upon stock. Provision is also made for a new mortgage, junior only to the underlying mortgages upon which there has been no default, and under this new mortgage the funded debt can be increased without limit, except as a limit is imposed by the stockholders or this commission. It is also provided that two-thirds of the net income after fixed charges, up to \$7,500,000, may be diverted to capital expenditures, or a possible maximum diversion of \$5,000,000 per year. If anything is clear it is that under this financial structure, and unless earnings in the future average much better than the past gives reason to anticipate, it will be utterly impracticable for the new company to finance by new issues of stock, and that the financing of its future needs *must* be done by repeated issues of the new mortgage bonds or such of the old general-mortgage bonds as are available, except to the extent that capital requirements are met by diversion from earnings at the expense of the adjustment-bond holders. The financial unsoundness of the practice of securing new capital wholly or even largely by continual increases in funded indebtedness is strikingly illustrated by the history of the St. Paul itself. It was one of the principal factors leading up to the receivership. In the past this practice might under wise management of the St. Paul have been avoided. But under this proposed new financial structure it becomes, in all probability, compulsory and inevitable. Is this in the public interest or 'appropriate for or consistent with the proper performance by the carrier of service to the public?' (pp. 705-706). Commissioner Lewis was equally convinced of the impropriety of the approved adjustment: "The new company is authorized by the majority to appear in the field of public service with a financial structure carrying \$13,663,489 of fixed interest charges. The earnings seem to cover that with a margin of safety. There then appears in the picture of that future which begins with the year 1930, less than two years distant, \$9,143,685 of adjust-

Commissioner Eastman, the most persistent dissenter in connection with reorganizations, has repeatedly urged the more constructive approach.

As early as 1922 he argued for the need of a clearer definition of policy and set forth some of its essential constituents: "In administering the provisions of the transportation act, 1920, which impose upon us the duty of supervising the issue of securities by railroad companies, we are faced by no more difficult problem than in connection with reorganizations following receiverships. In the past such reorganizations have largely been a matter of bargain and trade between groups of security holders without adequate consideration of the paramount public interest, so that the results have often been consistent neither with the public interest nor even with sound business principles, and recurring receiverships have been far from uncommon. . . . The bankers and lawyers and security holders by whom reorganization plans are evolved ought fairly to have, in the process of their bargain and trade, some guide as to what we will or will not approve. Otherwise we shall continually be faced, whenever a plan is

ment-mortgage bond-interest charges. This annual liability which attaches to the \$182,873,693 of adjustment bonds falls just outside the technical designation of fixed charges because interest is to be paid only when earned. It, however, is fixed and cumulative, and is senior to claims of stock to participation in any earnings; and before stock can participate there also is provision for diversion of earnings to capital account. So the analysis comes down to \$22,807,174 annual liabilities and obligations ahead of stock. This is a million and a quarter greater total interest charges than accruing under the old financial burden on which the St. Paul went into receivership. Is this a safe plan to approve? Submitting the conditions of the new St. Paul to a favorable analysis and accepting the fact that maintenance expenditures can be cut and that new management should bring or create new business, and indulging in the sanguine hope that there will be a healthy reversal of adverse conditions, there is little hope of the company being able to do more than meet its fixed charges and contingent cumulative obligation within any reasonable time. Therefore it seems that the stock, both preferred and common, is destined to nothing more than stock-market speculation for some time to come. With stocks that have only such value, the St. Paul must look to bond issues for new money which from almost the beginning of the new company's operations must flow to it. These issues probably must carry priorities over bonds authorized by the majority decision, except the \$182,130,960 of undisturbed underlying bonds. The effect must be still further to crowd stock out of use in financing. . . . It seems to me that we might well approve a financial structure in which fixed interest obligations might range from \$13,663,489 up to \$15,000,000 or \$16,000,000 if that be necessary, but that on a record of past performance which shows that not since 1916 has this carrier had an earning which would clear it, we should not approve a plan which carries \$22,807,174 of fixed and cumulative contingent interest liabilities" (pp. 716-717, 719).



submitted to us for approval, by the plea that disapproval would without warning undo the labor of years. . . . The public interest, I think, clearly demands that a reorganized property should begin its new career with a capitalization which will enable it, if that be possible, not only to keep clear of bankruptcy but also to attract the capital necessary for future development."<sup>528</sup> Again, in 1924, he deplored the negative path theretofore pursued by the Commission and urged the necessity of positive and constructive action: "I realize the difficulty that reorganization managers have in dealing with the holders of the various classes of securities of an insolvent company. But here is where the commission should bring its influence to bear. The only policy which it has adopted with respect to reorganizations is that a proposed new financial structure will be approved if it seems better than the old structure and if there is reason to believe that earnings will be sufficient to cover the new fixed charges. Such a policy seems to me negative and inadequate. The least that can be expected of reorganization managers is that the new financial structure will in some measure be an improvement upon the old and that a plausible showing of earnings can be made for the future. But the transportation act, 1920, introduced a new factor into the situation which should be made to count. That act recognized that the issue of securities is affected with a public interest and imposed upon us the duty of protecting that public interest. It can only be protected, in my judgment, by a positive and constructive policy on our part. The capitalization of a carrier does not determine or limit its earnings, but may have a great deal to do with its ability to finance its needs and serve the public properly. Net earnings, whatever they may be, can be converted into interest or dividends regardless of the volume of the capitalization, but that volume and the ratio between stock and

<sup>528</sup> "In this connection," he added, "we might well state that in such cases we will not approve an issue of bonds in excess of one-half the property investment, unless it be clearly shown that such a limitation of funded debt is impracticable. A limitation of this kind upon bonds would have the effect, not only of curtailing fixed charges and strengthening credit, but also of increasing the financial interest in the property represented by the stock which controls the management. The second effect, in my opinion, would be quite as important as the first. We might also state, I think, that we will not approve a new capitalization in excess of our best estimate of the original investment in the property. In many cases it should be lower." From his dissenting opinion in *Missouri-Kansas-Texas Reorganization*, 76 I.C.C. 84 (1922), at p. 108.

funded debt may determine whether the carrier is financially strong or financially weak. If a railroad becomes insolvent and its property is sold to satisfy its debts, we are subject to no other basic limitation than the public interest in determining the amount and character of the securities which the purchasing company may issue or assume for this purpose. It seems to me that we should at least insist, in the case of any such reorganization, that the new company shall start life with a reasonably sound financial structure. If this were our policy, reorganization managers would stand on firmer ground in dealing with the holders of the securities of insolvent companies than they now find under their feet."<sup>529</sup> Finally, in 1928, his severe criticisms of the reorganization plan approved in the *St. Paul* case were expressly grounded in the standards of sound financial organization, designed to further public ends, as previously defined: "When a railroad has been unable to meet its obligations and has fallen into receivers' hands, the 'proper performance by the carrier of service to the public' and the 'public interest' clearly demand that any reorganization shall leave the carrier, so far as practicable, with a sound financial structure which will reduce to a reasonable minimum the danger of recurring insolvency and which will make it possible to secure capital for future needs in a manner conforming to sound financial principles."<sup>530</sup>

That the majority of the Commission has been fully aware of the existence of serious deficiencies in some of the reorganization plans which it has approved is evidenced clearly by the nature of its express declarations in the *St. Paul* case. Divergences of view appear to have arisen within the Commission because of conflicts of judgment, not so much with respect to the abstract merits of proposed reorganization expedients, as with respect to the feasibility of such affirmative

<sup>529</sup> From his dissenting opinion, concurred in by Commissioner Aitchison and Commissioner McManamy, in *Denver & Rio Grande Western Reorganization*, 90 I.C.C. 141 (1924), at pp. 157-158.

<sup>530</sup> From his dissenting opinion, concurred in by Chairman Campbell and Commissioner McManamy, in *Chicago, Milwaukee & St. Paul Reorganization*, 131 I.C.C. 673 (1928), at p. 705. Note, also, the following from the dissenting opinion of Commissioner Lewis: "The time has come, and the opportunity is here, to require a financial structure that is sound beyond question, and an organization strengthened by at least some of the suggestions for safeguarding the mutual interests of the public and the carrier presented by the majority report, our report on the investigation into the receivership of the *St. Paul* [131 I.C.C. 615] and dissenting expressions. It seems to me that the act places on us the duty of requiring such a reorganization." *Ibid.*, p. 719.

regulatory action as might issue in the establishment of sound financial structures. Speaking specifically of the St. Paul reorganization, the Commission frankly conceded its defects and indicated unequivocally that approval was accorded to it for reasons of expediency: "That the plan, when regarded in the abstract and in the light of a possible ideal of sound financial theory, is defective is manifest. While the absolutely fixed charges, default in payment of which means bankruptcy, have been brought within reasonably safe limits, even assuming that capital expenditures in the next few years are met by sales of the bonds provided therefor, the issue of adjustment bonds may prevent the company for a considerable time from obtaining new capital by the sale of other than fixed-charge obligations. Moreover, the possibility of accumulation of unpaid interest on the new adjustment bonds after 1930 may make still more remote the possibility of stock financing. Such accumulations can not nowadays readily be adjusted by additional capital issues as has been done at times in the past, and to that extent they may become a clog upon the property in the future. Securities of this sort are hybrid things and have no place in a thoroughly sound financial structure. Were we dealing here with a new enterprise at its inception, and were it a question of a capital structure to be provided for that enterprise, the bonds and stocks of which were to be sold to the public, it would probably be our duty to disallow the inclusion of such a security in that structure. We have, however, a different situation before us. While in our consideration of the application we are not bound by any existing agreements that may have been made among the security holders, reorganization managers, purchasing committees, or others, and while both the applicant and the Jameson committee admit that possibly other plans could be devised which would enable the St. Paul receivership to be lifted, we do not feel warranted in deferring action until an ideal plan may be formulated and presented. . . . The properties have been in receivership over two and one-half years, and, if the application is approved, will probably have been in receivership for three years or longer before the receivership can be terminated. If the application should be denied, the receivership may continue indefinitely. The reorganization managers would have to prepare a modified or new

plan and if such plan were disapproved or not approved by any one of the three committees which are parties to the plan, or if the changes adversely affected to a material degree any class of securities, withdrawals would follow, and the reorganization would have to be started anew. We do not and can not know how long a time would be required to procure assents to a new or modified plan, or whether or not as large percentages of the securities would be deposited. Another or modified plan might provoke equal opposition from any other group or groups of security holders. Any material change in the plan will cause further expense and delay. Upon consideration of all the facts we are of opinion that the public interest will be served by an approval of the application, even though we should believe that a stronger financial structure might have been erected by the adoption of some other plan of reorganization.<sup>581</sup> By way of conclusion, moreover, in order to make clear that the subordination of principle to expediency was not distinctive of the instant proceeding, the Commission directed special attention to the fact that this approach had been pursued by it in other reorganizations: "It seems appropriate here to recall that in the last several years we have permitted to become effective a number of reorganization plans involving capital structures which, like that dealt with in this report, left something to be desired from the point of view of fully sound financial standards. We have done this in full appreciation of these shortcomings, and solely upon the ground that the major public interest seemed to us to

<sup>581</sup> *Ibid.*, pp. 694-696. Note, also, the following from the Commission's report of its investigation of the causes of the St. Paul's failure: "In the case of the St. Paul a plan of reorganization was prepared, was submitted to security holders, and after many months of negotiation approved by them; it was presented to the court having jurisdiction and approved by that court, and only after all these steps had been taken was it presented to us for approval of the securities proposed to be issued thereunder, according to the law. The effect was that we were confronted with two alternatives. The first was to approve in toto the securities proposed to be issued; the other, to reject them in toto, for in the nature of the case for us to require any real modification of the plan in this respect would void all the agreements made between security holders and compel the negotiation of new agreements with the likelihood of considerable additional delay and expense in taking the railroad out of receivership and restoring it to control of those interested therein. It seemed to a majority of the commission that the first alternative better served the major public interest, despite the obvious shortcomings of the structure represented by the securities for which application was made." *Chicago, Milwaukee & St. Paul Investigation*, 131 I.C.C. 615 (1928), at p. 671.

require that the properties concerned should at the earliest possible moment be released from receivership and restored to active management by those financially interested therein.<sup>1682</sup>

It is apparent that the difficulties encountered by the Commission in establishing sound financial structures, with reference both to the extent of the total capitalization and the character of the instruments employed, were grounded in the terms and conditions of issue, as reflected in the treatment accorded to the various classes of old security holders in the reorganization plans submitted for its approval. In other words, the Commission's refusal to reject or alter important reorganization plans sprang in no small measure from an unwillingness to assume responsibility with respect to the equities of the proposed arrangements as between the various parties in interest, the adjustment of which it deemed for the most part to be a matter of private agreement subject to the safeguards provided by the supervision of

<sup>1682</sup> *Chicago, Milwaukee & St. Paul Reorganization*, 131 I.C.C. 673 (1928), at p. 699. The dissenting commissioners were not only convinced that the public interest in the speedy termination of receiverships did not justify the Commission in disregarding its more fundamental duty with reference to the establishment of sound financial structures, but they were not persuaded of the existence of any urgent necessity for such speedy termination. Commissioner Lewis, for example, concluded his expression of dissent in the instant proceeding as follows: "All investigations indicate that the property and services have improved. Therefore, so far as the public interest is concerned there seems to be no pressing need for us to be spurred on to approval of the reorganization plan simply because if it is rejected, or changed, it will take some time to prepare and submit a new plan, and get the road out of receivership." *Ibid.*, p. 719. Note, also, the following from Commissioner Eastman's dissenting opinion: "As I understand their position, the majority of the commission are not here authorizing the desired securities because they regard all of the provisions of the reorganization plan with favor. On the contrary it is made quite clear in the final paragraphs of the report on the general investigation of St. Paul affairs that they recognize the 'obvious shortcomings' of the plan. They find themselves faced with the alternatives of either approving a poor plan or compelling the negotiation of new agreements with the likelihood of further considerable delay and expense in taking the railroad out of receivership. In this dilemma they choose approval of the plan as the lesser evil in the public interest. Such a conclusion, it seems to me, is ill-considered. This is not the first time that the commission has approved reorganization plans upon such a theory, and in at least two instances there have been successive reorganizations of the same property. The need for a more positive policy is clearly indicated. The effect upon the country of a rejection of this plan would be tonic. Moreover I believe that reasonable changes in the plan could and would be made without undue difficulty. But even if delay ensued, it would be no dire misfortune for the property to remain a little longer in receivership. It has so far been much improved during the receivership, and doubtless this improvement would continue." *Ibid.*, p. 711. For support of this position, see Nathan L. Jacobs, "The Interstate Commerce Commission and Interstate Railroad Reorganizations," *Harvard Law Review*, vol. 45 (March, 1932), pp. 855-889, 874-876.

the courts. In the beginning the Commission appeared to disclaim altogether any share of responsibility for the justice of the reorganization expedients. When, in an early case, the holders of small blocks of bonds protested against the plan of exchanging bonds for stock, Division 4 disposed of the protest summarily: "This is a matter properly to be brought before the court having jurisdiction in the premises, which has expressly reserved the determination of the equities in the receivership proceeding."<sup>583</sup> Subsequently, questionable adjustments sometimes received extended consideration, but without any resulting change in the set-up agreed upon by the security holders and approved by the court.<sup>584</sup>

In this as in other aspects of the reorganization process, the *St. Paul*

<sup>583</sup> *Securities of Chicago & Eastern Illinois Ry.*, 67 I.C.C. 61, 64 (1921).

<sup>584</sup> Note the following, for example, from *Reorganisation of A., B. & A. Ry.*, 117 I.C.C. 181, 184-187 (1926): "As a practical statement of the situation it may be said that the Atlantic Coast Line is acquiring control of the A., B. & A. property by a cash payment of about \$3,600,000 and the guaranty of an annual payment of about \$260,000 in dividends. The bondholders are receiving 60 per cent of the face value of their bonds in 5 per cent guaranteed stock, but nothing for unpaid interest. . . . No recognition is given the stockholders of the A., B. & A. in these plans. The contentions of the stockholders are based largely upon the fact that our valuation of the owned property of the A., B. & A. . . . shows a value of over \$23,000,000 as of June 30, 1914, from which it is argued that the consideration to be given by the Atlantic Coast Line for control of the new company, and therefore of the property, is grossly inadequate. It is also strongly urged by the stockholders through their counsel that the earnings of the A., B. & A. are now increasing to such an extent as to justify a hope that the company may be reorganized as an independent carrier, and that the execution of the present reorganization plan should be deferred to permit further test of the earning capacity of the property, as well as more complete investigation of the possibility of more advantageous disposition. Counsel also suggests that our authority has not been invoked to secure better divisions for the A., B. & A. from its connecting lines. . . . The objections of the stockholders were similarly urged before the court in the proceedings preceding the sale of the property and were dismissed. . . . There is no difficulty in reaching the conclusion that from the standpoint of transportation service the proposed reorganization and control by the Atlantic Coast Line is in the public interest. . . . Approval should therefore be given and the necessary authority issued, unless there be something in the terms and conditions of the proposed acquisition, or in the consideration, so inequitable as to require modification in the public interest. We find nothing of this character in the arrangement." Commissioner Eastman, who dissented on other grounds, was much more sympathetic to the claims of the stockholders, but reached the same general conclusion as the majority: "The price which in effect is being paid for the property is very low. While it is perhaps consistent with the record of earnings for the past six years since the end of Federal control, that record, I believe, affords a poor test of the inherent earning power of the property. Immediately after Federal control the company was plunged into a disastrous warfare with its employees, a warfare which not only depleted net earnings but must have engrossed the attention of the management to the exclusion of proper attention to efficient opera-

case is particularly illuminating.<sup>585</sup> The reorganization plan there approved unquestionably effected a redistribution of equities, in disregard of legal priorities, in favor of the stockholders and at the expense of the bondholders. This result was achieved, in face of a situation which appeared to wipe out the unsecured investors,<sup>586</sup> by enabling the stockholders to maintain their original position through the payment of a small assessment and the purchase at par of some of the new mortgage bonds,<sup>587</sup> whereas the old bondholders were required to make very substantial concessions, not only through exchange of their holdings for junior securities, but through according priority to

tion and the building up of business and revenues. My impression is strong that the management has not shown energy in seeking new sources of revenue, such, for example, as increased divisions from its connections. Furthermore within the past two years the trend of earnings has been sharply upward. In view of the rapid development of the South, the valuable terminal facilities which the Atlanta, Birmingham & Atlantic owns at certain points and its apparent strategic position with reference to the Atlantic Coast Line-Louisville & Nashville system, it seems to me that there is good reason for believing that it might with advantage have been permitted to continue in the receiver's hands longer, concentrating attention on management and operation and fostering the upward trend of earnings. However, this is a question of judgment, and in view of the fact that the bondholders have agreed to the price, and the further fact that a very substantial increase would be necessary before the stockholders would benefit, no sufficient reason has been shown for general disapproval of the price as inconsistent with the public interest." *Ibid.*, pp. 188-189. For a critique of this reorganization, as well as of the second Denver & Rio Grande Western reorganization, from the standpoint of their fairness as between different classes of bondholders, see Harold G. Moulton and Associates, *op cit.*, at pp. 339-342.

<sup>585</sup> *Chicago, Milwaukee & St. Paul Reorganization*, 131 I.C.C. 673 (1928). Supporting analysis for the above strictures upon the fairness of the reorganization plan will be taken from Commissioner Eastman's dissenting opinion, at pp. 701-714.

<sup>586</sup> "The property of the St. Paul was sold under foreclosure of the junior mortgages at a price which apparently wiped out the stockholders completely and left only 48 cents on the dollar for the bonds in default. A reorganization, however, is proposed which provides for both the bondholders and the stockholders. Sacrifices are necessarily entailed by a reorganization. Who makes the sacrifices here?" *Ibid.*, p. 708.

<sup>587</sup> Both the facts and the unanswerable conclusions concerning the position of the stockholders appear from the following: "The stockholders will have precisely the same number of shares as before, and their place in the new financial structure will in no important respect be inferior to their place in the old, except that the interest rate will average a trifle higher on the new than on the old bonds. To regain their position in this way the stockholders are called upon to do two things: 1. Contribute \$4 per share, which will be used in part for reorganization expenses and in part for working capital, and which it appears may also be returned in part at the discretion of the reorganization managers. 2. Invest \$24 per share, in the case of the preferred stock, and \$28 per share, in the case of the common, in new 50-year 5 per cent mortgage bonds at par. These bonds will have a lien on the property underlying the lien of the adjustment-mortgage bonds, which the defaulted bondholders are to receive, and will be junior only to the \$182,130,960 of undisturbed bonds and any bonds that may hereafter be

the mortgage bonds purchased by the stockholders and permitting diversion of income in large amount from interest payments on the bulk of their new holdings to capital expenditures.<sup>588</sup> The adjustment thus made, involving heavy sacrifices on the part of bondholders and but slight sacrifices on the part of stockholders, was effectuated without affording the bondholders an opportunity to provide directly the necessary new funds,<sup>589</sup> and despite the fact that failure and receivership

issued under the old general mortgage or the new first and refunding mortgage. The investment in new bonds obviously involves no sacrifice on the part of the stockholders, except to the extent that they are required to pay more than the bonds are worth. The chairman of the bondholders' committee testified that these bonds are 'intrinsically' worth par, and in view of the character of their security and the tendency of the money market he is probably right. They are now selling at about 96. The actual sacrifice involved in their purchase at par by the stockholders is, therefore, small in any event and likely to be nil. It follows that the only real sacrifice required by the stockholders in return for a position in the new financial structure equal to that which they held in the old is \$4 per share. Obviously this is not the sacrifice relied upon to put the new company upon its feet financially. . . . The contribution of the stockholders at \$4 per share amounts to \$9,330,072. Assuming that the bonds in which they are required to invest are worth only 96, their further contribution is \$2,427,067, making a total of \$11,757,139. They are to receive stock of the new company, the present curb quotations on which are about 26 for the common and 44 for the preferred, making a total market value on this basis of \$81,497,712. In other words, for a payment of \$11,757,139 at the maximum, they regain an equity worth \$81,497,712, in the face of the fact that the creditors secured by mortgage are being called upon to make serious sacrifices." *Ibid.*, pp. 708-709.

<sup>588</sup> A mere statement of the provisions of the plan discloses the great burdens imposed thereby upon the bondholders: "In place of securities which had a direct lien for the most part on the entire property, subject only to the undisturbed bonds, a lien which protected both principal and annual interest, these defaulted bondholders are to receive 20 per cent in the same 50-year 5 per cent bonds in which the stockholders are required to invest and 80 per cent in adjustment-mortgage bonds which are the equivalent of prior preferred stock. They are also to permit two new mortgages to be created, both of which are to be superior in lien to the adjustment mortgage and one of which is to be junior only to the undisturbed bonds and is to be subject to no limitation on the amount of bonds which may be issued under it. One of these superior mortgages which they thus permit to be created is also to be used to secure the major part of the new money which the stockholders are to provide. In other words this money is largely to be raised upon the strength of credit which the defaulted bondholders surrender. The latter further agree that up to \$5,000,000 per year two-thirds of yearly net income may be diverted from the payment of interest on their new adjustment bonds to capital expenditures, this interest not being cumulative until 1930." *Ibid.*, p. 709.

<sup>589</sup> There appears to be no sound basis for the contention that such an adjustment was necessary in order to raise the new money required by the reorganization: "Apparently such a reorganization is defended legally upon the ground that additional funds are essential to the success of the undertaking and 'it may be impossible to obtain them unless stockholders are permitted to contribute and retain an interest sufficiently valuable to move them.' But it would seem that this defense can only apply when the bondholders are themselves unwilling to supply the additional funds, something which



had eventuated under the management of the stockholders.<sup>640</sup> But the contentions of the protestants "that the plan is preferential to the stockholders and therefore prejudicial to the holders of the general and refunding bonds," and "that the deposits of the large percentages of the securities involved in the receivership were obtained by coercive measures and threats of penalties,"<sup>641</sup> did not approve themselves to the majority of the Commission. While it was conceded that the arrangements agreed upon by the security holders, the reorganization managers, and other parties in interest were not binding upon the Commission, these contentions were disposed of, without independent analysis of the equities of the situation or of the processes pursued in the adoption of the plan, by mere reference to the fact of agreement by the bondholders and approval by the court and to the absence of any legal bar to the result achieved: "The bondholders depositing their bonds under the plan have, through their representatives, purchased the properties, and have, pursuant to provisions in the plan, previously agreed upon, apportioned to the stockholders a share of the bondholders' equity. They have thus permitted the stockholders to retain an interest in the properties upon the terms which have been stated above. We have not been advised of any rule of law or equity which requires that the stockholders should be absolutely foreclosed and cut off, except to the extent of new money contributed by them,

they have been given no opportunity to do. And plainly here the stockholders have been given inducement much more than 'sufficiently valuable to move them.' . . . If the Government is to assume, as it has assumed, the responsibility for the regulation of railroad security issues, it is assuredly vital to the economical financing of the properties and to the public interest generally that the Government should, to the extent of its power, see to it that investors are treated with absolute good faith, and that the rights attaching to their securities are adequately protected." *Ibid.*, pp. 709-710.

<sup>640</sup> It is significant that this highly favorable treatment was accorded to the stockholders without regard to their responsibility for the shortcomings of past managerial policy: "In this connection it must be borne in mind that it is the stockholders, not the bondholders, who have been legally responsible for the management of the St. Paul in the past, and in so far as that management has been lax and has contributed to the financial downfall of the company, it is the stockholders who must shoulder the blame. If stockholders are to realize and be alive to their legal responsibilities, they should be made to carry at least their appropriate share of the load when the company meets with disaster. There surely can be no justification for restoring them, with small sacrifice on their part, to a position in the new company of practically unimpaired power and security." *Ibid.*, p. 710. For an analysis of the causes of the St. Paul's difficulties, including those centered primarily in mistakes and improprieties of management, see *Chicago, Milwaukee & St. Paul Investigation*, 131 I.C.C. 615 (1928).

<sup>641</sup> *Chicago, Milwaukee & St. Paul Reorganization*, 131 I.C.C. 673, 692 (1928).

. . . or which forbids bondholders from sharing with the old stockholders a portion of the equities purchased. The plan, which contains the provisions whereby the old stockholders are permitted to retain an interest in the new company, was submitted to the district court and approved by it. The applicant shows that the courts look with favor on the practice of permitting stockholders to retain an interest in reorganized properties, and especially in transportation systems where the conditions render such course lawful. We find nothing indicating that such practice here is contrary to the public interest."<sup>642</sup>

Toward one aspect of the relationships between the parties in interest—toward the matter of reorganization expenses, particularly in the form of compensation to reorganization managers, protective

<sup>642</sup> *Ibid.*, p. 693. Since the majority of the Commission placed primary stress upon the fact of agreement to the plan by the bondholders, the following survey of the circumstances surrounding the development of this agreement, as set forth in the dissenting opinion of Commissioner Eastman, becomes a matter of considerable significance: "The plan has the apparent support of most of the stockholders and bondholders. To gauge the weight which ought to be given to this fact, it is necessary to understand the auspices under which the plan was formulated and how this assent was secured. For many years the St. Paul had conducted its financial operations exclusively through Kuhn, Loeb & Company, in association after 1909 with the National City Bank or National City Company. In the report on the investigation of the St. Paul's affairs, issued contemporaneously with this report, it is shown that these bankers precipitated the receivership. Immediately thereafter they made themselves reorganization managers, and they named the chairmen of the three committees which were organized to protect the interests of the bondholders, common-stock holders, and preferred-stock holders. On the bondholders' committee, indeed, the reorganization managers were directly represented, and by the reorganization plan they were made the 'sole judges' of the compensation to be paid to all these committees. The reorganization managers and the committees were able within a comparatively short time to agree upon a plan, and it was then presented to the security holders with the very considerable prestige and momentum which it derived from such an agreement. But there were other reasons impelling, if not compelling, assent by the security holders. Under the plan, those who do not become parties 'within the periods limited or fixed therefor' can thereafter become parties only 'upon obtaining an express written consent of the reorganization managers,' and the latter are empowered 'in their absolute discretion' and 'upon such general or special terms and conditions as they see fit, to withhold or give such consent.' The evidence shows that the threat implied in this provision was not overlooked by the reorganization managers. . . . Nor is this all. In a sale under foreclosure the debts in default can be used in payment of the purchase price, but those not holding evidences of such indebtedness must pay cash. As a practical matter this makes it impossible, in the case of a great railroad property like the St. Paul, for other interests to bid. It has also become the practice of the courts in such cases, for reasons not wholly clear, to fix a very low upset price, and ordinarily the property is bid in at that figure. Here a slightly higher amount, \$140,000,000, was bid in behalf of the reorganization managers, which, added to unenclosed direct obligations of \$160,001,960, made a total of \$300,001,960, as contrasted with a property valuation on the so-called O'Fallon

committees, and their counsel—the Commission attempted to pursue a more positive policy, but encountered in the end legal difficulties which appeared to remove these adjustments from the scope of its jurisdiction. Questions of compensation have generally been determined in the first instance by the reorganization managers, and the amounts involved have been recovered through assessments upon the holders of the securities of the old company or through charges against the capital of the new company. Since the expenses thus incurred are part and parcel of the reorganization plan, they are subject to review by the court exercising jurisdiction of the receivership, and since their extent generally bears upon the propriety of the resulting financial structure, they become matters of concern to the Commission in its consideration of proposals to issue securities. The Commission's approach in the premises, in which we are primarily interested, has varied from time to time, but clearly in the direction of assuming active responsibility for the reasonableness of reorganization expenses. In the beginning a few minor plans were approved without special reference to these items;<sup>543</sup> but as early as 1922 there was express recognition of a definite public interest in the matter of reorganization expenses,<sup>544</sup> and in 1925, in pursuance of this recogni-

basis of not less than \$640,000,000. This sale price, however, determines the cash that a nonassenting bondholder who is not a party to the reorganization plan will receive, and it means about 48 cents on the dollar. . . . The security holders were, therefore, in this predicament. They could either join in the reorganization plan, or they could stay out and contemplate the necessity of employing counsel and experts in an endeavor to persuade the courts or the commission that the plan ought not to be approved. If they chose the latter alternative and failed, they ran the risk that they could then become parties to the plan only upon the payment of unknown penalties fixed at the discretion of the reorganization managers, or that they would be doomed to accept a ruinous cash settlement. From observation in the past the security holders knew also that a fight against reorganization managers behind Wall Street intrenchments is an uphill struggle against heavy odds. Summing up the situation, once the reorganization managers and their personally selected committees had agreed upon a plan, resistance upon the part of security holders involved a probability of heavy expense and also grave risk of ultimate disaster. That they at length flocked to the standard of the reorganization managers after considerable evidence of reluctance is not a fact which should weigh heavily in our deliberations." *Ibid.*, pp. 702-703. For a lively and stimulating analysis of the failure and reorganization of the St. Paul, in all their numerous ramifications, see Max Lowenthal, *The Investor Pays* (1933).

<sup>543</sup> See *Bonds, Stock, and Notes of Kansas, Oklahoma & Gulf Ry.*, 65 I.C.C. 672 (1921), 70 I.C.C. 78 (1921); *Securities of Texas City Terminal Ry.*, 70 I.C.C. 244 (1921).

<sup>544</sup> *Missouri-Kansas-Texas Reorganization*, 76 I.C.C. 84 (1922). In this proceeding

tion, the compensation of reorganization managers and the fees of their counsel, which were to be paid by the new company from assessments upon stockholders, were actually fixed by the Commission.<sup>648</sup> While the circumstances of some of the intervening proceedings

it was proposed that out of the cash to be raised by assessments on the stockholders for the benefit of the reorganized property, \$1,614,249.79 be paid as compensation to the reorganization managers and \$750,000 as fees to their counsel. In view of the "urgent necessity that a reorganization be accomplished without further delay," the various applications involved were approved, but only after being amended in accordance with an agreement between the applicant, the reorganization managers, and the Commission, whereby the amounts of compensation to be allowed to the reorganization managers and their counsel were to be determined by a court or by the Commission. In supporting its resort to this arrangement Division 4 first set forth the contentions of the applicants: "It appears from the testimony bearing on the item for managers' compensation that their tasks were exceedingly difficult; that their services have been continuous since 1914, and will continue for a considerable period of time; and that as sponsors for the plan of reorganization they carry serious responsibility. . . . The testimony is to the effect that the reorganization managers' compensation as proposed is measured by a percentage of the par value of the securities issued and that this method has the sanction of established custom. Furthermore, the rate of that compensation was distinctly stated as a term of the plan and agreement of reorganization which set forth the respective rights and interests of all security holders. It has been suggested to us that this agreement is controlling and that we are charged with no duty and possess no power to look beyond it. There is testimony that the fees of counsel bear a proper relation to fees customarily paid for services rendered in difficult matters of large magnitude" (pp. 105-106). But these contentions, and the testimony introduced in support thereof, did not prove sufficiently persuasive to justify an immediate determination of the issue: "We did not see our way clear . . . to grant such approval of the compensation of the reorganization managers or their counsel as would be involved in authorizing unconditional issuance of securities. If such compensation is appropriate, measured by the standards of current and recent practice, there arises the question as to the correctness of those standards. If in one instance compensation is excessive, it does not follow that the application of the same basis to a number of instances makes the basis proper. We were not prepared to accept the view that the situation presented involved only the usual relations of client and attorney or of parties to contracts determining by agreement their respective rights. There is involved an important question of public interest. By the amended application . . . provision is made for resolving the elements of doubt, and the effect to be given to the provisions of the reorganization plan and agreement in respect of compensation of managers and the charges of their counsel is not now determined and remains for future determination as thereby provided" (p. 106).

<sup>648</sup> In July, 1925, more than two and a half years after the above determination, the Commission found that the compensation of the reorganization managers and the fees of their counsel should not exceed \$900,000 and \$600,000, respectively, and ordered that the remainder of the fund of \$2,364,249.79, with its proportionate share of accumulated interest, should be paid into the treasury of the new company. 99 I.C.C. 330. Commissioner Eastman and Commissioner McManamy filed vigorous dissents. Commissioner Eastman, after pointing out that provision had been made for large outlays in connection with the reorganization independently of the items in question (pp. 334-335), and that numerous factors tended "to lessen the weight of the evidence support-

were such that the matter of reorganization expenses was passed over without discussion or protesting comment,<sup>646</sup> in at least one case disapproval was expressed, though without actual effect in the particular instance, of the practice of imposing the burden of reorganization expenses, incurred primarily for the benefit of the old creditors and investors, upon the financial structure of the new company.<sup>647</sup>

ing the compensation sought by the reorganization managers and their counsel" (pp. 335-338), concluded that "if they were allowed \$1,200,000 in the aggregate, they would . . . be generously treated" (p. 340). It should be noted that this conclusion, like that of the majority, was merely one of judgment, in the light of all relevant considerations, and hence introduced no new principle of decision. He also expressed his agreement, however, with the view of Commissioner McManamy "that no securities of a new railroad corporation, created upon reorganization to take over the property of an old company, ought to be issued to meet the expenses of reorganization" (pp. 340-341). In developing this view, Commissioner McManamy, after pointing out that "reorganization is undertaken in the interests of the creditors, secured and unsecured, and the shareholders of a corporation in financial straits" and that in this instance "everything these managers and counsel have done was, or is presumed to have been, in the interest of their clients, the shareholders and creditors of the old companies" (p. 341), proceeded as follows: "In my opinion it is economically unsound and incompatible with the public interest to saddle upon the new company the expenses of and compensation for the services of the reorganization managers and their counsel. That shareholders of the old company entered into agreements looking to the capitalization by the new company of these and other expenses, and that the reorganization managers agreed in writing to accept our determination of the amount of their compensation does not touch upon the merits of the question. Our authority and duty under section 20a of the interstate commerce act to examine into the propriety of proposed security issues, and into the propriety of the uses to which they may be applied, can not be diminished by any such agreement. I am convinced that this commission should not have accepted in principle, and should now disapprove, the capitalization by the new company of these expenditures. Certainly if such expenditures are chargeable at all to the new company in a reorganization designed to effect a sounder financial structure, they are not properly payable out of the proceeds of capital issues. Because of increased and increasing expenditures of time and money employed in such reorganizations, I am further convinced that we should now announce as a general rule that some method other than inclusion in the securities of a reorganized company, or embodiment in any new securities, must hereafter be devised to take care of expenses incident to the protection of the interests of creditors and shareholders of a railroad organization in financial difficulties" (p. 342).

<sup>646</sup> See *Securities of M. S., B. & P. Ry.*, 79 I.C.C. 509 (1923); *Securities of Eagles Mere Ry.*, 82 I.C.C. 648 (1923); *Denver & Rio Grande Western Reorganization*, 82 I.C.C. 745 (1923); *Columbus & Greenville Ry. Stock*, 86 I.C.C. 153 (1923). For a later determination of this character, see *Acquisition by J., G. & G. Ry.*, 124 I.C.C. 623 (1927).

<sup>647</sup> *Acquisition and Stock Issue by N. C. & E. R. R.*, 86 I.C.C. 617 (1924). In this proceeding the securities authorized included 14,800 shares of common stock "to be delivered to the reorganization managers in payment for their services, to pay for counsel, to defray the costs of the reorganization, and for any other purposes to which the reorganization managers may legally devote them" (p. 619). Under the circum-

Thereafter, despite some hesitancy,<sup>548</sup> the filing of full information concerning reorganization expenses was required,<sup>549</sup> with a view to

stances disclosed of record Division 4 approved the reorganization plan, despite this treatment of reorganization expenses, but it deemed the burdening of the new company in this way contrary to sound policy: "We believe this reorganization to be sound. It does, nevertheless, place the burden of the reorganization costs upon the new company. We are of the opinion that such practice is questionable and that the costs incurred on account of creditors' and protective committees and their counsel should be borne by the parties concerned. The object of such committees is the protection of the interests of creditors and security holders of the insolvent company. The expenses incurred in such work should be met by those intended to be benefited, and the new company should not have this additional burden. In this instance, however, the plan has been approved by the court, the expenses do not appear unreasonable, the financial structure involves no fixed charge, and the new company starts business with a fair amount of cash" (p. 620). Commissioner Eastman, in his dissent, deemed the principle of sufficient importance to justify disapproval even in this instance (pp. 620-621).

<sup>548</sup> In *Reorganization of A., B. & A. Ry.*, 117 I.C.C. 181 (1926), the plan was approved in the absence of adequate data concerning the reorganization expenses involved. Division 4, after noting that part of the common stock to be issued was to cover "various expenses in connection with the foreclosure and reorganization . . . not to exceed \$600,000," merely declared: "The amounts of these various items, some of which are to be fixed by the court, have not been determined. Their propriety may receive further attention in our consideration of the proposed issues of securities" (p. 183). This treatment of reorganization expenses was one of the matters stressed in Chairman Eastman's dissenting opinion: "Part of the price which the Atlantic Coast Line is to pay for the property consists of an amount which may total \$600,000, representing various expenses in connection with the foreclosure and reorganization. The record is barren of evidence as to the exact nature and amount of these expenses. All we are told is that they will not exceed \$600,000, and that the major items will be compensation to the receiver and his counsel, compensation to counsel who filed the creditors' bills, compensation to Atlanta, Boston, and New York counsel in connection with three foreclosure bills, compensation to the two bondholders' committees, compensation to the reorganization committee, Federal issue taxes, cost of printing, special master's allowance, and cost of advertising. This does not include \$12,000 per year throughout the receivership, which the receiver has already been paid. In my opinion this matter should not have been left on record in this state of haze, but should have been inquired into thoroughly. . . . The sum involved seems a tremendous sum, considering the character of the property, and experience has shown that in the case of such reorganizations there is no reason to presume that the expenditures will be reasonable. . . . Nor is this a matter which can be adequately covered, as I see it, in any subsequent proceeding. It should have been dealt with here" (p. 189).

<sup>549</sup> In its supplemental report in the above proceeding, in which the issuance of the necessary securities was authorized, Division 4 noted that an itemized statement of the reorganization expenses involved had been duly filed, and, although it did not pass independent judgment on the propriety of the items, it announced that it would thereafter require, as a matter of policy, full information concerning reorganization expenses: "There has now been filed for the record a sworn statement of the items of expenditure in question, aggregating about \$614,000 in amount. The major portion consists of attorney's fees, receiver's compensation, etc., fixed by the court. As to the remainder, we do not feel warranted in delaying action pending investigation of their propriety and reasonableness. The obligations of the new company, as a whole, are

subjecting their amount and payment to the control of the Commission.<sup>550</sup>

But in the *St. Paul* case the realization of this objective was effectively thwarted. Provision had been made in the reorganization plan whereby the \$4 assessment per share upon each of the stockholders, which was to be paid to the reorganization managers, was to be divided into two funds: \$2.50 was to be used as far as necessary to meet court costs and similar outlays, the remainder to go to the new company; and \$1.50 was to be used as far as necessary to meet reorganization expenses, the remainder to be transferred to the new

moderate. Reorganizations of railway companies necessitated by excessive burdens of fixed charges or lack of earning power and involving heavy losses to security holders, should not be made the opportunity for exploitation. As an aid in protecting the public interest, we shall require that full information regarding the expenses of reorganization be made a part of the public records of such proceedings." 117 I.C.C. 439 (1926), at pp. 441-442. See, also, *K. C., M. & O. Reorganization*, 145 I.C.C. 339 (1928); *Savannah & A. Ry. Co. Acquisition*, 162 I.C.C. 771 (1930).

<sup>550</sup> Thus, in *Reorganization of Georgia & Florida Ry.*, 117 I.C.C. 473 (1926), where statements were submitted estimating the aggregate of reorganization expenses at not less than \$492,000, Division 4 did not deem the showing sufficiently adequate or convincing and conditioned its authorization of securities upon the filing of detailed data concerning the amounts actually required for reorganization expenses and the withholding of any payments therefor without further order: "It is . . . obvious that the public interest requires that reorganization proceedings shall be free from any suspicion of exploitation. It is our view that in authorizing the issuance of securities to be devoted to the expenditures for reorganization and the winding up of receiverships incident thereto, we should have before us convincing evidence that such expenditures are necessary and reasonable. We shall, therefore, condition our authorization in this case upon the filing for the record of an itemized statement of the amounts actually required, with an adequate description of the services covered by each principal expenditure; the name of the proposed payee; the compensation already received, if any; and the portion of compensation to be paid in securities, if any, with the valuation thereof; no securities or proceeds of securities to be used for such expenditures until further authorized by us" (pp. 488-489). Upon the subsequent filing of the required data, which disclosed a proposed aggregate of reorganization expenses about \$50,000 less than the amount originally estimated, the above condition concerning the use of the securities or their proceeds was removed. In approving the charges, Division 4 placed primary stress upon the adequacy of the record as a whole rather than upon the propriety of each item, and it cautioned against the construction of the result as establishing any generally applicable standards: "In insisting upon the substantiation and the publicity of claims for expenses in connection with the reorganization of railroad companies, it is not to be understood that we shall attempt a scrutiny of every detail or to set up a standard of expenses allowable for capitalization to be applied in other cases. Expenditures which are 'necessary and reasonable' in one case might be either excessive or entirely inadequate in another." 117 I.C.C. 787, 788 (1927). It should be noted that the burden of the reorganization expenses was imposed upon the new company. On this ground Commissioner Eastman dissented (p. 789).

company for additional working capital or returned on a pro rata basis to the stockholders, within the discretion of the managers. Approximately \$3,500,000 was thus provided out of the \$1.50 fund for reorganization expenses. Under these circumstances, and in view of the inadequacy of the record with respect to the propriety and reasonableness of the sums involved,<sup>551</sup> the Commission reserved jurisdiction of the proceeding "for the purpose of taking further testimony as to the expenses of the reorganization, the nature and scope of the services performed for the compensation and fees claimed, and any other matters appropriate in the premises, and for the entering of pertinent orders in connection therewith";<sup>552</sup> and in order that this procedure might be rendered effective, the authority to issue securities under the approved reorganization plan was granted upon the express condition that the applicant "shall impound in a separate fund the money received from the payment by holders of preferred and common stock in an amount equal to \$4 a share, which shall not be paid out unless and until so authorized by order of the court in respect to payments subject to the court's jurisdiction or by this commission."<sup>553</sup> But the enforcement of this condition was permanently

<sup>551</sup> The need of additional evidence bearing upon reorganization expenses clearly appeared from the following: "There has been put in evidence a memorandum submitted to the Senate Committee on Interstate and Foreign Commerce at a hearing on March 25, 1926, which gives estimates of the expenses in connection with the termination of the receivership and reorganization of the St. Paul. The estimates are summarized under four headings: Expenses over which courts have jurisdiction, between \$1,000,000 and \$1,250,000; expenses to be paid out of the \$1.50 per share, between \$2,636,063 and \$3,381,063; other disbursements in connection with the reorganization, between \$336,400 and \$406,400; expenses of new company, between \$977,500 and \$1,397,500; a total of between \$4,949,963 and \$6,494,963. Memoranda have also been submitted giving the nature and extent of the services rendered by the several committees and their counsel. The evidence which was presented in respect of the total expenses of reorganization was not revised to date when introduced in this proceeding, and, as above shown, such estimates are over 18 months old. It would appear that at this later date estimates more nearly approximating actual figures could be furnished. The record is insufficient to enable us to arrive at an opinion as to the reasonableness of the expenses and the public interest affected thereby." *Chicago, Milwaukee & St. Paul Reorganization*, 131 I.C.C. 673, 699 (1928).

<sup>552</sup> *Ibid.*

<sup>553</sup> *Ibid.*, pp. 724-725. Commissioner Hall, concurring in the authorization of securities, protested against the inclusion of the condition concerning reorganization expenses in terms subsequently held to be controlling by the courts: "I do not conceive that as a commission we have anything to do with the application which may be made of the \$4 per share paid in to the reorganization managers by existing stockholders.



enjoined. The Supreme Court, affirming the decree of the lower federal tribunal with respect to the \$1.50 fund,<sup>554</sup> held that the transaction constituted a private contract between the stockholders and the reorganization managers of no interest to the carrier and hence beyond the scope of the Commission's powers,<sup>555</sup> and it found no obsta-

What those stockholders do with their money is their affair unless and until some part of the money is paid over to the applicant. We are not dealing with the merits or demerits of the reorganization plan as such" (pp. 700-701). It should be noted that in a supplemental report, issued some two months later, certain expenditures were actually authorized under the condition imposed by the Commission. *C., M. & St. P. Reorganization*, 138 I.C.C. 291 (1928).

<sup>554</sup> *Chicago, M., St. P. & P. R. Co. v. U.S.*, 33 Fed. (2d) 582 (1929).

<sup>555</sup> In the words of Justice Sutherland, speaking for the majority of the Court, with respect to the Commission's power of control over the special fund of \$1.50 per share created by provision of the reorganization plan: "That provision embodies a contract between the committees (voluntarily created by private persons), the managers, and such stockholders as shall elect to become depositors under the plan and shall advance, with other monies for other purposes, the specified sum for the distinct and sole purpose of paying the managers and others for services rendered in behalf of and for the exclusive benefit of these depositors. Neither the old company nor the new one was a party or was privy to this contract. Neither the contract when made nor any of the parties to it, in respect to the contract, was subject to the jurisdiction of the commission. It was not contemplated by any of the parties, by the new company, or by the court which held the plan to be valid, that the new company should have any enforceable interest in this special fund. Indeed, by contract between the new company, the managers and the purchasers at the sale, it was expressly agreed that the remainder of all cash received by the managers under the reorganization plan should be paid over to the new company, *except the special fund of \$1.50 per share of the old company's stock*, 'which, as provided in the reorganization plan, is to be set aside to provide for the compensation of the managers and the committees, fixed as therein provided, and the fees and disbursements of their counsel and of all depositaries and subdepositaries.' . . . The agreement in respect of the special fund, though contained in the body of the plan, is in effect as distinct as though it had been made by separate contract. It seems plain enough that the commission, by the condition here in question, has undertaken to lay its hands upon and control the disposition of a fund created by contract between private persons to which the carrier was not a party, in which the carrier had no enforceable interest, and which was not within the purview of the regulating power of the commission. . . . The proviso itself aptly illustrates by contrast the extent of the commission's power to impose conditions in respect of the matter under review. From the entire fund of \$4 per share, \$2.50 per share was set apart to be used for paying costs of foreclosure, court allowances, etc., and any balance remaining was to be paid over to the new company; and by a subsequent agreement this balance, together with an unexpended amount intended for expenses not yet liquidated, was formally conceded to be the property of the new company. This portion of the fund, therefore, was properly a part of the carrier's resources; constituted a subject matter upon which the legislative standards controlling the action of the commission in respect of the issue of securities had a direct bearing; was proximately related to, and might substantially affect, the commercial activities of the carrier; and, accordingly, was a subject in respect of which the condition properly could be imposed by the commission. In the case

cle to invalidating the condition in the fact that it had been made an integral part of the securities authorization.<sup>558</sup>

There is much ground for questioning the soundness of this judicial determination, from the standpoint both of law and of policy,

of the special fund of \$1.50 per share, however, the carrier had no such interest. That fund was owned by and subject to the sole control of private persons. Whether the carrier would receive any part of it in the future was a matter of speculation being wholly dependent upon the unrestricted will of its custodians. It results that the condition, in so far as it affects the special fund of \$1.50 per share, was an interference with private property and rights lying outside the field of federal jurisdiction." *United States v. Chicago, etc., R. Co.*, 282 U.S. 311, 324-327 (1931).

<sup>558</sup> It was contended by the Government that the authority of the district courts to enjoin, in part, an order of the Commission "applies to a severable part of the order, but not to a condition upon which the order was issued after the carrier has exercised the authority granted by the order" (p. 328). This contention was found to be without merit by the majority of the Court, on the basis both of general principles and of the particular circumstances of the instant proceeding. Justice Sutherland first spoke in general terms as follows: "A condition contained in the order by which the grant is limited is as much a part of the order as any of its substantive provisions, and if beyond the jurisdiction of the commission is not ratified by an acceptance of the valid part of the order. It long has been settled in this court that the rejection of an unconstitutional condition imposed by a state upon the grant of a privilege, even though the state possess the unqualified power to withhold the grant altogether, does not annul the grant. The grantee may ignore or enjoin the enforcement of the condition without thereby losing the grant. . . . Without attempting to determine how far this principle may be carried in its application to orders of the Interstate Commerce Commission, or attempting to formulate any general rule in respect thereof, we are of opinion that the principle does apply to the order now under review; and for present purposes that is enough" (pp. 328-329). He then set forth the special circumstances disclosed of record which supported the applicability of this principle to the particular controversy: "An examination of the report shows that the commission first considered the question in respect of the authority to issue securities sought by the new company. As to that matter it found specifically all the facts required by §20a as prerequisites to an order granting such authority. . . . The commission, having thus disposed of the application for authority to issue securities, turned to a consideration of the \$4 fund and announced that the authority granted to issue the securities would be upon the condition set forth. . . . But nowhere in the report do we find the slightest suggestion that any part of the fund was included with the properties which were held to be a sufficient basis for the issue of the securities. . . . The fund was dealt with as an independent and separate matter. . . . The order in itself, being complete and self-sustaining and resting upon grounds found to be sufficient to support it, cannot be made to depend upon submission to a collateral condition, which, as we have shown, is beyond the statutory and constitutional power of the commission to impose. Whatever may be the general rule, we have no difficulty in concluding that, under the circumstances above recited, the principle in respect of the separability of unconstitutional conditions imposed upon a privilege granted by a state is applicable to the present order of the commission—and for a stronger reason, since that body, unlike a state in the class of cases referred to, does not possess the power arbitrarily to deny the authority here sought by the carrier" (pp. 329-331).

along the lines forcefully developed in the dissenting opinion of Justice Stone and concurred in by Justice Holmes and Justice Brandeis.<sup>567</sup> It disregarded the public interest arising from the intimate relationship between the special fund and the financial structure of the new company;<sup>568</sup> it ignored the applicant's acceptance of the benefits

<sup>567</sup> As will appear in the three notes following, Justice Stone not only found the condition at issue to be within the Commission's statutory authority, but even on the assumption that it exceeded the bounds of its jurisdiction, he questioned the right of the respondent to obtain relief after availing itself of the benefits of the order to which the condition was attached, as well as the propriety of the Court's action in invalidating the condition without resubmitting the entire problem of the issuance of securities to the determination of the Commission.

<sup>568</sup> His major conclusion upholding the validity of the condition was based upon a clear grasp of the real nature of the transaction involved and its relationship to the Commission's functions: "The question is . . . presented, whether the salutary provisions of §20(a) can be avoided, and an issue of securities, so far as it is made to raise a fund to defray excessive reorganization expenses, withdrawn from the control of the Commission, by the simple expedient of so arranging the reorganization plan that reorganization managers may retain and disburse, from the moneys paid in by the old stockholders to procure stock in the reorganized company, such amounts as may be required for reorganization expenses. . . . It would seem that technical distinctions between possible methods of procuring payment of the last from funds raised by a security issue of the new company ought not to affect the authority of the Commission. I should have thought that, under our decisions, the Commission, where its order controls only the action of the appellee, might look through legal forms and, disregarding the corporate entity of the appellee, treat the action of the reorganization managers, in dealing with the sums paid by the stockholders for the new stock of appellee, as that of their creature and *alter ego*, the appellee. . . . But even if we disregard this identity of interest . . . the source of the expense fund was the assessments paid by the old stockholders, in reality and legal effect part consideration for, and proceeds of, the issue of the new stock. To say that so much of the reorganization agreement as related to the creation and expenditure of the \$1.50 fund for the payment of these expenses was a mere private agreement, unrelated to the issue of securities, with which the Commission is vitally concerned, is to ignore its plain terms and disregard its practical operation. . . . It cannot be supposed that one dollar of the \$1.50 fund would ever have been contributed by stockholders, had not the reorganization agreement definitely undertaken to issue the securities under the plan to those stockholders who deposited their stock and made the required payments. The creation of this fund for the payment of the reorganization and other expenses was a part of the necessary price exacted for the new securities. It was an important purpose for which the new stock was issued, and one of the purposes which the Commission was directed by the statute to investigate in determining, as it was bound to do, whether the issue was in the public interest and reasonably necessary and appropriate for the corporate purposes of appellee. The considerations affecting the judgment of the Commission in passing upon the reasonable necessity for the issue, its effect upon the public interest and upon the carrier's performance of its public service, are the same whether the expense fund was to be paid directly to the new company for disbursement by it, or short circuited, through the managers, from stockholders of the old to the various claimants for services rendered in creating the new. . . . If the Commission, as I think it might, could have refused to approve the present issue of securities on the ground that they were to be issued to

of the order prior to its petition for equitable relief from the burdens of the condition;<sup>559</sup> it permitted the condemnation of the condition to effect an unqualified authorization of the securities.<sup>560</sup> As a practical

procure payment of reorganization expenses which were or might be excessive, then, plainly . . . it could have made its consent to the issue conditional upon the modification of the plan, in such manner as to preclude the payment of unreasonable expenses" (pp. 333-340).

<sup>559</sup> On the question of the respondent's right to equitable relief in view of the advantage it had taken of the order as originally made, he said: "If appellee were unable or unwilling to comply with the order as made, equity and good conscience required, at least, either disclosure of that fact to the District Court before securing the transfer of the railroad property to it; application, upon full statement of the facts, to the Commission to exercise the jurisdiction, which it had reserved, to approve a modified plan; or prompt initiation of the present proceedings to test the validity of the order before a situation had been created prejudicial to the public interest and to the Commission's performance of its duties. Instead, appellee adopted a course of conduct consistent throughout only with its apparent purpose to comply with the order; and now, without tendering any excuse for the belated disclosure of its real purpose, it asks relief from the condition only after it has enjoyed benefits which it cannot be said would have been granted without the condition. Neither this Court nor the court below is acting any the less as a court of equity because its powers are invoked to deal with an order of the Interstate Commerce Commission. The failure to conform to those elementary standards of fairness and good conscience which equity may always demand as a condition of its relief to those who seek its aid, seems to require that such aid be withheld from this appellee" (pp. 341-342).

<sup>560</sup> Finally, he argued that the effect of invalidating the condition should be to set aside the order in its entirety and thereby permit the Commission to reconsider its authorization of securities: "By the opinion of the Court, the order of the Commission, so far as it approves the issue of the securities, is treated as effective without the condition. But even if we assume that the condition which the Commission attached to the order is beyond its power, we should not attempt to substitute our judgment for that of the Commission, since the statute requires its consent, not ours; and we should not allow the order to stand without the condition, since that is not the order which the Commission made. By the Transportation Act the giving or withholding of consent to the issue of securities is an administrative power, conferred, not upon the courts, but upon the Interstate Commerce Commission. Courts may determine whether the Commission lacks the power to impose a particular condition; but they may not strike from an order the condition upon which it was granted, and thus declare that it shall stand although the condition is not complied with. . . . Whether or not the Commission has in fact consented does not turn on whether the condition is good or bad, but on whether it can fairly be said that the Commission would have given its unqualified consent independently of the condition. As the report of the Commission discloses, consent to the issue was given only with reluctance, to release the properties from the receivership at the earliest possible moment, but with the undoubted assumption on its part as a moving cause for its consent, that by annexing the condition it would exercise control over the reorganization expenses, with respect to the amount of which it had expressed grave concern. With four of the Commissioners voting unconditionally against the issue, I see no sufficient warrant for assuming that any would have voted for it without the condition and without the further investigation which it thought necessary, and which it was authorized to make before unconditionally approving the issue. Both the report and order of the Commission state that the authority granted was

consequence, however, the Commission was not only frustrated in its attempt to control reorganization expenses in this important proceeding, but appeared to be virtually shorn of power with respect to this significant aspect of the reorganization process.<sup>561</sup>

upon the 'express condition' which is now the subject of this controversy. If in the face of this language there can be any doubt as to the intention of the Commission, we need not speculate upon what it might have done, had it thought it was without power to impose the condition, since it is able to speak for itself if this Court permits it to do so by setting aside the entire order without prejudice to further action by the Commission, under the statute, upon the application for approval of the issue of the securities" (pp. 342-343).

<sup>561</sup> While the Court's determination was expressly limited to the particular facts presented, it established the validity of a pattern, as worked out by counsel in the instant proceeding, which is likely to be followed in all major reorganizations. Furthermore, in laying stress upon constitutional considerations, the majority opinion appeared to cast doubt upon the Commission's power to deny finance applications because of unwillingness to accept proposed arrangements concerning reorganization expenses and even upon the power of Congress to confer adequate authority respecting them. Thus: "By subdivision (3) of §20a the commission is empowered to make its grant of authority to issue securities upon such conditions as the commission may deem necessary or appropriate in the premises. The power to impose such conditions, however, is not unlimited and may not be exercised arbitrarily or . . . unless there be found substantial warrant for the conditions in the applicable standards established by the provisions of the act relating to such securities. The powers possessed by the commission are delegated by Congress under, and are to be exercised in conformity with, the constitutional grant of authority to regulate interstate and foreign commerce. Proceeding under that grant, as applied to the present matter, neither the commission nor Congress itself may take any action which lies outside the realm of interstate commerce. . . . It follows that if the condition in question relates not to such commerce, or to the rights or duties of the carrier engaged in such commerce, but exclusively to extrinsic matters, it is imposed without authority of law" (p. 324). Again: "The power to regulate commerce is not absolute, but is subject to the limitations and guarantees of the Constitution, among which are those providing that private property shall not be taken for public use without just compensation and that no person shall be deprived of life, liberty or property without due process of law. . . . Both the liberty of contract and the right to property here are involved. The contract was valid and had been so adjudged by the court having jurisdiction of the foreclosure and sale. The parties to it were willing and were entitled to have the contract executed according to its terms. There is no power in any department of the government to order otherwise. And certainly a carrier whose only interest in the property lies in the speculative possibility that some remnant of it in the future may come to the carrier as a gift is in no position to take it as of right without compensation. In that view, any legislative or administrative edict which purports to empower the carrier to take the property without compensation and dispose of it, not as the contract provides, but as the governmental body may direct, must fail as a futile attempt to accomplish what the Constitution does not permit" (pp. 327-328). But see *Atlantic Coast Line R. Co. v. U.S.*, 284 U.S. 288 (1932), in which a unanimous Court, speaking through Justice Brandeis, upheld the validity of a condition imposed by the Commission in connection with its authorization of a lease, despite the fact that the condition was in conflict with a statutory provision prohibiting the Commission from requiring a carrier to "short-haul" itself.

Since the entire catalogue of difficulties thus disclosed in connection with the Commission's control of reorganizations was bound up in large measure with the character of the prevailing procedures, suggestions for modifying these procedures accompanied the more recent determinations. The Commission, in concluding the report of its investigation of the St. Paul, found it desirable, as a lesson of that experience, "that hereafter in each case of reorganization application by the new company be made at an early stage for exercise of our authority under section 20a to approve issuance of the securities or assumption of the liability contemplated by the reorganization, and that the plan be not declared operative until such approval has been had."<sup>562</sup> Commissioner Eastman went much further in his emphasis upon needed change. Convinced that the practices pursued in connection with the vicissitudes of the St. Paul constituted "an arbitrary and irresponsible method of effecting a reorganization and developing a plan therefor,"<sup>563</sup> he suggested guiding principles, at least for full and free discussion, in more extended detail: that "the public interest should be adequately represented, not in the final stage only, but from the beginning"; that bankers and lawyers should not dominate the preparation of the reorganization plan, but "should be employed as expert advisers upon a strictly professional and nonspeculative basis"; that the committees appointed to protect the interests of the various classes of security holders "should be selected at meetings of security holders called for the purpose and . . . not . . . by the reorganization managers themselves or by other outside volunteers"; that "the reorganization managers should be wholly impartial and neutral, not affiliated with any group of security holders nor with any particular group of bankers"; that "the plan should be submitted to the commission for its approval before the security holders are asked to assent to it, and an opportunity should be afforded for the presentation of protests at a public hearing"; and that "there should be no divided jurisdiction" as between the Commission and the courts.<sup>564</sup> Furthermore, the serious situation created by the economic depression, with its large toll of actual and threatened receiverships in the railroad field even in the face

<sup>562</sup> *Chicago, Milwaukee & St. Paul Investigation*, 131 I.C.C. 615, 672 (1928).

<sup>563</sup> *Chicago, Milwaukee & St. Paul Reorganization*, 131 I.C.C. 673, 713 (1928).

<sup>564</sup> *Ibid.*, pp. 713-714.

of generous governmental aid, intensified the need of reform measures, to facilitate reorganizations on a voluntary basis, to shorten the time and reduce the expense of their accomplishment, and to mold their terms in the public interest. At the end of 1932 the Commission reported to Congress as follows in the matter of receiverships and reorganizations: "Over 20,000 miles of railroad owned by more than 50 companies are now being operated by receivers. The current depression, as well as changing methods of transportation, threaten materially to increase the mileage operated in this manner. Receiverships under the present laws are not well adapted to public service operations. The process not only makes the continuation of adequate service difficult, but imposes on the public and the security holders losses and expenses which frequently are very burdensome and should be unnecessary. The receivership of a railroad corporation ordinarily extends over a period of years, and in most cases results in the foreclosure of mortgages and sale of the property. Seldom is such a sale one in the ordinary sense. It usually consists in 'bidding in' by a committee representing some class or classes of security holders with a view to reorganization. The reorganization normally consists of the acceptance by security holders of new securities in the property. To arrange reorganization, managers, usually banking concerns, are employed at large expense. Committees representing various classes of security holders are created to represent particular interests in the property. Counsel for such committees, counsel for the reorganization managers, counsel for the receivers, counsel for trustees, trustees, the receivers themselves, and other officials, have to be paid out of the property or at the expense of the security holders. In many cases members of the various committees also require payment out of the assets available. Litigation between interests claiming priorities of one sort or another is widespread and expensive. It, too, is usually made a charge on the property. The result is that security holders are deprived of a return on their investments for varying periods that may, and usually do, extend into years. Much of the delay, expense, and difficulty involved in a receivership and reorganization is due to the opportunity afforded, under our present laws, for a minority, no matter how small, to make trouble without regard to the interests of the property as a whole. We believe the subject of receiverships and

reorganization of carriers by railroad should be considered by the Congress, with a view to legislation intended to reduce the time and expense involved in the process. Such legislation should be directed primarily to facilitating the financial reorganization of a company in difficulties. In other words, voluntary reorganization of a financial structure should be made feasible when it is shown to be necessary and is in the best interests of the security holders concerned.<sup>565</sup>

Measurable compliance with these suggestions and recommendations was promptly achieved by the Act of March 3, 1933, amending the bankruptcy law, which included, in Section 77, special provisions relating to the reorganization of railroads engaged in interstate commerce.<sup>566</sup> "The legislation," the Commission has declared, "was responsive to the necessity of reducing the capital obligations and fixed charges of a growing number of railroads, and this was proposed to be effected through means which would avoid, in part, at least, the delays and difficulties ordinarily attending equity receiverships under existing statutes."<sup>567</sup> For our purposes it is sufficient to indicate briefly the character of the provisions which bear upon the Commission's

<sup>565</sup> *Annual Report*, 1932, pp. 15-16. Such legislative action was found to be required by the prevailing emergency as well as by more permanent considerations: "With respect to immediate financial relief for the railroads, much has been done during the year by the Reconstruction Finance Corporation and the Railroad Credit Corporation. . . . Such aid as they have given, however, is inherently of an emergency and temporary character. It has prevented receiverships which otherwise would have occurred, but relief through the lending of money can not be indefinitely efficacious in the absence of a change in fundamental conditions. While we believe that such a change for the better will come, it may well be that it will not come fast enough to enable some railroads, burdened by a heavy load of fixed charges, to avoid receiverships and reorganizations. As elsewhere indicated, we believe that the Congress should give consideration to ways and means of improving the procedure now followed in railroad receiverships and reorganizations, which have often in the past been a source of undue and unreasonable expense and unnecessary burden upon security holders" (p. 5). The Commission's formal recommendation in the premises was grouped with those which it deemed to be "of major and pressing importance" (pp. 100, 102). For detailed comments on necessary changes in reorganization procedure, see memorandum of Commissioner Eastman, dated January 31, 1933, which was submitted by him as chairman of the Commission's legislative committee to Senator Hastings of Delaware in connection with various bills pending in Congress.

<sup>566</sup> Public No. 420, 72d Congress, 47 Stat. 1474.

<sup>567</sup> *Annual Report*, 1933, p. 22. It may also be recalled at this point that by section 15 of the Emergency Railroad Transportation Act of 1933 the Commission was directed not to approve a loan to a carrier (but not including a receiver or trustee) under the Reconstruction Finance Corporation Act, "if it is of the opinion that such carrier is in need of financial reorganization in the public interest."



functions. When a petition looking to reorganization is filed by a railroad with a proper court, a copy thereof must at the same time be filed with the Commission; and when the petition is proposed to be filed by creditors representing not less than five per cent of the railroad's indebtedness, as provided in the statute, the need and propriety thereof must first be determined by the Commission. Upon approval of the petition by the court as appropriately filed, it may appoint a trustee or trustees to operate the property, pending reorganization, "from a panel of standing trustees qualified for such service to be selected and designated in advance by the commission," the trustee or trustees and their counsel to receive "such compensation as the judge may allow within a maximum approved by the commission." Before the creditors and stockholders are asked to accept a reorganization plan, the Commission must hold a public hearing at which the railroad is required to present its plan, and at which plans may also be presented by the trustee or trustees or on behalf of the creditors; and following such hearing the Commission must recommend a reorganization plan, which may differ from any of those proposed, that in its judgment will be equitable, non-discriminatory as between the various classes of creditors and stockholders, financially advisable, and compatible with the public interest. The recommended plan, accompanied by the Commission's reports dealing therewith, must be submitted to the creditors and stockholders for acceptance or rejection; and the Commission may also afford an opportunity to them to accept or reject any of the other plans which may have been filed. Final approval of a plan by the Commission is dependent upon the acceptance thereof, with certain exceptions, by two-thirds in amount of each class of creditors and stockholders, such acceptance to include acceptance in writing by a creditor or stockholder or acceptance by his duly authorized attorney or committee "acting under authority executed by him subsequent to the recommendation of the plan by the commission"; and upon acceptance of the plan as thus provided, "the commission may, without further proceedings, grant authority for the issue of any securities, assumption of obligations, transfer of any property, or consolidation or merger of properties, to the extent contemplated by the plan consistent with the purposes of the Interstate Commerce Act as amended." If the plan thus accepted is the one rec-

ommended by the Commission, it must certify the plan, its approval, and the acceptance thereof to the court; if the plan thus accepted differs from the one recommended by the Commission, it must certify the plan, its approval, and the acceptance thereof, if after further hearing it determines that the accepted plan satisfies the standards, as indicated above, governing the plan originally recommended. While the reorganization plan is subject to confirmation by the court, it is expressly provided that "no plan of reorganization shall be confirmed in any proceeding under this section except upon the approval of the Interstate Commerce Commission certified to the court"; and more specifically, furthermore, the Commission is empowered to determine the upset price of the property and the value of any securities in connection with settlements with objecting creditors and stockholders, and to fix the maximum limits of "compensation for the services rendered and reimbursement for the actual and necessary expenses incurred in connection with the proceeding and plan by officers, parties in interest, reorganization managers, and committees or other representatives of creditors or stockholders, and the attorneys or agents of any of the foregoing."

This legislation, which was hurriedly passed in the closing days of the seventy-second Congress because of the pressure of the emergency, unquestionably falls short of providing completely effective safeguards against the numerous abuses that have long characterized railroad reorganizations. The old procedure of equity receiverships may still be pursued; so-called friendly receiverships under the control of the management may still be established; supervision of the administration of the property pending reorganization is still vested in the courts; the activities of protective committees and reorganization managers may still, in all probability, exert an undue influence upon the redistribution of equities; there is doubt in some quarters, in view of the *St. Paul* decision, as to whether the contemplated control over reorganization expenses will prove enforceable; and the difficulties of divided jurisdiction have not been altogether eliminated, as is evidenced by the fact that a panel of trustees must be selected by the Commission but the appointment of particular trustees rests in the courts, by the fact that reorganization plans must first be approved by the Commission but become operative only upon confirmation by the

courts, and by the fact that maximum limits of reorganization expenses must be fixed by the Commission but actual allowances determined by the courts. While only the course of experience, dependent in no small measure upon the spirit in which the legislation is interpreted and applied by the courts and the Commission, will disclose the advantages and disadvantages of the new procedure, competent discussions of the legislative enactment suggest numerous points of criticism, from the standpoint both of those who are impatient of public control of the reorganization process<sup>568</sup> and of those who are convinced of the necessity of perfecting that control.<sup>569</sup> But whatever the shortcomings of the new legislation as far as the entire sphere of railroad receiverships and reorganizations independently considered is concerned, there can be no question that the authority of the Commission over reorganization expedients, in their relationship to the financial structures of the carriers, has been greatly strengthened. The Commission has been assigned, from the moment of the first emergence of difficulties requiring remedial action, an intimate and perhaps a dominant rôle in the development of the reorganization process, including the adjustment of equities as between the various parties, the establishment of terms and conditions of settlement, and the determination of reasonable compensation and expenses for services rendered in the course of the proceeding; and the obstacles to insistence upon sound financial plans encountered in the past because of failure to invoke the Commission's jurisdiction till toward the very end of the process have been effectively removed. Under these circumstances the new legislation, though doubtless in need of clarification and further extension, may appropriately be deemed a significant forward step. The administrative record under this legislation has thus far been too meager and inchoate to justify any attempt at appraisal, but it is not unreasonable to expect that the Commission will

<sup>568</sup> See, for example, Churchill Rodgers and Littleton Groom, "Reorganization of Railroad Corporations under Section 77 of the Bankruptcy Act." *Columbia Law Review*, vol. 33 (April, 1933), pp. 571-616. But compare Joseph L. Weiner, "Reorganization under Section 77: A Comment," *ibid.*, vol. 33 (May, 1933), pp. 834-852.

<sup>569</sup> See, for example, Max Lowenthal, "The Railroad Reorganization Act," *Harvard Law Review*, vol. 47 (November, 1933), pp. 18-58; Louis B. Wehle, "Railroad Reorganization under Section 77 of the Bankruptcy Act: New Legislation Suggested," *Yale Law Journal*, vol. 44 (December, 1934), pp. 197-233. In his report on *Transportation Legislation* of January 21, 1935, Coördinator Eastman submitted specific recommendations for amendment of Section 77 of the Bankruptcy Act.

be enabled, under its new authority, not only to facilitate more equitable readjustments following financial embarrassment, but to utilize the opportunities afforded by the reorganization process to establish, in the public interest, capital structures calculated to strengthen railroad credit and improve transportation service.<sup>570</sup>

#### §4. SUMMARY AND CONCLUSION

When Congress in 1920 reconstituted the existing scheme of railroad regulation, the main lines of needed revision were reasonably clear. In general, regulation had been chiefly concerned with preventing specific abuses, predominantly in the field of rates and practices; a more positive and comprehensive approach was necessary. The railroad net had been developed piecemeal over a long period, often to meet conditions which subsequently had disappeared, and without any broad grasp of national need; while in the large the achievement was a magnificent one, the motives and methods of those who participated in the development had not been uniformly creditable or wise or soundly related to public ends. The result, quite naturally, was a complex of physical facilities, owning entities, and financial structures imperfectly calculated to yield the best type of performance. The defects of the railroad system, progressively recognized for some time, were critically realized during the emergency of the war period, with a resulting temporary resort to government operation; and it was to be expected that upon return of the roads to private management, they would be subjected to a control designed, not merely to check abuses, but to establish a sounder basis for adequate and economical transportation service. Such a policy of control required, of

<sup>570</sup> As of October 31, 1933, the Commission reported as follows concerning developments under Section 77: "To date, petitions for reorganization have been filed by railroad corporations as follows: Missouri Pacific Railroad Co.; Minarets & Western Railway Co.; Akron, Canton & Youngstown Railway Co.; Chicago & Eastern Illinois Railway Co.; Fonda, Johnstown & Gloversville Railroad Co., Meridian & Bigbee River Railway Co.; Chicago, Rock Island & Pacific Railway Co.; St. Louis-San Francisco Railway Co.; Arkansas Valley Interurban Railway Co.; Spokane International Railway Co.; and Chicago, Lake Shore & South Bend Railroad. In several of these cases, additional petitions have also been filed in behalf of subsidiary corporations, proceedings upon which are expected to be consolidated with those upon the petitions of the controlling corporations. No petitions have been offered by creditors. In nine cases trustees have been appointed, from the panel designated by us, but in only one instance has a plan of reorganization been presented upon which a preliminary hearing has been held." *Annual Report, 1933*, pp. 22-23.

course, affirmative provision for the revenue needs of the carriers; but, more than that, it required direct concern with basic matters of organization and finance. On the physical side, changes in the railroad net, often theretofore of haphazard character, were to be guided in the public interest by regulation of extensions and abandonments; with respect to the ownership and interrelations of lines, such opportunities were to be offered and such pressures applied as would further desirable coöperation and combination; and since carrier effectiveness also depends upon the soundness of capital structures and methods of financing, the issuance of securities and assumption of obligations were to be embraced as an integral constituent of the sphere of authoritative control. It is the powers conferred upon the Commission along these related lines the exercise of which has just been surveyed at some length.

Diversity of opinion with respect to the propriety and adequacy of the Commission's policies in matters of organization and finance has sprung to a large extent from a single fundamental difference in regulatory attitude. In many connections the judgment to be rendered has hinged on whether the Commission should construe its authority as a broad charter of power, whereby it might strike out boldly to mold rail transportation along lines ideally adjusted to public ends, or whether it should view this authority as a restricted basis of control, whereby it might seek only to prevent obvious subversions of the public interest and plain departures from good business practice. A distinction is often drawn between regulation and management, accompanied by the assertion that the powers of regulation must necessarily avoid encroachment upon the domain of management. It goes without saying that these two functions are not clearly separable: not only is the boundary between them indefinite, but it is apparent that every regulatory act modifies the scope of managerial discretion in some measure or in some direction. Nevertheless, there is much persuasiveness in the view that any extensive effort to control investment, intercorporate relations, and financial arrangements strikes more directly at the core of private management than activity in the traditional field of rate control, and that regulation thus becomes something rather sharply different from the system of restraints upon quasi-monopolistic pricing in which, for the most part, it had its origin. How dis-

turbing these new powers would be was clearly dependent upon how the Commission chose to exercise them; and the Commission has exhibited decided hesitancy in imposing standards and practices greatly at variance from those already prevailing or generally accepted in the business world. Within its own ranks, Commissioner Woodlock, at one extreme, consistently argued that the fact of the return of the railroads from public to private operation after the period of Federal Control amounted to a declaration of policy that private management should be given the fullest latitude consistent with the statutory requirements; Commissioner Eastman, on the other hand, was equally insistent that the railroads, long subject to a control which set them apart from ordinary industry, had revealed deficiencies which required for their eradication the fullest use of the authority which Congress had seen fit to grant. Viewing the record of performance as a whole, it is obvious that the Commission, by a generally restrictive and self-denying interpretation of the law, gave ampler occasion for dissenting expressions by Commissioner Eastman than by Commissioner Woodlock. Whatever adverse comment its action may warrant in specific connections springs mainly from this general failure to envisage with sufficient breadth and clarity, against the background of a long past and an uncertain future, the defects in railroad organization and finance and the opportunity afforded for their correction.

In matters affecting the physical extent of railroad lines, the Commission has found the greatest degree of harmony, at least in principle, between the public interest and the desires of carrier managements. While the dependence of communities upon rail service constitutes a persuasive ground for its continuance, the inescapable fact that it must be supported, and that if the communities enjoying it are unable to do so the burden must be borne by others, argues strongly for authorizing the abandonment of unprofitable operations. In requiring of railroad lines convincing evidence that future self-support is wholly unlikely, the Commission has properly reasserted the basic legal obligation of common carriers to continue services once undertaken and has at the same time accorded appropriate recognition to the vested interests of affected communities in the enjoyment of customary facilities; but in being governed finally by the

financial showing of the lines, present and prospective, it has wisely identified the dominant guide to private action with the conditions of public advantage in the broadest sense. While the grant of power over line extensions was of slight consequence, in its probable effect on the pattern of rail transportation, in comparison with the bearing it would have had some decades earlier when railroad building was at its height, the possibilities, as disclosed by the record of performance, are nevertheless substantial. In conformity with the fundamental purpose of avoiding economic waste and preventing competition from exerting a destructive rather than a salutary influence, the Commission has properly denied certificates for new construction involving unnecessary duplication of facilities or undue diversion of traffic; but where it found that the public would gain added and beneficial services, the Commission has probably been too reluctant to override managerial judgments based upon prospects of gain and safeguards against loss of sometimes questionable soundness. The power to order extensions of line, independently of the wishes of carriers, appeared to provide an opportunity affirmatively to promote new construction in areas not adequately served; but in the single important exercise of this authority the Commission was restrained by judicial decree, and it seems from the judgment in that instance that its power of compulsion is rather narrowly limited. It is plainly not feasible, except on the initiative of the roads, to recast the physical plant of the carriers in any large measure.

Those defects of the railroad system which spring, not from the physical pattern of the lines, but from the multiplicity of owning and controlling organizations, frequently small and weak and often duplicating each other's services unduly, should have responded more readily, it would seem, to remedial treatment. All that appeared to be required was a reconstitution of corporate entities and their relationships. For the removal of such obstacles to effective transportation, the Commission was given authority to permit pooling arrangements, previously forbidden, and to approve combinations, whether accomplished through stock ownership, lease, or merger, with the condition that outright consolidations should conform to a comprehensive plan authoritatively established. But if the purpose of Congress to improve owning and operating relationships has been realized only

to a meager extent, the controlling responsibility for the limited nature of the result cannot properly be placed upon the Commission. The chief difficulty lay in the purely permissive character of the operative statutory authority, which was grounded in the mistaken assumption that the railroads, if permitted, would readily resort to concert of action along lines required by the public interest; in point of fact, it appears, the motivation governing intercarrier relations is very complex and not necessarily consistent with the purposes of Congress. It is true, nevertheless, that the Commission could probably have impressed itself upon the intercorporate relations of the railroads, in their formal aspects, more fully than it actually did. The principal shortcomings of performance consist in its failure to recognize the exclusiveness of its jurisdiction, its willingness to approve, independently of the complete plan, combinations which were virtual consolidations, and its delay in formulating a consolidation plan. But despite these circumstances, the Commission has acted in a large variety of situations with persistent and understanding emphasis upon the public interest. The standards established for outright consolidations—that competition be preserved as fully as possible and that existing trade channels be maintained wherever practicable—have been uniformly held in mind in connection with less permanent forms of control; evidence of probable operating economies and service improvements has been consistently given appropriate consideration; and the determinations have not ignored the problem of short and weak lines and the propriety of the financial and control arrangements incident to proposed unifications. A fuller supervision of intercorporate relations by the Commission should result from the recent extension of its authority to railroad holding companies; and a more effective performance should result from the removal, by the same legislation, of the somewhat artificial distinction between consolidations and other forms of combination and of the rigid capitalization requirement. But if it is believed that substantial gains would flow from a more rapid and complete rearrangement of railroad ownership and control, progress to that end is likely to rest on granting the Commission a power of compulsion which it does not now possess; and even with such added authority the extensive economies envisaged by many proponents of radical system reorganization



are not likely to be realized if the principle of competition continues to govern regulatory activity in this sphere.

Probably the greatest opportunity given the Commission to influence railroad policies traditionally deemed the exclusive concern of management came from its power to pass upon security issues. Here again the delegated authority was only permissive; but the normal course of refunding operations and new financing, coupled with the frequent need of distressed carriers to reconstitute their capital structures, placed in the Commission's hands a continuous opportunity to exert pressure toward the adoption of such principles and practices as might affirmatively promote the public interest. Not only the dismal record of financial looseness and mismanagement which tarnished the history of many roads, but the general continuance of disproportionate borrowing and of resort to other expedients of doubtful merit, indicated that the field of financial organization might provide an important sphere for constructive action; and it is in this connection that the problem has arisen most conspicuously as to how sweepingly the Commission should exercise its authority. There can be no question that on the whole its performance has been very creditable. With sound grasp of the public interest, it has disapproved excessive issues of securities; it has vetoed the assumption of fixed charges beyond the limit of normal earning ability; it has prevented undue concentration of voting power; it has insisted upon reasonable capital costs; and in some degree, notably in the case of equipment obligations, it has sought to lower the cost of financing by requiring competitive bidding in the marketing of issues. But throughout it has merely applied the approved standards of non-regulated business. Whether wisely or not, it has used its power neither to free the railroad industry, by drastic and painful action, of the accumulated burden of past ills, nor to establish principles and practices for this regulated industry beyond and above those recognized in the general competitive field. As in private industry, carriers have been permitted to capitalize their surpluses, though ideally a presumption might exist against such procedure; stock without par value has been unquestioningly authorized, though subject to possible abuse; rights to buy stock below the market have been recognized, though capitalization might thereby be unnecessarily increased; further issuance of bonds has been approved

for roads with excellent credit, though the sale of stock might have been entirely feasible; and roads with poor credit and excessive indebtedness have been permitted to resort to additional borrowings, though subjection to financial reorganization, while immediately disturbing, might have proved the better policy in the long run. The costs, delays, and doubtful outcome of receiverships may well have deterred the Commission from subjecting roads more frequently to that expedient; and, in the face of actual receivership and reorganization, the absence of authority to mold the preliminary agreements along desirable lines helps to explain the Commission's reluctance to disapprove security issues, even when of a decidedly questionable character, which were designed to give effect to the difficult and protracted negotiations. But under the recent amendment of the bankruptcy law as applied to railroads, which expressly vests a large measure of guiding authority with respect to the reorganization process in the Commission, it should be more readily disposed to precipitate reorganizations and to employ its powers for control of the resulting financial structures on a constructive basis.

While it is apparent that the Commission has not fully exploited its opportunities for meritorious reform in the field of organization and finance, substantial considerations may be advanced in support of its approach. As an agency of Congress the Commission has at all times been properly concerned with the legislative intent respecting particular mandates; and in this instance it is not clear how drastic a policy was intended. It is not necessary, of course, to hold with Commissioner Woodlock that the very return of the roads to their owners manifested a desire to reduce governmental interference to a minimum; on the contrary, the return of the roads was accompanied by a grant of unprecedented regulative authority. But if the new authority had been so employed as to curtail managerial discretion on an extensive scale in the field of organization and finance, the reassertion of the desirability of private management might have appeared to be nullified. Moreover, the character of the specific powers granted, especially in connection with coöperation and combination, might reasonably suggest that radical changes were not contemplated, or any greatly reduced reliance upon the incentives governing private business. Indeed, in view of the competing opportunities afforded in

non-regulated fields, any considerable disturbance of these incentives would scarcely be practicable, as long as private capital and enterprise are depended upon for the provision of rail transportation. It is not to be inferred that the particular requests of Commissioner Eastman for more thoroughgoing control threatened the success of private railroad operation; they merely reflected a philosophy of change to which the normal run of responsible and conservative men are willing to turn only under the force of pressing circumstances. That such circumstances were not present during most of the period appears unmistakably when the Commission's administrative record is thrown against its general economic background. After a year or two of difficulty following their return to private hands, the railroads gained in strength and improved in service to a marked degree. If private management was placed on trial by the termination of Federal Control, it may fairly be said to have vindicated itself by its performance during the 1920's. Those deficiencies which induced drastic governmental action during the war period and a striking extension of regulatory authority in 1920 seemed, for the most part, to have disappeared. It is pleasant to believe that a powerful public body like the Commission is governed at all times by a broad perspective of past problems and embarrassments and a deep insight into probable future developments; but it is contrary to all experience to suppose that such a body is not mainly influenced by contemporary conditions. These conditions, during the 1920's, appeared to justify the Commission's restrained policies.

But its powers and their exercise may be viewed more significantly against the background of events following 1929. With the depression the railroads were probably hit no harder than the average of business; but the incidence of the blow was more disastrous because of their tremendous burden of interest-bearing obligations. In view of this distressing condition, the essential nature of railroad service, and more than that, the public dependence upon banks and insurance companies which held billions in railroad bonds, led the Federal Government through the Reconstruction Finance Corporation to lend heavily to prevent defaults and meet current requirements. It is not unreasonable that a depression of unprecedented severity should evoke emergency measures of striking magnitude; but in the popular

view at least, the aid required by the railroads was convincing evidence of basic unsoundness. Their predicament might be due to defects of management, to the appearance of rival transport agencies, or to the remissness of government, either in the legislation enacted or in its administrative enforcement; but whatever the dominant source of difficulty, it seemed that a condition had been reached from which only radical action would rescue them. Even with some discounting of the popular analysis, it appears in retrospect that the Commission would have done well in earlier years to apply stronger pressure for the reduction of indebtedness; and for the future such a course is plainly indicated, whether through greater reliance upon stock issues, or through insistence that bond issues provide for amortization, or through enforcement of more severe reorganization policy. Had the aims of Congress respecting the combination of railroads been brought to fruition, the carriers would probably have withstood the depression somewhat better; but the statutory basis of the Commission's authority was adequate neither to produce that result nor to effectuate the more radical and grandiose schemes of consolidation, had they seemed desirable, which the depression brought forth. The slight resort to the pooling device under the 1920 legislation clearly reflected the lack of any strong disposition on the part of railroad managements to effect economies through coöperative action; whereupon leadership in this direction was appropriately assumed by the Government, as an emergency measure, through the creation of the office of Federal Coördinator of Transportation. While the railroads' difficulties were due chiefly to the depression itself, increasing importance came to be properly attached to the growing competition from other agencies. It was recognized that, even apart from the abnormal curtailment of traffic resulting from business stagnation, the country was becoming seriously over-provided with transport facilities; and a control aimed directly at the supply of transportation was deemed increasingly necessary. In the case of railroads, ample authority was already in the Commission's possession through its power over extensions and abandonments; but however defensible its policies in this sphere had been during the 1920's, the changed economic conditions pointed to a more stringent control of new construction, and particularly to a more liberal attitude toward applications for

abandonment. Not only is the abandonment of rail service less objectionable as highway and other facilities become available, but when the vigor and effectiveness of even the stronger roads become a matter of public concern, the continued support of unprofitable lines is deprived of all economic warrant. An adequate control of the supply of transportation requires, moreover, an extension of federal authority, as repeatedly recommended by the Commission and recently confirmed by the Coördinator, over other agencies of interstate transportation; and this control, embracing the various artificial stimuli to transport development provided through direct and indirect public subsidies, necessitates the coördinating direction of a single regulatory tribunal.

The extension of the regulatory process in 1920 to many matters of organization and finance, as well as the Commission's exercise of the powers involved, thus acquires an aspect of mildness—of marked restraint—when viewed in the light of conditions in the railroad industry during the early 1930's. And even those more thoroughgoing measures of control which have been proposed, and in some degree adopted, seem entirely lacking in revolutionary implication when surveyed against the far-reaching changes which have been effected in the community's attitude toward the whole field of business and its appropriate relations to government. As the depression deepened general confidence declined abruptly in the ability of individual enterprises, controlled by market forces, to order their affairs in the public interest; and measures were adopted for the guidance of industry and agriculture in striking departure from traditional policy. With a Federal Securities Act imposing heavy restrictions upon the issuance of all corporate securities in interstate commerce, a fuller and more constructive use of its finance powers by the Commission would appear to be wholly proper for a basic industry long subject to extensive regulation. With broad relief from anti-trust legislation afforded under the National Industrial Recovery Act, and with all industries encouraged to soften the asperities of competition through coöperative action, a greater unity of approach in the railroad field, with its tested safeguards against monopolistic abuse, would seem to be entirely justified. And with codes of fair competition explicitly restricting capacity and output in various industries, and with an agricul-

tural policy directed chiefly to that end, a courageous use of regulatory machinery to control the supply of transportation can scarcely be deemed out of place. Most of the recent measures of general applicability were enacted, it is true, for an emergency; but they reflect conditions not without precedent, and they themselves set precedents for future governmental action. In any event they clearly support the reasonableness of vigorous and forward-looking employment of public authority over extensions and abandonments, combinations and coöperative relations, and financial policies and practices, in an industry where the case for extensive regulation is peculiarly strong even under normal conditions; and at the same time the Commission, in its exercise of these powers, may be blazing trails and accumulating experience, in a degree never suspected in 1920, toward a fuller public control of all industry.

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