RAILROAD VALUATION BY THE INTERSTATE COMMERCE COMMISSION

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by

Homer B. Vanderblue, Ph.D.
Associate Professor of Transportation in Northwestern University

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INTRODUCTORY NOTE

VALUATION PROVISIONS OF THE TRANSPORTATION ACT, 1920

THE Transportation Act of 1920 recognizes the dual problems involved in fixing railroad rates.[1] The Interstate Commerce Commission is granted "reasonable latitude to modify or adjust any *particular* rate which it finds unjust or unreasonable." But the significant contribution of the new act is the standard directed for measuring *total* income:

> In the exercise of its power to prescribe just and reasonable rates, the Commission shall initiate, modify, establish or adjust such rates so that carriers as a whole (or as a whole in each of such rate groups or territories as the Commission may from time to time designate) will, under honest, efficient and economical management and reasonable expenditures for maintenance of way, structures and equipment, earn an aggregate annual net railway operating income equal, as nearly as may be, to a *fair return upon the aggregate value of the railway property* of such carriers held for and used in the service of transportation.

From a rule of negation designed to protect the railroads from "confiscation" an affirmative program has been evolved. This directs a conscious effort to regulate total railroad earnings. Heretofore it has been the "reasonableness" of individual rates that has received the burden of emphasis in the opinions of the Interstate

[1] This discussion of the Cummins-Esch Bill is based upon House Report 650, 66th Congress, 2d Session. The Valuation section of the new act will appear as Sec. 15a of the Interstate Commerce Act; it is Sec. 422 of the Conference Bill as passed.

Commerce Commission.[1] But the doctrine written into the Interstate Commerce Act by the provisions of the Amendment of 1920 goes beyond the common law doctrine of rate reasonableness recognized in the original Act of 1887. It goes beyond the very doctrine of constitutional law upon which it is based. When Justice Harlan in 1898 declared that "the company is entitled to ask . . . a fair return upon the value of that which it employs for the public convenience," [2] he sought only to *guarantee* a minimum. The Act of 1920, using the "fair return upon value" formula directs the establishment of schedules with the frank aim of limiting maximum revenue. In short, it seeks to secure for the public a part of any future "unearned increments" which may accrue in railroad earnings.

For the two years following March 1, 1920, the Act directs that the Commission shall take, as the total fair return to *all* carriers, a sum equal to 5½ per cent of the aggregate value of the transportation properties of all carriers. The Commission may, however, "in its discretion," add to this amount an additional one-half per cent to provide improvements, betterments or equipment (presumably so-called "unproductive improvements"), properly chargeable to capital account. This mandate of Congress governs only for two years following the return of the roads to their private owners. Thereafter the "legislative discretion" is delegated to

[1] See the discussion in the writer's Railroad Valuation, pp. 1–7, in the cases there cited, and in the Fifteen Per Cent case, 45 I. C. C. 303.

[2] Smyth v. Ames, 169 U. S. 466, 546. The Mississippi statute of 1884 which came before the Court in Stone v. Farmers' Loan & Trust Co., 116 U. S. 307, 309, directed the State Railroad Commission to revise the carriers' tariffs, permitting "a fair and just return on the value of such railroads, its appurtenances, and equipment." The California statute directing local bodies regulating water rates to "estimate, as nearly as may be, the value," etc., was identified by Justice Holmes with the value rule of the Supreme Court. San Diego Land & Town Co. v. Jasper, 189 U. S. 439, 442.

the Commission: the Commission will determine and publish the percentage which shall constitute the "fair rate of return." [1]

By the device of throwing all the carriers into one big basket, the problem of determining upon a fair rate of return for each carrier is avoided. The theory of the act would seem to be, however, that there is one single fair rate of return which should be applied to all carriers alike, any amount above this rate being in excess of a fair return.[2] The Act provides that a percentage once fixed shall be uniform for all rate groups or territories designated by the Commission. The same standard is invoked in the rules established to govern the action of the Commission in its study of the problem of consolidating the railways into a limited number of systems:

> 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. [3]

[1] For the distinction between the legislative and judicial view points see Minnesota Rate cases, 230 U. S. 352, 432; and the fuller discussion in Knoxville v. Knoxville Water Co., 212 U. S. 1, 16; Wilcox v. Consolidated Gas Co., 212 U. S. 19, 41; Louisville v. Cumberland T. & T. Co., 225 U. S. 430, 436; L. & N. R. R. Co. v. Garrett, 231 U. S. 298, 313. It is in the latter case that the phrase "legislative discretion" is used.

[2] This attitude is reflected in the following language of the new Act (par. 5 of Sec. 422):

"Inasmuch as it is impossible (without regulation and control in the interest of the commerce of the United States considered as a whole) to establish uniform rates upon competitive traffic which will adequately sustain all the carriers which are engaged in such traffic and which are indispensable to the communities to which they render the service of transportation, without enabling some of such carriers to receive a net railway operating income *substantially and unreasonably in excess of a fair return upon the value* of their railway property held for and used in the service of transportation, IT IS HEREBY DECLARED that any carrier which receives such an income so in excess of a fair return, shall hold such part of the excess, as hereinafter prescribed, as trustee for, and shall pay it to the United States."

[3] Transportation Act of 1920, Sec. 407, amending Sec. 5 of the Interstate Commerce Act.

But until such consolidations can be effected, it is expected that different rates of return will accrue to individual carriers. Given equal competitive rates (and the new Act recognizes that uniform rates on competitive traffic are inevitable) gross earnings will continue to reflect relative traffic density. Operating conditions will govern operating expense. The differential advantages possessed by the Union Pacific over its competitor the Rio Grande — to use an obvious example — will continue, until absorbed through consolidation.

One-half of the excess over 6 per cent of the value of any individual line or system, the Act leaves with the carrier. This 6 per cent figure, in the present state of the Act, is a standard, regardless of any action of the Commission in subsequently establishing a fair rate of return above or below this figure. The other half of the excess must be retained by the carrier as a reserve, until the accumulation equals 5 per cent of the value of the property.[1] Thereafter the carrier may use its half for " any lawful purpose." Presumably, tho on this subject the Act is silent, if reinvested in plant, as, for example, if spent for double tracking, enlarging tunnels, or eliminating curvature, the amounts so " put back into the property " will receive recognition in the value figure.

The other half of any excess above 6 per cent the carrier will pay into a " revolving fund," the property of the United States administered by the Commission. This " general railroad contingent fund " will be loaned to carriers for new capital expenditures or for refunding maturing obligations, or will be expended for equipment and facilities to be leased subsequently to the railroads.

[1] Only for the purpose of paying interest, dividends, or rentals may a carrier draw on this reserve, and then only to the extent that its net railway operating income for any year is less than a sum equal to 6 per cent of the property value.