ECONOMIC ASPECTS OF REPARATION AWARDS BY THE INTERSTATE COMMERCE COMMISSION

R. W. HARBESON †

The extensive literature dealing with various aspects of railway rate regulation contains singularly few discussions, so far as the writer is aware, of the administration by the Interstate Commerce Commission of reparation for past maladjustments in rates.[1] While this task is merely incidental to the main purposes of rate regulation and has declined in importance relative to other aspects of the Commission's work it has increased greatly in absolute magnitude and poses questions of public policy which possibly deserve more consideration than they have received. The present paper does not undertake to discuss the reparation problem as a whole but is confined to a consideration of the economic justification of the prevailing legal doctrines concerning the kind and amount of proof of injury necessary to justify a reparation.

A brief summary of the statutory provisions governing reparation may be convenient. Section 8 of the Interstate Commerce Act establishes the liability of carriers for the full amount of damages resulting from violations of the Act. Section 9 provides that claims for reparation may be made either before the Commission or before a court of competent jurisdiction, but despite this statutory alternative it has been settled by judicial interpretation that resort must be had first to the Commission except where the claim is based upon the performance of an act concretely defined and prohibited by the statute, such as a departure from the published tariffs.[2] Awards of reparation are made chiefly on the basis of the latter offense and for rates found unreasonable or unjustly discriminatory under the first four sections of the Act. Section 16 requires the Commission, after hearing, to determine whether a complainant is entitled to damages, and if so, to order

† A. B., 1925, Western Reserve University; A. M., 1926, Ph. D., 1931, Harvard University; Principal Economic Analyst, Division of Research, Office of Price Administration, on leave from Rutgers University. Author of numerous articles in economic and legal periodicals.

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1. 3B SHARFMAN, THE INTERSTATE COMMERCE COMMISSION (1931-37) 325-59. The writer acknowledges his indebtedness to this source in the preparation of this paper.

2. Texas & Pacific Ry. v. Abilene Cotton Oil Co., 204 U. S. 426, 27 Sup. Ct. 350, 51 L. Ed. 553 (1907); Pennsylvania R. R. v. International Coal Co., 230 U. S. 184, 33 Sup. Ct. 893, 57 L. Ed. 1446 (1913).

the carrier to pay the damages due. These orders are not legally binding upon the carriers, but if not complied with the complainant may appeal to the courts for enforcement, in which case the findings of the Commission are treated as prima facie evidence of the facts stated.

During the first twenty years of the Commission's history the power to award reparation was treated not only as a means of compensating private wrongs but as an instrument of rate regulation. This was true especially after the denial in 1897 of power to prescribe rates for the future and the nullification of Section 4.[3] Thereafter, until 1906, resort to the reparation device appeared to be the only available means of making effective the prohibitions of the Act against unreasonable and unjustly discriminatory rates, although the Commission stressed the futility of this procedure as a method of rate control. The grant of rate-making powers to the Commission in 1906 marked the beginning of a great expansion in the number of reparation cases, the possibility of securing reparation being, in many instances, a dominant factor in the initiation of rate proceedings. As a consequence of this development the Commission in its annual report for 1916, after reviewing the rapid growth of its reparation activities during the preceding decade, concluded that "If we had no power to award reparation, a mass of cases which now require consideration and decision, with all their attendant detail work and expense, would be kept off the Commission's docket."[4] In 1930 the Commission again emphasized the continued growth of this aspect of its work during the 1920's and the resultant administrative burden, in the following words:

> "Since the effective date of the transportation act, 1920, we have issued reports in 9,231 rate cases . . . in which matters affecting the rate structure were considered. The amounts of reparation sought and awarded have increased year by year during that period. In a large proportion of the cases the amounts involved are small and no question of particular public interest is involved. Our awards have amounted to approximately $4,000,000 per year, including the waiver of the collection of outstanding undercharges. During the reporting year we issued orders upon 10,656 special docket applications in amounts totaling $1,804,780.56. These orders also waived collection of outstanding undercharges amounting to $592,094.85. The increased number and complexity of these so-called reparation cases have so encroached upon our time and energies as to deprive us of adequate time for

3. Interstate Commerce Commission v. C. N. O. & T. P. Ry., 167 U. S. 479, 17 Sup. Ct. 896, 42 L. Ed. 243 (1897); Interstate Commerce Commission v. Alabama Midland Ry., 168 U. S. 144, 18 Sup. Ct. 45, 42 L. Ed. 414 (1897).

4. I. C. C. (1916) Annual Report, pp. 75, 76.

the thorough consideration of the many larger and more important problems continually coming before us."[5]

Turning to the question to which the present paper is addressed, a point of basic importance is that the issue of the kind and amount of proof necessary to justify an award of reparation has grown out of the distinction maintained in the Interstate Commerce Act between rates which are unreasonable under Section 1 (5) and those which are unjustly discriminatory under Sections 2, 3 and 4. Originally the Commission made no distinction between the two types of cases and awarded reparation merely upon proof of shipment at a rate found to be unreasonable or unjustly discriminatory, in an amount equal to the difference between such a rate and the rate found to be proper.[6] In the course of time it changed this policy, retaining the rule in connection with cases under Section 1 while requiring proof of the fact and amount of injury as a precondition of awarding reparation in the case of rates found to be unjustly discriminatory. This latter requirement was sustained by the Supreme Court in 1913 in the leading case of *Pennsylvania R. R. v. International Coal Min. Co.*[7]

A few years later, in another leading case, *Southern Pacific Co. v. Darnell-Taenzer Co.*,[8] involving reparation for a rate found to be unreasonable, the Court upheld the Commission's changed policy and elaborated on the matter as follows:

> "The general tendency of the law, in regard to damages at least, is not to go beyond the first step. As it does not attribute remote consequences to a defendant so it holds him liable if proximately the plaintiff has suffered a loss. The plaintiffs suffered losses to the amount of the verdict when they paid. Their claim accrued at once in the theory of the law and it does not inquire into later events . . . . If it be said that the whole transaction is one from a business point of view, it is enough to reply that the unity in this case is not sufficient to entitle the purchaser to recover, any more than the ultimate consumer who in turn paid an increased price. He has no privity with the carrier . . . . Behind the technical mode of statement is the consideration well emphasized by the Interstate Commerce Commission, of the endlessness and futility of the effort to follow every transaction to its ultimtae result . . . . Probably in the end the public pays the damages in most cases of compensated torts. The cases . . . where a party

5. I. C. C. (1930) Annual Report, p. 92.

6. Compare Perry v. Florida Central & Peninsular Ry., 5 I. C. R. 97 (1892), with Board of Trade of Lynchburg v. Old Dominion S. S. Co., 6 I. C. R. 632 (1896).

7. 230 U. S. 184, 33 Sup. Ct. 893, 57 L. Ed. 1446 (1913). See also Interstate Commerce Commission v. U. S. *ex rel.* Campbell, 289 U. S. 385, 53 Sup. Ct. 607, 77 L. Ed. 1273 (1933).

8. 245 U. S. 531, 38 Sup. Ct. 186, 62 L. Ed. 451 (1918).

> that has paid only the reasonable rate sues upon a discrimination because some other has paid less, are not like the present. There the damage depends upon remoter considerations. But here the plaintiffs have paid cash out of pocket that should not have been required of them, and there is no question as to the amount of the proximate loss." [9]

Almost simultaneously with the handing down of this opinion the Commission again changed its views on the topic in question and in its annual reports immediately following the *Darnell-Taenzer* decision took the position that the latter was unsound both as to legal reasoning and as to its consequences, and recommended that the law be amended to provide that no party was entitled to reparation except to the extent that he could prove that he was damaged, regardless of whether the basis of the complaint was an unreasonable or an unjustly discriminatory rate.[10] The Commission criticized the legal basis of the *Darnell-Taenzer* doctrine as resting upon the erroneous idea that an unreasonable rate was equivalent, under common-law principles, to an extortion or overcharge, whereas the common-law action was more nearly analogous to an action to recover a charge over and above the published rate.

Inasmuch as the law has not been amended in accordance with the Commission's recommendations the latter has necessarily adhered formally to the *Darnell-Taenzer* rule and in some cases has given it an unduly literal interpretation. The doctrine would seem to require that the person who bore the burden of the charge in the first instance should be allowed to recover, regardless of whether he also paid the charge in the first instance. But the Commission has held that consignors who paid the charges which they subsequently recouped from consignees, with or without a separate invoice, could recover.[11] As Commissioner Hall, dissenting to this interpretation, remarked, the consignor was "designated as the beneficiary of a sum of money which it may keep as compensation for the mere act of advancing the freight charges to the carrier." [12] This position was nevertheless subsequently upheld by the Supreme Court.[13]

On the other hand, as Professor Sharfman has pointed out, the Commission by holding in some cases that the reasonableness of a rate is not an exact concept and that therefore findings which would be fairly appropriate for the determination of future charges are not necessarily

9. *Id.* at 533-35, 38 Sup. Ct. at 186, 62 L. Ed. at 455.
10. I. C. C. (1919-1921) Annual Reports, pp. 17-21, 78, 58.
11. Missouri Portland Cement Co. v. Director General, 88 I. C. C. 492 (1924); Chicago Livestock Exchange v. A. T. & S. F. Ry., 100 I. C. C. 266 (1925).
12. Missouri Portland Cement Co. v. Director General, 88 I. C. C. 492, 498 (1924).
13. Adams v. Mills, 286 U. S. 397, 52 Sup. Ct. 589, 76 L. Ed. 1184 (1932).

adequate as a basis for awarding damages, and in others by considering the injury caused by the alleged unreasonable rate, has by indirection largely obliterated the distinction between the cases involving unreasonableness and those involving unjust discrimination.[14]

We inquire next whether there is any economic justification for the distinction required by the *Darnell-Taenzer* case between the rule of damages applicable in connection with unreasonable and discriminatory rates respectively. In the writer's view the answer to this question is definitely in the negative. There could be no economic basis for this distinction unless there were an economic distinction between an unreasonable and an unjustly discriminatory rate, and there is no such distinction.[15] There can be no such thing as the reasonableness of an individual rate per se and apart from its relationship to other rates because there is no ascertainable total unit cost of movement for the individual shipment represented by such a rate. A large part of a railway's expenses are composed of overhead costs which result from investments made on behalf of the business as a whole and which, along with joint costs (such as those involved in back-hauls), cannot be traced to particular segments of traffic.[16]

This proposition is denied by cost accountants, but the consensus of opinion among economists is that the position of the cost accountants on this question is unsound. The fundamental fallacy involved in the position of the latter is that in apportioning overhead costs the cost per unit of traffic depends upon the volume of traffic and the volume of traffic upon the rate charged, so that to some extent cost of carriage is a function of rates and not rates of cost. Another important criticism is that the cost accountants in distributing the overhead cost to particular segments of traffic are not in reality finding what the overhead or total cost per unit of such traffic actually is but how much of the overhead should, as a matter of managerial policy, be borne by each segment of traffic, and that in so doing they generally neglect or minimize the controlling importance of demand, with the result that prices are set on the basis of "cost" for individual services which are frequently neither in the interest of the companies nor of the public generally. This is not to deny, of course, the substantial usefulness of cost accounting, particularly in determining out-of-pocket

14. SHARFMAN, *op. cit. supra* note 1, at 353-57, citing Sloss-Sheffield Steel & Iron Co. v. L. & N. R. R. Co., 51 I. C. C. 635 (1918).

15. The writer has discussed this point further in his paper *Economic Theory and Railway Rate Regulation* (1936) EXPLORATIONS IN ECONOMICS, pt. III, c. 10.

16. Only at full utilization, where average and marginal costs are equal, does the problem of allocating overhead disappear, but full utilization is normally a rare condition on railways. Even then full unit cost remains indeterminate because of presence of joint costs.

costs and thereby helping management to avoid non-compensatory rates.[17]

If it be granted that the full unit cost of individual segments of traffic cannot be determined it follows that joint and overhead costs must be distributed over the various portions of traffic either according to some so-called "welfare" principle or according to the principle of charging what the traffic will bear, that is, according to the relative elasticity of demand, with safeguards imposed by public authority both with respect to the relativity of individual rates and as to the total receipts derived by the railway from its entire business. The further conclusion follows that there can be no such thing as the reasonableness of an individual rate considered alone and apart from its relationship to other rates. The point was well stated nearly forty years ago by Judge Noyes when he remarked that "It is about as easy to show that a rate is reasonable or unreasonable *per se* as it is to demonstrate that a certain river is, or is not, deep. Comparison is necessary. And, taking into consideration the different factors, by comparison and in no other way a rate may be made which, while it may not be demonstrated to be correct, can seldom be shown to be wrong." [18]

That this is true is indicated by the fact that the Commission, although adhering formally to the legal distinction between unreasonable and unjustly discriminatory rates, has in both earlier and later cases found it necessary to resort to the comparative method of testing the validity of rates under Section 1 (5) no less than in cases involving Section 3, and has, of necessity, relied upon the same basic data—out-of-pocket costs and the so-called "value of service" factors —in both types of cases.[19] The Commission's practice is well summed up in the following statement:

> "It is seldom, if ever, that a rate can be found unreasonable without comparison with the rates to other points. One of the best tests of the reasonableness of a rate is by comparison with the rates on like traffic in the same territory. The interstate commerce act recognizes no distinction between relative unreasonableness and intrinsic or absolute unreasonableness." [20]

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17. See LOCKLIN, ECONOMICS OF TRANSPORTATION (Rev. ed. 1938) 164-65, and writers there cited.

18. NOYES, AMERICAN RAILROAD RATES (1905) 61.

19. Among early cases see, for example, Evans v. Oregon Ry. & Nav. Co., 1 I. C. R. 641 (1887); Rice v. Louisville & Nashville R. R., 1 I. C. R. 722 (1888); *Re* Chicago St. P. & K. C. Ry., 2 I. C. R. 137 (1888); F. Schumacher Milling Co. v. C. R. I. & P. Ry., 6 I. C. R. 61 (1893); Page v. D. L. & W. Ry., 6 I. C. R. 548 (1896).

Among later cases see, for example, New England Lumber Rates, 43 I. C. C. 641 (1917); Blackman & Griffin Co. v. A. C. & Y. Ry., 49 I. C. C. 649 (1918); Lackawanna Steel Co. v. Director General, 87 I. C. C. 383 (1924); News Corporation v. M. P. R. R., 93 I. C. C. 381 (1924); Container Service, 173 I. C. C. 377 (1931).

20. Sioux City Chamber of Commerce v. B. & O. R. R., 120 I. C. C. 7, 14 (1926).

The implication of the foregoing analysis is that from the economic standpoint the concept of reasonableness as applied to the individual rate is exhausted by the provisions of the Interstate Commerce Act other than Section 1 (5). Protection from unjust relationships among rates is provided by Sections 2, 3 and 4; protection from noncompensatory rates, along with added power over discrimination, is provided by Section 15; and protection from an unreasonable level of rates and carrier earnings is afforded by the revised Section 15A. The further implication follows, of course, that there is no economic justification for the distinction drawn in the *Darnell-Taenzer* case between the rule of damages applicable in the case of unreasonable and of unjustly discriminatory rates.[21]

If it be granted that Section 1 (5) serves no purpose economically we may inquire next concerning its possible legal justification. In this connection it should be noted, first, that this section performed a necessary function in affording protection against an unreasonable *level* of rates during the period prior to the addition of Section 15A in 1920. It was deficient in this respect, however, in that it should have referred specifically to the reasonableness of rates in the aggregate and should have been supplemented by provisions giving the Commission the powers necessary to make this type of rate control effective. Second, and more important, the scope of the protection afforded by Section 3 has been narrowed as a result of interpretations of the Commission and the Supreme Court. In order to invoke this section it must be shown (1) that a competitive relationship exists between the commodities or localities affected, (2) that the existing relationship of rates injures the complainant, and (3) that the carrier or carriers concerned control the rates both to the point alleged to be preferred and to the point alleged to be prejudiced, in the sense that they are able to change the rate relationship complained of by their own act.

This last is the so-called *Ashland* rule.[22] It has been followed by the Commission in numerous cases and has been upheld by the Supreme Court.[23] Referring to Section 3 the latter has said that "What Congress sought to prevent by that section . . . was not differences between localities in transportation rates, facilities and privileges, but

21. It would seem that the rule of Arizona Grocery & Atchison Ry., 284 U. S. 370, 52 Sup. Ct. 183, 76 L. Ed. 348 (1932), precluding an award of reparation in the case of rates previously held to be reasonable, should also be extended to cases where rates had previously been held to be not unjustly discriminatory.

22. Ashland Fire Brick Co. v. Southern Ry., 22 I. C. C. 115 (1911).

23. Texas & Pacific Ry. v. U. S., 289 U. S. 627, 53 Sup. Ct. 768, 77 L. Ed. 1410 (1933). The Court noted in this case that the *Ashland* rule had been applied by the Commission in at least forty-five cases. *Id.* at 649, n. 37, 53 Sup. Ct. at 776, 77 L. Ed. at 1428.

unjust discrimination between them by the same carrier or carriers." [24] In view of this situation it is evident that Section 1 (5) permits the Commission to correct what it considers to be instances of unjust discrimination which could not be reached under Section 3. While it would appear that the minimum rate power under Section 15 (1) is also available for this purpose the extent to which it could be so used under prevailing judicial interpretations is uncertain.[25]

Two objectionable consequences flow from the co-existence in the Interstate Commerce Act of Section 1 (5) and the sections governing discrimination. The first is that, as already suggested, it is the basis of an illogical and unjust doctrine governing the award of reparation for past rate maladjustments. The second is that Section 1 (5) has been used to secure, by *indirection,* a degree of control over rate relationships such as would obtain if Section 3 were amended so as to nullify the restrictions referred to above.[26] While the economic analysis of railway rates outlined above logically calls for a merging of Sections 1 (5) and 3 and the removal of the present restrictions on the use of the latter section, such an extension of the Commission's power over rate relationships has serious and widely ramifying implications. These include the danger to the Commission's independence from the pressure, exerted through political channels, of rival sections and localities seeking favorable rate adjustments; the question of the extent to which the competitive interests of individual carriers may properly be subordinated in the interest of national policies; and the disturbance which would probably result in the economic situation of sections and localities which have benefited from past competitive adjustments.

It would seem, therefore, that if it be felt desirable to remove the present restrictions on the control of rate relationships under Section 3 the decision should be made by Congress after careful consideration of the issue as a whole, and that it is unfortunate that the issue should have been prejudged by indirection in specific situations. Congressional action merging sections 1 (5) and 3 would remove both of the aforementioned objectionable aspects of the present situation, but if such action should be deemed unwise the Act should in any event be

24. Central R. R. of N. J. v. U. S., 257 U. S. 247, 259-60, 42 Sup. Ct. 80, 83, 66 L. Ed. 217, 222 (1921).

25. Compare U. S. v. Chicago M. St. P. & P. R. R., 294 U. S. 499, 55 Sup. Ct. 462, 79 L. Ed. 1023 (1935), with Youngstown Sheet & Tube Co. v. U. S., 295 U. S. 476, 55 Sup. Ct. 822, 79 L. Ed. 1553 (1935). See also Anchor Coal Co. v. U. S., 25 F. (2d) 462 (C. C. A. 1928), reversed upon appeal on the ground that the controversy had become moot, U. S. v. Anchor Coal Co., 278 U. S. 812, 49 Sup. Ct. 262, 73 L. Ed. 971 (1928).

26. For example, in Lake Cargo Coal Rates, 126 I. C. C. 309 (1927), 139 I. C. C. 367 (1928). See also SHARFMAN, *op. cit. supra* note 1, at 653-56.

amended, as the Commission has recommended, to provide that parties should be entitled to reparation only if, and to the extent that, they could prove they were damaged, regardless of whether an unreasonable or an unjustly discriminatory rate was involved.[27]

This latter recommendation has the disadvantage of increasing the magnitude of an administrative problem of which the Commission has long complained, namely, the task of determining in each case whether the complainant has actually suffered damage by reason of paying the rate of which he complained. It may be appropriate to point out briefly the economic reasons why this problem must inescapably be one of great and increasing difficulty. The problem is essentially one of determining the incidence and effects of a freight rate, which is precisely analogous to determining the incidence and effects of an excise tax. That this is one of the most difficult and intricate branches of economic analysis should be evident from a mere listing of some of the elements of the problem, which is all that can be attempted here.[28]

The incidence of a freight rate, or an excise tax, depends upon whether the charge is peculiar to a given individual or group or whether it is of general application; upon whether the firm operates under conditions of pure competition, simple monopoly, oligopoly or monopolistic competition; upon the elasticity of demand for the product of an industry and upon the elasticity of supply of the agents of production; upon the length of time allowed for an adjustment and the prevailing phase of the business cycle; and upon various other circumstances. Depending upon conditions, a charge imposed on a manufacturer may be shifted forward to consumers of the product or backward to the suppliers of the agents of production.

In connection with the present discussion it is important to note that the fact that a charge is shifted does not mean that the individuals upon whom it is levied thereby escape all the consequences of the charge. Unless the imposition of the charge increases the demand for the product in question, and there is no reason why this should be the case, the charge can be shifted only if supply is curtailed, which means crowding out marginal producers and eliminating the marginal portion of the output of those who remain in business. Another important point is that the difficulty of determining the incidence of a charge is very greatly increased where the firm concerned operates under conditions of oligopoly or monopolistic competition, and these are now the

27. Another possibility would be a clear-cut ruling by the Supreme Court permitting Section 15 (1) to be so used as to circumvent the present restrictions on the use of Section 3, but this, of course, would not improve the situation with respect to reparations.

28. See SELIGMAN, THE SHIFTING AND INCIDENCE OF TAXATION (5th ed. 1927); BOWMAN and BACH, ECONOMIC ANALYSIS AND PUBLIC POLICY (1943) c 48.

predominant types of market organization. Finally, it is always difficult, and sometimes virtually impossible, to isolate the effect of a given factor such as a tax or a freight rate upon a particular price and profit situation because of the multiplicity of influences which continually influence prices and profits. The implication of the foregoing discussion is that there may be grave doubts as to the advisability of allowing the function of awarding reparation to remain with the Commission in view of the importance of conserving the time and energy of its members for dealing with the fundamental tasks of regulation.