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## SHOULD THE REGULATION OF RAILROAD RATES BE "STREAMLINED" TOO?

JERVIS LANGDON, JR.

Traveling from New York to Chicago on May 31, 1936, a regular<sup>1</sup> coach passenger of the New York Central or Pennsylvania railroad paid \$32.70 for his ticket, or 3.6 cents a mile.<sup>2</sup> But if the same passenger had delayed his trip one day he would have paid only \$18.20, or 2 cents a mile, a reduction of 44 per cent.

Thus did the Interstate Commerce Commission "dispose" of a problem which had concerned railroad management for some time: What to do to improve passenger earnings?<sup>3</sup> "The most important remaining avenue of appeal to the public is that of a reduction in fares," said the Commission,<sup>4</sup> and it proceeded to enforce its judgment by finding that "a maximum-fare basis, one way or round trip, for general application, of 2 cents per mile in coaches and 3 cents per mile in pullmans would be most likely to lessen the transportation burden of respondents and to harmonize with present-day economic conditions, with consequent fuller assurance to the respondents of realizing a fair return upon their property investment."<sup>5</sup>

Whether the Commission's judgment was right or wrong is a much-debated question which we shall not pause to discuss here.<sup>6</sup> Rather, our purpose

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<sup>1</sup>As distinguished from a week-end excursion or special fare passenger about whom we shall learn later. See pp. 313-314, *infra*.

<sup>2</sup>The authorized fare per mile applies, usually, over the short-line route which, for competitive reasons, the longer routes are required to meet.

Morover, so-called differential fares between eastern and western cities have long been maintained by certain of the eastern carriers. The differentials range from \$2 between New York and Chicago over such carriers as the Erie, the Lackawanna, the Nickel Plate, and the Wabash, to \$1 between Chicago and Cleveland, Ohio, over the Nickel Plate.

<sup>3</sup>Passenger Fares & Surcharges, 214 I. C. C. 174 (1936), hereinafter referred to as the *Passenger* case. The order therein was nation-wide, but, since the basic fares in the south and west had previously been reduced voluntarily to levels the same as, or lower than prescribed, it affected directly only those in the so-called Eastern district; that is, generally speaking, the fares of lines operating east of Chicago and north of the Ohio and Potomac Rivers, but including the Chesapeake & Ohio and Norfolk & Western.

<sup>4</sup>*Id.* at 184.

<sup>5</sup>*Id.* at 255.

<sup>6</sup>It may be observed, however, that after the reduced fares had been in effect well over a year the Eastern lines were far from convinced, and on November 5, 1937, asked the Commission to permit an increase in coach fares to 2.5 cents a mile. This the Commission at first refused to do, Eastern Passenger Fares in Coaches, 227 I. C. C.

in this paper is to consider the *Passenger* case<sup>6a</sup> in some detail; its far-reaching implications; and, most important, the apparent necessity (as illustrated by the decision in question) for a radical change in the so-called regulation of railroad rates in order that railroad managements, in their struggle to exist in a transportation world swamped with new and unrelenting competitors, may have some reasonable freedom of action.

Ordinarily, when a public service is being conducted at a loss, the last thing to be expected from a regulatory body is an order reducing rates. But the Interstate Commerce Commission is no ordinary body; and its order in the *Passenger* case<sup>6b</sup> is no ordinary order.

## I

In 1920 the peak of railway passenger travel in the United States was reached, some 47 billion passenger miles.<sup>7</sup> During the same year the Commission authorized a 20 per cent increase in the then passenger fares (established two years previously by order of the Director General of Railroads), and they became 3.6 cents a mile for both coach and pullman travel.<sup>8</sup> But from that year until 1930 there was a gradual decline in travel, and with the advent of the depression, it became precipitous. At the very depths of the depression, according to the Commission's report, the passenger miles aggregated a little more than one-fourth of those in 1920; the *per capita* travel was less than in any year since 1880; and the average *per capita* expenditure for rail travel smaller than in any year since 1871.<sup>9</sup> Between 1929 and 1933 the passenger revenues were off more than the freight revenues,<sup>10</sup> and during the latter part of this period the deficits from the passenger service, with no allowance for interest, exceeded \$200,000,000

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17 (1938); but later it acquiesced. *Id.*, Report on Further Hearing, 227 I. C. C. 685 (1938). See Petition for Reargument and Reconsideration, dated May 11, 1938, filed by carriers in Eastern territory.

But last autumn, reports of dissatisfaction with 2.5-cent coach fare began to appear. N. Y. Times, September 22, 1938, at pp. 31, 35; September 26, 1938, at p. 24. Cf. editorial, N. Y. Herald-Tribune, September 23, 1936, entitled "Higher Fares, Less Revenue". More recently, the dissatisfaction has apparently increased, and the problem of what to do is presently in the hands of an Eastern railroad committee with Mr. Williamson, President of the New York Central, as chairman. TIME, January 16, 1939, at p. 49, under title, "Fare Ideas"; N. Y. Times, January 22, 1939, financial section at p. 7, under title, "Railways Puzzled on Fare Reduction". In the South the railroads, after experimenting with a 2-cent fare in coaches for over a year, returned to 1.5 cents January 15, 1939.

<sup>6a</sup>*Supra* note 3.

<sup>6b</sup>*Ibid.*

<sup>7</sup>Passenger case, 214 I. C. C. 174, 176 (1936).

<sup>8</sup>Increased Rates, 1920, 58 I. C. C. 220. A surcharge of approximately 10 per cent of the basic fare was also authorized for pullman travel. Upon complaint, this was subsequently found not to be unreasonable, Charges for Passengers in Sleeping & Parlor Cars, 95 I. C. C. 469 (1925).

<sup>9</sup>Passenger case, 214 I. C. C. 174, 176 (1936).

<sup>10</sup>*Id.* at 178.

annually for the country as a whole.<sup>11</sup> Even when taxes, rentals and interest were left out of consideration, the losses were impressive, and in the Eastern district (the real target of the Commission's order, as we shall see) they reached a high of \$11,500,000 in 1933.<sup>12</sup>

That this was an alarming state of affairs no one denied. The railroads were thoroughly aroused; so was the Commission. Repeatedly did it exhort the managements to find a "solution". Even before the worst years of the depression, it pointed out (while denying an application for a 15 per cent increase in freight rates) that "railroad managements face new conditions which compel changes in methods of operation, manner of service, and price policies," and indicated as "foremost among the problems to be solved . . . that presented by the passenger service".<sup>13</sup> Emphasizing that "if the carriers were able to conduct the passenger business as profitably as the freight business, they would even now, under adversity in a period of great depression, be earning enough to stabilize their credit situation," it found inadequate the steps already taken and urged the need for "much more drastic measures". "Our knowledge," the Commission concluded, "is too inadequate to enable us to specify the remedies which must be applied."<sup>14</sup> Later, again demanding "genuinely creative enterprise", it observed that much had been done "to meet this situation" and, indicating "many other possibilities", said: "Trial and experiment will be needed before the solution will be reached."<sup>15</sup> Still later, it informally solicited the views of railroad presidents "as to (a) whether by a general reduction in basic fares a betterment could be brought about in the volume of passenger traffic, and (b) what suggestions they might care to offer for relieving the users of freight service from the burden due to unprofitable passenger ser-

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<sup>11</sup>Including interest, the annual deficits were amounting to some \$450,000,000, based, of course, on the Commission's formula (which has been substantially changed three times in the last 25 years) for dividing expenses between freight and passenger services, and the apportionment of taxes and investments in the same ratio as such assigned expenses. In the case of a typical railroad, over one-third of its operating expenses (in accounts, 146 of a total of 168, under eight general classifications) do not identify themselves with one service class and must, therefore, be arbitrarily assigned. Moreover, the Commission itself has pointed out that "no approved formula has ever been devised" for the "apportionment of investment accounts between freight and passenger". *Atlantic Coast Line R. Co. v. Arcade & Attica R. Corp.*, 198 I. C. C. 375, 377, 378 (1934).

<sup>12</sup>"These deficits," the Commission said, "do not necessarily mean an out-of-pocket loss, as the expenses include a proportion of common maintenance of way and general expenses. If all of these were charged to freight, the net revenue in 1933 from passenger and allied services before taxes would have been \$45,377,000 in the East, a deficit of \$10,192,000 in the South, a deficit of \$21,093,000 in the West, and a net of \$14,092,000 for all districts." Passenger case, 214 I. C. C. 174, 176 (1936).

<sup>13</sup>Fifteen Per Cent Case, 1931, *Ex Parte* 103, 178 I. C. C. 539, 584. The application as a whole was denied; however, "as a temporary measure of relief", a system of modest surcharges was permitted to become effective under a "loaning" plan. *Id.* at 578. See also First Supplemental Report, 179 I. C. C. 215 (1931).

<sup>14</sup>*Id.* at p. 584.

<sup>15</sup>FORTY-FIFTH ANNUAL REPORT (Interstate Commerce Commission 1931) 118.

vice."<sup>16</sup> And still later, the Commission said that "the time is near at hand when some aggressive action should be taken by *the carriers* to determine whether it is possible to regain passenger business, or whether they shall be compelled to give up what at one time was a lucrative part of their business."<sup>17</sup>

So it was that, during 1934, the Commission on its own motion instituted an investigation "with the object of determining what, under the law administered by us, can and should be done".<sup>18</sup>

The Southern lines appeared individually at the hearings and offered the results of their experiments.<sup>19</sup> The Southern Railway was of the opinion that, at 1.5 cents per mile, coach travel on its line could be made profitable, and attributed to the reductions made in 1933 "the improvement in its passenger earnings in 1934".<sup>20</sup> The Seaboard Air Line expressed substantially the same view. The Louisville & Nashville, which was found to have "experimented longer and more extensively with the 2-cent coach fare than . . . any other carrier", preferred "to experiment further before determining upon a reasonable fare basis".<sup>21</sup> The Atlantic Coast Line, with a higher proportion of passenger revenue to total revenue than any other major Southern line, was discovered to have established the reduced fares only because forced by competition and to have "consistently opposed any reduction . . . or the elimination of the surcharge".<sup>22</sup> With a heavy winter pullman travel between the East and Florida resorts, it believed 2.5 cents to be "the appropriate coach fare for general application", attributed the improvement in its 1934 earnings "largely if not entirely to improved economic conditions",<sup>23</sup> and said that an even better showing would have resulted from higher fares.<sup>24</sup>

After stating the "problem" to be "what reasonable fare basis will meet with the greatest revenue response from the public", the Commission then turned to the experience in the West.<sup>25</sup> There, it learned that the results of the experimental fares in 1934 were not "as satisfactory as those in the South", but this was principally owing, it thought, to the severe drought of that year.<sup>26</sup> But the Commission did find encouragement on the part of Western carriers,<sup>27</sup> which asked only that "they be permitted to work out

<sup>16</sup>FORTY-SIXTH ANNUAL REPORT (Interstate Commerce Commission 1932) 29.

<sup>17</sup>FORTY-SEVENTH ANNUAL REPORT (Interstate Commerce Commission 1933) 31 (italics supplied).

<sup>18</sup>FORTY-EIGHTH ANNUAL REPORT (Interstate Commerce Commission 1934) 30.

<sup>19</sup>Passenger case, 214 I. C. C. 174, 188 *et seq.* (1936).

<sup>20</sup>*Id.* at 191.

<sup>21</sup>*Id.* at 195.

<sup>22</sup>*Id.* at 195-6.

<sup>23</sup>*Id.* at 196-7.

<sup>24</sup>*Id.* at 198.

<sup>25</sup>*Id.* at 201.

<sup>26</sup>*Id.* at 202.

<sup>27</sup>With the exception of the Chicago, North Shore and Milwaukee Railroad Company which serves the territory between Chicago and Milwaukee with electrified lines and,

their own solution of the perplexing passenger problem".<sup>28</sup>

It was of course upon the situation in the East that the Commission concentrated its attention. Here, and here only were the basic fare and surcharges being maintained; and here were the carriers which, with heavy travel and infinitely more at stake,<sup>29</sup> were apparently convinced that the voluntary reductions made in the South and West would not meet *their* problem.<sup>30</sup> And to the Commission these Eastern lines<sup>31</sup> demonstrated that their passenger revenues had not declined as rapidly as in the country as a whole,<sup>32</sup> and pointed out that, as distinguished from the situation elsewhere, their principal travel was "high-class commercial traffic" between the industrial centers of the East which "would not be appreciably increased by any reasonable reduction in fare".<sup>33</sup> They urged that their service was more valuable and expensive than in 1920 when the fares were authorized and emphasized the increased speed, safety, and comfort of their trains.<sup>34</sup> They contended that the low

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in the Western district, ranks second from the point of view of passengers carried per mile of road operated. Contrary to the experience of the railroads generally, the passenger revenues of the North Shore reached a peak in 1927, and in the next two years dropped only 3.1 per cent. With the depression, the revenues fell rapidly but that carrier attributed the decrease "almost wholly to the depression" and insisted "that its business has not been seriously affected by other forms of competition". It pointed out, moreover, that the reduced experimental fares which, because of competition, it had been required to establish "had no appreciable affect upon the number of passengers carried by the competing bus lines" in its territory; and it asked the Commission to find non-compensatory any coach fare between Chicago and Milwaukee which was lower than 2.5 cents per mile. *Id.* at 203-6.

<sup>28</sup>*Id.* at 203.

<sup>29</sup>The New York Central, Pennsylvania, and New Haven. While representing only 12.9 per cent of the rail mileage, these three carriers, in 1934, carried 40.8 per cent of the total rail passengers in the country, and earned 42.3 per cent of the revenue. In fact, the total passenger revenues on all the lines in the South in 1933 were only about 55 per cent of similar revenues in that year of the Pennsylvania Railroad alone. *Id.* at 207. Moreover, as found by the Commission: "Passenger revenue is relatively more important to these three systems than to respondents generally. The passenger-train revenues of all respondents in 1933 constituted about 16 per cent of their total railway revenues, but the percentage on the three systems was 28.5. Passenger revenue alone on these systems was 19.5 per cent of their total revenues in 1933 and 19.8 per cent in 1934." *Id.* at 208.

With 65 to 70 per cent of the passenger travel of the country, the Eastern lines asked special consideration; and particularly was this true of the three lines which, in 1934, had more than a 72 per cent interest in the heavy Eastern travel.

See Brief, dated May 31, 1935, in *Passenger* case filed on behalf of lines in Eastern district, other than Baltimore & Ohio Railroad Company, at 13 to 17.

<sup>30</sup>Only the Baltimore & Ohio and Norfolk & Western favored reductions in the East. In fact, counsel for the former road asked the Commission to enter the order that it ultimately did because, as he said, the 3.6-cent fare was "prohibitive". See pp. 1944 to 1956, particularly pp. 1946, 1954 of the minutes of the oral argument before the entire Commission on October 3rd and 4th, 1935, in the *Passenger* case, 214 I. C. C. 174. See *infra*, at p. 332.

<sup>31</sup>As referred to herein, Eastern lines will be understood to exclude the Baltimore & Ohio and Norfolk & Western.

<sup>32</sup>*Passenger* case, 214 I. C. C. 174, 219 (1936).

<sup>33</sup>*Id.* at 210. See Brief, *supra* note 29, at 75-89.

<sup>34</sup>As reported by the Commission: ". . . Among the improvements thus detailed are replacement of wooden with steel cars, improvement in locomotives to increase speed so as to insure faster but dependable schedules, installation of greatly improved coaches,

week-end, excursion and special fares which they had established<sup>35</sup> were effective and compensatory but, as set forth in the Commission's report, "in a like effectiveness of such reduced fares on commercial traffic or of a general reduction in the basic fare for all traffic they . . . manifested no faith."<sup>36</sup> They argued that "a reduction in the basic fare in the East would simply mean a further reduction by the bus lines".<sup>37</sup> They suggested that in the other territories the estimated cost of handling passenger traffic, on either a car-mile or train-mile basis, was lower than in the East, and the passenger investment per mile of road substantially less.<sup>38</sup> And finally, they stated a belief that, without a substantial increase in train and other services, fare reductions alone "would be of little avail in securing increased traffic".<sup>39</sup>

A majority<sup>40</sup> of the Commission was, however, far from satisfied. Based on a series of compilations appended to its report, the majority found it "reasonable to assume" that, had reductions been in effect during 1934, the Eastern lines would have gained, and for this, it relied upon the experience in the South and West; indeed, any other assumption it regarded as "hardly conceivable".<sup>41</sup> It dismissed certain of the opinions of these lines as not carrying "conviction either way", and said that their attitude appeared to "regard too lightly" the fact that they had lost ground while the passenger market was increasing. It reported that, prior to the depression, "they [had] failed to orient themselves either in accommodations or fares, or both, to the new and powerful highway competition."<sup>42</sup> While acknowledging that much had recently been done "toward meeting that competition in the way of better and more attractive accommodations", it emphasized<sup>43</sup> the controlling impor-

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remarkable development of air conditioning in both pullmans and coaches, installation of train-control and other safety devices, and construction of new station facilities and improvement of existing facilities." Passenger case, 214 I. C. C. 174, 211 (1936). See Brief, *supra* note 29, at 30-43.

<sup>35</sup>The influence of such experimental fares is apparent when it is realized that, in 1934, the average revenue per passenger mile of 2.8 cents on the three principal passenger lines in the East reflected a decrease of 21 per cent under 1923, while in the East generally the decrease was 26.2 per cent, and for the country as a whole 36.5 per cent. In other words, a large share of the passenger traffic in the East was being handled at fares lower than 3.6 cents. During September, 1934, on the New York Central, 60 per cent of the passengers were moved at fares lower than 3.6 cents, and they produced 50 per cent of the passenger revenue. On the Pennsylvania, during a typical week in April, 1934, only 59 per cent of the passenger revenue accrued from travel on the basic fare; on the New Haven, 49.6 per cent. Passenger case, 214 I. C. C. 174, 209, 223 (1936).

<sup>36</sup>*Id.* at 219. See Brief, *supra* note 29, at 74, 75.

<sup>37</sup>*Id.* at 219.

<sup>38</sup>*Id.* at 220.

<sup>39</sup>*Id.* at 222. See Brief, *supra* note 29, at 92-98.

<sup>40</sup>Separate dissenting opinions were written by Chairman Mahaffie, and Commissioners Meyer, McManamy, and Lee. Commissioner Tate did not participate.

<sup>41</sup>Passenger case, 214 I. C. C. 174, 216, 217, 221, 223, 224 (1936).

<sup>42</sup>*Id.* at 218, 219.

<sup>43</sup>The Commission said: ". . . no one conversant with conditions which have brought about the present relative standing of the rails to the highway in respect of passenger-

tance of the "price factor" to which "the Eastern respondents have failed to give the proper weight". It found that no great increase in expenses would accompany a fare reduction, based on the experience in the South and West, and, in any event, "there is no reason to believe that increased train miles and car miles thus entailed would not return more than their share of the additional transportation burden."<sup>44</sup> As for additional service on branch lines, "immediate and sympathetic consideration" should be given to the operation of "light trains of inexpensive and flexible motive power", or of "a coördinated bus transport".<sup>45</sup> The busses would not, the Commission suggested, make comparable reductions.<sup>46</sup>

In thus setting aside the judgment of the Eastern lines and imposing its own (in the form of a mandatory order requiring reduced rates), a majority of the Commission side-stepped the principle of law that rates may not be reduced where a public service is being conducted at a loss with the observation that "that rule of law has no application" where "reduced rates will most likely increase the net revenues of the carriers".<sup>47</sup> To the contention that it was up to the carriers to say whether the reductions would increase revenues or not, the Commission, referring to a few instances where it had refused to permit proposed rate reductions, held that "if we have the power to set aside managerial discretion where the latter seeks to impose an undue burden upon carriers generally by an unwarranted reduction in rates, we must have the same power where it is sought to effect a like result by maintaining an unwarrantedly high level of rates."<sup>48</sup> Citing the provisions of the "new" Section 15a(2), the rate-making rule in the Interstate Commerce Act enacted in 1933,<sup>49</sup> it regarded "the duty plainly laid" upon it to find unreasonableness where:

". . . a general rate reduction would have a beneficial effect upon the movement of traffic in such degree as to enhance the ability of the carriers to furnish adequate and efficient railway transportation service, and at

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miles made will seriously contend that the rail carrier can hope to regain from the motor carrier any substantial volume of traffic, much less obtain its reasonable share of future increased travel, by improved accommodations alone. This record is convincing that passenger service was not the major factor which caused the rail carriers either to lose so much of their traffic prior to the depression or to fail to gain their share of the increased travel in that period. A more important factor than as now is the price of travel, either actual or imagined by the traveler. The average traveler in private automobile does not realize the full cost to him of motor travel. Intensive and intelligent education along that line might help to divert some business away from the highways. But after all other possibilities of attracting traffic to the rails are given full consideration, the conclusion seems inevitable that it is the price factor to which the Eastern respondents have failed to give the proper weight and which is most likely to be the controlling element for travel in the future". *Id.* at 219, 220.

<sup>44</sup>*Id.* at 222, 225.

<sup>45</sup>*Id.* at 222, 225.

<sup>46</sup>*Id.* at 219. See *infra* note 112.

<sup>47</sup>*Id.* at 229.

<sup>48</sup>*Id.* at 230.

<sup>49</sup>See, for provisions of this rule, *infra* note 103.

the same time that the resulting reduced rates would be the maximum which had been justified by the value of the service to the public affected thereby . . ."<sup>50</sup>

The Commission recognized "that most of what has been said . . . bears chiefly upon the important rate-making element of what the traffic will bear, and upon our duty, in the public interest, to conserve the revenues of the carriers,"<sup>51</sup> and it emphasized that, in appraising the former element, the competition of the private automobile and bus "may no longer be disregarded" — a competition which was given "little or no consideration" when, in 1920, the fares were originally authorized.<sup>52</sup> The Commission concluded its decision by finding the fares in the East "out of harmony with current economic conditions",<sup>53</sup> and under the heading "Value of the Service",<sup>54</sup> took judicial notice of the reduced income of the average passenger and prospective passenger and the lowering of commodity prices generally—facts which "must have consideration, especially in times of general financial difficulties".<sup>55</sup>

## II

Fully to appreciate the implications of this decision, let us, for a moment, indulge one assumption contrary to fact: At the time of the investigation, the passenger service was, on the whole, making a reasonable return, but no more. Would such a circumstance have affected the result? For the purposes of this inquiry, we shall accept the accuracy of the Commission's finding that the fares were higher than justified by the value of the service when viewed in the light of (1) a "new and powerful highway competition" which was not in existence when they were authorized, and (2) the then current economic conditions. We shall also adopt the assumption in the report that the passenger operations were "being conducted in an efficient and economical manner"<sup>56</sup> and the finding that, during recent years, the lines "have done much . . . in the way of better and more attractive accommodations".<sup>57</sup> With such an assumed set of facts, we have presented ourselves with a direct conflict between two criteria of reasonable rates. Which is superior, the right of the railroads to a fair return or the right of the travelling public to reasonable fares reflecting the value of the service?

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<sup>50</sup>Passenger case, 214 I. C. C. 174, 231 (1936).

<sup>51</sup>*Id.* at 231.

<sup>52</sup>*Id.* at 231.

<sup>53</sup>*Id.* at 233.

<sup>54</sup>*Ibid.*

<sup>55</sup>*Ibid.*

<sup>56</sup>*Id.* at 228. Cf. The Five Per Cent Case, 31 I. C. C. 351, 408, 414 (1914); General Rate Level Investigation, 195 I. C. C. 5, 55 (1933); Construction & Repair of Railway Equipment, 107 I. C. C. 721, 735 (1926); New Mexico Central Ry. Co. v. A. T. & S. F. Ry. Co., 81 I. C. C. 718, 722 (1923); Missouri-Kansas-Texas R. Co. v. Kansas City Terminal Ry. Co., 104 I. C. C. 203, 204 (1925); see also Chicago & G. T. Ry. Co. v. Wellman, 143 U. S. 339, 345, 346 (1892).

<sup>57</sup>Passenger case, 214 I. C. C. 174, 219 (1936).

Much has been written about this conflict.<sup>58</sup> In 1919, Henry White Edgerton, after a careful review of the decisions and relying upon *Northern Pacific Railway v. North Dakota*,<sup>59</sup> and *Norfolk & Western Railway v. Conley*,<sup>60</sup> both decided by the Supreme Court in 1915, reached the conclusion that "all the talk of courts—including the Supreme Court itself,—commissions and text-writers to the effect that rates may be fixed so low that they will not produce a reasonable return to the company, if that is necessary in order that they may not exceed the value of the service to the public, is baseless."<sup>61</sup> He said that the law was clearly in accord with the dictum in *Atlantic Coast Line Railroad v. North Carolina Corporation Commission*:

"In a case involving the validity of an order enforcing a scheme of maximum rates, of course the finding that the enforcement of such scheme will not produce an adequate return for the operation of the railroad, in and of itself, demonstrates the unreasonableness of the order."<sup>62</sup>

However, in an article appearing in the same review 14 years later, David E. Lilienthal pointed to the value of the service as the "maximum limitation upon rates" and expressed the view: "Nothing in the decisions of the United States Supreme Court indicates that that Court has departed from this tenet."<sup>63</sup> Whether this "maximum limitation" should also be a minimum limitation Mr. Lilienthal did not discuss; but he gave every indication that it should not.<sup>64</sup> So far as the railroads are concerned the only question of

<sup>58</sup>See, e.g., POND, PUBLIC UTILITIES (3rd ed. 1925) § 350, p. 571; NASH, PUBLIC UTILITY RATE STRUCTURES (1933) 320; 1 SPURR, GUIDING PRINCIPLES OF PUBLIC SERVICE REGULATION (1924) 201.

<sup>59</sup>236 U. S. 585 (1915). The Commission has cited this decision as supporting the same principle contended for by Edgerton. See, *infra* note 102.

<sup>60</sup>236 U. S. 605 (1915).

<sup>61</sup>Edgerton, *Value of the Service as a Factor in Rate-Making* (1919) 32 HARV. L. REV. 516, 529.

<sup>62</sup>206 U. S. 1, 24, 25 (1906).

<sup>63</sup>Lilienthal, *Public Utilities During the Depression* (1933) 46 HARV. L. REV. 745, 761.

<sup>64</sup>*Id.* at 767. But Lilienthal does suggest the accumulation of a reserve in good times to offset the reduced earnings of depressions. *Id.* at 755. In *Central of Georgia Ry. v. R. R. Commission*, 161 Fed. 925, 994 (C. C. M. D. Ala. 1908), the court indicated that rates higher than those necessary to produce a fair return might be justified by the value of the service. "This dictum," Edgerton remarked, "is perhaps unique." See Edgerton, *supra* note 61, at 536. *Cotting v. Kansas City Stock Yards Co.*, 183 U. S. 79 (1901), is however, sometimes cited as supporting it. That case involved the constitutionality of an act of the Kansas legislature which sought to impose, among other things, state regulation of charges on stock yards which handled a certain number of live stock per day. The Kansas City Stock Yards Company was the only yard large enough to fall within its provisions; and its complaint was grounded upon an alleged denial of the equal protection of the laws. This contention (and this contention only) the Court upheld in a brief, one-paragraph opinion of six justices. The minority views of Mr. Justice Brewer, as expressed at p. 95 *et seq.*, to the effect "that the state's regulation of . . . charges is not to be measured by the aggregate of . . . profits, determined by the volume of business, but by the question whether any particular charge to an individual . . . is, considering the service rendered, an unreasonable exaction" in no wise entered into the Court's decision. As stated by Edgerton, "The Court had no opportunity, if it had

any possible pertinence today (unfortunately) is whether it is a maximum limitation; *i.e.*, should the value of the service come first even if rates lower than necessary to earn a fair return are thereby enforced? Unquestionably, there is much language to be found in support of an affirmative answer,<sup>65</sup> and there are even a few state court decisions to this effect.<sup>66</sup> But the decisions of the Supreme Court are definitely the other way. That Court has never held that a public service, *able* to earn a fair return, did not have a primary right to do so. In *Bluefield Water Co. v. Public Service Commission* the following principle of law was found "so well settled by numerous decisions of this Court" that citations were considered unnecessary:

"Rates which are not sufficient to yield a reasonable return upon the value of the property used at the time it is being used to render public service are unjust, unreasonable and confiscatory, and their enforcement deprives the public utility company of its property, in violation of the Federal Constitution."<sup>67</sup>

Again, in *United Railways & Electric Co. v. West*, the Supreme Court pointed out: ". . . the fundamental principle to be observed is that the property of a public utility, although devoted to the public service and impressed with a public interest, is still private property; and neither the corpus of that property nor the use thereof constitutionally can be taken for a compulsory price which falls below the measure of just compensation. One is confiscation no less than the other."<sup>68</sup>

The question<sup>69</sup> was squarely raised in recent litigation before the United

the inclination, to decide such a thing, and the majority did not intimate that it had any such inclination." See Edgerton, *supra* note 61, at 537.

*Cf.* the attitude of the Commission on this subject as expressed on several recent occasions. Fifteen Per Cent Case, 1931, *supra* note 13, at 581, 582; General Commodity Rate Increases, 1937, 223 I. C. C. 657, 730. During the first years of the depression, it called upon the Congress to recognize, by legislation, that in times of prosperity railroad earnings should rise above normal, since in times of depression they inevitably fall below. FORTY-FOURTH ANNUAL REPORT (Interstate Commerce Commission 1931) 581, 582.

<sup>65</sup>Three opinions of the United States Supreme Court are usually referred to: *Covington & Lexington Turnpike Road Co. v. Sandford*, 164 U. S. 578, 596 (1896); *Smyth v. Ames*, 169 U. S. 466, 547 (1898); and *Public Service Commission of Montana v. Great Northern Utilities Co.*, 289 U. S. 130 (1933).

None of these is, we think, a dispositive authority. The suggestion in the *Covington* case that the value of the service is paramount in rate-fixing is pure dictum, and, in any event, has been overruled by later decisions. The finding in *Smyth v. Ames*, moreover, is only to the effect that the company's right to a fair return and the public's right to rates reflecting the reasonable "worth" of the service are coördinate; there is no intimation that the latter criterion should prevail in case of a clash. Finally, if those who cite the *Northern Utilities* case as supporting the priority of the value of the service would only turn to pp. 136, 137 of that opinion they would find that that question was specifically found not to have been properly raised.

As we shall see, *infra* note 80, the Interstate Commerce Commission has also referred to *CORPUS JURIS*, Vol. 10, p. 418, on this point.

<sup>66</sup>*Gay v. Damariscotti-New Castle Water Co.*, 162 Atl. 264 (Me. 1932), following *Hamilton v. Caribou Water, Light & Power Co.*, 117 Atl. 582 (Me. 1922). *Contra*: see state court decisions cited *infra* note 70.

<sup>67</sup>262 U. S. 679, 690 (1923).

<sup>68</sup>280 U. S. 234, 249 (1930).

<sup>69</sup>See *supra* p. 317.

States District Court in Utah.<sup>70</sup> There, the state commission had required a 10 per cent reduction in the rates of an electric company which, it was found, had only received an average return of slightly in excess of 4 per cent during the preceding five years.<sup>71</sup> The depression, the drouth and the low price of farm products were said to justify the reduction, and the commission's order rested "on a finding that the value of the complainant's commodity to its patrons was not worth to them the existing rate".<sup>72</sup> While it was agreed "that any material reduction . . . would mean service at rates quite generally held by the courts and commissions to be confiscatory", the commission<sup>73</sup> nevertheless held that "in matters of regulation the public interests must always be regarded first and as a paramount".<sup>74</sup> The statutory District Court promptly upset this finding and, without dissent, could not agree "that any opinion of the United States Supreme Court sustains the proposition that in fixing fair and reasonable rates the customer's ability to pay and the value of the service to him are paramount and controlling".<sup>75</sup> One year later, another District Court reached the same conclusion on essentially similar facts.<sup>76</sup>

<sup>70</sup>*Telluride Power Co. v. Public Utilities Commission*, 8 F. Supp. 341 (D. Utah 1934), before a three-judge District Court consisting of Lewis and Bratton, Circuit Judges, and Johnson, District Judge.

The decision has been cited with approval by the highest courts of three states. *State v. Dept. of Public Works of Washington*, 38 P. (2d) 350 (Wash. 1934); *Mountain View Rural Telephone Co. v. Interstate Telephone Co.*, 46 P. (2d) 723 (Idaho 1935); *Oklahoma Cotton Ginners' Ass'n v. State*, 51 P. (2d) 327, 341 (Okla. 1935). In the decision first cited, at p. 353, the court said: "It is true, perhaps, that the abandoning of the farms will affect the future demands for power, but if enlightened self-interest does not lead the respondents to go as far as they can or may in maintaining a market, the law may not compel it."

<sup>71</sup>*Telluride Power Co. v. Public Utilities Commission*, *supra* note 70, at 342.

<sup>72</sup>*Ibid.*

<sup>73</sup>Citing practically the same decisions as relied upon by Mr. Lilienthal for a similar conclusion, i.e., *Covington & Lexington Turnpike Road Co. v. Sandford*, 164 U. S. 578 (1896); *Smyth v. Ames*, 169 U. S. 466 (1898); *San Diego Land & Town Co. v. Jasper*, 189 U. S. 439 (1903); *Cotting v. Kansas City Stock Yards Co.*, 183 U. S. 79 (1901); *Vandalia Railroad Co. v. Schnull*, 255 U. S. 113 (1921); *Brunswick & T. Water Dist. v. Main Water Co.*, 59 Atl. 537 (Me. 1904); *Hamilton v. Caribou Water, L. & P. Co.*, 117 Atl., 582 (Me. 1922).

Of the five cited Supreme Court decisions, the *Covington* case and *Smyth v. Ames* are discussed briefly, *supra* note 65, and the *Cotting* case, *supra* note 64. The other two decisions appear to give even less support to the state commission's conclusion. Thus in the *Jasper* case a unanimous court, through Mr. Justice Holmes, held "it no longer . . . open to dispute that under the Constitution 'what the company is entitled to demand, in order that it may have just compensation, is a fair return upon the reasonable value of the property at the time it is being used for the public', and it pointed out, in this regard, that "reasonable value" did not necessarily mean the "original cost" of the property but only the present value of that "proportionate part of the system . . . actually used and useful" in the public service. In the *Vandalia Railroad* case the only question was whether state-imposed rates, unremunerative on a particular traffic, might nevertheless be upheld on the ground that the return as a whole from state business was satisfactory, and the Court, relying upon *Norfolk & Western Ry. Co. v. Conley*, 236 U. S. 605 (1915), answered in the negative.

<sup>74</sup>*Telluride Power Co. v. Public Utilities Comm.*, *supra* note 70, at 342.

<sup>75</sup>*Ibid.* at 343.

<sup>76</sup>*Kern Island Canal Co. v. R. R. Comm. of Calif.*, 12 F. Supp. 848 (N. D. Cal. 1935).

If, then, it be assumed that at the time of the investigation in the *Passenger* case<sup>76a</sup> the fares were generally yielding a fair return, but no more, it seems reasonably clear that their reduction, in the light of the facts revealed by the investigation, could not have been required. Any other conclusion could hardly be reconciled with the notion, which still persists in some quarters, that, since the railroads are privately owned, they must continue, if at all, on investments presumably made for profit.

### III

Does a withdrawal of this assumption, with a facing of the actual situation revealed by the *Passenger* case, warrant a different conclusion—the conclusion, indeed, arrived at by the Commission? Because the returns of the Eastern lines from their passenger business were far from satisfactory, was the Commission, in other words, justified in taking their competitive problem in its own hands and forcing upon them a policy of rate-making which it thought would help? In reviewing rates, has the Commission, in still other words, properly assumed a right to judge not only the value of railroad service *per se*,<sup>77</sup> but also the relative value of that service as compared with the value of the services offered by competitors?

<sup>76a</sup>214 I. C. C. 174 (1936).

<sup>77</sup>The Commission has spoken of the value of the service and its "bundle of constituents". *Boileau v. Pittsburgh & Lake Erie R. R.*, 22 I. C. C. 640, 652 (1912). It has been held to have relation to the value of the goods transported, *Silk Association of America v. Pennsylvania R. R.*, 44 I. C. C. 578, 580 (1917), and to the ability of a shipper to reach a market and "make his commodity a subject of commerce . . . at a profit". *Imperial Coal Co. v. Pittsburgh & Lake Erie R. R.*, 2 I. C. R. 436, 442, 443 (1889). More recently, the Commission has drawn a distinction between this element and what the traffic will bear. In *Mountain-Pacific Oil cases*, 192 I. C. C. 599, 636 (1933), it said: "In determining reasonable freight rates, we have always recognized that consideration should be given, among other things, to what has been called the value of the service. This has never been very clearly defined, and it has been confused with what the traffic will bear. There is some resemblance between the two things, but they are not identical. It has been deemed reasonable that the higher valued commodities should pay somewhat higher rates, relatively, than the lower valued commodities, and that the relative burden of transportation cost in the distribution of a product should be taken into account. That is, in substance, what is meant by giving weight to the value of the service. It is equivalent to charging what the traffic can reasonably be required to bear. But charging what the traffic will bear carries this doctrine to an extreme, and we have never recognized that it has any place in public regulation."

Edgerton, *supra* note 61, at 542, 543, says that the value of the service is "public policy", and Cabot, *infra* note 120, at 804, points out that, through use of the concept, an effort is made to regulate as if competition existed. In an article by Clarence M. Updegraff, *Changing Factors of Reasonable Rates* (1931) 29 *MICH. L. REV.* 306, 310, this element is said not to be what the shippers are willing to pay but what they should fairly be expected to pay in the light of existing economic and social conditions. In SHEARFMAN, *THE INTERSTATE COMMERCE COMMISSION* (1936) Part III, Vol. B, 425, *et. seq.*, is set forth an exhaustive analysis of various definitions, and the conclusion is reached, at pp. 427, 428, 440, 441, that the "value of the service is an elusive concept which has lent itself to interpretations related only loosely, if at all, to the underlying justification for its use. . . . The standard . . . is grounded essentially in economic factors. . . . The problem is essentially one of apportioning the total cost burden." Cf. 1 SPURR, *GUIDING PRINCIPLES OF PUBLIC SERVICE REGULATION*, *supra* note 58, at 195, *et seq.*

Before attempting to answer these closely related questions (which really are but one question), it is important to observe that they also arise in connection with the Commission's treatment of several recent applications seeking freight rate increases. In 1931, for example, in filing the first of a series of such applications, the railroads were "not seeking [a] full return on value" but only some relief from "a part of their present burden".<sup>78</sup> But, despite an unquestioned deficiency in earnings, they were turned down<sup>79</sup> because, said the Commission, the value of the service should come first.<sup>80</sup> By such a finding, the Commission apparently meant no more than that, in its judgment, the "actual revenue results" of an increase would be unfavorable, and it expressed the unqualified view that "we are not justified in approving a rate increase if we are convinced that such increase will not operate to the revenue advantage of the carriers."<sup>81</sup> Pointing to movements by truck as "developing with great rapidity"—a competition which the railroads were found to have "underrated"—and to other conditions which, if the increase were granted, would, in its opinion, tend to divert or stifle traffic, the Commission concluded that "the facts . . . show beyond question that there are elements of plain peril to the railroads in such an increase . . . as they propose, . . . a 15 per cent increase . . . would . . . harm rather than help the railroads."<sup>82</sup> Again in 1935, it was agreed that "so far as revenue needs" were concerned, the railroads had "made out their case",<sup>83</sup> but the Commission

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*Cf.*, finally, the attitude of some shippers as represented in a letter (incorporated in a report of the Board of Trade of Burleigh, England, 1890, on transportation rates) which Spurr, in his *Guiding Principles of Public Service Regulation*, *supra* note 58, sets forth: "What we want is to have our fish carried at half the present rate. We don't care a — whether it pays the railway or not. Railways ought to be made to carry for the good of the country or they should be taken over by the Government. That is what all traders want and what they mean to get." 2 Boyle & W. R. & Canal Traffic, 126."

<sup>78</sup>Fifteen Per Cent Case, 1931, *supra* note 13, at 557.

<sup>79</sup>With the exception of the surcharges described *supra* note 13.

<sup>80</sup>Fifteen Per Cent Case, 1931, *supra* note 13, at 563. The Commission regarded the law as "accurately" stated in the following passage from CORPUS JURIS Vol. 10, p. 418: "The public is entitled to demand that no more shall be exacted from it than the services rendered are reasonably worth, and this right takes precedence even over the right of the carrier to a fair return on its investment when the two rights cannot stand together. In consequence, the value of the services to the public is an important factor in determining the reasonableness of the rates charged therefor." For the Supreme Court decisions on this point, see *supra* at pp. 318-319.

<sup>81</sup>*Id.* at 563. See *supra* note 13.

<sup>82</sup>*Id.* at 575, 576, 577. That the Commission rejected this application because it thought increased rates would hurt the railroads was pointedly emphasized by its refusal, two years later, to reduce rates on basic commodities despite express findings to the effect that (1) "the value of the service to the shipper . . . has been lowered", and (2) "the competition of other forms of transportation has grown to such formidable proportions that the opinion expressed in 1931 no longer portrays the situation." General Rate Level Investigation, 1933, 195 I. C. C. 5, at 69, 70. Reaffirming "a duty to do that which presents the greatest promise of preserving in operation the efficient railroad mileage of the country", it found in the cited case that, since sufficient additional traffic was not in sight, "general reductions in rates would tend to defeat that end." *Id.* at 9, 64, 65, 69, 71. "The country," the Commission concluded, is not "ready to abandon its railroads."

<sup>83</sup>Emergency Freight Charges, 1935, 208 I. C. C. 4, at 57 (1935).

rejected another application for increased rates with the familiar advice that "the ultimate effect of establishing the proposed rates as a whole would probably be to harm rather than help the railroads through diversion of traffic to other forms of transportation and in other ways."<sup>84</sup> And when, in 1937, still another attempt to increase rates was made, the railroads were able to obtain a substantial part of what they asked for only because, as found by the Commission, "the evidence does not warrant a definite conclusion that the increased rates will not yield applicants additional income, both immediate and ultimate."<sup>85</sup> During the next year, 1938, the Commission permitted further limited advances in rates<sup>86</sup> to offset wage increases,<sup>87</sup> but only to the extent that, in its opinion, they would help.<sup>88</sup> In this last decision, with its eye always on the competitive situation,<sup>89</sup> it pointed out that, as to "need for improvement of their financial condition",<sup>90</sup> the trucks were no better off than the railroads,<sup>91</sup> and "if the present trend in the motor industry continues, it will not, in the long run, be capable of transporting as considerable a portion of the traffic as that which has been successfully attracted to the highways from the rails."<sup>92</sup>

But the question remains, should the Commission make its own appraisal of the effect of rate changes upon the competitive position of the railroads and, often overruling management, decide what will help them, what will harm them?

There would seem to be but one answer to this question if we recognize, as we must, that the railroads (theoretically at least) are still privately owned.<sup>93</sup> For their right to a reasonable return is unqualified in our consti-

<sup>84</sup>*Id.* at 58. Because the emergency of "such gravity" the Commission did allow, however, as a temporary measure, a system of "Emergency Charges", and this was done because "the evidence is not sufficient to warrant us in expressing a judgment, counter to that of applicants' traffic managers, that no increase *whatever* would be efficacious at this time." *Id.* at 58, 59 (italics supplied).

<sup>85</sup>General Commodity Rate Increases, 1937, 223 I. C. C. 657, 728, 729. Cf. Fourth Supplemental Report on Further Hearing in this case, 229 I. C. C. 435, 440 (1938), quoted from, *infra* note 127.

<sup>86</sup>Fifteen Per Cent Case, 1937-1938, *Ex Parte* 123, 226 I. C. C. 41.

<sup>87</sup>See *Report of the Emergency Board under the Railway Labor Act*, referred to *infra* note 95.

<sup>88</sup>Fifteen Per Cent Case, 1937-1938, *supra* note 86, at 74, 77, 78. That there was a real need for help is apparent from the Commission's finding: "The present revenues of the applicants are inadequate, whether the simple common-law tests be applied, or if they be judged by the statute with reference to their sufficiency, under honest, economical, and efficient management, to provide in the public interest adequate and efficient railway transportation service at the lowest cost consistent with furnishing such service." *Id.* at 136.

<sup>89</sup>*Id.* at 72 to 74.

<sup>90</sup>*Id.* at 74.

<sup>91</sup>*Id.* at 136.

<sup>92</sup>*Id.* at 74.

<sup>93</sup>As said by the Commission in General Commodity Rate Increases, 1937, *supra* note 85, at 728, 729, "The public service which our railroads perform has been committed to private enterprise sustained by private capital. . . . The game must be played according to the rules."

tutional law,<sup>94</sup> and when, as at present, that return is not being (and apparently cannot be) earned, they should be free to take such steps as, in their opinion, will go as far as possible towards that goal.<sup>95</sup>

Under the Interstate Commerce Act, as originally passed in 1887, the scope and policy of regulation were authoritatively defined as follows:

“Subject to the two leading prohibitions that their charges shall not be unjust and unreasonable, and that they shall not unjustly discriminate, so as to give undue preference or advantage, or subject to undue preference or disadvantage persons or traffic similarly circumstanced, the act to regulate commerce leaves common carriers, as they were at common law, free to make special contracts looking to the increase of their business, to classify their traffic, to adjust and apportion their rates so as to meet the necessities of commerce, and generally to manage their important interests upon the same principles which are recognized as sound and adopted in other trades and pursuits.”<sup>96</sup>

Later, under the Hepburn Act of 1906, the Commission of course was given the power to prescribe reasonable rates, but this did not authorize it to interfere with the essential right of the railroads to adopt such *policies* of rate-making as they desired. Almost two years after this act was passed, the Supreme Court reaffirmed the principle of the earlier cases,<sup>97</sup> and still later expressly denied the power of the Commission “to control the general policy of the owners of the railroads as to fixing rates”. Any other conclusion, the Court said, “would in effect assert public ownership without any of the responsibilities which ownership would imply”.<sup>98</sup> And when, in 1920, the power of the Commission was further extended to the fixing of minimum rates, the principle was left untouched. “The Transportation Act,” the Supreme Court said, “has not abolished this proprietorship.”<sup>99</sup> In 1924, the Court again pointed out that “a carrier is entitled to initiate rates, and, in this connection, to adopt such policy of ratemaking as to it

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<sup>94</sup>*Supra* pp. 316-320.

<sup>95</sup>It is of course recognized that, as to the base upon which the railroads should be entitled to earn a return, there are many questions. Cf. *Report of the Emergency Board under Section 10 of the Railway Labor Act*, dated October 29, 1938, refusing to recommend reduced wages for railroad workers, at 14, 15, 49. And it is also recognized that the constitutional right of a weak road to a reasonable return may be illusory because of the practical necessity of its meeting the rates of stronger competitors. But these are questions beyond the scope of this paper, which is concerned with action taken by the Interstate Commerce Commission *after it has first determined that the railroads need and deserve greater earnings.*

<sup>96</sup>*Interstate Commerce Commission v. Baltimore & O. R. R.*, 43 Fed. 37, 50, 51 (C. C. S. D. Ohio 1890). This language was specifically adopted by the Supreme Court: *Cincinnati, N. O. & T. P. Ry.*, 167 U. S. 479, 493 (1897); *Interstate Commerce Commission v. Alabama M. R. R.*, 168 U. S. 144, 165 (1897).

<sup>97</sup>*Interstate Commerce Commission v. Chicago G. W. Ry.*, 209 U. S. 108 (1908).

<sup>98</sup>*Southern Pacific Co. v. Interstate Commerce Commission*, 219 U. S. 433, 443, 444 (1911).

<sup>99</sup>*Interstate Commerce Commission v. Oregon-Washington R. & N. Co.*, 288 U. S. 14, 41 (1933).

seems wise,"<sup>100</sup> and in 1935, it emphasized the same point in sustaining an injunction against an order of the Commission which sought to prevent a reduction in certain coal rates proposed by a carrier.<sup>101</sup>

In the light of this language of the Supreme Court it is difficult to defend the decision in the *Passenger* case and the repeated findings of the Commission to the effect that rate increases should be denied because they will, in its opinion, do more harm than good.

Such a defense is no less difficult because, in every one of the cited cases, the Commission appears to have recognized the railroads' right to a reasonable return.<sup>102</sup> Indeed, the basic fault with the Commission's recent approach to the "regulation" of railroad rates is found in its insistence upon dictating the methods by which that end may be attained (so far as it may be attained these days). And *the more* the Congress, by its rate-making directions,<sup>103</sup>

<sup>100</sup>United States v. Illinois Central R. R., 263 U. S. 515, 522 (1924), the Court citing: Interstate Commerce Commission v. Chicago Great Western Ry., 209 U. S. 108, 118-119 (1908); Southern Pacific Co. v. Interstate Commerce Commission, 219 U. S. 433 (1911); Interstate Commerce Commission v. Louisville & Nashville R. R., 227 U. S. 88, 92 (1913).

<sup>101</sup>United States v. Chicago, M., St. P. & P. R. R., *infra* note 106. Cf. Baltimore & O. R. R. v. United States, 22 F. Supp. 533 (N. D. N. Y. 1937), where the Commission's power to enforce competitive sugar rates from the South to the North was successfully challenged.

<sup>102</sup>See *supra* note 93. Cf. FIFTY-FIRST ANNUAL REPORT (Interstate Commerce Commission 1937) 8: ". . . It will be generally agreed, not only that the railroads are constitutionally entitled to an opportunity to earn a reasonable return on the fair value of their carrier properties but also that it is imperative that they be able, in general, to earn such a return under what may be called normal conditions, if the system of private ownership of railroads is to function at all satisfactorily. It will also be agreed, although perhaps not so generally, that if a reasonable return cannot be earned in times of depression, the railroads should have a somewhat corresponding opportunity to earn more than a reasonable return in times of prosperity, so that the average may be fair." See *supra* note 64.

In Mountain-Pacific Oil cases, 192 I. C. C. 599, 637 (1933), the Commission said: "The Supreme Court has held that we cannot require traffic to be carried at less than cost plus a reasonable profit, regardless of whether the traffic can bear such rates. Northern Pacific Railway v. North Dakota, 236 U. S. 585."

<sup>103</sup>Prior to 1920, there was no so-called rate-making rule; but since that year there have been two. The "old" Section 15a, enacted as an integral part of the Transportation Act, 1920, provided:

"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; *Provided*, That the commission shall have reasonable latitude to modify or adjust any particular rate which it may find to be unjust or unreasonable, and to prescribe different rates for different portions of the country." (February 28, 1920, c. 91, § 422, 41 STAT. 488.)

This mandate was held to have imposed upon the Commission, in unqualified terms, "an affirmative duty . . . to fix rates" which would produce a fair return upon the aggregate value of railway properties. Wisconsin R. R. Comm. v. C. B. & Q. R. R., 257 U. S. 563, 585 (1922); Dayton-Goose Creek Ry. v. United States, 263 U. S. 456 (1924). No other direction was given; no other criterion of reasonableness included; and yet, two years after its enactment, the Commission decided that its "function under

emphasizes the carrier's need for adequate revenues, *the more* the Commission feels under obligation to inquire into the "actual" results which, in this era of competition, the proposed rate changes will produce. Upon the same underlying theory, it has forbidden the proposed reduction of certain rates and ordered others to be raised because, in its judgment, they constituted a threat to railroad revenues.<sup>104</sup> While the Commission has held that its minimum rate power should be "sparingly exercised",<sup>105</sup> and the courts

the law is not that of mere computers" and, although the carriers were not earning a fair return in the aggregate, ordered a ten per cent rate reduction. *Reduced Rates*, 1922, 68 I. C. C. 676, 730. It was also in purported compliance with this statutory direction that the Commission found the value of the service to take precedence over the railroads' right to a fair return and, at a time when they were badly in need of more revenue, declined to permit a rate increase because it would "harm rather than help the railroads". *Fifteen Per Cent Case*, 1931, *supra* note 13. See *supra* at p. 321.

In 1933, the "old" section gave way to a "new" Section 15a, which is still in effect, and it provides:

"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."

(As amended June 16, 1933, c. 91, Title II, § 205, 48 STAT. 220.)

This "new" rate-making rule brought no real change in the substantive law. The "attracting of capital" was pointed to by Commissioner Eastman as "a central and cardinal need, which ought to be recognized . . . particularly . . . under present conditions", and that is precisely the need, according to the Supreme Court, which the amendment, as passed, *did* recognize. See *Railroad Legislation, Testimony before House Committee, infra* note 116, at 451-453. In *State of Florida v. United States*, 292 U. S. 1 (1934), the Court held, at p. 8: "The substituted rule of rate making by its express terms emphasizes the carriers' need of adequate revenues. . . . The new Act discloses no intention to weaken national control for essential national purposes over the railway system of the country. It was rather designed to aid that control in the light of the depressed economic condition of the railways." Cf. *United States v. Interstate Commerce Commission*, 88 F. (2d) 780 (App. D. C. 1937); *Algoma Coal & Coke Co. v. United States*, 11 F. Supp. 487 (E. D. Va. 1935); *Baltimore & O. R. R. v. United States*, 22 F. Supp. 533 (N. D. N. Y. 1937).

Even the Commission, in rejecting a contention on behalf of shippers (opposing a rate increase) that the amendment had "great significance" and made the "free movement of traffic" the "prime" consideration, as distinguished from "carriers' revenues" under the "old" Section 15a, pointed out: "We have heretofore expressed the view that the broad purpose of and the ultimate responsibilities imposed upon us by both the old and new Section 15a (2) are the same." *Emergency Freight Charges, supra* note 83 at 25, 26. Moreover, "the effect of rates on the movement of traffic" is a consideration which has always entered into the decisions of the Commission, and when the "new" Section 15a was favorably reported to the House, Chairman Rayburn's Committee stated that it would be difficult to conceive of reasonable rates which would ignore it. See *Railroads—Recapture and Valuation*, H. R. REP. No. 15, 73rd Cong., 1st Sess. (Committee on Interstate and Foreign Commerce 1933) at p. 4. See, also *Passenger case*, 214 I. C. C. 174, 231, and cases there cited; SHARFMAN, *THE INTERSTATE COMMISSION* (1936) Part III, Vol. B, 439, note 212; Commissioner Eastman, *Railroad Legislation, Testimony Before House Committee, infra* note 116, at pp. 71, 73, 124, 125. To Congressman Hoch's suggestion that the value of the service be specified as an element in the rate-making rule, Commissioner Eastman replied that "that would be considered in any event". *Id.* at 460.

<sup>104</sup>*Salt Cases of 1923*, 92 I. C. C. 388; *In re Container Service*, 173 I. C. C. 377, 430-1 (1931); *Gasoline from San Francisco Bay Points to Ogden, Utah*, 198 I. C. C. 683 (1934).

<sup>105</sup>*Sugar Cases of 1922*, 81 I. C. C. 448, 472; *Ex Lake Iron Ore from Chicago to Granite City*, 123 I. C. C. 503 (1927).

have not always encouraged its use,<sup>106</sup> it can hardly be said that the railroads, when proposing reductions, are regarded as better managers than when proposing increases.<sup>107</sup> Particularly is this so when they seek to meet the competition of other forms of transportation,<sup>108</sup> and the Commission feels called upon to decide whether the reduction is greater than necessary for that purpose<sup>109</sup>—an inquiry closely related to the one which, as we have seen, it now pursues in a review of maximum rates.<sup>110</sup> Only a few weeks

<sup>106</sup>See *United States v. Chicago, M., St. P. & P. R. R.*, 294 U. S. 499, 505, 506 (1935). There, a proposal to reduce certain bituminous coal rates, condemned by the Commission as promising to impair "the revenue of the carriers . . . and their ability to provide the adequate and efficient transportation service contemplated by section 15a of the act", was found justified by the Court as an instance where "a carrier is entitled to initiate rates and . . . to adopt such policy of rate making as to it seems best."

<sup>107</sup>But *cf.*, *Lumber from Pacific Coast to Eastern Points*, 210 I. C. C. 317 (1935); *Citrus Fruit from Florida to North Atlantic Ports*, 211 I. C. C. 535, 549 (1935), 226 I. C. C. 315, 325 (1938).

<sup>108</sup>*Phosphate Rock and Related Commodities*, 174 I. C. C. 373 (1931); *Iron & Steel from Illinois Territory*, 188 I. C. C. 359 (1932); *Sugar from California to Chicago*, 211 I. C. C. 239, 253 (1935).

<sup>109</sup>The power to divide the traffic between the trunks, let us say, and the railroads—both under the jurisdiction of the same Commission—has alarming possibilities. See *infra* note 112 for the test which the Commission has tentatively adopted in this connection—a test which cannot be satisfactorily applied because "costs" are not known, and never will be.

<sup>110</sup>When the Commission considers the effect of the rates on the movement of traffic (as it professes always to have done in the past and is presently directed to do by the "new" Section 15a), it is an entirely different inquiry from what it was a relatively few years ago.

This change in the "regulation" of railroad rates may be illustrated by two decisions. In *Stockton Port District v. Southern Pacific Co.*, 200 I. C. C. 783 (1934), it was said: "The theory that the value of the service to the shipper, as determined by the rates available to him by competing agencies of transportation, must be given paramount weight is not tenable." But two years later, in the *Passenger* case, the Commission found that "this competition . . . may no longer be disregarded in passing upon the reasonableness of fares by railroad." Indeed, only five years before he wrote the majority report in the *Passenger* case, Commissioner Porter, dissenting in *Refined Petroleum Products in the Southwest*, 171 I. C. C. 381, 454 (1931), observed: "It is said, however, that we must cut these rates or the railroads will lose their traffic to competitors—the trucks, the water ways, and the pipe lines. When, may I inquire, were we appointed the managers of the railroads? Matters such as meeting competition under circumstances like these are entirely for those who are charged with the management of these properties, and not for regulatory bodies. It is not within our province to consider competition as a factor in fixing maximum reasonable rates. *Southern Class Rate Investigation*, 100 I. C. C. 513 (1925)."

For a collection of other decisions to the same effect as the *Stockton* case, see *Report of the Special Committee on Competition as a Factor and Motif in Transportation Regulation*, A. B. A., Section of Public Utility Law, presented at 1936 annual meeting. The rule was the same whether the competition was by water, *North Carolina Pine Assn. v. A. C. L. R. R.*, 85 I. C. C. 270 (1923); by pipe-line, *Proportional Rates on Petroleum*, 74 I. C. C. 349 (1922); or by truck, *National Poultry, Butter and Egg Association v. A. & R. Co.*, 192 I. C. C. 13 (1933). The reason for the rule was well stated in *Mountain-Pacific Oil cases*, 192 I. C. C. 559, 638 (1933)—the one decision cited by the Commission in the *Passenger* case for a contrary doctrine—as follows: "The initiative in this respect should be left to the railroad managers, who should be able to appraise the necessity for such reductions more accurately than can we." See *Passenger* case, 214 I. C. C. 174, 231 (1936).

All of the cases above referred to were cited in the Eastern lines' Brief in the *Passenger* case, but there is no reference to them in the Commission's report. All that is therein said on the point is this: "Reference is made to a number of cases in which

ago were the carriers told that, to regain to the all-rail routes a fair share of the pig iron traffic now moving from Cleveland, Ohio, to Worcester, Mass., via water to Beacon, N. Y., thence rail to destination, they need publish a rate no lower than \$6.60 a gross ton, as compared with a rate of \$6.05 which they sought to establish. Unless the Commission, on reconsideration, can be persuaded to permit the lower rate, the railroads will not, apparently, move a pound of this attractive, heavy-loading business.<sup>110a</sup>

#### IV

In any consideration of this modern regulation of rates it cannot be overlooked that the same Commission which has been attempting to solve the business problems of the railroads and to save them from "plain peril" has, since 1935, also been under obligation to "foster . . . develop and preserve" the trucks and busses.<sup>111</sup> In carrying out this mandate, will the Commission, for example, require the busses to reduce their fares so that passenger traffic may be diverted from the rails to their revenue advantage? And when the reduced bus fares are in effect, will it find that, on account of greater bus competition, the value of the railroad service is less and its fares should come down too? In the *Passenger* case the Commission evaded such questions.<sup>112</sup>

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the courts and the Commission have declared that the latter is not the manager of the railroads. We have said a number of times that the law does not contemplate the transfer to us of the duties of the general managers of the railroads. That the law does confer upon us the power to review some of the duties which ordinarily repose in railroad management is beyond question, for the making of rates is such a duty. Just where such duties which are reviewable by us end and those which are not so reviewable begin has never been clearly defined, perhaps is impossible of specific definition, and must depend upon the particular circumstances as they arise." *Passenger* case, *supra*, at 229.

<sup>110a</sup>Pig Iron to Worcester, Mass., Fourth Section Application No. 17165, mimeographed, decided February 17, 1939.

<sup>111</sup>MOTOR CARRIER ACT, 1935, Section 202 (a); INTERSTATE COMMERCE ACT, Part II, as added August 9, 1935, c. 498, 49 STAT. 543.

<sup>112</sup>By finding, over the objection of counsel for the National Association of Motor Bus Operators, that the reduced fares "will insure to respondents more adequate revenue by drawing to the rails a substantial portion of the public now traveling by private automobile or not traveling at all." *Passenger* case, 214 I. C. C. 174, 231, 232.

More recently, the Commission's attitude has been somewhat clarified; and apparently either agency of transportation may meet the competition of the other if financial gain to it will result. See *Petroleum from California to Oregon*, 214 I. C. C. 668 (1936); *Petroleum Between Washington and Oregon*, 225 I. C. C. 382 (1937), and particularly the concurring opinion of Commissioner Eastman in the latter case. In this regard the Commission is looking with favor upon studies of the cost of service of the competing agencies. See *Bunker Coal, Alabama Mines to Gulf Ports*, 227 I. C. C. 485 (1938); *Examiner's Proposed Report in Naval Stores from Mississippi Points*, Docket 27571, as reported in *TRAFFIC WORLD*, August 27, 1938, at 381. Cf. *Refrigerator Material from Memphis, Tenn. to Dayton, O.*, 4 M. C. C. 187 (1937). Here, the Commission disallowed reduced truck rates predicated on an out-of-pocket cost theory, but said that "if the railroads are hereafter to be allowed to apply this theory in competing with the trucks, the latter must fairly be allowed equal leeway." Subsequently, this "leeway" was accorded in permitting truck rate reductions to meet rail rate reductions. *Stoves from Alabama and Tennessee to Interstate Points*, 4 M. C. C. 641 (1938).

Moreover, in dealing with railroad rates, the Commission has also to recognize the "declared policy of Congress to promote, encourage, and develop water transportation service, and facilities in connection with the commerce of the United States, and to foster and preserve in full vigor both rail and water transportation".<sup>113</sup> Certainly such a duty does not add to the qualifications of the Commission as a manager of the railroads, and in discharging it, there is evidence that the water carriers have not had too much to complain about.<sup>114</sup> The Supreme Court recently felt called upon to say:

"The admonition does not mean that carriers by rail shall be required to maintain a rate that is too high for fear that through the change they may cut into the profits of carriers by water. The most that it can mean, unless, conceivably, in circumstances of wanton or malicious injury, is that where carriers by land and water are brought within the range of the regulatory powers of the Commission, as *e.g.*, in establishing through routes or joint rates, there shall be impartial recognition and promotion of the interests of all."<sup>115</sup>

Obviously, a general manager for the railroads should be one who has no obligation to "foster" the trucks and "promote, encourage and develop water transportation". If nothing else may be said for those who are on railroad pay-rolls, they are, supposedly, railroad men.

## V

In defense of the Commissions, it will be urged that, if the railroads were free to adopt such policies of rate-making as they thought best in an effort to achieve something like a reasonable return, there could no longer be any effective control of the level of their rates. Even if this were the result of recognizing the principle repeatedly announced by the Supreme Court, it would not be an unfortunate one.<sup>116</sup> Other agencies are at work to keep railroad rates down; and they do a much better job in that direction than can any public authority. So far as minimum rates are concerned, there is much to be said in favor of letting the railroads meet their competition, unhampered by the possible interference of the Commission.

<sup>113</sup>TRANSPORTATION ACT, 1920, § 500, 49 U. S. C. A. § 142.

<sup>114</sup>*E.g.*, Transcontinental cases of 1922, 74 I. C. C. 48; Tin Plate to Sacramento, 140 I. C. C. 643, 646 (1928).

<sup>115</sup>Mississippi Valley Barge Line Co. v. United States, 292 U. S. 282 (1934).

<sup>116</sup>In Fifteen Per Cent Case, *supra* note 13, at 558, for instance, the railroads sought increased freight rates as we have seen but, as noted in the Commission's report, "no increase in passenger fares is sought, because of the feared effect on traffic and revenue."

As Commissioner Eastman pointed out in 1932: "In 1920, we allowed the standard passenger fare to go up to 3.6 cents per mile. Now, we have not changed that since and, although the passenger business is falling far short of a fair return, is much less profitable in fact than the freight business, no one, not even the railroads, is claiming that it would pay to increase that 3.6 cents per mile. On the contrary there are many, even among the railroads, who think that it might probably be well to reduce it. Now, that is a question of judgment. I think that can only be determined by experiment". *Railroad Legislation; Testimony before the Committee on Interstate and Foreign Commerce*, H. R., 72nd Cong., 1st Sess., on H. R. 7116 and 7117, January and February, 1932, at 33.

Nowadays, as Commissioner Aitchison has exclaimed, "No traffic is so 'tied to the rails' that it cannot be taken away by another competing form of transport, or for which a substitute cannot be found which can be transported at the lower rates afforded by some of these competitors, or which cannot be relieved from high freight rates by the relocation of the industry so as to avoid long rail hauls, or, indeed, any rail hauls at all. . . . All traffic is now potentially competitive; none is 'tied to the rails'".<sup>117</sup> If this be true of freight traffic, it is certainly true of passenger traffic.<sup>118</sup>

In its further defense it may be said that, after some years of experience, the Commission has proved a superior manager and, since it has often saved management from itself, should not be displaced. In denying the railroads a 15 per cent freight rate increase in 1931, for instance, the Commission, as a chief freight traffic officer, may possibly have exercised a superior judgment,<sup>119</sup> and in reducing the passenger fares of the eastern lines in 1936, it may have demonstrated marked ability as a chief passenger traffic officer. But such possibilities are beside the point. It cannot be assumed that railroad managements will propose a rate increase if, in their judgment, it will have the effect of reducing earnings.<sup>120</sup> Nor can it be assumed that

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<sup>117</sup>General Rate Level Investigation, 195 I. C. C. 5, 78 (1933). See also *Regulation of Transportation Agencies*, a Report of the Federal Coördinator of Transportation, SEN. DOC. No. 152, 73d Cong., 2d Sess. (1934); *Coördination of Motor Transportation*, 182 I. C. C. 263 (1932). For a full discussion and bibliography on the subject of competition, see MOULTON, *THE AMERICAN TRANSPORTATION PROBLEM* (Brookings Institute 1933).

*Cf. Report of the Emergency Board under Section 10 of the Railway Labor Act*, dated October 29, 1938, *supra* note 95, at 10, 11. *Report of the Special Committee on Competition as a Factor and Motif in Transportation Regulation*, A. B. A., Section of Public Utility Law, presented at annual meeting, August 25, 1936, at 6. See *infra* note 126, and particularly report of Commission's Bureau of Statistics there referred to. <sup>118</sup>The "Economies" of the Proposed Railroad Consolidation (1931) 7 PUB. UTIL. FOR. 323, 325: "The services of the one road [New Haven] between New York and Boston and of the other [Southern Pacific] between San Francisco and Los Angeles and between San Francisco and Portland are virtually non-competitive. Certain forms of competition do confront them; in each case the brisk rivalry of coastwise steamship lines and, of course, the eternal and irritating competition of the highway and airway . . . each road offers its through passengers, at least, trains which for comfort and luxury are not excelled by others elsewhere in the world."

<sup>119</sup>See Fifteen Per Cent Case, 1931, *supra* note 13, at 571. There, the Commission pointed to its qualifications as a manager, as follows: "It is not inappropriate to say that we approach this question with a background of experience with railroad rates, and the conditions under which they are made and can be maintained. We deal with hundreds of rate complaints every year, and in recent years have in addition carried on most extensive investigations of class rates and the rate adjustments on particular commodities. Evidence as to commercial and industrial conditions has been prominent in all of these investigations. We have also made extensive inquiries into motor transportation and are informed in regard to transportation by water-ways and pipe-lines, and we know the extent to which the railroads have reduced rates to meet such competition." See, also, Fifteen Per Cent Case, 1937-1938, *supra* note 86, at 78, where the same qualifications were stressed.

<sup>120</sup>*Cf. Cabot, Rate Making and Rate Regulation* (1932) 57 A. B. A. REP. 792. He says at pp. 793, 794, 807: "The problem is in its essence a problem of marketing; that is, of finding out what people want, and what they will pay for it. It is an economic problem of much the same character as that confronting the manager of a retail store, which can only be solved by understanding the mind, or the whim, of your customer. Your legal rights are matters of minor importance and if you give them a front seat

they will resist a rate reduction if it promises an improvement—an improvement to which they have every legal right.<sup>121</sup> The only valid assumption in the premises is that the railroads still retain a burning desire to function,<sup>122</sup> and to function in the best interests of their properties, as they see them.<sup>123</sup> Prior to the investigation in the *Passenger* case, for instance, the Eastern lines were only too aware of the fact, distressing to them, that people were traveling, by the thousands, in their private automobiles and by busses. For what other reason did they establish hundreds of excursion and special fares which, in the case of the New York Central (during a typical month in 1934), were used by 60 per cent of all its passengers? For what other reason did their average revenue per passenger mile decrease 23 per cent from 1923 to 1933? For what other reason did they (in the midst of a depression) quicken their schedules, air-condition their equipment, improve their facilities, hasten the installation of the latest safety devices?<sup>124</sup>

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they will obscure your view. . . . 'Fair value x fair return = fair price' is a formula which has often been used in public utility rate making, but it is a delusion and a snare, and I would recommend the rate maker to forget it. It will only tend to confuse him. . . . If the companies would think less about their rights and more about their duties they would serve their own interests better, for it is not so much their legal rights as their customers' requirements that are the question, and it is my rooted conviction that their own interests will be best served by a thoroughly selfless handling of them. Those who are animated by a spirit of narrow selfishness are unserviceable and may be dangerous advisors for the companies, the customers, and the commissions alike."

<sup>121</sup>Cf. NASH, PUBLIC UTILITY RATE STRUCTURES, *supra* note 58, at 320-5; 323, 324: "An old adage that a satisfactory trade must be of advantage to both parties cannot be over emphasized. . . . The present charges for transportation by local and interurban utilities are obviously fixed by the value of the service rather than its cost, owing to the intensive and increasing competition of private motor vehicles. . . . On the other hand, it is generally recognized that rates for communication service, particularly telephone service, are generally lower and in some cases much lower than the value of the service to the users. The prevailing rates for such service have brought about a remarkable increase in number of subscribers and volume of business."

Cf., also, Colonel Thom, formerly General Counsel, American Railway Association, who, in 1932, testified: "The fact is, that rates are not made by rate bases and not made by value, and cannot be. Rates are the outgrowth of economic force. If a carrier attempts to fix a rate and sustain it in spite of the economic conditions with which he has to deal, he loses the traffic." *Railroad Legislation; Testimony before House Committee*, *supra* note 116, at 226. See also pp. 244, 245, 324.

<sup>122</sup>See POND, PUBLIC UTILITIES, *supra* note 58, at 600.

<sup>123</sup>Cf. Cooper, *New Horizons in Public Utility Control*, A. B. A., Section of Public Utility Law, Addresses Delivered at Cleveland Meeting, July 26-27, 1938, Appendix. He points out, at 19: "It is a mistake to assume that the effectiveness of the regulatory device can be measured by the extent of interference with the legitimate functions of management. Such administrative intervention, although necessary to effectuate many legislative policies, may act as a barrier to the accomplishments of progressive management. When considerations of public interest compel the regulatory commission to share actively in managerial responsibility, there is grave danger that initiative and elasticity of operation may be subordinated to other less consequential factors."

<sup>124</sup>Cf. Lilienthal, *Public Utilities During the Depression*, *supra* note 63, at 761. It is here asked: "How is the value of any public utility service to be measured? What objective criteria are there for a commission to follow in giving effect to this limitation upon rates? Obviously, no general rule can be laid down to cover all situations. Where the customer has an alternative in the way of a substitute service and he continues to take the utility service instead of adopting the substitute or erecting his own plant, the objective evidence would seem fairly satisfactory that the value of the utility's

## VI

To summarize and conclude: Like any other public service enterprise, a railroad has a constitutional right to live. On this there is general agreement.<sup>125</sup> But for some time many railroads have hardly made operating expenses; and the future does not look very bright. Perhaps the principal reason for this has been, and will be, the rapid and continuing growth of competing agents of transportation.<sup>126</sup> To keep their properties going (let alone receive the return to which they are entitled), railroad managers must take this competition into account in proposing general rate changes and consider their effect upon the movement of traffic *by rail*. Whether they like it or not, these managers now have a standard for rates which

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service is in excess of the rates. But in the domestic field, where there are no genuine alternatives, to apply such a test would be to nullify the principle."

Cf., also, NASH, PUBLIC UTILITY RATE STRUCTURES, *supra* note 58, at 291: "An aggressive and unhampered management would logically so adjust its rates progressively downward until the point of maximum total profits had been reached, although this procedure would involve a decrease in unit profits." See DEWING, THE FINANCIAL POLICY OF CORPORATIONS (3rd ed. 1934) 222-224.

<sup>125</sup>Subject to the possible qualifications previously observed in note 95, *supra*. Cf. Fourth Supplemental Report of the Commission on Further Hearing, General Commodity Rate Increases 1937, *Ex Parte* 115, 229 I. C. C. 435 (1938) at 459.

Of course, as we have seen, *supra* notes 80 and 103, the Commission once said that a right to a fair return must give way to the value of the service, if there be a conflict. But this was purely dictum, unsupported by any decision of the Supreme Court. See pp. 318-319, *supra*. For if the rates were higher, the service would earn even less, and as Robert L. Hale has said with reference to several early decisions of the Wisconsin Railroad Commission: "The 'value of the services' concept was not needed to justify the commission in the situation described, as it must be quite clear that the company is deprived of nothing at all when its rates are kept down to the point where they yield the utmost net earnings commercially possible." Edgerton made the same point and indicated that "where this condition exists, the enforcement of rates which produce an inadequate return, whether because of a conflicting right in the public to a reasonable rate or for any other reason . . . involves merely a recognition of the fact that to charge the customer more in order that the company may earn less would benefit nobody." See Hale, *The Supreme Court's Ambiguous Use of "Value" in Rate Cases* (1918) 18 COL. L. REV. 208, 210; Edgerton, *supra* note 61, at 524.

Cf. LOCKLIN, ECONOMIES OF TRANSPORTATION (1935) 345, 347: "Sometimes it is economically impossible for a carrier to charge rates that will yield a fair return. . . . This may be due to the fact . . . that the traffic will not bear rates sufficiently high to yield the desired return. . . . What commissions usually mean when they invoke the value-of-service principle in cases involving the general rate level is one of two things: They mean that increasing all rates, or practically all rates, will result in rates on particular commodities and hauls that will exceed the value of service and effectively stop such shipments, or they mean that a higher rate level will reduce the volume of traffic and result in less revenue for the railroads. In the latter case rates on particular commodities and hauls are increased above the most profitable point, that is, the point which makes the largest contribution to overhead. In either of the above situations the commission is hardly setting forth a standard of reasonableness coordinate with or superior to the fair-return-on-fair-value principle but is merely recognizing a stubborn fact, namely, that higher rates may so curtail the volume of traffic as to result in lower net revenues for the carriers."

<sup>126</sup>For some evidence that this competition may already have reached its peak, see an interesting report entitled *Fluctuations in Railway Freight Traffic Compared with Production*, released by the Bureau of Statistics of the Interstate Commerce Commission, February 2, 1939. It is therein stated: "The annual loss or diversion in tons has become continually greater since 1928, but the percentage relation between actual and potential railway tons changed but little in 1936 and 1937." This fact, it was concluded, lends "some color to the view that the flight of traffic from the rails is tapering off." Statement No. 3867, Bureau of Statistics, File No. 314-B-2, at p. 1.

cannot, for a moment, be ignored. The difficulty arises when the Commission, employing precisely the same standard, overrules their judgment as to what is to *their* best advantage.<sup>127</sup> While the Commission may agree that the railroads deserve better earnings, and usually does, it insists upon telling them how these may be achieved. And in an attempt to lend some color of authority to its intervention, the Commission has seized upon the old and battle-scarred element of the value of the service and conferred upon it still another and a new meaning—the value of rail service as compared with the value of competing services. Clearly, this would appear to be a denial of the railroads' right, as recognized by the Supreme Court, to adopt such policies of rate-making as they think best.

What to do in the premises?

Unfortunately, the unwillingness of the Baltimore & Ohio Railroad (and certain others) to submit to a further possible suspension of the reduced fares ordered in the *Passenger* case, together with the strategic competitive position which that line occupies in the East, made it impossible really to attack the decision in court.

But what is more, it would seem that the railroads should expect little relief from such a revision of the rate-making rule (the "new" Section 15a referred to *supra* note 103) as suggested by the "Committee of Six"—the Committee,<sup>128</sup> appointed September 20, 1938, by President Roosevelt, which recently submitted its "Recommendations Upon the General Transportation Situation". What the Committee suggests, in substance and effect, is that there be substituted for the presently effective Section 15a a revised rate-making rule which would permit:

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<sup>127</sup>The latest available re-statement of the Commission's approach in this connection is found in its fourth supplemental report on further hearing in General Commodity Rate Increases 1937, *Ex Parte* 115, 229 I. C. C. 435 (1938), wherein its principal decision in the cited case (as referred to *supra* note 85) was summarized as follows, at 440: "The proceeding was essentially a revenue case, with the need of the carriers for additional revenue generally conceded, but as above indicated, it took on the aspects of a maximum-rate case. The questions presented were whether the proposed increased rates would actually produce additional revenue, and whether we could find them not to be in excess of maximum limits of reasonableness. Upon the first question we stated that 'the evidence justified the conclusion that the immediate effect of the increased rates would be a gain in revenue, but not necessarily that this would be the ultimate effect.' The evidence, particularly as to coal, that the ultimate effect of the increased rates would be to diminish, rather than add to, railroad revenue, we described as 'cogent and impressive'. We said that a definite conclusion that the increased rates would not yield applicants increased revenue, both immediate and ultimate, would be unwarranted. The second question, whether the increased rates would be reasonable, presented greater difficulties. We concluded that the showing of need of applicants for additional revenue and of trends tending to continue or increase that need made further postponement of at least a measure of relief undesirable, and that many, but not all, of the general commodity increases proposed were justified. As to coal and coke we recognized that the long-run wisdom of increases was more doubtful. But we found that the conclusions already reached as to the general justification for applicants' proposals applied to coal and coke, with exceptions indicated."

<sup>128</sup>The Committee consisted of three railroad executives, Messrs. Norris, of the Southern Railway, Gray, of the Union Pacific, Clement, of the Pennsylvania Railroad, and three railroad brotherhood officers, Messrs. Harrison, Jewell, and Robertson. Its report was made under date of December 23, 1938.

“. . . the establishment by each mode of transportation of rates which, as a whole, will be adequate, under honest, efficient and economical management: (a) to sustain a national transportation system sufficient at all times to meet the needs of commerce, of the Postal Service and of the National defense; (b) to establish and maintain credit so that capital essential to provide the needed facilities and service may be attracted to the transportation industry; and (c) to afford fair treatment to those having their money invested in the property held for and used in the service of transportation.”<sup>129</sup>

So far as it affects railroad rates, the suggested revision is in line with one which, for some time, the railroads have been advocating.<sup>130</sup> As they see it:

“The present so-called rate-making rule embodied in Section 15a of the Interstate Commerce Act has proven unsatisfactory in practice. Responsibility for its failure is largely chargeable, we think, to the construction placed by the Commission on the direction contained therein that in fixing rates it should give consideration, among other things, ‘to the effect of rates on the movement of traffic’. That phrase has been taken by the Commission as evidencing an intent that where the only real issue presented with respect to proposed changes in rates is whether they would result in greater or less net earnings than the old rates, its own judgment rather than that of the railroads shall control. To deny the railroad the discretion involved in determining that question does not merely subject them to regulation but deprives them of one of the most important functions of management.”<sup>131</sup>

Surely there can be no quarrel with the Committee’s desire to reinstate an important function of railroad management. But would an adoption of its suggested revision of Section 15a bring this about? In the opinion of the writer there must be grave doubts on this point, and it may well be argued that the Committee of Six has missed the mark.<sup>132</sup> For if, as the Committee

<sup>129</sup>*Report of the Committee of Six, supra* note 128, at 14, 15.

<sup>130</sup>Under *Measures for Immediate Action*, the Association of American Railroads, in a pamphlet dated September, 1938, entitled “Railroad Program” says, in part, at p. 4: “The remedy for a situation which has brought the railroads to the brink of disaster is such a revision of Section 15a of the Act (the rate-making section) as will direct the Commission to consider the revenue needs of the railroads as a primary consideration, and to use as a rate base a figure which can be definitely ascertained.”

<sup>131</sup>*Report of the Committee of six, supra* note 128, at 14. A bill incorporating its recommendations was introduced in the House on March 8, 1939. H. R. 4862, 76th Cong. 1st Sess. The new rate making rule, Section 30, H. R. 4862, at 97, 98, embodies, almost to a word, the recommendations in the text of the committee’s report. Cf. testimony of Mr. Gray on the Lea Bill (H. R. 2531, 76th Cong., 1st Sess.) before the House Committee on Interstate and Foreign Commerce, February 1, 1939, at pp. 349, 350 (unrevised typewritten copy). See *Wall Street Journal*, February 2, 1939, at p. 8.

The pending Lea bill would apparently leave Section 15a intact. But it would add a new provision, Section 15b, empowering an enlarged and revamped Commission to prescribe minimum rates for all transportation agencies. On the hearings so far held, railroad witnesses have told the House Committee that Section 15a should be revised. See Testimony before House Committee on H. R. 2531, February 1, 1939, at pp. 337, 339 (unrevised typewritten copy). See particularly the clear statement of Mr. R. V. Fletcher, Vice President and General Counsel of the A. A. R., February 8, 1939, at pp. 712, 715 (unrevised typewritten copy).

<sup>132</sup>Cf. editorial entitled *Roosevelt Rail Committee Report*, *THE TRAFFIC WORLD*, December 31, 1938, at p. 1364, wherein it is said: “The railroads have urged revision of the

suggests, the Congress should again emphasize the need for adequate railroad revenues, the Commission would simply feel called upon to examine *more critically than ever* the "actual" results which, in the competitive field of transportation, rate changes proposed by the railroads would yield. It is only necessary to recall the experience under the "old" Section 15a to realize this.<sup>133</sup> A clearer statement of its desire that the railroads, in the aggregate, receive adequate revenues could hardly have been devised by the Congress; and yet it was under this statutory direction, as we have seen, that the Commission rejected a proposal to increase freight rates—while the railroads were admittedly not earning a fair return on any base (or even approaching it)—on the ground that they would do more harm than good.<sup>134</sup> Indeed, the particular direction in the "new" Section 15a to which the railroads now attribute the Commission's exercise of a managerial discretion, *i.e.*, that the Commission shall consider, among other things, "the effect of rates on the movement of traffic", was not included in the "old" Section at all, but it was an adverse finding on this point, it should be repeated, that led to a denial of their 1931 application for rate increases.<sup>135</sup>

If the railroads are again to have the right to say whether rate changes will "do more harm than good", it is submitted that, as the only reasonably certain method of accomplishing the result, the Congress should (1) withdraw from the Commission the power to fix maximum rates, and (2) relieve it of any further statutory responsibility for railroad earnings. According to the Committee of Six, this is exactly what its suggested revision of Section 15a would *not* do.<sup>136</sup>

On the first recommendation we have only to repeat that the self-interest of the railroads<sup>137</sup> is doing, and will continue to do much more in the way

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rate-making rule of section 15a to permit them, as they put it, 'greater latitude in pricing their product'. The committee recommends a revision of the rule. In explanation of the proposed change, it indicates that the Commission should not substitute its judgment for that of railroad management as to whether or not proposed changes in rates would result in 'greater or less net earnings than the old rates'. To accomplish the objective of the railroads, we think much more specific language is necessary than that proposed by the committee. We think it would still be possible, under the language suggested, for the railroads to propose a 15 per cent increase in rates and the Commission to allow an increase of 5 per cent."

<sup>133</sup>*Supra* note 103.

<sup>134</sup>*Supra* p. 321; note 103.

<sup>135</sup>*Ibid.*, particularly note 103. Under the "new" Section 15a requiring a consideration of "the effect of rates on the movement of traffic", the Commission does no more than it has always done. Moreover, it is not to be overlooked, as observed *supra* note 103, that, if anything, the "new" Section 15a went even further than the "old" Section in emphasizing the necessity for adequate railroad revenues.

<sup>136</sup>As stated in its report, "this proposal would not limit the power of the Commission to prescribe maximum and minimum rates or to suspend new rates." See *Report of Committee of Six*, *supra* note 128 at p. 15.

<sup>137</sup>As well put in a recent editorial in *The Wall Street Journal*, January 6, 1939, entitled *The I. C. C. Sees It*: ". . . How can a rate which moves traffic be unreasonable when it is made under competition? And why should any carrier keep in its tariffs a rate that will not move traffic? The conclusion is inevitable, that the rail carriers are entitled to make a rate that will move traffic and to find it by experimentation, and that whatever changes are necessary in law or in policy to permit considerable freedom

of keeping their rates down than any action the Commission could, or would take. Only those who are unaware of the railroads' present plight can have a different view.<sup>138</sup> Of course, this recommendation would still leave the Commission with power to cure undue prejudice and preference, and to find unreasonableness in individual rates.<sup>139</sup> And temporarily, until some order shall come out of the present chaos in the transportation world, the Commission should probably retain its jurisdiction over minimum rates (though consistency would demand a removal of that power too, since it is, in effect, a power to overrule management).<sup>140</sup>

On the second recommendation, it is evident that a duty to protect railroad earnings, in the form of two Congressional mandates,<sup>141</sup> has had the effect of transforming the Commission into an omnipotent general manager who, when measuring the reasonableness of rates, has developed a fondness for a yardstick which has no place in their public regulation. A business inquiry pure and simple has become a standard of rate regulation, *i.e.*, the effect of rates on the movement of traffic by rail as compared with its movement otherwise. In addition, this general manager, with his business orders for the railroads, is required by law to be impartial—impartial, that is, among the trucks, and busses, and water carriers, and railroads.

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in this experimentation' are wise and necessary. Policing of such experimentation is necessary to exclude rebating, discrimination and undue prejudice and preference, but in other respects it should be confined to a minimum. *All this, of course, presupposes that rail carrier management will itself rise to the occasion. Truth to tell it is something of an assumption, but we must make it. . .*" (Italics supplied.)

<sup>138</sup>In three years of regulating truck rates, the Commission has directed practically all of its attention to keeping them up, not down. See *Supplementary Report of the Special Committee to Appraise the Regulation of Motor Vehicles*, by Mr. Parker McCollester, A. B. A., Section of Public Utility Law, presented at annual meeting, July 25-27, 1938, at pp. 19, 20, 21.

<sup>139</sup>*Cf. McCurdy, The Power of a Public Utility to Fix Its Rates and Charges in the Absence of Regulatory Legislation* (1924) 38 HARV. L. REV. 202.

<sup>140</sup>Senator King introduced a bill, S. 1132, February 1, 1939, which would, among other things, carry out this recommendation. By Section 2 the Commission would be deprived of any further power to determine or prescribe "any rate, fare, or charge to be observed by any common carrier" and of the right to suspend "any schedule of rates, fares, or charges". Apparently, the sole rate-making power of the Commission, under Senator King's bill, would be that provided in Section 3 thereof which, as presently drafted, reads as follows:

"SEC. 3. (a) Upon the expiration of one hundred and eighty days after the date of enactment of this Act, hearings may be held by such Commission for the purpose of determining whether any rate, fare, charge, classification, regulation, or practice of a common carrier subject to part I of the Interstate Commerce Act is or will be unjust or unreasonable or unjustly discriminatory or unduly preferential or prejudicial, or otherwise in violation of any of the provisions of such part, but such hearings shall be held only after a complaint made as provided in section 13 of such part I has been filed with the Commission.

"(b) If, after a full hearing upon such complaint, the Commission shall determine that such rate, fare, charge, classification, regulation, or practice is or will be unjust or unreasonable, or unjustly discriminatory or unduly preferential or prejudicial, or otherwise in violation of part I of such Act, the Commission shall make an order that the common carrier concerned shall cease and desist from such violation to the extent to which the Commission finds the same does or will exist."

See pp. 4, 5 of S. 1132, 76th Cong., 1st Sess.

<sup>141</sup>See *supra* note 103.

That an adoption of these recommendations is necessary again to put railroad management on its feet is apparently appreciated by the Commission; for, tucked away in a corner of that body's Fifty-Second Annual Report, 1938, to the Congress, released during January, 1939, is the following significant comment—a comment which, so far as the writer has observed, has completely escaped the attention it deserves:

"The railroads have proposed changes in section 15a of the Interstate Commerce Act for the purpose of limiting our discretion in passing upon rate increases, so that upon proof of low earnings approval of such increases would necessarily follow. We do not favor such an amendment, but suggest that the simple way to accomplish the real result desired would be to limit our authority to the fixing of minimum rates and the removal of unjust discrimination (using this term in its broad sense), leaving maximum rates to the discretion of the railroads. We venture to believe, however, that if such a change were made, the railroads would make limited use of the freedom so accorded. It is one thing to increase rates where the Government, through this Commission, shares the responsibility, and it is quite another thing for the management, under present competitive conditions, to accept sole responsibility."<sup>142</sup>

It is high time for a return to first principles in the regulation of railroad rates. Privately operated, privately owned, the railroads have a right to make a fair return on a proper base and to take such steps as will bring them one, or something like one. But the Interstate Commerce Commission, through its control of their rates, has taken upon itself the task of indicating steps which must be tried, and steps which must not be tried. This is not regulation; it is management, and what is worse, it is management without responsibility to invested capital. In reporting to his shareholders, the president of a road which is doing poorly is not any the happier because a rate change which he thought would help was disallowed by the Commission with a finding that it would not help. What can that railroad president do? Is he responsible, or is he not? Patently, the present situation is intolerable. The sooner the country realizes this and permits railroad management to call its name its own, the sooner it will learn whether or not that management can, in fact, perform in competition. If it can, the railroad "problem" will be a long way towards solution. If it cannot, Government ownership and operation will probably follow, and the chaos will be complete.

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<sup>142</sup>Fifty-Second Annual Report, Interstate Commerce Commission, 1938, at p. 20, note 9. Cf. editorial comment, *N. Y. Times*, January 8, 1939, § 4, at p. 8: ". . . Naturally, the Commission stands by its own decision of last Spring, not to grant as high a rate advance as was asked for by the railways. It answers criticism by citing 'the severe conviction of a large proportion of those who ship freight', that many rates 'had already become too high'. But this does not answer the contention that the only way to discover if the proposed advance was too great was to try it, leaving the railways to reduce the new rates voluntarily if they found that the increase hurt instead of helped them. . . ."