

# ADVANCING FREIGHT RATES TO INCREASE REVENUES

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The right of the railroad carriers to advance freight rates for the purpose of increasing revenues has been considered frequently by the Interstate Commerce Commission during the past seven years; the carriers have complained that their net operating revenues are inadequate, and have, with much consistency, repeated with growing elaboration and varying statement the reasons why this condition exists. Generally, they have come asking for increased rates after a year of remarkable business, and though the commission each time has reviewed conditions over a period of years, the preceding highly productive year has had much influence on the decision.

The latest of these cases was decided only in June, 1917, and it furnished a climax to the series in that the railways of practically the entire United States were concerned in the request. All these circumstances make it worth while to take a synoptic view of this group of cases.<sup>1</sup>

## AN EARLY CASE

The earlier case of *Proposed Advances in Freight Rates* decided in April, 1903, relates to official classification territory, and is the forerunner of the group of cases mentioned. It developed in a very thorough manner the considerations and principles applicable. Commissioner Prouty, speaking for a unanimous commission, regarded a rate from two standpoints, namely, with respect to cost and value of the service and in its relations to other rates, and absolutely, or in the guise of a tax levied on the industry of the country by a quasi-

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<sup>1</sup> The cases especially considered herein are:

*Proposed Advances in Freight Rates* (Apr. 1, 1903) 9 I. C. C. 382;

*In Re Investigation of Advances in Rates by Carriers in Official Classification Territory (Eastern Rate Advance Case)* (Feb. 22, 1911) 20 I. C. C. 243;

*In Re Investigation of Advances in Rates by Carriers in Western Trunk Line, Trans-Missouri & Illinois Freight Committee Territories (Western Rate Advance Case)* (Feb. 22, 1911) 20 I. C. C. 307;

*Five Per Cent Case* (July 29, 1914) 31 I. C. C. 351; *Five Per Cent Case, Supplemental Hearing* (Dec. 16, 1914) 32 I. C. C. 325;

*1915 Western Rate Advance Case* (July 30, 1915) 35 I. C. C. 497;

*Fifteen Per Cent Case* (June 27, 1917) 45 I. C. C. 303.

I have intentionally not used technical language to state how these various cases came before the commission; procedure here is not important. Cf. 45 I. C. C. 311.

public institution—the carrier; it is the latter phase that he proceeded to discuss.<sup>2</sup> He argues that the highest rate a carrier should be permitted to earn is not what the federal Government would probably pay for money if it were the railroad owner, nor is it correct to determine the rate on the basis of the cost of reproducing the railway property, or the actual money investment, or the capitalization; in the case of a particular system, it might be found that some one of these bases might alone be sufficient, but he denies that a general rule as to one, or as to the combination of them, exists. He then lays down the “precise question before the Commission” thus:

“We find a rate fixed by competition, sufficiently remunerative, and properly adjusted to other rates. Is there anything in the financial operations of these carriers which justifies an advance in that rate? Should the property invested in these railroads be allowed to lay a larger tax upon the general public when and largely because competitive conditions have been so far restrained that it can?”

In a review of the kind here contemplated the detailed reasoning of the commission cannot be followed, but the purpose is to develop the commission’s view of the nature of the factors involved and their appropriate influence.

It is denied in this case that a rate is a commodity whose value is determined by supply and demand, and therefore the era of advancing prices for commodities does not necessarily produce a corresponding advance in freight rates. Assent is given to the broader proposition that the railways should share in the general prosperity; the “law of increasing returns” in railroad operation is discussed and illustrated, and the result of its application in particular cases is seen only by continuous observation, and accordingly the commission considers several important factors in this connection, namely, the number of ton-miles, the gross receipts, the net receipts, and the railroad mileage, from 1897 to 1902, for the whole United States, and for the territory embraced in this inquiry, and concludes that the figures show a prosperous condition.

Rising costs in materials and supplies and increased wages are also factors in the situation; and as these greatly augment operating expenses, the commission proceeds to examine the financial showing of the leading carriers in this territory “for the purpose of determining whether the claim of the carriers that they ought to advance rates for the sake of increasing their gross revenues is well founded.” The elements of the financial showing then considered are the *mileage*, the *funded debt* per mile, *capital stock* per mile, the *net income* for the last fiscal year, *interest* on funded debt, *rentals* and *taxes*, appropriation out of income for *permanent improvements*, *dividend* paid, and

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<sup>2</sup>9 I. C. C. 401, 404.

*balance* remaining; the increase in wages far exceeds this balance, and the commission does some constructive figuring to find the sources of revenue to take care of the large wage increase made and to be made; refunding soon to take place will save so much from the interest account; strict adherence to the published rates and ending the pernicious practice of rebating will realize another very large amount, overbalancing the wage advance. As to the surplus, of course the carrier is entitled to enough income to create that also; but recent improvements in the property of the carrier will tend to increase revenues and effect economies, and it cannot be permitted that these improvements shall be made out of current earnings and that the enhanced value of the property thus produced shall also be the basis upon which to determine an increase of rates. In other words, the carrier should not increase rates to improve the property and then increase them again to maintain a proper percentage of return on the property!

The clear exposition of this principle did not convince the carriers, for in the 1911 *Eastern and Western Cases*, Commissioners Prouty and Lane vigorously reiterate and amplify the argument and fix the principle unquestionably. To determine whether the carrier is sharing in the general prosperity which marked that period, the capital stock quotations are shown to have risen in 1902 to about 100 per cent of the quotations in 1896. The conclusions may be expressed in the language of the commission:<sup>3</sup>

"We have now examined upon this proposition the main lines of the Vanderbilt and the Pennsylvania systems. It appears that for the last three years in all instances gross earnings have steadily increased; that in most instances where permanent improvements have not been charged against operating expenses, net earnings have increased in even greater proportion; that the stocks of these companies have advanced from 50 to 100 per cent. in market value; that net earnings per mile are in every case large and must yield an abundant return upon a fair valuation of the properties. There is probably no case in which the rate of dividend paid in 1902 cannot be maintained without any advance in rates, beyond those sanctioned in this report, notwithstanding the material increase in wages. While we are not prepared to hold that these returns are excessive, nor that rates ought to be reduced for that reason, we are clearly of the opinion that they in no respect indicate that rates should be advanced."

Several respects in which rates may be advanced are indicated; for instance: restoration of rates which had been lowered to meet depressed commercial conditions in iron articles; withdrawal of low export rates, and maintaining the published rates.

In the 1911 *Eastern and Western Cases* the carriers were specifically asked by what standard the reasonableness of the proposed advances

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<sup>3</sup> 20 I. C. C. 424.

should be measured, and they answered solely and unanimously that "increased operating expenses required additional gross revenue"; the application of this test produced the results above stated.

In these cases the carriers made the contention—which had been made before and has often been made since—that the test of reasonableness is what the traffic will bear; that only traffic and commercial conditions need be estimated to ascertain a rate; and that so long as traffic moves, the rate is conclusively reasonable. But the commission answers this contention with reference to the question whether a carrier has a right to advance its tariff for the sole purpose of increasing its revenues, by citing especially<sup>4</sup> the elements named in the case of *Smyth v. Ames*<sup>5</sup> and found that not one of the rate fixers of the carriers had any such criteria in mind when he formulated the rates here in question.

The mild judicial tone of the commission in this early opinion is remarkable and suggestive; at that time, some of the greatest excesses of railroad management and stock manipulations were not so completely understood as they were later when the supervision over railroad accounts was more thoroughly established; in fact, many of the most highly culpable transactions had not then occurred. This opinion, like all succeeding ones, carefully recognizes the vastly important part played by the carriers in the welfare of the country and their right to fair treatment; some of the subsequent opinions, in their occasional sharp and rebuking references to railroad mismanagement, also clearly reflect the popular mind. Such utterances may be regarded as somewhat by way of retort to the argument that the carriers' alleged troubles are due to governmental regulation!

#### JURISDICTION OF THE COMMISSION<sup>6</sup>

No question is made in this early case (*Proposed Advances in Freight Rates*) of the jurisdiction of the commission to consider the subject under its accorded authority to pass on the reasonableness of rates; indeed, the power seems to be expressly claimed;<sup>7</sup> but in the *Eastern Rate Advance Case*, where the same territory and a very similar advance of rates are involved, Commissioner Prouty, in rendering the opinion of the commission, suggested lack of jurisdiction although the statutory power of the commission to consider reasonableness of rates had in the meantime in that respect not been narrowed in any way. There is an absence of authorization specifically to increase or establish or approve a rate to produce greater revenue,

<sup>4</sup>20 I. C. C. 256.

<sup>5</sup>(1898) 169 U. S. 466.

<sup>6</sup>For jurisdiction to consider rates, see I. C. Act, s. 1, ¶ 3; s. 12, ¶ 1 (jurisdiction to enforce the act); s. 13, ¶ 1; s. 15, ¶¶ 1, 2 (suspension).

<sup>7</sup>9 I. C. C. 382, 438.

and all the great changes in the Act to Regulate Commerce had been incorporated in the Elkins Law of 1903, the Hepburn Amendment of 1906, and the Mann-Elkins Amendment of 1910; and all of the changes—excepting, possibly, the proposed establishment of the Commerce Court—were in the direction of broadening the powers of the commission. Thus, at the time the *Eastern Advance Case* comes on, the act had in all essential matters reached its present form. Therefore, if jurisdiction in the matter here raised was questionable, the question might still be pertinent, or in any case the conclusions reached would be applicable to the same statutory language we now have in the act.

Let us look at this question in some detail. Early in his opinion in the *Eastern Rate Advance Case*, Commissioner Prouty says:<sup>8</sup>

“ . . . the question presented to us is, Are these defendants justified in laying this additional transportation burden upon the public for the purpose of obtaining greater net revenue?”

“Strictly speaking, this Commission has no jurisdiction to hear and determine that question. We have no authority, as such, to say what amount these carriers shall earn, nor to establish a schedule of rates which will permit them to earn that amount. Our authority is limited to inquiring into the reasonableness of a particular rate or rates and establishing that rate or practice which is found lawful, in place of the one condemned as unlawful. . . . This Commission is called upon to deal with rates as they exist, and in so doing we ordinarily consider them, not from the revenue standpoint, but rather from the commercial and traffic standpoint. At the same time it is now the settled law that there is a limit below which the revenue of railways cannot be reduced by public authority, and if there were no such constitutional limitation it would nevertheless behoove every regulating body to permit the existence of such rates, when possible, as will yield just earnings to the railways. The question of revenue is therefore fundamental and ever-present in all the considerations as to the reasonableness of railroad rates, although it may not be and seldom is when single rates are presented, the controlling question.”

He then goes on to say that the consideration of the commission is not confined to single rates, and when the entire rate fabric of a territory is affected by advances and the propriety of these advances is involved, and the question is whether the advance is justified by lack of adequate revenue upon the existing rate basis, “this Commission must determine the *fundamental* question.” Although jurisdiction is denied at first, after this short argument it is concluded that the commission must settle the question which it has no authority to settle. Must it usurp authority? Clearly he does not mean that; evidently his conclusion is that the commission has jurisdiction as shown by this course of reasoning based on the statutory functions

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<sup>8</sup> 20 I. C. C. 243, 247-248.

of the commission. Still the matter haunts him, and he says further:<sup>9</sup>

"We must take the history of these properties [*i. e.*, the railways here involved] and, from a consideration of all the facts before us, arrive at some rough notion of their value for railroad purposes. As a part of that same inquiry we must form some idea of the rate of return to which the property of these carriers is entitled.

"Here, again, it should be observed that this Commission has no jurisdiction to deal with that question as such. We have no authority to say that a railroad ought to earn, either as a matter of right or as a matter of public policy, any given per cent upon its value; but in discharging our duty, to say whether these particular rates which the carriers propose to establish are just and reasonable, we must determine in a general way what a fair return would be, and that matter will be next considered."

In the end, therefore, the commission concludes that it may determine whether a particular rate is reasonable, or whether a group of rates is reasonable, and indirectly it thus fixes the income of the carrier; the body of rates is unreasonable unless they produce a fair return. So the jurisdiction over this subject matter is proven.

In the companion case—*Western Rate Advance Case*<sup>10</sup>—decided on the same day, the matter is naturally not adverted to.

In dissenting in the *Five Per Cent Case*,<sup>11</sup> where the same official classification territory was involved, general advances were asked, and allowances were awarded only partially and in detail, Commissioner Daniels for some unexplained reason argues and cites precedents<sup>12</sup> to establish the authority of the commission to deal with the question, although the majority of opinion does not refer to the question and a footnote<sup>13</sup> states that the expression of Commissioner Daniels' views does not imply that they are opposed to the views of the majority. Presumably, that had been under discussion in commission conferences, and he thought to spread an argument on the record which might furnish some light in the future. However that may be, he finds no difficulty in showing to his own satisfaction the jurisdiction of the commission. He shows that when the statute authorizes the commission to consider the reasonableness of a proposed rate it does not mean a single rate—that meaning would load the commission with a physical impossibility; and so to accomplish the statutory purpose, the consideration of rates in group or *en bloc* may be construed to be a consideration of the component individual rates; evidence as to inadequate returns on a carrier's property is rate evidence, and such evidence applies to specific rates. In further support of his position

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<sup>9</sup> 20 I. C. C. 261-262.

<sup>10</sup> 20 I. C. C. 307.

<sup>11</sup> 31 I. C. C. 351.

<sup>12</sup> 31 I. C. C. 448-450.

<sup>13</sup> 31 I. C. C. 448.

he cites *Arlington Heights Fruit Exchange v. Southern Pac. Co.*,<sup>14</sup> where a uniform blanket rate was placed on lemons from Colorado to the Atlantic seaboard covering a multitude of different hauls of varying lengths; *Intermountain Rate Cases*<sup>15</sup> (*City of Spokane v. Northern Pac. Ry.*),<sup>16</sup> *Railroad Commission of Texas v. Atchison, T. & S. F. Ry. Co.*<sup>17</sup> Commissioner Daniels concludes:

"The obvious conclusion, both from reason and from precedent, is that the Commission may legally deal with rate schedules as a whole, and also that insufficiency of revenue is a proper ground upon which, nothing substantial to the contrary appearing, to accord advances which will result in just and reasonable rates."

We may surmise that Commissioner Daniels was arguing for the benefit of Commissioner Clements, for upon the supplemental hearing<sup>18</sup> of the *Five Per Cent Case*, the latter enters a vigorous dissent to the award of increases on the ground that the carriers need more revenue to enable them to furnish

"adequate service to the public, to meet their financial obligations, and maintain dividends in such manner as to encourage further investments in railways and their securities. If these considerations constitute a sufficient basis for wholesale approval of a body of increased rates agreed upon by all carriers in a given territory, competing or connecting, weak or strong, the same must be equally true if every road in the country, as well as every rate, were included in a proceeding before us."<sup>19</sup>

His view is that the power here claimed is legislative, inasmuch as it is the power to inaugurate and shape public policy, which is clearly a legislative function.

In the *1915 Western Rate Advance Case*,<sup>20</sup> the commission says:

"The effort has been made to constitute the present investigation essentially one of the propriety of increased rates which the carriers seek to impose on a relatively small number of articles";

but no finding is made on the subject of "increased revenues." This failure to "meet the issue" is criticized by Commissioner Daniels in his dissenting opinion, but there is no intimation anywhere in the majority opinion or in the two dissents of lack of jurisdiction.

<sup>14</sup> (1910) 19 I. C. C. 148, affirmed *per curiam* (1913) 231 U. S. 736.

<sup>15</sup> (1914) 234 U. S. 476.

<sup>16</sup> (1911) 21 I. C. C. 400.

<sup>17</sup> 20 I. C. C. 463.

<sup>18</sup> (1914) 32 I. C. C. 325, 337.

<sup>19</sup> This was actually the case in the *Fifteen Per Cent Case* (*infra*); there the commission did not stick at the matter of jurisdiction.

<sup>20</sup> 35 I. C. C. 497, 502.

We come now to the most recent case considered, the *Fifteen Per Cent Case*,<sup>21</sup> where the question is one of a horizontal increase in rates in the three classification territories, involving practically all the rates and railroads in the United States. Here, the subject of increasing rates for revenue is presented in the most extensive and complicated manner possible, and it includes the plan of a horizontal increase. No individual rates could receive consideration and no one line of railroad could receive especial attention except for purposes of comparison; the very condition prophesied three years before by Commissioner Clements as the most extreme which could be suggested under the ruling he was then criticising, had now come to pass, yet no whisper of lack of jurisdiction is heard; the commission bravely attacked the problem presented and squarely decided it. And it may be noted that in Commissioner Harlan's *concurring* dissent, and in the dissent of Commissioner McChord, a readiness is expressed to grant rates brought before the commission in this wholesale manner. It does not seem probable that the question of jurisdiction will ever be raised again in the commission, and in view of the opinion in the *Intermountain Rate Cases*,<sup>22</sup> it is thought that the objection would meet short shrift if carried to the Supreme Court of the United States.

#### ESSENTIAL FACTORS

No attempt will be made to enumerate in detail the matters considered or mentioned by the commission in deciding these cases, but the factors which were deemed of great importance will be selected from the cases with the intention of showing how far they agree, what factors have uniform consideration, what the chief railroad contentions are, how far they influence the commission, and finally, to determine whether the view of the commission has been an enlarging one. Keep in mind that the system of accounting by railroads, under the supervision and orders of the commission, was constantly growing more complete, harmonious and truthful about financial operations, and therefore railroad information bearing on rate questions became increasingly available. Likewise, the interaction and interrelation of groups of statistics are more clearly discerned and become capable of more varied expression and significance. These are gratifying matters apparent on the face of the reports.

Attention may here be directed to the changes in 1910 in the Act to Regulate Commerce which authorized the commission to suspend proposed rate schedules during investigation, and laid the burden of proof regarding these schedules on the carriers; but it is not seen that the factors considered by the commission, or the weight attached

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<sup>21</sup> (June 27, 1917) 45 I. C. C. 303.

<sup>22</sup> (1914) 234 U. S. 476.



to them, are altered in any manner by these statutory changes. All the cases to be considered now came on after the enactment of 1910 and were alike subject to its provisions; therefore, it is not a peculiar element needing specific attention, and we dismiss it with this statement.

In the *Eastern Rate Advance Case*<sup>23</sup> many carriers in official classification territory made a general advance on all class rates and about half of the commodity rates, and contended in support of this action that on account of wage increases their net operating income was insufficient, and they therefore needed additional revenue. In determining whether to grant this alleged need, the commission considered only typical lines in this territory and staked the fortunes of the remainder upon the outcome of an inquiry into the Baltimore & Ohio, the Pennsylvania, and the New York Central systems over the period from 1901 to 1910, comparing the figures for the earlier year with those for the latter.

Taking the Baltimore & Ohio first:

a. The single-track and the all-track *mileage* show increases respectively of 36 per cent and 50 per cent, indicating a great improvement by the addition of main-line tracks and switch tracks.

b. The *cost of construction* (which must be taken from the books of the company, although it is open to much question) had increased about 50 per cent for the system; for single-track mileage the increase in book cost was about 23 per cent and in all-track mileage about 15 per cent.

c. Total *capitalization* had grown about 85 per cent, which, applied to the mileage, would be an increase as to single-track mileage of about 37 per cent, and as to all-track mileage of about 23 per cent.

The *funded debt* included here had increased about 75 per cent, while the stock capital had more than doubled; but in 1901 the funded debt was about 67 per cent of the total, and in 1910 was about 63 per cent.

d. Total *operating revenues* had almost doubled for the period, and per mile all-track mileage had grown by 20 per cent.

e. *Operating income* went up 60 per cent or, in all-track mileage, about 5 per cent per mile, and the *total operating expenses* had more than doubled.

f. *Corporate income* more than doubled, although its percentage of the outstanding capital stock had advanced only from 7.48 to 7.66.

g. *Preferred stock dividend* of 4 per cent had been regularly paid, and the stock had averaged about \$90 per share.

h. *Common stock* had varied in market value from about \$85 to \$114 per share and was then selling at \$107.

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<sup>23</sup> (1911) 20 I. C. C. 243.

i. *Net earnings*: Out of these the interest on the funded debt and the preferred stock dividend had been paid; the dividends paid on common stock had gone from 2 per cent in 1901 to 6 per cent in 1907 and the year following, and \$34,000,000 had been put into property improvements.

j. To maintain the *credit* of the company the commission thought it should have earnings sufficient to devote from 7 per cent to 8 per cent to dividends on the common stock and to surplus. On this basis for the fiscal year ending June 30, 1910, assuming the wage increase to have been then effective, a dividend of 5 per cent on the common stock could have been declared and a surplus of over 4 millions of dollars would have remained.

k. The *cost of maintenance* of equipment and of way and structures was shown to be greater for the last year than for the average year—and, indeed, for almost any single year,—so an increase therein in the near future was not deemed probable.

l. Ratio of *operating expenses* to *operating revenues* had steadily increased since 1901, but no reason appeared for further increase in the immediate future over 1910 except *wage increases*, since the ratio for the 10-year period was 66.84, for the first five years 64.54, for the last five years 68.56, and for 1910 was 70.09.

One other matter was urged, namely, that notes recently issued would add a large item to the interest charge; it was answered that the improvements in the property thus made should lead to greater business and greater economies, and what cannot thus be made out of the business for a few years may be very properly carried out of the large surplus accumulated during the period; and anyway, if the new interest had been borne by the net revenues in the last year, and the wage increase had also been paid therefrom there would still have been 5 per cent for the common stock and a surplus of 2½ millions which was regarded as ample.

This analysis, in view of the principles generally applicable to rate making as discussed and illustrated over the preceding thirty pages of the report of this case, did not show a condition of affairs which would justify an increase in rates over the Baltimore & Ohio system. Practically all of these elements are employed in the analysis of the other systems mentioned with more or less detail, since naturally the facts are variable; the conclusion is that in the case of the Baltimore & Ohio and the Pennsylvania systems no increase is justifiable, and therefore none can be permitted on the New York Central system,—although analysis does not show it so prosperous,—since the rates on these three systems must be the same.

Parenthetically, let it be stated that the commission found about 57 millions of stock of the New York Central for which nothing had ever been paid, and about 120 millions of dividends paid thereon

which if otherwise used would have produced a startling difference in its financial condition, and the commission "can not entirely close our eyes to bits of history" of that sort! Attention was also given to the huge expense being incurred in the building of the Grand Central passenger station in New York City.

Although individual roads in this territory might show a condition of need, yet the carriers as a group were before the commission and the decision was a group decision based especially upon the statistics relating to the three great systems operating in the territory.

In the *Western Rate Advance Case*,<sup>24</sup> more than 200 carriers operating in Wisconsin and the two tiers of states between the Mississippi River and the Rockies proposed increases in the rates on some 300 commodities. The commission selected for investigation six systems, *viz.*, the Chicago, Burlington & Quincy, the Atchison, Topeka, & Santa Fe, the Chicago & North Western, the Chicago, Milwaukee & St. Paul, the Chicago, Rock Island & Pacific, and the Chicago & Alton, covering the years 1901-1910.

The chief contentions of the carriers were the same as in the *Eastern Case*, and in addition to many general considerations applicable to rate regulation, Commissioner Lane, announcing the opinion of the commission, submits these six carriers to the test of the application of the factors set forth in the *Eastern Case*, and the additional factor of unit cost of operation, approximate figures on which were available for several roads.

A somewhat greater variety of presentation is given to these factors, but the course of the argument, allowing for these necessary individual variations of fact relating to the carriers, is quite the same.

To individualize this case the factors as set forth in a tabular fashion are here enumerated, namely:

a. *For the six systems.* Total capital, funded debt, common stock, preferred stock (also calculated per mile of single-track mileage), rate of interest on funded debt, dividends on preferred stock, and ratio of balance of corporate income (after deducting dividends on preferred stock) to common stock.

b. *For the individual systems.* Average mileage operated, gross operating earnings, operating expenses, operating ratio, net earnings, miscellaneous income, net income, taxes, fixed charges, and net profits. This list on the whole will be recognized, *mutatis mutandis*, as the list in the *Eastern Case* (*supra*) decided the same day.

The *Five Per Cent Case*<sup>25</sup> again involved the carriers in official classification territory, which was involved in the case of *Proposed*

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<sup>24</sup> (1911) 20 I. C. C. 307.

<sup>25</sup> (1914) 31 I. C. C. 351.

*Advances in Freight Rates*<sup>26</sup> and the *Western Case*.<sup>27</sup> The questions considered were:<sup>28</sup>

"1. Do the present rates of transportation yield to common carriers by railroads operating in official classification territory adequate revenues?"

"2. If not, what general course may carriers pursue to meet the situation?"

Here the question of an increase for greater revenues is not only raised, but the increase is to be applied horizontally. To make their case the carriers contended:<sup>29</sup>

"(a) That the rate of return in net operating income upon the property investment is declining.

"(b) That the principal cause of this decline is a steady and constant increase in operating expenses, due to matters of a continuing character, such as wage increases, legislative requirements, and the necessity of maintaining a higher standard of track, equipment, and facilities generally.

"(c) That the return upon money invested in railway facilities since 1903 has been utterly inadequate, and that no return at all has been received upon the money so invested since 1910.

"(d) That the effect of these things is so to impair the credit of the railway companies as seriously to check the normal construction and development of railway facilities which are required to meet the public demands."

In 1903 and 1911 the commission had used the three leading systems in this territory—the New York Central, the Pennsylvania, and the Baltimore & Ohio systems—as the standards for the territory, but in this proceeding the thirty-five systems involved are treated as a single group for most purposes, although for certain purposes the interested carriers are arranged in four groups.

Net *corporate* income is regarded an untrustworthy factor, and net *operating* income is held before the mind as the crucial factor in such inquiry.

The investigation in the *Five Per Cent Case* is extended over the period 1900-1913, and utilizes not only the usual tabular analysis of the carriers' activities, but introduces a chart in graphic form to illuminate these same activities. The factors considered, with some variation of expression and tabulation, are essentially those enumerated in the *Western Case*,<sup>30</sup> but a more intimate study is made of the causes of increased operating expenses, in an analysis of expenditures for,

<sup>26</sup> (1903) 9 I. C. C. 382.

<sup>27</sup> (1911) 20 I. C. C. 307.

<sup>28</sup> 31 I. C. C. 355.

<sup>29</sup> 31 I. C. C. 360.

<sup>30</sup> *Supra* (1911) 20 I. C. C. 307.

and ratios to revenues of, (a) maintenance of way and structures and (b) of equipment; (c) transportation and traffic; (d) general and outside operations (conducted by carriers, *e. g.*, boat and ferry lines, sleeping, dining-car and special-car services, stockyards) and depreciation and renewal charges; the subject of taxes is also given detailed attention, taxes having greatly increased.

The commission considered the business of the last fiscal year, compared it with the preceding year, and found a falling off in operating revenues, an increase of expenses, and a heavy decrease in net revenue; but the greater reliance for conclusions is placed on the tendency of the showing for the period of fourteen years.

The commission considers these roads in three divisions, central traffic association territory, grand trunk line territory and the New England roads,<sup>31</sup> and concludes that the tendency toward a diminishing net operating income in the whole territory is more marked in central freight association territory, which is singled out for relief.

The *Five Per Cent Case* came to a supplemental hearing<sup>32</sup> two months later, on a showing concerning (a) completed returns for the fiscal year ending June 30, 1914, and returns for the July, August and September following; (b) war in Europe; (c) results of original order; and the commission says:<sup>33</sup> "Collectively they present a new situation."

The figures presented for July, August and September showed a continuation of the unprosperous conditions, but the commission seems to have drawn its conclusions from the last fiscal year, with all of which—except the last month—it was familiar on the early hearing, and had expressly declined to be persuaded thereby to change its conclusions based on the period 1901-1913, in which it found relief due to only one section of the country.

To base a finding for relief on the history of one month or two months, or to give any particular weight thereto, would be such a radical departure from the long-established and conservative *modus operandi* of the commission as to lead to the belief that it did not in fact accord relief for that reason. There was really nothing in the records of the operations of the carriers which the commission had not estimated and valued on the original hearing.<sup>34</sup>

Further, there were no perceptible results of the order of July 29 in the matter of economies or improved regulations and practices, so such results admittedly could not have aided in presenting the "new situation."

The European war is the remaining factor, and logically the only factor, which changed the old situation; it is entirely improbable that

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<sup>31</sup> This is a departure from the method pursued in 1903 and in 1911.

<sup>32</sup> (Dec. 16, 1914) 32 I. C. C. 325.

<sup>33</sup> 32 I. C. C. 327.

<sup>34</sup> See 31 I. C. C. 423.

there would have been a supplemental hearing before the carriers had acted on some of the constructive suggestions of the original opinion if the war in Europe had not broken out. The commission emphasizes<sup>35</sup> the provocative influence of the war and recites a sufficient reason for the aid now extended to the carriers. If the commission had based its finding therein solely on the war, in view of matters carefully considered by it and its general conclusion at the original hearing, its opinion would have rested upon reasons which, to say the least, could be more readily comprehended.

But to Commissioner Harlan, fresh from the composition of the very noteworthy opinion in the original hearing, neither the recent reports of the carriers nor the war furnished a legal or economic reason for the horizontal relief now extended to trunk line carriers, while to Commissioner Clements the action in this case seemed<sup>36</sup>

“out of harmony with the spirit and purpose of the law, and as taking a step that leads away from the sound principles necessary to conserve the ends of justice.”

Hence, it seems fair to say that a horizontal advance in rates is here permitted really on the conclusions based on the factors considered in the original case, plus the determining factor—the war in Europe.

In the *1915 Western Rate Advance Case*,<sup>37</sup> the carriers in western trunk line and southwestern tariff committee territory asked for an increase in the rates on a few commodities totaling an increase in revenues of almost 8 millions, and placed the increase on the ground of inadequate revenues. The increase is not horizontal, but laid on particular commodities, and is an ideal case for the determination of the question involved in all these cases. The important factors discussed in the earlier cases are here, in varied form of arrangement, again presented and considered; the data used by the railroad witness Powell, the protestants' witness Wetling, and the data abstracted from the commission records and tabulated by the commission, are comparatively studied and the tendencies shown in each are noted. The data are also applied to the roads concerned by groups, the graphic charts are also introduced, and generally the analysis follows the versatile and most thorough plan and manipulation of data characterizing the original *Five Per Cent Case*.<sup>38</sup>

Extensive data to show whether the carriers' credit has been impaired are considered, and at the end of the general consideration of all these factors the commission says:<sup>39</sup>

<sup>35</sup> 32 I. C. C. 330, “While we differ,” *et seq.*

<sup>36</sup> 32 I. C. C. 336.

<sup>37</sup> 35 I. C. C. 497.

<sup>38</sup> (1914) 31 I. C. C. 351.

<sup>39</sup> 35 I. C. C. 565. The italics are those of the present writer.

"Up to this point we have discussed evidence of a general character, chiefly financial. As the views of individual Commissioners might vary with respect to particular features and different degrees of importance to be attached to the same fact, our comments have been primarily narrative; they have been interpretative only incidentally and within the range of financial facts of record. No attempt has been made on the record nor in our discussion of it to review the entire financial history of these carriers, nor to bring into relief *other facts* which have an important bearing upon their present financial condition. In other words, this preliminary discussion leaves uninterpreted many consequential facts. However, in our view a wider examination in this respect is not necessary for a proper disposition of the issues involved regarding proposed increased rates. We proceed to the consideration of the particular tariff schedules in which it is proposed to increase the rates."

The whole case is decided upon the conclusions as to the individual commodity later proposed; and in finding that a certain rate should or should not be increased, the decision is based on the "whole record," although the exact pertinency of the preceding portion is not stated, and apparently sufficient reasoning is developed in connection with the consideration of each commodity to indicate and support the finding thereon. In the first 66 pages of the opinion, the discussion is almost an ideal one on the question whether revenues are inadequate, or in the language of the opinion:<sup>40</sup>

"As the carriers first presented testimony relating to the inadequacy of their present revenues, that question may properly be considered prior to any consideration of the reasonableness of the proposed rates."

To the student of these questions and to the lawyer the failure to find any holding thereon is disconcerting; while it may be admitted that its decision is not necessary to the determination of the individual rate problems, still these problems are solved on the "whole record"; it may also be admitted that a tribunal may use its own discretion as to the compass and language of its opinions, but nevertheless the question why upon so elaborate a discussion no holding is predicated will not retire.

What are the "other facts" above alluded to? There may be a multitude in any of the cases of this kind, yet in the preceding cases enough were drawn into the record to support findings on this general question, and they were of the nature of those adduced here. It would be surmised, if Commissioner Daniels had not mentioned it in his dissent, that recent cases of railroad maladministration were in the commission's mind, such as the Alton, the Rock Island, the 'Frisco, and from earlier cases it may be inferred that these and possibly other wrongdoers were to be permitted to suffer the effects of their own

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<sup>40</sup> 35 I. C. C. 502.

willful and self-inflicted troubles. This feeling is mentioned in both the *Eastern* and the *Western Rate Advance Cases*,<sup>41</sup> and is gently hinted in the original *Five Per Cent Case*.<sup>42</sup>

It is to be noted that in both the *Five Per Cent Case* and the supplemental hearing of the same case<sup>43</sup> the commission was badly divided and a state of entirely unusual disagreement is shown by the vigorous dissents in both cases, and those in the instant case. Apparently, the commission was irrevocably divided upon the questions of the legality and the propriety of the general relief sought; also, the members of the commission were finding themselves consistently unable to agree on the conclusions which their statistical analyses would require. Possibly all these elements contribute to the failure to pass on the large question here.

#### THE FIFTEEN PER CENT CASE

We come now to the last of these cases, the *Fifteen Per Cent Case*,<sup>44</sup> in which practically all the carriers and all the rates in the United States are involved. The carriers are asking for a horizontal increase, and present the very situation which Commissioner Clements visualized as the worst possible under the ruling made in the supplemental hearing<sup>45</sup> of the *Five Per Cent Case*. Clearly, the general proposition we set out to investigate is here presented in its most comprehensive setting, and the factors considered should be attentively regarded.

The commission says:<sup>46</sup>

"The consideration of a general increased rate case is necessarily a study of tendencies. The trend of the curves shown in the different diagrams for the respective periods of time is unmistakably in a certain direction. It will be observed that there have been numerous ups and downs, but the general tendency has been favorable, including, for the country as a whole, the first four months of 1917. These figures and diagrams do not suggest a country-wide emergency. Emergencies of greater or less intensity may have existed with respect to individual carriers during various limited periods, but the direction of the curves shows recovery in each instance before the lapse of extended periods of time. The general trend has been distinctly favorable."

And further:<sup>47</sup>

"From the proceedings of 1910 and 1911 to the present time all such cases have involved the consideration and weighing one against the other of certain fundamental factors. The essential character of

<sup>41</sup> (1911) 20 I. C. C. 243, and 20 I. C. C. 307.

<sup>42</sup> (1914) 31 I. C. C. 351.

<sup>43</sup> (1914) 32 I. C. C. 325.

<sup>44</sup> (June 27, 1917) 45 I. C. C. 303.

<sup>45</sup> (1914) 32 I. C. C. 325.

<sup>46</sup> 45 I. C. C. 314.

<sup>47</sup> 45 I. C. C. 317.



these primary factors was the same in all the cases, but the attendant circumstances, the relation of the factors to one another, and certain significant secondary factors were not the same in all. This lack of identity in the relationship and surroundings of the individual factors accounts for the different conclusions arrived at in different proceedings.

"In this connection we refer especially to Tables 13 to 21 in the appendix, which reflect operating results through the entire period embracing all the important increased rate proceedings. They are the tables used in our reports of July and December, 1914, [*Five Per Cent Case* and supplemental hearing] brought down to date."

These tables include and show the effect of the following factors in graphic form:

1. Ratio of operating expenses to operating revenues.
2. Comparison of increase in property investment and traffic.
3. Ratio of net operating income to property investment.
4. Ratio of total operating revenue to property investment.
5. Ratio of certain groups of operating expenses to operating revenues.
  - a. Maintenance of way and structures.
  - b. Maintenance of equipment.
  - c. Transportation and traffic.
  - d. General and miscellaneous operations.
6. Passenger traffic and revenue per unit.
7. Ratio of taxes to operating revenues.
8. Ratio of taxes to property investment.

All these charts cover the period 1900 to 1917.

Certain other tabular views considered show over a varying number of years, month by month (and especially the first four months of each year) the factors: (a) Average operating revenues per mile; (b) Average operating income per mile, both for the whole United States, and separately for the three districts here involved, namely, eastern, western, southern, working out also (c) Average investment per mile of road, and (d) Ratio of operating income to average investment.

Finally, the commission considers, *per mile of road operated* for the whole United States and the three districts separately, these factors, for each month from July to December, 1916, and from January to April, 1917, namely: (a) Railway operating revenues; (b) Railway operating expenses; (c) Net revenue from railway operations; and (d) Railway operating income, and from the consideration of all the foregoing well-known factors, the commission reaches its conclusions.

Some relief was granted, but note that it was not granted horizontally; it is said<sup>48</sup> that on the hearing it was generally admitted that a *percentage increase* would destroy existing rate relations, which are of dominant importance; and it is concluded<sup>49</sup> that percentage

<sup>48</sup> 45 I. C. C. 316.

<sup>49</sup> 45 I. C. C. 324-325.

increases are very undesirable because of the serious effects on commercial conditions and established relationships.

The record of dissents is further enlarged in this case; although Commissioner Harlan voted with the majority to secure some affirmative action, yet his views as to why he concurs have all the essentials of a dissenting opinion. He really favored granting the relief requested throughout the country instead of confining it to the eastern district, whereas Commissioners Meyer and McChord viewed the record as not showing a case for any relief. Verily, the inherent difficulty of the problem is emphasized when these three able commissioners are found disagreeing among themselves and from the remainder of the commission. It should also be noted that the statistical analysis indulged in led two commissioners to the view that financial conditions were satisfactory and needed no aid in any parts of the United States; led one of the commissioners to the conclusion that they were unsatisfactory and needed aid in every part of the United States; and led three of the commissioners to the conclusion that they were unsatisfactory and needed aid on the merits in only one of the three districts of the United States!

To summarize and leave something concrete on this subject of factors, it is probable that, on the whole, the selection, arrangement, and manipulation of them, as well as the treatment given to them, in the original *Five Per Cent Case*,<sup>50</sup> make that case typical. The general discussion there was centered about the tendencies—all over a period of time named—manifested by:

(a) Property investment. (b) Total operating revenue. (c) Ratio *a* to *b*. (d) Total operating expenses. (e) Ratio *d* to *b*. (f) Net operating revenue. (g) Taxes. (h) Hire of equipment, joint facilities, etc. (net). (i) Net operating income. (j) Ratio *i* to *a*. (By the year and the average.) (k) Comparison of property investment with traffic units and operating revenue. (l) Details showing operating expenses grouped. (m) Depreciation and renewal charges. (n) Tax ratios to operating revenue and property investment. (o) Analysis comparatively of property investment and operation and capitalization.

In a given case, incidental factors are likely to appear, and more or less manipulation of the steady factors may be desirable to develop a variety of phases; and so we have found it.

#### RAILWAY CREDIT

In the hearings since 1910 the railway representatives have introduced evidence and arguments to show that railway credit is rapidly ebbing, and this is reflected in the rapid decline annually in new mileage. Railway expansion reached its zenith about 1910, and since

<sup>50</sup> 31 I. C. C. 351.

that time the capital needed to make extensions, enlargements, and developments to care of the traffic has not been available. The stock market reflects this situation because dividends are small, as a rule; hence, issuing stock can no longer be resorted to as formerly to raise money. Further, bonds and short-time notes come more and more into use, so that the funded debt is growing in much larger volume than the capital stock, and mortgages the property to an extent that renders new money from that source a fading possibility; the railroad security must compete with others of a more attractive sort, and it is failing in the race because the railway under state and federal regulation can control neither its income nor its expenditures; the day of railway speculation and stock bonuses is gone, and the railway must now appeal for new money to the conservative investor. The railway representatives admit the cases of the Erie, the New York Central, the Rock Island, the Alton, the New Haven, the 'Frisco, the Cincinnati, Hamilton & Dayton, the Pere Marquette, and other instances of flagrant railway manipulation resulting in a depressing effect upon stocks; but they say further that these are exceptional cases, they do not characterize the railway management of the country and are now so recognized; that all such methods of financing are obsolete. Accordingly, they ask a constructive policy, and to that end lay before the commission a program of development based on increased rates to produce a greater and an adequate revenue. They have also argued that large improvements could be made from such net revenue, and further development on a large and necessary scale could be made with new capital attracted by the liberal rates; and that it is possible that the proposed new policy would enable the payment of such dividends as to make new stock issues readily marketable.

Not only have the railroads in a constructive way repeatedly made this argument to the commission, but they have made it over and over to congressional committees as a reason for new legislation of a constructive kind; until to-day this course of reasoning is fundamental in the railroads' statement of their conditions and needs. An accompanying reason has always been that the costs of everything a railroad uses are rapidly rising, and that the interest rate also advances.

How has the commission in the cases before us received these arguments?

In the 1911 *Eastern Case*<sup>51</sup> the commission viewed these arguments with sympathetic interest, recognizing that rates should be sufficient to enable railroads to maintain a high state of efficiency, and the treatment of the railroads by the public should be such as to inspire confidence in the investing public and make the long-time railroad bond a favorite investment. But on the evidence the commission found

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<sup>51</sup> 20 I. C. C. 243.

the railway bond to be more stable over the last ten-year period than the municipal bond, and, comparatively, had gained favor, although the low-rate bond did not sell for as much as it did in 1900. The evident course pointed out is to pay more interest. The commission charged the railway interests with having subsidized the press to proclaim threatened disaster because of government regulation,<sup>52</sup> and places the blame for much of the foreign suspicion of American railway securities upon the practices of the railways before governmental supervision was extended. Some concern is expressed for holders of railway securities, and a public duty is declared to exist to make good, so far as possible, the legitimate expectations of investors, inasmuch as the government, by failing to establish rates and by inviting railway construction by private capital, has in a way opened the gate for such stock and bond transactions as have occurred. The whole question, therefore, is whether higher rates are now needed to yield to this railroad capital as large a return as it could have obtained from "other investment of the same grade." Then the commission paints an alluring picture of the railroad security as an investment, directly contrary to the complaints of the railway operators!

In the 1911 *Western Case*<sup>53</sup> Commissioner Lane, on the commission's conception of the facts, produces arguments that sweep away all foundation for the railroads' claims on the proposition of decadent credit, although earnestly recognizing the public duty toward railroads and expressing the heartiest interest in railroad prosperity and the intention of the commission at all times to foster it.

He charges the railroads with insincerity in their instant complaints and representations<sup>54</sup> and quotes the brief of the Atchison, Topeka & Sante Fe Railway Co. to the effect that rates have always been inadequate, and therefore development has halted and can now go forward only on higher rates which will produce the needed cash and credit; he then observes:

"We must not regard too seriously, however, the effort of railroad counsel to establish this Commission in *loco parentis* toward the railroads. We must be conscious in our consideration of these rate questions of their effect upon the policy of the railroads and, ultimately, upon the welfare of the state. This country can not afford to have poor railroads, insufficiently equipped, unsubstantially built, carelessly operated. We need the best of service. Our railroad management should be the most progressive. It should have wide latitude for experiment. It should have such encouragement as would attract the imagination of both the engineer and the investor. Nevertheless, it is likewise to be remembered that the government has not

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<sup>52</sup> The Mann-Elkins Act was passed in 1910 after a tremendous legislative conflict with the railway interests.

<sup>53</sup> 20 I. C. C. 307.

<sup>54</sup> 20 I. C. C. 316, 317.

undertaken to become the directing mind in railroad management. We are not the managers of the railroads. And no matter what the revenue they may receive there can be no control placed by us upon its expenditure, no improvements directed, no economies enforced."

He thinks the unfavorable public attitude toward railway securities is the result of financial manipulations, not regulation. He finds that from 1899 to 1909 the railroads of the United States floated bonds to the amount of more than  $4\frac{1}{4}$  billions of dollars; the mortgage indebtedness was thus increased 77 per cent while the mileage increased 36 per cent, and the rate of interest paid was actually less in 1909. He proceeds to show that there is no evidence to support a fear that new capital may not be had, and shows also that the bond holder is not aided by increased rates, his rate of income is fixed, and he merely desires stability in the security. As to stocks, he finds in some cases an utter recklessness in their issue which affects their value and also the inclination of the public to invest in them or others; clearly, increased rates will not revive confidence in stocks already issued! He then inquires,

What is the connection between rates and capitalization? In the railroad rate maker's mind, nothing! In the instant case President Ripley of the Sante Fe stated his view to be that the making of freight rates has no relation to the capitalization of the railroads; and in testifying before the Joint Congressional Committee on Interstate Commerce in March, 1917, Judge Lovett, Chairman of the Executive Board of the Union Pacific, stated<sup>65</sup> that he had never heard of a case where a traffic manager or rate-making authority of a railroad company paid any attention to the amount of securities in making rates, and he appeared, of course, as a railroad witness, and one of the foremost authorities on railroad matters! So the railroad point of view has not changed since 1910.

In the original *Five Per Cent Case*<sup>66</sup> *net corporate income* is considered as a factor in indicating railroad prosperity, and it is found that some systems with large property investment have comparatively small capital stock, and *vice versa*, and the relatively inefficient Erie Railroad is seen to have capital obligations about 57 per cent greater per mile than the average for the three great systems in official classification territory, that is, the New York Central, the Pennsylvania, and the Baltimore & Ohio. Further, net corporate income of the Central of New Jersey for the preceding year was almost 25 per cent, while this account for the Cincinnati, Hamilton & Dayton showed a deficit of almost 14 per cent; this great difference can be accounted for largely by difference in management of the property

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<sup>65</sup> Testimony, 751.

<sup>66</sup> (1914) 31 I. C. C. 351.

as an earning concern, and also as a basis for stock speculation (and worse); at the same time, the average in this territory was over 8 per cent.

But net corporate income is a factor which includes within its scope a multitude of corrupt transactions as well as the *bona fide* transactions in many properties managed in a fine public-spirited manner, and it is therefore not regarded in that case as a *reliable measure* of the adequacy of rates.

As stated in the 1911 *Eastern and Western Cases*,<sup>57</sup> the great increase in capitalization over the ten-year period since 1900 showed that stocks and bonds had found, comparatively, a ready market, while in the instant case the data for the period 1900-1913 show a +45 per cent increase in capital stock and a +80 per cent increase in the funded debt, and a +64 per cent increase in the total; also, it appeared that the ratio of stock to funded debt had decreased from +45 per cent to +40 per cent, which indicated again that stock was less attractive to railway investors than bonds and notes which were based on the property as security and carried their rate of income on their face, and, further, did not involve the holder in any of the duties and tribulations of an owner of stock. The interest rate was also seen to be close to 4 per cent over a period of six years. But when the thirty-five systems of carriers were distributed into groups and the analysis applied, a somewhat less favorable result appeared. A group of ten (almost all in trunk line territory) showed, for the year 1913, fine results in an average of 8.55 per cent net operating income on a total capital obligation of over 811 millions, and 16.92 per cent net corporate income on the capital stock; the three great systems showed less favorably with 5.16 per cent net operating income on total capital obligations of over 3 billions and a net corporate income of 9.05 per cent on capital stock; at the same time, the five New England lines with a total capital of over 654 millions showed a net operating income of 5.56 per cent and a net corporate income of 3.98 on capital stock; and the remaining seventeen systems scattered through trunk line and central freight association territory, with over 1807 millions total capital, showed 2.15 per cent for net operating income and 12 per cent net corporate income on capital stock, with eight of them showing an actual deficit in this item. Although since the opening of the calendar year 1914 it was shown that over 500 millions of bonds and notes had been marketed and 35 million of Baltimore & Ohio notes went quickly at par, yet in view of the above analytical review, the decreasing net corporate income, and the recent upward swing in the interest rate, these carriers were, generally speaking, found to be in need of more money. Some other facts coupled with the analysis tended to show a declining credit. These

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<sup>57</sup> 20 I. C. C. 243 and 307.

facts are: great competition for money with government, public service and industrial securities which generally were proffered at the same interest rate; flagrant railroad mismanagement in some instances had shocked the public; decline in securities on the market; railroad receiverships; intimate relationship between badly-managed railroads and banking institutions of great reputations for conservativeness; interlocking relations and directorates among strong and weak (or mismanaged) lines, *e. g.*, Baltimore & Ohio and Cincinnati, Hamilton & Dayton; unwise extensions of the lines of large systems; acquiring property not forming a part of the system or being non-railroad property; and lastly in this indictment, the great campaign of publicity carried on by the railroads during the pendency of this case to induce the commission to grant the requests of the railroads.<sup>58</sup> The commission thereupon expresses the view that a restoration of credit will soon follow a conservation of revenues.

This subject is merely mentioned in the supplemental hearing<sup>59</sup> of the *Five Per Cent Case*, to indicate that the fears of the carriers in the 1911 cases have fortunately not been realized; that they have borrowed vast sums of money in the intervening time; but that the great war undoubtedly will render acute the financial needs of the carriers; the increasing interest rate is an important factor in the situation.

In the 1915 *Western Rate Advance Case*<sup>60</sup> the credit of railroads as measured by the rate of interest was compared exhaustively with the credit of municipalities, manufacturing and industrial enterprises, and public utilities, in all of which a gradually rising interest rate is found running over the preceding 14-year period, while railroad credit had not been depressed relatively. After a careful study of the financial experiences of these western roads, the commission concludes that they have not suffered as a whole any impairment of credit not common to comparable industrial enterprises; that such relatively equal depression of credit is not evidence either of the adequacy or inadequacy of rates; that investors are showing a decided preference for bonds and notes over stock; that, as the underlying mortgage security is progressively covered by these loans, the prospect narrows for new capital from the same sources; and further, that these roads are not relatively so prosperous as they were in 1901. All of these conclusions seem to point to higher rates as the most reasonable source

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<sup>58</sup> The extent and insidious character of this campaign are clearly shown in the letters, articles, editorials and telegrams published at the request of Senator La Follette, in the CONGRESSIONAL RECORD for May 12, 1914, covering 360 pages. Commissioner Harlan devotes three pages of the opinion to a deprecatory notice of this campaign.

<sup>59</sup> (1914) 32 I. C. C. 325.

<sup>60</sup> 35 I. C. C. 492.

of additional money. Thereupon, on a consideration of the commodities individually, certain increases were awarded.

Coming to the *Fifteen Per Cent Case*,<sup>61</sup> the matter of *railway credit* is not introduced into the opinion of the commission, but it receives the attention of the witnesses for the carriers. President Rea of the Pennsylvania Lines says that railroads are suffering from increased costs and taxes, and an inadequate property investment; hence, the facilities are inadequate and the credit is insufficient. President Smith of the New York Central says, with more detail, that stock is not now an inviting investment, for the dividend rate is not high enough, and the conditions do not provide sufficient assurance of the railroad situation; earnings must be at a level which will attract investors in securities—that is, they must show a proper surplus above charges to create credit. President Elliott of the New Haven spoke in detail of the needs of his system, and of the necessity for income sufficient to assure dividends in order to bolster the credit of the system. But on account of revelations of New Haven practices in recent years under the Mellen *régime*, anything tending to show a bad credit condition there would be explained by local conditions and could shed no light on railroad needs in general. President Harrison of the Southern Railway referred to the need of increased credit. Mr. Kruttschnitt, chairman of the executive board of the Southern Pacific, detailed the low status of railroad credit as shown partially by the virtual impossibility for some years past of getting new capital by stock issues, by the great increase in the bonded indebtedness, and by increased rates of interest. He quotes Commissioner Daniels in the *Five Per Cent Case* on “rising prices” and their influence in railroad matters. Other witnesses also refer to this subject of diminishing railroad credit, and all incline to harmony in the opinion that an increase in the rates is the only solution.

In this matter of credit, therefore, the findings of the commission running back to 1910 have quite uniformly been that the railroads are not suffering from diminishing credit, except possibly in some instances where their own conduct is responsible for an unfavorable public opinion; at the same time, the railroad evidence for the same period is insistent that credit is at an ebb and increased rates are needed to revive it, and the railroads have also insisted that the many honestly managed systems should not be forced to suffer for the misdeeds of a relatively small number. They also urge that they may be permitted to have such revenues as will enable them to project improvements of such magnitude and character as to accommodate for the near future a transportation business which has grown out of all proportion to railroad facilities. And the best railroad operators in the country have been in entire agreement in advocating this program

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<sup>61</sup> (1917) 45 I. C. C. 302.



before the commission; they have deprecated the necessity for reappearing before the commission at short intervals, and although they agree that regulation is one of the best things that ever befell the American railroads, yet, since the effects of the close regulation under the amendments of 1906 and 1910 have more and more become evident, the railroads of one or more sections of the country have now been before the commission for the sixth time in seven years—each time with practically the same arguments and representations as to conditions! Usually, when relief has been accorded, it has been because of an emergency of very recent origin. The commission has been conservative, and has acted as the law requires it, namely, it has required the railroad to assume the burden, and has in no case found that the railroads have entirely supported that burden. Generally, the commission has been guided by the statistics and has uniformly acted on what it has deduced as the “tendencies” shown thereby; the carriers have never been satisfied with these deductions and have uniformly proposed a constructive program which necessarily has a future aspect which they base on experience.

Commissioner Meyer adheres to the statistical formulae entirely and finds in the *Fifteen Per Cent Case* that the carriers, on that basis, have failed to show a case for relief; Commissioner McChord agrees, but expresses a willingness, if the conditions become more acute, to sanction a large horizontal increase universally; Commissioner Harlan in the *Five Per Cent Case*<sup>62</sup> shows signs of leaning toward the carriers' views, but disagrees with them as to the means of securing increased revenues, and proposes a program of reform which the commission thought the carriers ought to try. In the *Fifteen Per Cent Case* he is very close to the carriers' point of view when he says:<sup>63</sup>

“This month-to-month and purely statistical view of the matter seems to me to be wholly inadequate. Nor do I regard that course as altogether safe. We are facing a much larger problem, and it must be approached in a much broader way if we are to reach a sound solution.”

Railroad evidence has growingly made reference to the public side of the transportation question and has come more into accord with the necessary view of the commission, and Commissioner Harlan says further:<sup>64</sup>

“The record in my judgment demonstrates a proposition that has long been clear to me, namely, that a rate is a public question and that the existing rates, aside from any interest that the owners of our

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<sup>62</sup> (1914) 31 I. C. C. 351.

<sup>63</sup> 45 I. C. C. 327.

<sup>64</sup> 45 I. C. C. 329.

railroads may have in the matter, could well be advanced in the public interest, in order that assurance may thus be given for the early enlargement of our transportation facilities.

"I express the thought in that way because it is clear that so long as we look to private interests to furnish a transportation service for the country we must see to it that the rewards are sufficient to attract capital for its further development. Under present conditions this appears not to be the case. Executives of great insurance companies and of great saving institutions testified during the hearings that the volume of their holdings in railroad securities has been steadily diminishing and that they and other large investors are looking with decreasing favor on railroad securities. . . . We must not overlook the fact that at this time, and apparently for the next few years, new capital must be sought by the carriers in competition with the demands of many governments for war loans and in competition with the very large returns of industrial companies."

This doctrine is not new, but it has seldom been advocated by a commissioner with such clearness and directness; a like note is clearly struck by Commissioner Daniels in his dissent in the *Five Per Cent Case*<sup>65</sup> although he does not there express his individual views. But no majority opinion yet indicates that the commission has acceded to this viewpoint.

#### THE ATTITUDE OF THE COMMISSION

It is almost a superfluity to comment on this point, because the attitude has always been what would be expected of a responsible body entrusted with issues of such vast importance; but since the commission itself has in nearly all of these cases adverted to its attitude toward the problems involved and to the carriers, a brief statement is appropriate and reassuring. Freed from the formalities and technicalities marking the procedure of the common-law courts, it has always addressed itself in the simplest and most direct fashion to the crux of the situation; parties almost without end have appeared in these great rate advance cases, and multitudes of witnesses have testified on the manifold phases of the questions involved. The commission has not held aloof like an arbitrator or forum called upon to decide a dispute, but has been a patient and sympathetic body positively standing for the great mass of the public otherwise unrepresented which is uncomplaining, because the incidence of most rates in the item of increased costs has long since been shown to be practically negligible so far as a particular individual is concerned. Generally speaking, counsel for railways and protestants may be relied upon to develop the case, but the commission has usually supplemented such testimony by information elicited upon its own investigations, frequently conclusive in its nature. At the same time, the commission

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<sup>65</sup> 31 I. C. C. 351, 434.

has been keenly impressed with the needs of railroads as well as their practices, and has had a uniformly broad outlook upon the railroad situation. Let the cases speak for themselves.

In the early case of *Proposed Advances in Freight Rates* it is said:<sup>66</sup>

"To the broader proposition, that railways should share in the general prosperity, we assent. Railway stocks and railway properties ought not to fluctuate in value like industrial stocks or industrial enterprises, and it is hardly probable that they will do so. The causes which have contributed to this in the past will not operate to the same extent in time to come. The great systems have taken permanent form. The tendency is to operate railways as business enterprises; not for the stock market. Consolidations in ownership, whatever their other effects, contribute to the maintenance of rates and will prevent in case of future dearth of traffic the suicidal competition which might otherwise be induced. Still, whatever may be true in the future, they have certainly suffered severely in the past and should be allowed to recuperate in this era of good times."

In the *Eastern Rate Advance Case* it is said:<sup>67</sup>

"Now, the ordinary considerations of justice require that the money so invested by invitation of the Government should be allowed a fair return. . . .

"Our railroads must be maintained in a state of high efficiency. This the public interest demands. Commerce and industry can not afford to wait on transportation facilities. Our rates should be such as to render possible a high class, not an extravagant, service.

"If, therefore, we are to rely in the future, as we have in the past, upon private enterprise and private capital for our railway transportation, the return must be such as will induce the investment. It is therefore not only a matter of justice, but in the truest public interest that an adequate return should be allowed upon railway capital."

In the *Western Rate Advance Case* the commission says:<sup>68</sup>

"The Constitution of the United States guarantees the carriers against the confiscation of their property or the taking of the same without due process of law. Without this constitutional guaranty, which is distinctively American—for here property rights are more sacredly safeguarded than in other lands of more mobile law—the railroads of our country are protected from injury of any lasting character by the popular consciousness that they are essential to the industrial life of the people. To harm these roads is to injure ourselves. Our laws do not seek to establish dominion over private capital for any other purpose than to make sure against injustice being done the public, and thereby make such capital itself more secure. We are dealing here with a difficult problem, involving mul-

<sup>66</sup> (1903) 9 I. C. C. 382, 406.

<sup>67</sup> (1911) 20 I. C. C. 243, 262-263.

<sup>68</sup> (1911) 20 I. C. C. 307, 378.

titudinous facts and an infinite variety of modifying conditions, which make the establishment of principles and the framing of policies a matter of slow evolution. Congress has laid down a few rules. These rules we are attempting to apply."

In the original hearing of the *Five Per Cent Case*,<sup>69</sup> the same sentiment is differently expressed, and it is further said:<sup>70</sup>

"We may justly feel proud of the development of our transportation system. Despite occasional discreditable chapters the history of our railroads has been marked by great achievements. There is among the carriers a growing spirit of co-operation with the Commission in its efforts to enforce the law. With the application of correct and helpful accounting, the establishment of sound business methods, and a better understanding by both carriers and the public of their mutual obligations, to which we believe this investigation has contributed, the future is full of promise. We see no reason why our American railroads should not enjoy a large measure of prosperity consistently with just and reasonable rates."

Further to manifest the sympathetic spirit of helpfulness, the commission suggested to the carriers ten items relating to their practices and regulations adapted to improve the service and add to the revenues—a real constructive program in economies and practices based upon the results of an independent investigation prosecuted by the commission.

The outcome of the supplemental hearing<sup>71</sup> of the *Five Per Cent Case* in itself expressed the helpful attitude of the commission.

In the 1915 *Western Rate Advance Case*<sup>72</sup> the same attitude is shown as in the preceding cases regarding a liberal policy towards the carriers.

In the *Fifteen Per Cent Case*<sup>73</sup> the expressions on this point are cordial; and inasmuch as the opinion is vastly shorter than in any of the other cases except the supplemental hearing of the *Five Per Cent Case*, and deals briefly with the large volume of evidence submitted, no excursion for this purpose should be expected, and certainly, in view of the oft-expressed attitude of the commission, none is needed.

#### SUMMARY

The commission in the case of 1903 and the cases of 1910-1911 came to the unanimous agreement that it could lawfully consider the question of advancing rates to secure greater and adequate revenues; and, in a manner astonishing for its patience, thoroughness, and desire to work out the best interests of railroads and public alike,

<sup>69</sup> (1914) 31 I. C. C. 351, 359.

<sup>70</sup> 31 I. C. C. 427.

<sup>71</sup> (1914) 32 I. C. C. 325.

<sup>72</sup> 35 I. C. C. 497, 520.

<sup>73</sup> (1917) 45 I. C. C. 303.

unanimously concluded (except as to some fragmentary details in one case) that the case made by the carriers was not convincing.

In the *Five Per Cent Case*<sup>74</sup> the matter of a horizontal increase in rates is first raised, and the relief accorded by the commission is in the main a horizontal one, yet it arouses no protest on that ground, and is approved as to class rates and certain commodities. But a most vigorous and well-reasoned dissent is voiced in this case, and the commission does not act unanimously in any of the subsequent cases. On the supplemental hearing,<sup>75</sup> under the stress of the cataclysmic struggle in Europe, the percentage increase, with exceptions, is extended to other territory, but again most vigorous dissent arises.

Commissioner Harlan deplors the percentage plan of increasing rates and thereby crystallizing in the law rate structures teeming with irregularities and discriminations, and he predicts disaster from the course there pursued; Commissioner Clements makes an argument against the whole ground of the opinion and the jurisdiction of the commission.

In the *1915 Western Case* Commissioner Daniels again vigorously dissents and concludes:<sup>76</sup>

"In the matter of rate regulation and fixation we have reached a point where one of two courses ought deliberately to be chosen and clearly announced. If, despite increased costs not offset by increased revenue, increases in rates are to be denied, except where in individual instances gross injustice would be occasioned by their denial, the carriers ought to be apprised of this policy, so that they may set their house in order, if they can, against such a situation. If, on the other hand, we are to acknowledge in general, what we are perforce compelled to admit in detail, just and reasonable increased rates should be permitted not grudgingly but with such fair measure of allowance as will indicate that the transportation industry is entitled in the interest of the public to earnings sufficient to supply a service commensurate with public needs."

Commissioner Harlan also dissents, approving the manner in which the carriers have requested the increases and finding them justified substantially as made; he further suggests several items of a constructive nature.

Again in the *Fifteen Per Cent Case*<sup>77</sup> the dissents and explanations are vigorous. Commissioner Harlan expresses what is practically the view of the transportation question so laboriously and insistently presented by the railroad authorities in season and out of season for the last seven years. Commissioner Meyer occupies the antipodes, and insists that the well-known factors considered hitherto in such cases

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<sup>74</sup> 31 I. C. C. 351.

<sup>75</sup> 32 I. C. C. 325.

<sup>76</sup> 35 I. C. C. 497, 680.

<sup>77</sup> 45 I. C. C. 303.

are sufficient, and a proper construction and rating for them would lead to the conclusion that no increases should be allowed; he wants the evidence to show the "most conclusive proof" of the need for the advance. His view is that the application of reasoning and methods similar to those applied in the former cases would lead to the conclusion that no increases are proper.

Commissioner McChord agrees with Commissioner Meyer as to the weight of the well-known factors, but is willing, as a war measure, to raise all rates everywhere. He expresses the view that the questions involved are largely of governmental policy as to prices.

This review shows that the commission is now badly split on this question; to pursue the matter further or to predict future action would be useless. The commission is not tied to precedent like a court, but it clearly believes that action should be piecemeal and the results thereof observed and made the basis for future action; it is plainly unwilling to follow the program of the carriers, and it remains unconvinced of their failure of credit and their inability to effect further economies and reforms. The statute places the burden upon the carrier, and a "show me" frame of mind is legally justifiable; yet there is nothing in the statute which forbids the commission from being a helpful and constructive influence, or from taking a broad view of the problems and parties involved in these proceedings. The word "reasonable" applied to rates is capable of almost unlimited interpretation and application in view of the public interest involved, and there are potent signs that the commission is taking a somewhat larger view of the whole rate structure and the legitimate needs of the carriers, the vast majority of which are managed in good faith, and many, with rare ability.

But it would be a mistake to conclude that the commission has ever taken a "narrow" view of these great questions; it should be characterized as a "developing" view based on a most intensive and extensive study supplemented by the observations of many years; in fact, its course seems the only one logically possible; it has advanced as the great remedial enactments of 1906 and 1910 have been applied and have produced a progressively improving condition in the practices, accounting, and sense of responsibility of the carriers. It must not be forgotten that only recently has valuation of the carriers' property by the commission been provided for; authentic information as to one of the chief essentials of rate determination has never been available, and skepticism as to carriers' figures was well founded. It is also to be remembered that the commission has never been given any control over the issue of securities, and therefore a potent factor in the question of credit is still without regulation and its presumed beneficent results.

Although Mr. Acworth, the English writer on Railway Economics, holds the view that American railway rates are now too low, and have been so for years, and that a 20 per cent increase would in time produce the needed railway prosperity, and although a considerable number of writers in the United States take the same view, yet the commission has aimed to secure sufficient benefits for the carriers, and to protect the interests of the shippers and the consuming public; and its course has been based on an exhaustive study of facts and tendencies as illustrated in a wealth of statistics. Its course has kept the carriers reminded of economies and reforms which they might achieve, and has tended to put the carriers on their mettle; further results in this direction are being insisted upon. One who will carefully study these great cases cannot escape the conviction that the commission has been painstaking, progressive, and—in view of the numerous great and discordant interests always involved—eminently reasonable in its findings.

One will gain the impression that the railroads are far beyond the point where they render mere lip-service to the idea of public regulation for the public interest; that their cases are framed with that idea prominent, and that the era of recrimination is permanently past. Although it is to be expected that their own individual interests will continue to be strongly advanced by them, yet they meet the commission on ground progressively common, and the relation to-day is fast approaching mutual recognition of *bona fide* and cordial co-operation.