VALUATION OF LEASED RAILROAD PROPERTY*

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Among the various purposes¹ from which the valuation of the railroads was undertaken that of affording a basis for making rates stands out as the most prominent.² The discussion following is undertaken solely from the standpoint of valuation for rate-making.

The value which is determinative in rate-making and which hereinafter will be referred to as the rate base, is the value of the property used or to be used in earning the return with which the rate based is to be compared, whether such property be owned or leased.

In order to use such an amount as a rate base, it is necessary to compare it with another amount representing earnings derived under existing rates or likely to be derived under proposed rates and upon the basis of such a comparison to determine the adequacy or inadequacy of the rates. It is essential that the classification of property, determinative of whether or not the property is to be reflected in the rate base, be in harmony with the method adopted for arriving at the figure representing earnings. Unless this be so, a fair comparison cannot be made.

With respect to property owned and used, no difficulty is encountered. Such property is naturally reflected in the rate base of the owner. In no other way could the owner be compensated for devoting it to the public use.

The proper classification of leased property, however, is dependent upon whether the rental paid or received is taken into account before or after arriving at the figure representing earnings. When taken into account after arriving at earnings, the rental is paid out of earnings, and the leased property should be included in the rate base of the lessee so as to permit earnings out of which payment may be made. When so taken into account rentals received are not included in earnings and no occasion arises for reflecting the property in the rate base of the lessor.

When rental paid is taken into account before arriving at earnings, it is charged against the public as if it were operating expense, and the inclusion in the rate base of the lessee of an amount representing the

* As affected by the method of rate-making prescribed by Congress, with special reference to the valuation of leased equipment and of jointly used but not owned property.

¹ These purposes are given in section 15a of the Interstate Commerce Act (section 15a was inserted by the Transportation Act of 1920 [41 Stat. at L. 456, 488]).

² The Interstate Commerce Commission has apparently adopted the view of its Chief Counsel, Mr. Farrell, that "The term value has no definite meaning, except where the purpose for which the value is to be used is indicated." See *San Pedro, L. A. & S. R. R.* (1922) 75 I. C. C. 506, 510, and *Atlanta, B. & A. R. R.*, *ibid.* 645, 666.

leased property would result in charging the public twice for the use of the property. Under these circumstances, the property should be reflected in the rate base of the lessor because the rental received is charged against the lessor as if it were operating revenue, and the failure to include in the rate base an amount representing such property would have the effect of denying the lessor any return thereon.⁸

This proposition is subject to modification when the amount of the rental differs materially from a fair return on the value of the property in question. If the rental be less the lessee should not be denied opportunity to earn something in addition to compensate for the risk undertaken in operating the property. If the rental be more the public should not be charged with the excess over a fair return. This will be illustrated in detail in the discussion which follows.

Rentals are usually taken into account after arriving at the figure representing earnings. That course is followed by the Interstate Com-

⁸ The proposition may be illustrated as follows: Assume that carrier "A," in addition to property owned and valued at \$1,000,000, uses property of equal value which it leases from carrier "B"; that "A" pays a rental of \$60,000 for the leased property; that this rental is not deducted before arriving at the railway operating income of "A" of \$120,000, and that 6% is a fair rate of return. Under these circumstances, and if it is for the purpose of comparison with the income of \$120,000, it will be fair to fix the rate base for "A" at \$2,000,000, comprised of \$1,000,000 for property owned and used plus \$1,000,000 for property used but not owned. "A" would be entitled to its full earnings of \$120,000 and no more, since this represents exactly 6% of the rate base of \$2,000,000. Out of these earnings it would pay the rental of \$60,000 and retain the remainder as its return on the \$1,000,000 of property owned and used by it. Rates would remain undisturbed.

But should the rental be taken into account before arriving at earnings, it would be deducted from operating revenues just as if it were an operating expense and the figure representing earnings would be reduced to \$60,000. Under these circumstances, if the rate base were again fixed at \$2,000,000, higher rates would be called for than under the previous illustration although no additional property was devoted to the public use. Rates would have to be adjusted so as to yield the \$60,000 of rental deducted before arriving at net earnings in addition to the \$120,000 called for in the first illustration. The inequitable result would follow that the public would be charged twice for the use of the leased property.

Assume further that "B," besides owning property of a value of \$1,000,000 which it leases to "A," owns and uses additional property also worth \$1,000,000, and that its earnings from operating the latter are \$60,000. In that event, the rate base for "B" could fairly be fixed at \$1,000,000, representing the property actually used, only so long as the rental received were not added in arriving at the earnings figure with which the rate base is to be compared. If the rental received were added, the earnings figure would become \$120,000 and, if then the rate base were confined to \$1,000,000, "B" would be permitted, under the provisions of the act, to retain earnings of only 6% of that amount or \$60,000, and would be subjected to the recapture of the excess. In the measure that it would be forced to part with such earnings, it would be deprived of the rental to which it would be entitled. However, if the rate base were \$2,000,000, as it should be if it is to be compared with the total earnings derived from leased as well as used property, "B" would properly be permitted to retain its full earnings.

merce Commission in the classification of accounts which it prescribes,⁴ and which carriers are required to observe, with the exception of certain rentals of comparative unimportance.⁵

However in section 15a of the Interstate Commerce Act, Congress requires that certain important rentals be taken into account before arriving at the figure representing earnings. The mandate of Congress is contained in the following definition of the term "Net Railway Operating Income":⁶

" the term 'net railway operating income' means railway operating income, including in the computation thereof *debts and credits arising from equipment rents and joint facility rents.*"

It is with "net railway operating income" that Congress directs the Interstate Commerce Commission to compare the value found under 19a in order to ascertain, first, the adequacy or inadequacy of rates for the railroads as a whole or for such groups as the Commission may designate, and, second, to ascertain whether or not the earnings of individual roads are excessive and should in part be recaptured.⁷

Since only equipment and joint facility rents are separately treated by Congress, the discussion hereinafter will be confined to leased equipment and property jointly used but not owned. During the calendar year 1921, joint facility and equipment rents paid by Class I roads aggregated \$153,908,251.⁸ This amount capitalized at 6% results in over \$2,500,000,000, which may be accepted as indicating, at least in some measure, the probable value of joint facilities and leased equipment used by the railroads of the country. It is therefore apparent that, even if it were regarded merely as a matter of administrative detail, the subject presented is one of considerable importance.

The attempt will be made, first, to indicate the course which should be followed in valuation in order to meet the requirements of 15a; second, to point out that in certain respects the present practice of the Interstate Commerce Commission in the valuation of railroads is and in other respects is not in accord with the procedure advocated; and third, to show the necessity of uniformly following this procedure.

Equipment rents are paid or received for the use of equipment, including both rentals paid for the use of equipment interchanged

⁴ See the form of income statement prescribed by the Interstate Commerce Commission for the annual report of carriers.

⁵ Rentals, which when received are taken into account as operating revenue and when paid as operating expense, are indicated in the "Classification of Operating Revenues and Operating Expenses of Steam Roads" and at pages 241 and 242 of the separate publication by the Interstate Commerce Commission entitled "Index to the Classification of Operating Expenses of Steam Roads."

⁶ 40 Stat. at L. 456, 488. *Italics mine.*

⁷ Paragraphs 2, 4, and 6 of section 15a (40 Stat. at L. 456, 488, 489). Section 19a was inserted by the Act of March 1, 1913 (37 Stat. at L. 701).

⁸ *Preliminary Abstract of Statistics of Common Carriers for 1921*, p. 8 (published by the Interstate Commerce Commission).

between carriers and rentals paid for equipment leased outright, over the use of which the lessee has the same control as an owner would have.⁹ They do not include any part of lump sums paid as rental for both road and the equipment used in its operation.

Joint facility rents are paid or received for the joint use of property.¹⁰ The joint use may be with an operating carrier or with a non-carrier corporation or individual. Such property ranges from a simple crossing to expensive terminals and sections of track in some cases many miles in extent.

Section 15a provides that in determining the rate level for groups of carriers, a comparison be made between the aggregate of the values ascertained with the aggregate of the amounts representing the net railway operating income of the individual roads in the group. In group rate adjustments the difficulties in valuation which arise when rentals are taken into account before arriving at the earnings figure are somewhat lessened by the fact that the debits and credits in equipment and joint facility rentals will counterbalance except in so far as equipment or joint property may be leased to or from carriers without the group, or to or from parties other than common carriers.¹¹

In the recapture of excessive earnings from individual roads, debits and credits from equipment and joint facility rents are very likely to be wide apart and it is here that the greatest inequalities will result if leased equipment and property jointly used but not owned are reflected in the rate base of the lessee but not of the lessor. This may be illustrated as follows:

1. Let us assume that a carrier uses property under terms and with operating results as indicated below.

Value of property owned and used or wholly used but not owned, other than leased equipment	\$100,000,000
Leased equipment with a value of \$10,000,000 or property jointly used but not owned, the portion of the value of which property corresponding to the carrier's use thereof is	10,000,000
Rental, per annum, paid for the use of property referred to in the preceding item	600,000
Railway operating income of this particular carrier	6,600,000

By including the value of the leased equipment or of the jointly used but not owned property in the rate base of the lessee in the hypothetical case stated above, the rate base would be \$110,000,000, assuming that no other elements enter in. By fixing the rate base at this figure, this carrier, under the provisions of section 15a would be permitted to retain net railway operating income of 6% of \$110,000,000, or \$6,600,000. However, under 15a this carrier would have been permitted to

⁹ Interstate Commerce Commission, *Classification of Income Accounts* (1913) sec. 503.

¹⁰ *Ibid.* sec. 508.

¹¹ The Philadelphia and Reading Railway for instance leases property valued at \$72,000,000 from a non-carrier corporation.

take the \$600,000 paid as joint facility or equipment rental into account before arriving at net railway operating income. It would thus actually be permitted earnings of \$6,600,000 plus \$600,000 or \$7,200,000. Had the same carrier owned its equipment, or jointly owned the property which it jointly used, it would have been permitted earnings of only \$6,600,000. Clearly it would be accorded a distinct advantage by reason of the fact that it leased the property in question instead of owning it.

2. Assume that a carrier, owning and using property valued at \$100,000,000, leases to other carriers either equipment or joint property valued at \$10,000,000, at a rental of \$600,000 and that this carrier has a railway operating income of \$6,000,000. Under 15a, it would be compelled to add the \$600,000 rental received to its revenues before arriving at net railway operating income. Its total net railway operating income would therefore be \$6,600,000. But its rate base of only \$100,000,000 would entitle it to retain a net railway operating income of only \$6,000,000. Under the recapture clause of section 15a it will be forced to part with one-half of the \$600,000, received as equipment rental and will be denied free use of the other half. Clearly its property will be taken without due process.

In order to avoid a double return to the lessee of equipment and of property jointly used but not owned and in order to avoid taking from the lessor the rental for such property, there should in no case be included in the rate base of the lessee any amount representing property jointly used but not owned or representing leased equipment, except in so far as adjustments should be made to remedy gross discrepancies between the rentals on the one hand and a fair return to the user of the property on the other hand. The value of such property, subject to the above exception, should be included in the rate base of the lessor, unless the latter be a non-carrier.

Under this rule, the rate base in the first illustration given above would become \$100,000,000. The carrier would be permitted earnings equal to 6 per cent on the property owned and used plus the rental paid and not a double return on the leased property. In the second illustration given, the rate base would become \$110,000,000 and the carrier would be permitted to retain a net railway operating income of \$6,600,000, which would be made up of \$600,000 equipment rental and \$6,000,000 representing a return of 6 per cent on the property value of \$100,000,000.

The exception to the rule, whereby it is proposed to make adjustments to take care of gross discrepancies between the rentals on the one hand and a fair return to the user of the property on the other hand, may be explained as follows. If the rental received or paid were exactly equal to a fair return upon the property in question complete justice would result under the suggested procedure. If the rental were less than a fair return, the lessee operating the property would be limited to a return equal to the rental and would be prevented from receiving any compensation, over and above the rental paid, for the

risk¹² undertaken upon assuming the operation of the property. If the rentals paid were more than a fair return the public would be charged with more than a fair return, except in cases of group rate adjustments where the lessee and lessor both belong to the same rate group. In order to take care of such inequalities it would be practicable for the Interstate Commerce Commission to police the rentals paid, particularly the more important joint facility and equipment rentals, and then add or subtract appropriate amounts from the rate base of the lessor or the lessee. However, this action should not be taken until, in any particular case, there is a reasonable basis for a charge that one or more of the interested parties are prejudiced. The manner in which such adjustments might be made is indicated in the illustrations given below:

(A) Let us assume that a carrier owns and uses road and equipment with a value of \$100,000,000, that the rate of return determined by the Commission is 6 per cent; and that the same carrier has leased to another at a rental of \$300,000 equipment upon which we would fix a value of \$10,000,000. Under the proposal made the rate base for the owning carrier would be \$110,000,000, which, in applying section 15a, would call for a net railway operating income of \$6,600,000. Since only \$300,000 was earned by the equipment leased to the second carrier, the property used by the first carrier in serving the public would be burdened with a return of \$6,300,000, which is in excess of 6 per cent of its value.

In such a situation the Commission might value the leased property to the lessor by capitalizing the \$300,000 rental at 6 per cent, that is, at \$5,000,000. With the rate base thus \$105,000,000 it would be necessary to raise only the normal \$6,000,000 on the \$100,000,000 property both owned and operated by the lessor.

The lessee would be permitted to earn a return upon the full value of the leased property if \$5,000,000 were added to its rate base, representing the difference between the capitalized rental and the full value of the leased property.

(B) Let us assume that the lessor receives an excessive rental. In that event no adjustment should be made of the rate base for the lessor, although the public served by that company will be benefited by reason of the inclusion in the net railway operating income of such lessor of the excessive rental received. The contract made by the lessor should not be regarded as entirely a private transaction and, therefore, it would seem fair to limit the lessor to a return on the fair value of the property leased. But an adjustment could be made in the rate base of the lessee by deducting therefrom the difference between an amount arrived at by capitalizing the rental paid at 6 per cent and such portion of the value of the property used as is represented by the lessee's proportional use thereof.

¹² As between the lessee and the lessor, the former, having undertaken the risk of not making any profit from the operation of the property, is entitled to a greater return than that received by the latter, who is assured a definite return by his contract, provided the rental is less than a fair return from operation. When a carrier does not operate its property it is not entitled to operating profits, does not assume operating risks, and must be satisfied with the returns afforded from the rental. Any operating profits from the use of a leased property should go to the using carriers.

The above procedure would require a division to be made of joint property on the basis of use only in cases where the rentals paid are important items and appear to be materially out of line. Unimportant properties for which the rentals are inconsiderable in amount could be ignored without injustice to the parties. It will be found that the rentals for important joint properties and for equipment are generally based on a valuation of the property agreed to by the interested parties, thus indicating an attempt to arrive at a just rental. Also, joint facility and equipment rentals would naturally tend to adjust themselves to the rate of return determined by the Commission. Thus, in case a carrier should lease its equipment, at an inadequate rental, from a non-carrier corporation, all of the stock of which is owned by the carrier, that carrier would lose little time in so re-arranging its contracts with its creature as to insure itself an adequate return.

The various considerations advanced above indicate that, from the standpoint of arriving at a rate base, substantial justice will be attained, under the above suggestions, without going into further refinements.

Although upon first thought it might appear that the rule prescribed by Congress for arriving at net railway operating income had complicated matters with respect to valuation and the application of valuation in rate-making, upon more careful consideration, this will not be found to be the case. In fact the converse is true. Unless equipment and joint facility rents were taken into account before arriving at the figure representing earnings, with which value is to be compared, it would become necessary to make a division between using carriers of the value of each piece of jointly used property and of all interchange equipment. The difficulty of such an undertaking cannot be overemphasized.¹³

Any division other than in accordance with the proportion of use made of the property would be upon an arbitrary basis. To ascertain the proportion of use of the multitude of pieces of property so used by carriers throughout the country would be an endless task. Not only is the matter of proportion of use at any particular moment largely

¹³ At present the Commission divides jointly owned property between the joint owners in proportion to their ownership. That is a simple workable basis. In no other way could the owners secure a return on their respective investments in the property. But such property is not here in question.

The property here in question may all be owned by one carrier or by a non-carrier. If its value is to be divided, it must be between parties one or more of whom have no share in the ownership. The difficulty of making a division between joint users who do not share in the ownership is emphasized by the fact that in those cases where the Commission has attempted such a division, it has been done by arbitrarily according each joint user an equal share. When all of the joint users pay rental a division might be made on the basis of the respective rentals paid, but with the inequitable result pointed out of permitting the lessees a double return. But even that basis is of no avail when the property is jointly used with the owner.

speculative, but it varies from time to time. Hence it would appear that Congress very wisely created a situation where the value of jointly used but not owned property may be entirely left out of the rate base of the lessee and included entirely in the rate base of the lessor and both parties be treated fairly.

Had 15a never been enacted, the Commission would have had to hit upon some such scheme as that presented by the definition of "net railway operating income" in order to permit a practical application in rate-making of the values ascertained in response to 19a. The necessity for this rests upon the proposition stated early in this paper that it is essential that the methods adopted in arriving at the two figures which are compared, namely, the one representing value and the other representing earnings, should be in harmony. That proposition affords the ground for the contention that the method prescribed by Congress in 15a for arriving at the figure representing earnings should in the degree indicated be regarded determinative of the method to be followed in arriving at value under 19a. And so premised the contention made is sound even though 15a was not passed until seven years after the enactment of 19a and cannot in any way be regarded as changing the language or intent of 19a.

The necessity for finding a practical solution in valuing leased equipment and joint facilities seems in a degree to have been recognized by the Interstate Commerce Commission.¹⁴ That this necessity is not fully recognized is indicated by the fact that the practice of the Commission with respect to the valuation of equipment and joint facilities differ, dependent upon whether equipment is interchanged or is leased outright for a definite term, and upon whether or not the owner of the joint facility is also one of the joint users thereof.

The value of interchange equipment and of joint facilities in the joint use of which the owner participates is reflected by the Commission only and entirely in the rate base of the owner, no portion of the value thereof appearing in the rate bases of the other joint users. This

¹⁴ In its valuation report, *Texas Midland R. R.* (1917) 1 Val. Rep. 1, the Commission indicated its consciousness of the difficulties that might arise with respect to joint property. See pp. 20-23 and also App'x 3, pp. 123-125, where the Commission described its trouble in valuing certain trackage owned by the Cotton Belt, and used jointly with the Texas Midland and justifies its decision not to inventory to any carrier property partially used, such as office room in an office building, on the following grounds:

"In instances of this kind we report the rental paid. Since under the accounting rules of the Commission the carrier is permitted to deduct rental paid from the revenue derived from operation, this method is as fair to the carrier as to the public. Of course if the amount of the rental paid is more than the value of the use, the public will be injured to the extent of the amount in excess of a fair rental so far as the particular carrier is concerned, while, on the other hand, if the amount of the rental paid is less than the value of the use the public will be benefited to a corresponding extent."

Illustrations given included minute trackage rights, jointly owned and used passenger stations, city ticket offices rented usually from non-carriers, and others.

practice is in conformity with that herein urged as correct. However, the Commission follows the practice of reflecting in the rate base of the lessee the value of equipment leased outright for a definite term, and the value of jointly used but not owned property in the joint use of which the owner does not participate.¹⁵

¹⁵There are given below illustrations to which others might be added; first, under (a) and (b) of cases where the Commission has followed the procedure herein advocated, and, second, under (c), (d) and (e) of cases where the Commission has not followed this procedure.

(a) The Boston and Maine Railroad, during the year ended June 30, 1914, used equipment owned by other carriers or by private parties, under interchange arrangements and without leasing the same for a definite term, for which it paid rentals aggregating \$221,498.60. No part of the value of this equipment is reflected in the amount of \$234,189,816.00 which the Commission in its tentative valuation report found to be the value, as of June 30, 1914, of the property used by the Boston and Maine Railroad.

(b) The Texas Midland Railroad uses jointly with the owner that portion of the St. Louis Southwestern Railway of Texas, between Commerce and Greenville, Texas, 13.97 miles in length, as a part of its main line. This portion forms a connecting link between two sections of main line owned by the Texas Midland Railroad. In its supplemental tentative valuation for the Texas Midland, the Commission includes no part of the value of this property in the amount of \$3,096,851, designated as the total value of property used by the Texas Midland. The cost of reproduction new of the joint property referred to is stated in the Commission's engineering report for the St. Louis Southwestern Railway of Texas to be \$372,752, and its cost of reproduction less depreciation, \$279,536. The full value of this property is included in the amount of \$26,029,939, tentatively found to be the total value of property used by the St. Louis Southwestern Railway of Texas.

(c) The Chicago and Eastern Illinois Railroad Company during the year ended June 30, 1915, leased for a definite term equipment owned by the Mather Horse & Stock Car Company and the American Tar Products Company, for which it paid a rental of \$115,748.49. In its tentative valuation report, as of June 30, 1915, the Commission found the value of this equipment to be \$562,621 and included this amount in the total value found for property used of \$69,206,753.

When these findings are applied in rate-making, in accordance with 15a, the Chicago and Eastern Illinois Railroad Company will be permitted to charge the public with \$115,728.49 paid as rental, and will also be permitted to retain a return of 6% on the value of the leased equipment, or \$33,757.27. Since the owners of this equipment are not common carriers a duplication in returns will also result when rates are adjusted for the group to which the Chicago and Eastern Illinois Railroad Company belongs.

A cursory search through the Commission's reports discloses that for 25 properties equipment similarly leased for a definite term has been accorded a cost of reproduction new of over \$172,000,000. Wherever the rental for such equipment is properly taken into account, the lessee will under the Commission's practice find itself in a better position than if it owned the equipment.

(d) The Chicago and Eastern Illinois Railroad Company owns equipment which, on June 30, 1915, it leased to the Vandalia Railroad Company and the Frisco Refrigerator Line. The Commission found that the value of this equipment on the date named was \$1,470,000. Since this amount is not included by the Commission in the \$69,206,753 found as the value of the property used, which amount, under 15a, will serve as the rate base for the Chicago and Eastern Illinois, the rental paid that carrier for the equipment in question will be taken from it contrary to due process.

(e) Similarly, the Commission has divided between joint users, property owned by the Louisville and Nashville Terminal Company, White Oak Railway Company, Piney River and Paint Creek Railroad Company, Lansing Manufacturers Railroad, Allentown Terminal Railroad Company, Bay Shore Connecting Railroad Company, the Buffalo Creek Railroad Company and Wilmington Railway Bridge Company, for which the cost of reproduction new of structures plus present value of lands amounts to over \$7,900,000. Following the above precedent, the value of such property will be reflected in the rate-base of the

No justification can be presented for the Commission's practice of valuing differently the two classes of leased equipment and joint facilities which have been referred to. There is no logical basis for a differentiation. The practice pursued of including the value of interchange equipment and of joint facilities, in the use of which the owner participates, only in the rate base of the owner can be justified only on the ground that under the rule prescribed in 15a the rentals paid or received for such property are taken into account before arriving at net railway operating income. If the practice last referred to can be justified on that ground, then the same provisions of 15a require a like practice with respect to equipment leased for a definite term and joint facilities in the joint use of which the owner does not participate. If the provisions of 15a do not afford a justification for valuing to the owner alone the class of property last referred to then the same provisions afford no justification, and no justification can be advanced, for the practice pursued by the Commission with respect to interchange equipment and joint facilities in the joint use of which the owner participates.

In support of the differentiation made by the Bureau between the different kinds of joint facilities and of leased equipment, it may be urged that when Congress used the term "equipment rental and joint facility rental" it did not mean to include what was embraced at the time of enactment of 15a in the definition of such rentals prescribed by the Interstate Commerce Commission in its classification of accounts and that Congress really meant to include only the rentals of such property as the Commission now values exclusively as used by owners thereof even though others join in its use. However, Congress was dealing with the accounts as defined in the Commission's classification and merely made a certain grouping of those accounts to arrive at a figure which Congress labeled "*net* railway operating income" as distinguished from "railway operating income." The Commission itself has never grouped and does not to-day group these accounts in such fashion either in its classification of accounts or in the form of income statements which it requires carriers to follow in their annual reports to the Commission. It cannot be assumed that Congress did not know what it was dealing with; that it was unaware of what is embraced by

using carriers who will thereby have the advantage of charging, under 15a, the rentals paid for such property to the public and also securing a fair return on the part of the value allocated to them.

In illustrations (c), (d) and (e) the lessee is in no position different from that in the illustrations given under (a) and (b). The only distinction between the illustrations given of cases where the Commission follows the procedure herein advocated and those given of cases where that procedure is not followed with respect to equipment is that in the one case it is interchanged and in the other it is leased for a definite term and in the case of joint facilities in the one case the lessor joins and in the other does not join in the use of the property.

the accounts which it grouped together. Moreover, in the Federal Control Act,¹⁶ Congress provided, prior to the enactment of 15a, that carriers operated under federal control shall receive as just compensation an annual sum not exceeding a sum equivalent as nearly as may be to their average annual railway operating income during the test period. And in that connection required that:¹⁷

"In the computation of such income, debits and credits arising from the accounts called in the monthly reports to the Interstate Commerce Commission equipment rents and joint facility rents shall be included."

It is evident that Congress had definitely in mind the accounts as defined in the Commission's classification.

Also the Commission, in certifying the standard return as required by the Federal Control Act, has consistently taken into account all equipment and joint facility rents. It could not now be heard to say that a different interpretation should be placed upon the language of the statute.

It must therefore be plain that the Commission will not be able to remove the difficulty presented by making adjustments in the manner of arriving at net railway operating income. This leaves the Commission faced with the question of whether it should, with eyes open, reach such determinations under 19a as will inevitably result in giving a preference to certain carriers who lease part of their property rather than own it and in taking property from other carriers without due process.

It may be urged that the Commission's hands are tied by 19a and that the situation, if it cannot be remedied by adjustments in the method of arriving at net railway operating income, can only be remedied by an amendment of the Act.¹⁸

¹⁶ Act of March 21, 1918 (40 Stat. at L. 451).

¹⁷ *Ibid.* 452.

¹⁸ The only amendment of the provisions of section 15a with respect to the methods of ascertaining net railway operating income which might be considered would be to provide that the rentals for equipment leased for a definite term and for property jointly used but not owned, in the use of which the owner does not join, should not be taken into account before arriving at net railway operating income. If the Act were so amended, the present practice of the Commission could be followed in establishing values subsequent to the date of amendment.

However, justification for the continuance of the Commissioner's present practice with respect to interchange equipment and with respect to property jointly used but not owned, in the use of which the owner joins, could only rest upon the fact that the rentals for such property would continue to be taken into account before arriving at net railway operating income. Also values fixed for dates prior to the enactment of such an amendment, with respect to all leased equipment and all joint facilities, would have to be in accordance with the procedure herein advocated so as to avoid inequalities which would otherwise follow from the application of the recapture clause of 15a.

Such an amendment would simplify matters with respect to equipment leased for a definite term but not with respect to joint property. The value of the

The situation is not so hopeless. It must be remembered that the value ascertained of property used will serve the purpose not of any scheme of rate-making which the Commission may adopt, but of a very definite scheme prescribed by Congress in 15a. Under that scheme, the rate base will be compared with net railway operating income. Courts have repeatedly held that rates should be such as to yield a fair return upon the *fair* value of the property devoted to the public use. To the extent that any amount arrived at as a rate base, under the scheme of rate-making adopted by Congress, will either permit a carrier to earn a double return or will have the effect of taking property without due process, it is not fair in the sense that courts have employed that term. It must be taken as fundamental that, if earnings are to be predicated upon fair value, the bases of arriving at earnings and of arriving at fair value must be comparable.

It may be urged that under 19a the Commission is required to find the value of all property used and that it would not be doing this if the rate base did not include some amount for each piece of property used.

By not reflecting in the rate base any of the elements of value with respect to leased equipment or property jointly used but not owned, the Commission would not be refusing to comply with the mandate of the statute. It simply would have determined, bearing in mind the use to which the rate base is to be put, that such property has no fair value for consideration as part of the rate base. That would not be denying that such property had a value for other purposes. It would not be inconsistent with reporting the reproduction cost of the property, or, in the case of lands, its present value as measured by adjoining lands. It would merely be asserting that for the purpose in hand, that of a rate base for use under the specific provisions of 15a, the property cannot fairly be assigned a value.

In order that the findings of value may be definitely applied in rate bases and in cases of excessive earnings, the value found for property used should be designated in the Commission's reports as value for rate-making purposes.¹⁹ If the amount so designated does not include the value of certain joint property or equipment, that fact should be stated so that it may be considered in cases involving divisions of rates

equipment referred to would all be reflected in the rate base of the lessee, but the value of the joint property would have to be divided between joint users thereof in all cases where the owner does not participate in the use.

While such a division would remain unnecessarily in the large number of cases of joint property in the use of which the owner joins, the difficulties presented in making such a division in all other cases are such as to make inadvisable such amendment of the Act. An amendment which would seek to eliminate consideration of any equipment or joint facility rents in determining net railway operating income clearly would be a serious mistake.

¹⁹ This the Commission has done in its two most recent final valuation decisions, *San Pedro, L. A. & S. R. R.*, *supra* note 2, and *Atlanta, B. & A. R. R.*, *supra* note 2.

between different carriers and in cases involving terminal charges or otherwise involving the value of individual lines or portions thereof. Obviously the rate base plays no part in cases involving the issuance of securities or in consolidation cases, where the value taken into account will be that of property owned rather than property used and may include non-carrier as well as carrier property.

The Commission's findings of value in reports that have been issued permit the making of various combinations of value of owned and leased carrier and non-carrier property. Care should be taken that all the data required to make necessary combinations of values should be included in the concluding paragraphs on final value. Thereby the findings reached can be made to serve all the purposes to which valuation may be placed.