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# Common Carriers -- Railroads -- Possibility of Changes in the Law Due to Changed Economic Conditions

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competition drive the nonconforming state banks out of existence and to retain national banking laws as they presently exist.

JOHN R. JENKINS, JR.

**Common Carriers—Railroads—Possibility of Changes in the Law Due to Changed Economic Conditions.**

That the law of railroads—and perhaps of other common carriers—is entering upon a period of metamorphosis does not seem to be an extravagant prediction.<sup>1</sup> Rather does it appear to be an almost inevitable conclusion. An unmistakable warning of that change is implicit throughout the opinion of the Supreme Court of the United States in the case of *Nashville, C. & St. L. Ry. v. Walters*.<sup>2</sup> It is not the actual decision in the case which prompts the above prediction; it is the discussion of Mr. Justice Brandeis.

A Tennessee statute imposes upon a railroad one-half the cost of eliminating a grade crossing over its road, when such elimination is ordered by the state highway commission.<sup>3</sup> Plaintiff railroad was ordered to contribute one-half the cost of an underpass at a point where a new federal-aid highway intersected its line. It did not question the power of the state to build the proposed highway; its power to require the separation of grades; the appropriateness of the plan adopted for such separation; nor the reasonableness of the cost. It conceded the settled rule of law that, ordinarily, the state may, under its police power, impose upon a railroad the whole cost of eliminating a grade crossing, or such part thereof as it deems appropriate.<sup>4</sup> It did contend, however, that, in view of special circumstances set forth, the order, and the statute as so applied, were so unreasonable and arbitrary as to deprive it of property without due process of law in violation of the Fourteenth Amendment. The trial court found that, with but one exception, the evidence fully supported every averment of fact in the bill, and upheld plaintiff's contention. The Supreme Court of Tennessee reversed the trial court, holding the statute constitutional upon its face, and declining to consider the special facts relied upon by the railroad.<sup>5</sup> The Supreme Court of the United States decided that the state Court erred in refusing to consider those facts.

The Court summarizes the special facts alleged in the bill as relating to "the revolutionary changes incident to transportation wrought in re-

<sup>1</sup> No attempt will be made herein to predict specific changes.

<sup>2</sup> 55 Sup. Ct. 486 (U. S. 1935).

<sup>3</sup> Tenn. Pub. Acts 1921, c.132; amended by Pub. Acts 1923, c.35; Pub. Acts 1925, c.88.

<sup>4</sup> See 55 Sup. Ct. 486, 487 (U. S. 1935), and cases cited in n. 3.

<sup>5</sup> *Nashville, C. & St. L. Ry. v. Baker*, 167 Tenn. 470, 71 S. W. (2d) 678 (1934).

cent years by the widespread introduction of motor vehicles; the assumption by the federal government of the functions of road builder; the resulting depletion of rail revenues; the change in the character, the construction, and the use of highways; the change in the occasion for elimination of grade crossings, in the purpose of such elimination, and in the chief beneficiaries thereof; and the change in the relative responsibility of the railroads and vehicles moving on the highways as elements of danger and causes of accidents."<sup>6</sup> These topics, which the Court discusses at length, relate basically to the changed economic condition of the railroads, with emphasis, of course, upon those factors which may have contributed to that change, and which are relevant to the particular issue presented.

If, then, problems in railroad law must be viewed in the light of the present economic condition of the railroads, it may not be amiss to consider some aspects of that condition. The railroads are no longer the business and financial giants of two decades ago. They are fighting for their very existence, and in that fight, they are weighed down by the burdens imposed upon them in a bygone—and, for them, happier—age. Perhaps the most graphic commentary upon the present condition of the railroads is the news that nearly eighty of them are now in receivership, bankruptcy, or in the process of reorganization under the recent amendments to the Bankruptcy Act.<sup>7</sup> These eighty roads operate approximately one-fifth of the total railroad mileage in the country.<sup>8</sup> Furthermore, roads operating 67 per cent of the total mileage, and with an aggregate capitalization of more than \$2,500,000,000, were in default at the end of 1934.<sup>9</sup> This picture is set out in bolder relief by the knowledge that it exists, in spite of the fact that, up to the end of February of this year, the Reconstruction Finance Corporation had loaned over \$450,000,000 to railroads;<sup>10</sup> the Railroad Credit Corporation made loans of over \$73,500,000 during the fifteen months ending May 31, 1933; and the Public Works Administration had, up to

<sup>6</sup> 55 Sup. Ct. 486, 489 (U. S. 1935).

<sup>7</sup> MOODY, RAILROADS (1934) a 11, a 124; *id.* (1935) 708.

The amendments of the Bankruptcy Act referred to are to be found in §77, 11 U. S. C. A. §205 (1934 Supp.).

<sup>8</sup> According to the WORLD ALMANAC (1935) 327, total mileage owned in 1933 was 245,703. The roads referred to in the text operate nearly 50,000 miles. MOODY, RAILROADS (1934) a 11, a 124.

In this connection, it is interesting to note that total mileage owned has been dropping off steadily since the 1916 high of 254,037. WORLD ALMANAC (1935) 327. For a discussion of the extent, character, and causes of abandonments, see MOULTON, AMERICAN TRANSPORTATION PROBLEM (1933) 147-52.

<sup>9</sup> WORLD ALMANAC (1935) 84.

<sup>10</sup> MOODY, RAILROADS (1935) 721. The same agency has authorized an additional \$7,600,000, approximately, in loans to railroads, which had not, at that time, been disbursed.

August 1, 1934, disbursed \$86,400,000 of the \$190,950,500 allotted to railroads.<sup>11</sup>

The depression is not alone responsible for these conditions. It served only to accelerate the operation of forces which were at work before 1929. The railroads were in a very strong financial position in the period roughly from 1906 to 1913. From 1910 to 1920 a progressive weakness was evident. For the portion of this period from 1916 on, the main explanation of the weakness lies in the failure of rates during the war period to follow the upward movement of prices and wages. From 1921 to 1929 there was a recovery, which, while substantial, did not restore the strength of the period ending in 1913.<sup>12</sup> The decline beginning in 1930 has, of course, been sharp.<sup>13</sup> But passenger service petition of motor vehicles.<sup>14</sup> And although the volume of freight traffic

<sup>11</sup> MOODY, RAILROADS (1934) a 41-3. According to more recent figures, the railroads have received loans of \$200,000,000 from the Public Works Administration. WORLD ALMANAC (1935) 84.

<sup>12</sup> These are substantially the conclusions reached by Dr. Moulton after a study of the financial trend of the railroads during the period 1890-1929. MOULTON, *op. cit.*, *supra* note 8, 26-48. Dr. Moulton's study includes the analysis of numerous indices of financial condition, such as, operating ratio (ratio of operating expenditure to operating revenue), ratio of income to expense, relationship between income available for capital and the investment, and relationship between net income and the equity of the stockholders in the property, separately, and then as compared with one another. He supplements this aspect of the study by an investigation of the railroads' ability to raise capital during the period.

<sup>13</sup> The most important reaction of the railroad business to the depression is reflected in the volume of business. Net ton miles of revenue freight handled by Class I roads dropped from 433 billion in 1928 to 383 billion in 1930, and to 309 billion in 1931. The latter figure was slightly below the low record of 1921 and far lower than that of any other year in the post-war period. The first eleven months of 1932 showed a further drop of 25 per cent below the figure for the corresponding period in 1931.

The decline in passenger service was even more pronounced. Revenue passenger mileage of Class I roads decreased in 1931 13 per cent below the 1928 figure, and in 1931 20 per cent below the 1930 figure. There was a further loss of 23.5 per cent in the first eleven months of 1932. MOULTON, *op. cit.*, *supra* note 8, 49-50.

Unfortunately, no figures for these indices have been found which bring the picture up to date. However, it does appear that the number of passengers carried showed a further decline in 1933, while the number of tons of freight carried increased slightly. This was reflected by a decline in passenger revenue, and a slight increase in freight revenue. However, both revenue per ton mile, and per passenger mile decreased. WORLD ALMANAC (1935) 327.

The figures for 1934 are even farther removed from the original indices; they will serve, however, to convey a general idea of the trend. Gross operating revenues for the first ten months of 1934 showed a gain of 6.3 per cent over the same 1933 period. However, the gain was more than absorbed by the restoration of the wage deduction and higher prices for fuel, materials, and supplies resulting from the application of codes under the National Recovery Act. The result was a decrease of 1.9 per cent below 1933 in net operating income. Passenger revenues showed the first increase in 1934 since 1923. This latter change reflects the roads' intensive effort to reclaim passenger business through reduced and special fares and special equipment. WORLD ALMANAC (1935) 84.

had been dropping off since 1920, chiefly because of the increased com-

<sup>14</sup> As early as 1918, automobiles replaced the railways as the most important

was still increasing up to 1929, the rate of increase was much lower than before the war, and the railroads' percentage of the total volume of traffic was falling.<sup>15</sup> Thus the decline in railway traffic since 1929 reflects in part a decrease in the total volume of transportation work being done, in part a diversion to other agencies which would have taken place even under prosperity conditions, and in part the increased severity of the competition of these other agencies under depression conditions.<sup>16</sup>

This decline in volume of traffic has been reflected in a marked decline in gross operating revenues,<sup>17</sup> rates having changed but little.<sup>18</sup> Operating expenses have been elastic enough to keep pace with the reduction in operating revenues to some extent,<sup>19</sup> but in contrast with that elasticity, taxes and fixed charges have remained relatively rigid.<sup>20</sup> The result appears in the fact that net earnings dropped off sharply after 1929,<sup>21</sup> and in 1932, 150 railroads showed an aggregate net deficit of over \$150,000,000, followed by a similar deficit of nearly \$14,000,000 in 1933.<sup>22</sup> This inelasticity of taxes and fixed charges introduces another problem stressed by the Court in the principal case.

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agency for passenger traffic. MOULTON, *op. cit.*, *supra* note 8, 15, 17, 51, 86-98. Compare tables WORLD ALMANAC (1935) 327. See also last two sentences in note 13 *supra*.

<sup>15</sup> MOULTON, *op. cit.*, *supra* note 8, 18, 51.

<sup>16</sup> *Ibid.*

<sup>17</sup> Gross operating revenues have declined steadily from \$6,508,678,781 in 1926 to \$3,138,185,942 in 1933. WORLD ALMANAC (1935) 328. See also the last paragraph of note 13 *supra*.

As to Class I roads, the 33 per cent decline in gross operating revenues from 1928 to 1931 was the joint result of a 30 per cent drop in freight revenue, a 40 per cent drop in passenger revenue, a 45 per cent drop in express revenue, a 25 per cent drop in miscellaneous revenue, and a trifling increase in mail revenue. MOULTON, *op. cit.*, *supra* note 8, 57.

<sup>18</sup> MOULTON, *op. cit.*, *supra* note 8, 53-6.

<sup>19</sup> The ratio of operating expense to operating revenue shows that revenue shrank more rapidly than expense, but not to the extent which might be anticipated. The ratio varied as follows: 1929, 71.85%; 1930, 74.56%; 1931, 77.10%; 1932, 77.06%; 1933, 72.82%; 1934 (first ten months), 74.32%. WORLD ALMANAC (1935) 328, 84. For a more detailed discussion of the factors involved, see MOULTON, *op. cit.*, *supra* note 8, 57-61.

<sup>20</sup> See MOULTON, *op. cit.*, *supra* note 8, 61; WORLD ALMANAC (1935) 328. Federal taxes are not of the kind to create the railroad tax problem, although they have amounted to substantial sums during the past 20 years. They are largely taxes which vary in proportion to the roads' ability to pay, and have never amounted to more than one-fourth of the taxes paid by Class I roads. During the depression, they have been reduced to only about 3.5 per cent of the taxes imposed upon railroads.

It is the state and local taxes which are the principal factor in the railroad tax problem. They constitute well over three-fourths of the railroads' tax burden, and are relatively inflexible in the face of changes in business conditions. Except for 1915, this group of taxes increased every year from 1912 to 1930 inclusive, and after the increase in 1930, decreased only \$14,000,000 below the 1929 level of \$306,565,000 in 1931. See MOULTON, *op. cit.*, *supra* note 8, 231-72.

<sup>21</sup> MOODY, RAILROADS (1934) a 7.

<sup>22</sup> *Ibid.*

Mr. Justice Brandeis forcefully points out<sup>23</sup> that plaintiff railroad was paying nearly 28 per cent of its gross revenues for state and local taxes and the cost of maintaining the roadway acquired and constructed at its own expense. In contrast, motor carriers, which have contributed appreciably by their competition to the present plight of the railroads, pay not more than 7 per cent of their gross revenues in state and local taxes,<sup>24</sup> and operate upon a roadway supplied by the state. Whether or not railroads are too heavily taxed is one problem, and one which has provoked severe criticism of tax policies.<sup>25</sup> But another problem, quite as important to the railroads and to the public, is whether or not motor carriers should be subsidized by the state to the extent of having their roadways furnished, and still be taxed at only the same, or perhaps a lower, rate than that imposed upon the railroads with which they are in competition. Furthermore, it is not impossible that a portion of the fixed charges now borne by the railroads is attributable directly, or indirectly through refunding issues, to outlay for the acquisition and construction of roadways. Seemingly there is no justification for such a policy of governmental favoritism. Our transportation system is capable of paying its own way. The process of selecting those agencies which can serve the public most efficiently and most cheaply should be conducted on the basis of equal opportunity. Therefore, plain justice would seem to require that motor carriers, competing with other transportation agencies, should be required to pay in taxes, not only a percentage equal to that imposed upon their competitors, but if the competitors have to acquire, construct, and maintain their own roadways, while the carriers operate upon governmentally built highways, an additional percentage which will equalize the burden cast upon the respective types of agency.<sup>26</sup>

<sup>23</sup> 55 Sup. Ct. 486, 494 (U. S. 1935).

<sup>24</sup> The figures used by the Court here relate specifically to the plaintiff railroad, and presumably to motor carriers in Tennessee. Unfortunately, no figures for a general comparison have been found.

<sup>25</sup> See, for example, McDermott, *The Over-Taxation of the Railroads* (1928) 116 BANKERS MAG. 329, in which the author depends upon such graphic facts as that the railroads pay over \$1,000,000 a day in taxes, and that the New York Central Lines pay the revenues from one-fourth of their total mileage in the form of taxes. Compare MOULTON, *op. cit.*, *supra* note 8, 231-72.

<sup>26</sup> Compare REPORT OF THE NATIONAL TRANSPORTATION COMMITTEE (1933). The Report reads (I): "Government policies should be freed of any purpose either to favor or to handicap any form of transportation with relation to any other form." At I (b), it reads: "Government has a positive duty to see to it that neither the railroads nor their competitors are either unduly handicapped or unduly advantaged. . . . In a fair field and no favor, economic competition must decide the question of survival under private ownership and operation." Again, at I (5), we find: "Automotive transportation should be put under such regulation as is necessary for public protection. It should bear its fair burden of tax but only on a basis of compensation for public expenditure on its behalf, plus its share of the general tax load."

A current complaint against the railroads condemns their practices as wasteful, inefficient, and without foresight. The charge may be, to some extent, justified; certainly it is not so well founded as to explain altogether the predicament in which the railroads now find themselves. The war left the railroads in such weak financial condition that the period since 1920 has been one of struggle for greater efficiency. Just how effective that struggle has been is probably not fully realized by the public. That it has been of considerable influence is not to be doubted.<sup>27</sup> But the results have been purchased at a cost—a cost mounting to over a billion dollars for the year 1923, representing the investment for additions and betterments to existing lines.<sup>28</sup> That is not to say that the railroads have done all that could be done to promote efficiency.<sup>29</sup> But it should be borne in mind that improvements leading to increased efficiency in railroad operations are expensive, and that, in view of the present impecuniousness of the railroads, not too much is to be expected of them.<sup>30</sup>

Probably no one doubts the economic importance of an efficient transportation system. Very few will admit any doubt as to the essential part played by the railroads in the American system.<sup>31</sup> The problem, then, is to put the system into its strongest and most efficient position. This requires a preservation of the railroads.<sup>32</sup> That this result cannot be accomplished alone by a change of business policies of, and in respect to, the railroads is clear. Many of the changes must come from the coöperation and application of the law, both by way of statutory enactment and judicial decision. In this respect, the law cannot remain a bare abstraction—the major premise upon which cases are decided. A statute cannot be satisfactory “upon its face.” The abstractions of railroad and other law were induced by the applica-

<sup>27</sup> See MOULTON, *op. cit.*, *supra* note 8, 99-111.

<sup>28</sup> *Id.* at 101. The amount spent for additions and betterments dropped off to \$314,674,000 in 1931.

<sup>29</sup> Both the National Transportation Committee and Dr. Moulton have suggestions as to methods for increasing efficiency, within the several roads as units in the system, and within the system as a whole. See REPORT OF THE NATIONAL TRANSPORTATION COMMITTEE (1933), and MOULTON, *op. cit.*, *supra* note 8, part VIII.

<sup>30</sup> See MOULTON, *op. cit.*, *supra* note 8, 778, where he says, “During the next few years it is improbable . . . that the necessary capital can be obtained to effect significant operating improvements—and in any event the most obvious types of improvements have already been effected.”

<sup>31</sup> In spite of the inroads made by competing agencies upon the business of the railroads, the ton mileage on the railways in 1929, for example, was roughly two and one-half times that on all other forms of agency combined. In 1930, the capital invested in railroads was greater than that represented by the country-wide system of highways. As to the relative importance of the various transportation agencies, see MOULTON, *op. cit.*, *supra* note 8, 14-18.

<sup>32</sup> The opening sentence of the REPORT OF THE NATIONAL TRANSPORTATION COMMITTEE (1933) reads: “The railroad system must be preserved.”

tion of policies in view of then existing facts. Now the Supreme Court of the United States announces that the law must be tested by the application of policies upon *present* facts. If it does not meet the test, it must be replaced. The decision in the principal case is an enlightened one.

D. W. MARKHAM.

### Conflict of Laws—Forum's Use of the Construction Given a Foreign Statute by a Third State.

Plaintiff, a gratuitous guest in defendant's automobile, was injured in an accident occurring in South Carolina. Suit was brought in Georgia, and the South Carolina "guest statute"<sup>1</sup> was pleaded as the basis of recovery. The complaint, which relied on the host's unlawful speed, failure to equip the car with a suitable steering apparatus, operation of the car with knowledge of its defective condition, and inattention while driving, was *held* demurrable as failing to show that the accident was "intentional on part of the owner or operator or caused by his heedlessness or his reckless disregard of the rights of others" so as to permit recovery under the statute.<sup>2</sup>

In attempting to apply the rule of *lex loci*,<sup>3</sup> the Georgia court, as the forum, found it necessary to find the meaning of the terms "heedlessness or reckless disregard" as used in the South Carolina statute in order to construe and apply that statute to the facts alleged in the complaint.<sup>4</sup>

The statutes of a foreign jurisdiction are generally given the same construction by the courts of the forum as that given by the courts of last resort in the foreign state.<sup>5</sup> But the statute in question here had never been construed by the South Carolina court. In view of this fact, the forum considered the Connecticut court's construction of the Connecticut "guest statute"<sup>6</sup> on the presumption that South Carolina in adopting a statute verbally the same adopted it in view of previous Connecticut constructions. This presumption is supported by reason

<sup>1</sup> S. C. CODE (1932) §5908. This statute, passed in 1930, changed the common law rule of ordinary negligence to require intent or heedlessness or reckless disregard on the part of the owner or driver before his gratuitous guest could claim a right of action against him. See notes 8 and 20, *infra*.

<sup>2</sup> Lee v. Lott, 177 S. E. 92 (Ga. App. 1934).

<sup>3</sup> White v. Seaboard Air Line Ry., 14 Ga. App. 139, 80 S. E. 667 (1914); Wise v. Hollowell, 205 N. C. 286, 171 S. E. 82 (1933); GOODRICH, CONFLICT OF LAWS (1927) §92; RESTATEMENT, CONFLICT OF LAWS (1934) §§411X, 413.

<sup>4</sup> Lee v. Lott, 177 S. E. 92, 94 (Ga. App. 1934).

<sup>5</sup> Magnolia Petroleum Co. v. Turner, 188 Ark. 177, 65 S. W. (2d) 1 (1933); Georgia, Fla. & Ala. R. Co. v. Sasser, 4 Ga. App. 276, 61 S. E. 505 (1908); White v. Seaboard Air Line Ry., 14 Ga. App. 139, 80 S. E. 667 (1914).

<sup>6</sup> Conn. Pub. Acts 1927, c. 308.