FULL TEXT OF FINDING THAT AFFECTS WESTERN FREIGHT RATES

RATE CASE

property, an estimate was made showing the quantities of earth and rock work of various kinds involved in the construction of the system as it then existed. Since that due to the mountments have been widened, curvatures have been reduced, and many improvements requiring the movement of earth and rock have been made. The engineer of the campinny started with this estimate of 1878, which he said had been carefully made and was, in his opinion, reflect the quantities of earth and rock work which the quantities of earth and rock work which would be required to regrade the present road.

A statement, was furnished showing the length and character of all tunnels, the length and character of all bridges, the number of culverts, etc. The amount and weight of the ratis both in branch lines and in sldings were given, together with he number of culverts, etc. The amount and weight of the ratis both in branch lines and in sldings were given, together with he number of culverts, etc. The amount and weight of the ratis both in branch lines and in sldings were given, together with he number of culverts, etc. The amount and weight of the ratis both in branch lines and in sldings were given, together with he number of culverts, etc. The amount and weight of the ratis both in branch lines and in sldings were given, together with he number of culverts, etc. The amount and weight of the ratis both in branch lines and in sldings weight of the ratio and the precise at which muterials of different linds could then be beught in the open with the contract prices then prevailing for the various kinds of weight of the ratio and the precise at which muterials of different linds could then be beught in the open with the contract prices then prevailing the rocket of the prevailing five produced in constructing the rocket of the first previous kinds of the purchase of successful t

some witnesses that this estimate for cost poses. of right of way was grossly excessive, but there is nothing in this record upon which the Commission can intelligently criticise that estimate. It is doubtless somewhat high, but is by no means certain that upon the basis pon which it was estimated it is extrava-

money value of this property, not including coal properties, based on the cost of reproestimated in the manner above stated, would, in the Spring of 1907, have equaled at least \$325,000,000. The operated mileage of this system, as reported in its statistical return to the Commission for the year end-ing June 80, 1807, was 5310 miles, and the above valuation would therefore mean a total of about \$50,000 per mile.

This estimate seemes to cover slightly more miles than are reported to the Commission,

suit.

In estimating the present money value of its property the Northern Facilic puts upon its coal lands a valuation of \$50,000,000. These properties are certainly of great importance to that company. Eastern coal is used upon its lines east of the Missouri River, which are about 2300 miles in extent, but for the 3500 miles west of the river practically the entire supply comes from the Northern Pacific mines.

The location of these mines was given, but need not be stated here. It is sufficient to

need not be stated here. It is sufficient to say that the location is such as to make them almost indispensable to the operation of them almost manapensable to the operation of the railroad. The title to these coal prop-erties is not in the Northern Pacific Com-pany directly, but in the Northwestern Im-provement Company, a subsidiary corpora-tion of which the Northern Pacific Railway Company owns the entire bond leave and practically all the stock. The improvement company mines this coal and sells it to the company mines this coal and senis to the relificad company at so much per ton, in addition to doing a certain amount of commercial business. The cost of producing the coal at the different mines and the price paid by the Northern Pacific were both given, showing a handsome margin of profit to the

ement company. bonds of the improvement company are 27,000,000 in amount and pay 4 per cent interest; the stock was said to be \$2,775,000, it did not appear upon the hearing what divisinds, if any, had been paid upon this stock; are what the result of the financial operators of the improvement company had been, set since the hearing and since the preparator of this report the improvement company had been at this case the life and the preparator of this report the improvement company ion of this report the improvement company has paid a dividend of 629 per cent and the Northern Pacific Company, from the proceeds Northern Pacific Company, from the proceeds of this dividend, has distrubuted to its own stockholders a dividend of \$11.25 per share.

Cost of Original Construction-Northern Pacific.

The construction of the Northern Pacific Railway was begun in 1870, and the first receivership occurred in 1875. The present auditor of the company testified that at the end of that receivership the books of the company showed cost of construction up to that three to have been, in round numbers, \$45,000,000, and that the milesage then in operation was 550 miles. Considerable work had been done in surveying and possibly some uncompleted construction may have been un-

second receivership began in 1893 and The second receivership began in 1893 and ended in the Summer of 1895. The same witness testified that the books of the company were better kept during this period than during the first period. He had, however, made no personal examination and had no personal knowledge of the accounts and could give no idea of the meaning of the figures. He said that for him the North-

The complainants attempted to show by amount of common were reserved as a consequential and by the introduction of treasury stock and for reorganization pur-

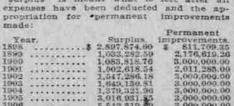
capitalization of the old companies embraced

additional issue of \$95,000,000 of common stock, none of which was at the time of the filing of that report outstanding. There is nothing in this case to show the necessity for or purpose of this stock issue. The Northern Pacific and the Great Northern companies own jointly the Burlington system and have each issued their obligations in the sum of \$107,000,000 in payment for that property. We have treated the groperty as worth the indebtedness and have made no account of this \$107,000,

Earnings-Northern Pacific. The preferred stock issued in accordance with the plan of reorganization was entitled to a dividend of 4 per cent before anything was paid upon the common stock, and this dividend was regularly paid down to the time when that stock was retired by the issue of an entitle amount of contracts.

equal amount of common stock. No divi-dends were paid on the common stock until 1899, when a dividend of 2 per cont was declared. In 1990 this was increased to 3 per cent, in 1991 to 4 per cent, in 1992 to ber cent. In 1903 the conversion of pre-ferred into common stock occurred and the dividend of that year was equivalent to about 6% per cent upon the entire stock issue. Beginning with 1904, 7 per cent dividends have been regularly declared.

The first full year in which this property was operated under the new management after the receivership was that ended June 30, 1898. Beginning with that year the provements and remaining as surplus.



In the year 1906 this company, in addition to the permanent improvements and sur-

treasury stock and for reorganization purposes. Of the balance, a certain amount of preferred seems to have been used in the satisfaction of mortgage liens. The balance was exchangable upon the following terms: Vpon payment of \$10 a share of preferred stock was issued to stockholders having \$50 of old preferred stock and \$50 of old common stock, and a share of new common stock was issued in exchange for a share of old common stock upon payment of \$16 in cash. The new preferred stock seems to have been practically all taken up under the pian of reorganization, but a large number of shares of common stock was not subscribed for by the holders of the old common stock and this was subsequently sold to Mr. James J. Hill, and his assosold to Mr. James J. Hill. and his asso

clates, for \$15 per share.

The capitalization of the Northern Pacific Rallway at the present time, therefore, a about \$332,000.000, or substantially \$57.

800 per mile of line. It was said that the in the present system was approximately \$380,000,000,

The statistical report of the Northern Pacific for the year ended June 30, 1907, shows that this company has voted an additional issue of \$85,000,000 of common

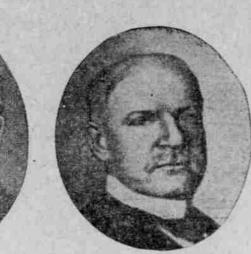
and have made no account of this \$107,009,000 of obligations upon the part of the Northern Pacific Company.

company has, in addition to the payment of its fixed charges, interest and dividends, as above stated, shown each year the fol-lowing amounts invested in permanent improvements and remaining as surplus. By 'surplus' is meant what is left after all



Totals\$31,776,714.41 \$22,999,613.61

MEMBERS INTERSTATE COMMERCE COMMISSION, WHICH DECIDED SPOKANE



JAMES S. HARLAN.



JUDSON C. CLEMENTS,

MARTIN A. KNAPP.

whole 6523 miles was \$52,500 per mile, as we have indicated, the cost of reproducing the 5335 miles, covered by the report of the Great Northern to us, would be not far from \$270,000,000.

These estimates of the cost of reproduction in case of both the Northern Pacific and the Great Northern were made in the Spring of 1907, and it was said in the testimony that the cost of reproduction, not including the right of way, at that time would have been from 12 to 15 per cent higher than three or four years before. The cost of constructing these properties when these estimates were made would probably exceed by 50 per cent the cost of constructing them when the Pacific extension of the Great Northern was built.

This investigation conclusively shows that if any importance whatever is to be attached to the cost of reproduction in the establish-

This investigation conclusively shows that if any importance whatever is to be attached to the coet of reproduction in the establishment of railway rates, the valuation must be undertaken by the Government itself. No individual has the means and no individual if he had the means could afford the expense of produring even a rough estimate, accurate within reasonable limits, of the cost of rebuilding either of these defendant properties. In the present case we are impressed that the engineers of the defendants have proceeded in good faith, and the complainants were fortunate in being able to submit their estimates to the criticism of a witness unually well qualified to pass an opinion upon their accuracy; but even so we have little confidence in the reliability of the conclusion reached. There can be no satisfactory knowledge upon this point until public authority makes a detailed valuation upon a uniform basis.

The Great Northern Company owns either all or practically all of the capital stock of certain railroad companies which are operated not by the Great Northern Company as such, but by the subsidiary company itself. The statements of the Great Northern showing cost of reproduction evidently include this mileage, upon the theory that a railroad whose stock was entirely owned by the Great Northern Company was in fact a part of that railway system.

Oost of Original Construction-Great North-

tributed among stockholders at par, and this made up the capital stock of the Manitoba Company when it leased its property to the Great Northern.

Very early in its history it issued \$10,000,-000 in bonds, which were apportioned among its stockholders at 10 per cent of the face value. These bonds were perfectly good and were saleable upon the market at par.

The first dividend paid upon the capital stock of the Manitoba Company was in August, 1882, and was 3½ per cent. From that time on dividends continued to be paid at the rate of 6 per cent or more down to the date of the lease. The Grest Northern by the terms of this lease guaranteed the interest upon the bonds of the Manitoba Company which were then outstanding or which might be issued in the further construction of that road and also guaranteed a dividend upon its etock. This \$20,000,000 of Manitoba stock was subsequently retired in exchange for \$25,000,000 of Great Northers stock.

The last annual report of the St. Paul.

stock.

The last annual report of the St. Paul, Minneapolis & Manitoba Hailway to this Commission before its property was taken over by the Great Northern was for the year

plus above stated, charged off an item of \$5.081,980.16 as depreciation of equipment.

The roadbed and structures of the Northern Pacific have undoubtedly been fully maintained out of operating expenses; indeed, up to 2000.16. Its outstanding capital stock

Earnings-Great Northern. Earnings—Great Northern.

The Great Northern Railway Company is an operating and holding company exclusively, owning no railway itself. As previously stated, it owns a haif interest in the Burlington system, which it carries in its accounts at \$107,000,000, and against which it assumes a liability of a like amount. This asset has been treated as offsetting the liability.

It appears from the last annual report of that company to this Commission that the Great Northern had in its treasury stocks which it valued at \$75,000,000 and bonds which it valued at \$22,000,000, making in all \$100,000,000. These stocks and bonds are all interest-paying securities and are

That company also owns the stocks of certain railroad companies which operate their own properties and pay a dividend to the Great Northern Company. For example, it has \$5,500,000 of the capital stock of the Wilmar & Sloux Falls Railway Company, upon which that company area. Cost of Original Construction—Great Northern.

There is no evidence in this record from which any satisfactory conclusion can be reached as to the actual amount of cash expended in the construction and development of the Great Northern Railway system. As is well understood, the basis of that system is its lessehold interest in the St. Paul, Minneapolis & Manitoba Railway, of which it took possession in 1890. The Manitoba Company limit was organized in 1879 and began operations in 1880 by acquiring certain other railroads which were in the hands of receivers. The first acquisition by the Manitoba Company represented 505 miles of completed road and a land grant of 2,000,000 acres, and the price paid was about \$7,000.

One of the first acts of that company was to issue to its stockholders \$15,000,000 of stock, for which me money was ever paid. Subsequently, \$5,000,000 of stock, was distributed among stockholders at par, and this made up the capital stock of the Manitoba Company when it leased its property to the Great Northern does not fairly represent either one which it derives from its ownership of some 1200 other miles of railway which are controlled through stock ownership and not by lease. These companies are accumulating a surplus on their own account, and hence the financial starement of the Great Northern does not fairly represent either the operating results from its entire system or from the mileage which it operates their own to the financial starement of the Great Northern does not fairly represent either the operating results from its entire system or from the mileage which it operates itself. With this explanation, we give below for the various years since we give below for the various years since we give selow for the various years since 1890 the surplus, the permanent improvements, and the dividends paid by the Great Nerthern Railway Company.

By "surplus" is meant what remains after payment of dividends, fixed charges, taxes

and all other expenses, and the deduction of "permanent improvements."

ar, Surplus.

5 588,621

544,475

1,182,230

Deficit

189,208

1,042,547

1,207,267

2,011,763

1,771,191

2,217,763 \$ 2,250,000 1,800,000 1,800,000 1,859,054 2,000,000 2,000,000 2,116,990 4,133,979 3,432,181

The stands of th

89.700,000. The Great Northern guarantees of the leases are fulfilled according to their \$89.700,000. The Great Northern guarantees. When it is remembered that none of the Manitoba leases to the Great Northern 3875 miles. It reports are cutstanding bond is sue of \$04,000,000. Including \$12,000,000 of improvement bonds issued to the Great Northern stock was issued as a firm itself and a stock issue of \$20,000,000, which, as we have already seen, has been retired by an issue of Great Northern stock. The remaining mileage operated by the Great Northern stock was issued as a gratity, or at least represented no cash Northern filed no reports with this Commission and we have no information as to its capital accounts. enough to reimburse him for the original cost of his stock. A considerable part of the Great Northern stock was issued as a gratuity, or at least represented no cash advance. These ore certificates at 196 each would considerably more than return to stockholders all the money ever actually advanced to the Great Northern Company in payment for stock. The complaints in-sist that in determining what returns those stockholders may demand from the public the fact that this stock represe

tically no investment of cash must be kept in mind by this Commission. Without attempting to determine what the rights of the public may have origwithout attempting to determine what the rights of the public may have originally been in these ore lands—a question which could not be intelligently determined upon this record—it is difficult to see how, at the present time, any practical application can be made of the idea of the complaints. These certificates are transferable and they are in no way connected with the stock on account of which they were originally issued. The stockholder having received his certificate might sell his stock and retain the certificate or sell the certificate and retain his stock. It is altogether probable that the ownership of stock and certificate in many cases has ceased to be the same. How, then, could we say that the holder of Great Northern stock who has purchased his stock in open market, who does not today own and never has owned an ore certificate, can be accountable for the value of these ore lands? Certainly this was a most momentous transactors. in all \$100,000,000. These stocks and are of two classes.

It has been already stated that the Great Northern Company issued its own stock in the amount of \$25,000,000 par in exchange for the Manitoba stock amounting to \$20,000 or par. This Manitoba stock is now carried as a treasury asset by the Great Northern Company, and in its income account, as stated to this Commission, it is its-count, as stated to this Commission, it is paid for the Manitoba property. This, of a course, produces no effect upon the net result, but does swell the amount of income which the Great Northern derives from other sources than operation.

That company also owns the stocks of certain rallroad companies which operate their own properties and pay a dividend to the Great Northern Company. For extending the content of the capital stock in and retain the certificate or sell the certificate or sell the certificate or sell the certificate or sell the certificate and retain the certificate or sell the certificate or sell the certificate or sell the certificate and retain the certificate or sell the certificate and retain the certificate or sell the certificate and retain the certificate or sell the cert

Of this same character is the contention of the complainant with respect to the manner in which the stock of the Great

of the complainant with respect to the manner in which the stock of the Great Northern Company has been issued. It has been already said that since about 1801 the stock of this company has sold upon the market at above par. It has also appeared that all the stock issues of the company after the first, with the exception of that issue made to retire the Manitoha stock, were distributed pro rata among the holders of the stock of the company at par. The actual market value of the stock at the time of these various issues so distributed ranged from \$140 to \$264 per share. A stockholder could therefore have paid \$100 for his share of stock and at once sold the same upon the market for a much higher price, thus realizing from the transaction from \$40 to \$104 per share. The complainant insists that this manner of selling stock is victous and unlawful, and that in determining the return to these stockholders we must have in mind the benefit conferred upon those stockholders by this operation.

Assuming, without deciding, that the complainant is right in its position that this practice is both unlawful and unwise, how can we, in this proceeding, take any practical note of what has been done? This stock is selling today, January, 1903, upon the market at something less than \$120 per share. If the original stockholder has retained and now owns his stock at the above advance. While the profit to him has been a handsome one, there is certainly nothing here which would call for a penalizing of the stockholder. Suppose, now, that necessities of own the stock from parchaser who paid the market price and the configured to own the stock from parchaser who paid the market price and the stockholder who has been a handsome.

that instead of retaining the stock, the stockholder sold the same to some innocent purchaser who paid the market price and who has continued to own the stock from then until now. This present stockholder paid perhaps \$264 a share for his stock. He has lost \$144 per share. Should we, for

manipulated may furnish a strong argument against the propriety of permitting
the sale of new stock in this manner, but
so far as this particular company and the
transaction is ended and can be given no
practical consideration in determining what
rates shall be charged by the Great Northern Railway Company.

Watered Stock firsts Northern

ern Ratiway Company this \$30,000.000 and allow that company to earn dividends not upon \$150,000.000, its actual issue, but upon \$150,000.000, its actual issue, but upon \$150,000.000, its actual issue, but upon received.

This claim is undoubtedly somewhat different from the two precedings. A stock-them the two precedings. A stock-them the two precedings and allow every other stocks of necessity stand like every other stocks in the manner in which such shecomes a part of the corporation and must of necessity stand like every other stocks in the manner in which such stocks even though he pays parfor it, becomes telnied with that infinite in the stock of a railway company may earn we can properly a superstand matter, this must be so. But ing what rate of dividend the stock of a railway company may earn we can properly its impossible to distinguish the spiritual stock, without consideration have usually toold be identified, it evered by the stock without consideration have usually toold be identified, it evered by the stock without consideration. The whole stock has gone upon the market, has subject of laws may be usually toold be identified, it evered by the consideration. The whole stock holders. We may undoubtedly and we should have in mind the manner in which which way paid for it, but we do not think that we should, for example, treat the outstanding capital stock of the Great North-which way paid for it, but we do not the fact that the prevented to begin with. Great must standing capital stock of the Great North-paid and the company and securities and the "confer in earning to which the Northern Pacific Stock." The same observation applies to the claim of the compalainants that we could to entire the part of the prevented to begin with. Great among a part of the properly saved the public the series of the stock of the received their part sannot be safely undone. If this Government and the "confer in earnings and securities of the stock of the received their part of the prevented to begin with the prevented to

Now, the complainants insist that this \$70,000,000 has been obtained by the imposition of unjust and unreasonable rates; that it belongs not to the Great Northern Company, but to the public which has paid these rates, and that upon whatever basis we fix the return to which this company is entitled, we must first deduct this \$70,000,000.

A somewhat similar question is raised touching the estimated value of the right of way, which is embraced in the cost of the reproduction of these properties. It will be remembered that the total value of the structures and equipment of the Northern Pacific Company was stated by us to be not far from \$250,000,000. This represents the total cost at present prices of reproducing that entire property. Now, it was estimated that the land upon which this structure stands was worth \$107,000,000, almost one-third of the statics value of the property itself upon the basis of reproduction.

Much of this right of way was given to

Much of this right of way was given to Much of this right of way was given to the Northern Pacific originally by the Government and by individuals. A considerable part of it has indeed been since acquired at large expense, but still the total cost to that company of this right of way has been but a fraction of the amount at which it is carried into this cost of reproduction. The complainants insist that the defendant Northern Pacific Company cannot charge the public with this enormous sum for which it has never paid.

These two questions are not by any means the same, but the argument by which they are sustained on the part of the complainant is substantially dentical and may be briefly stated.

In 1872 a considerable part of the business portion of the City of Boston was destroyed

ante is substantially identical and may be briefly stated.

In 1872 a considerable part of the business portion of the City of Boston was destroyed by fire. The Legislature of the State of Massachusetts, then in session, authorized Boston to issue the bonds for the purpose of loaning mensy to individuals with which to rebuild this burnt district. Suit having been brought by a taxpayer to restrain the city from this action on the ground that the statute authorizing it was unconstitutional, the Massachusents court enforced the bond issue.

Its decision was placed upon the ground that no public tax could be levied for the benefit of a private enterprise. No matter how great the Indirect benefit to the entire City of Boston might be from the rebuilding of these burnt ators promptly, the loan in the first insignce was to a private individual; the public benefit was only an incident, Hence, the massachusents the imposing of a public tax was unconstitutional and void. Lowell vs. Boston, III Mass. 454.

Somewhat before the great Boston fire the Legislature of the State of Wisconsein authorized the County of Fond du Lac to make a money contribution in aid of the construction of a certain railroad in that county, and the county, in pursuance of this act of the Legislature and in observance of its requirements, issued certain notes to the railroad company. These notes were not paid at maturity and suit was brought against the county by a bona fide purchaser into whose hands they had previously come.

The Supreme Court of the State of Wisconsin held that the act of the Legislature authorizing this expenditure of money by the county was unconstitutional for the reason that it involved the levying of a public was essentially a private undertaking; the funds with which it was constructed were private; its profits belonged to private individuals. Hence, the County of Fond du Lac could not by a general tax subsidies the private venture.

This holding of the State Court was reversed by the Supreme Court of the United States. It

formance of this public function happened to be a private corporation was of no sig-

upon this question but it does not seem profit-able to discuss or double it in this connection. We shall assume, in disposing of this case, that the cost of reproduction is properly estimated upon the basis followed by those defendants, and that the item of value of right of way le to stand as a part of that cost, like any other item.

Surplus Earnings.

We come now to the complainants' claim that the surplus which has been documulated by these defendants from earnings should be first subtracted from the value of their properties in determining the amount upon which they may properly earn. The contemtion of counsel is that this surplus is a fund held by the railway company as trustee for the public, which this Commission should in some way manake to redistribute to the public in the establishment of just and reasonable rates. The railway is certainly an agent of the Government in the construction and operation of its propthe construction and operation of its property, and it is only allowed to charge for its services a reasonable compensation. Does it, from this follow that the surplus of the Great Northern Hallway, for example, which is said to be \$70,000,000, is

held by that company in trust for the public? Does it follow, even, that the value of this property today should be decreased by \$70,005,000 upon the theory that the public has paid into the property that amount?

It is well understood that rates by all lines to Spakes from a true. lines to Spokane from a given Eastern deati-nation must be the same. We have already held that in establishing a reasonable rate the strongest line should not alone be con-aldered; the necessities of the weaker line must also be taken into account. In the must also be taken into account. In the application of this principle it is evident that a rate might be fixed which would pay a very moderate return by one line and a very handsome return by the other. Under the operation of these rates the Great Northern, by reason of its cheaper construction and its easier operation, might accumulate a surplus, while the Northers Pacific did not. If so, could it be said that the surplus of the Great Northern had been improperly accumulated when its rates had been just and reasonable? Does the more fact of the accumulation of a surplus by a

been just and reasonable? Does the mere fact of the accumulation of a surplus by a particular road show that the rates upon that road have been excessive? But assume that they have been. This \$70,000,000 to which the complainants re-fer in case of the Great Northern surplus is the result of the operations of the Mani-toba and the Great Northern companies aince the year 1880; that is, for 27 years During all that beried this surplus has buring all that period this surplus has been gradually accumulated and has gone into the property. Should the Govern-ment today take note of that surplus for the purpose either of so reducing the rates of the company that no carnings can be made upon this much of the property or with a view to in some sense turn that surplus back again into the hands of the

There is no absolute test of a reasonable rate, and the Government has supplied none. During all this period the excess has gone into the property, which has gradually into the proporty, which has gradually become more valuable, and this increased value has reflected itself in the market price of the securities of that company. It is impossible to restore what has been improperly taken in the way of excessive rates to those persons from whom it has been received. The Government, under those circumstances, cannot lay held on this surplus as a fund held in trust for the public.

This case strongly illustrates the fact that if any Government tribunal is to de Justice between the railway and the public, if it is to feel any confidence in the correctness of its conclusions, its supervision must be continuous and not spannodic. These must be some point of departure and from that point the knowledge of the Government

(Concluded on Page 18.)