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COMMENTS

RAILROAD MERGERS

J. Roger Edwards, Jr.

Almost every major railroad in the United States either is involved currently in merger proceedings or is entertaining the idea.¹ Indeed, the railroads are setting a blistering pace in attempts to secure the most advantageous alignment. If proposals fail in one quarter, out come the maps and the search is on for another suitable partner. In this atmosphere, a heavy premium is placed on early agreement. Those unable to negotiate successfully may find that alignments between other railroads have created a situation in which substantial amounts of their traffic will be diverted to the newly merged systems. The smaller roads even may be forced into a merger at unfavorable exchange rates.

¹ For a list of merger proposals already approved and others now pending before the ICC, see *Hearings on Rail Merger Legislation Before the Senate Subcommittee on Antitrust and Monopoly*, 87th Congress, 2d Sess., Pt. 2, at 1146 (1962). As of August 1, 1964, the status of merger and control applications were as follows:

BUREAU OF FINANCE
STATUS OF MERGER AND CONTROL CASES
BEFORE
INTERSTATE COMMERCE COMMISSION

Finance Docket No.	Description	Date Filed	Hearing Dates		Examiner's Report
			First	Last	
21215	Seaboard Air Line- Atlantic Coast Line merger*	7-22-60	11-28-60	7-28-61	8-16-62
21313	Illinois Central control of Louisville & Nashville	10-10-60	(deferred pending decision in 21215)		
21314	Southern Pacific control of Western Pacific	10-12-60	(consolidated with 21334)		9-9-63
21334	Atchison, Topeka & Santa Fe control of Western Pacific	10-25-60	7-17-61	11-21-61	9-9-63
21478	Great Northern-Northern Pacific-Chicago, Burlington & Quincy merger**	2-17-61	10-10-61	7-11-62	
21510	Norfolk & Western-New York, Chicago & St. Louis merger***	3-17-61	10-10-61	5-2-62	4-10-63
21755	Missouri Pacific control of Chicago & Eastern Illinois	9-19-61	(consolidated with 21892)		9-26-63
21773	Louisville & Nashville control of Chicago & Eastern Illinois	9-28-61	(withdrawn)		

* Commission's report made Dec. 2, 1963.

** Commission's report made August 1964.

*** Commission's report made June 24, 1964.

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This merger movement does not represent a new phenomenon in the American economy, but it differs from previous movements in several respects. First, the railroad industry no longer is a natural monopoly. Trucks, barges, and pipelines have made inroads into its freight position; private cars, buses, and airlines now compete with it for passenger business. Second, in order to regain financial health, railroads are using merger as a means to reduce fixed costs and thus attain more efficient operations.³ Third, the Interstate Commerce Commission has aided the movement. The result: a good chance railroads will be consolidated into regional systems.

BUREAU OF FINANCE
STATUS OF MERGER AND CONTROL CASES
(Continued)

Finance Docket No.	Description	Date Filed	Hearing Dates First Last	Examiner's Report
21892	Illinois Central control of Chicago & Eastern Illinois	12-26-61	3-6-62 6-12-62	9-26-63
21920	Norfolk & Western control of Akron, Canton & Youngstown	1-10-62	7-18-62 7-19-62	4-10-63
21989	Pennsylvania-New York merger	3-9-62	8-20-62 10-2-63	
22235	Norfolk & Western lease of Pittsburgh & West Virginia	8-21-62	10-30-62 10-31-62	4-10-63
22274	Texas & Pacific control of Kansas, Oklahoma & Gulf, Midland Valley and Oklahoma City-Ada-Atoka	9-28-62	1-21-63 3-20-63	11-6-63
22382	Atchison, Topeka & Santa Fe control of Oklahoma City-Ada-Atoka	12-18-62	(consolidated with 22274)	
22465	Atchison, Topeka & Santa Fe; Gulf, Colorado and Santa Fe; Panhandle and Santa Fe; and Kansas City, Mexico and Orient merger	2-14-63	6-24-63 9-11-63	
22688	Chicago & North Western control of Chicago, Rock Island & Pacific	7-5-63	(hearings deferred awaiting related application by UP and SP)	
22951	Missouri Pacific, Texas & Pacific, and Texas & Missouri Pacific Railway Company consolidation	1-28-64		

³ Although the railroad industry generally has not prospered in recent years, the eastern district railroads perhaps have suffered more than their share of the financial problems. For example, as of 1961 the eastern district roads represented between 34% and 38% of the industry (measured by funded debt outstanding, number of employees, freight cars, locomotives, state and local taxes, total operating revenues, and net investment), yet they lagged behind in such important financial indicators as gross capital expenditures (22%), dividends paid (10%), and net operating income (none). Also in 1961, the net income for the eastern roads was a deficit equaling more than 25% of the industry's net earnings. A deficit in working capital also existed. *Id.* at 930.

Opposition to this movement, however, is not lacking. Shippers, unions, cities, states, other railroads, and the Department of Justice frequently oppose mergers in order to protect legitimate interests which each has. The Railway Labor Executives Association, composed of leaders of the various labor unions, voiced its disapproval of the ICC's merger policy in these terms: merger approvals should be the responsibility of "an agency that is not ridden with bureaucratic incompetence and dominated by the interests they [*sic*] are supposed to regulate."³

I. HISTORY OF RAILROAD MERGERS

There have been several distinct periods in which railroad merger activity either was intense or noticeably absent.⁴ Prior to 1904, railroads merged whenever possible. Between 1904 and 1920, mergers were prevented by law and few occurred.⁵ After 1920 the government supported consolidations,⁶ but few were completed prior to the recent movement. The regulation of railroads began with the Interstate Commerce Act,⁷ passed in 1887, which subjected them to regulation because of their discriminatory and monopolistic pricing practices. The Sherman Act followed in 1890.⁸ In cases before the Supreme Court in 1897⁹ and in 1899,¹⁰ plausible arguments were made for exemption of railroads from the antitrust laws because of the Interstate Commerce Act. In both cases the Court held the antitrust laws applicable to railroads and found that the defendants had violated section 1 of the Sherman Act by fixing prices. The antitrust laws, however, were not applied specifically to railroad mergers until 1904 in *Northern Sec. Co. v. United States*.¹¹

In the sixteen years that followed *Northern Securities*, the anti-trust laws effectively thwarted all attempts at consolidation. This policy was relaxed by the Transportation Act of 1920,¹² passed to

³ Wall Street Journal, Dec. 27, 1960, p. 2, cols. 2 and 3.

⁴ Railroad mergers are not new. For example, the present 500 or more railroads represent a combination of what was once 6,000 roads. The Pennsylvania Railroad system was once 600 roads. Staff of Senate Comm. on Interstate and Foreign Commerce, 87th Cong., 1st Sess., Preliminary Draft of Report on National Transportation Policy 229 (Comm. Print 1961) [hereinafter cited as Doyle Report].

⁵ See text accompanying and following notes 9 and 10 *infra*.

⁶ See text accompanying and following note 12 *infra*.

⁷ 24 Stat. 379 (1887), as amended, 49 U.S.C. §§ 12-27 (1958).

⁸ 26 Stat. 209 (1890), as amended, 15 U.S.C. §§ 1-7 (1958).

⁹ *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290 (1897).

¹⁰ *United States v. Joint Traffic Ass'n*, 171 U.S. 505 (1898).

¹¹ 193 U.S. 197 (1904).

¹² Act of Feb. 28, 1920, ch. 91, 41 Stat. 456 (codified in scattered sections of 49 U.S.C.).

retrieve railroads from precarious financial condition.¹³ This was to be accomplished by consolidating financially sound roads with weaker ones.¹⁴ Under the 1920 act, ICC approval of a merger gave it immunity from the antitrust laws.¹⁵ A limitation, however, that "competition shall be preserved as fully as possible and whenever practicable the existing routes and channels of trade and commerce shall be maintained" was to be imposed by the Commission.¹⁶ The plan was a failure. First, the act made consolidation voluntary, and strong carriers were very reluctant to merge with weak roads. Second, in accordance with the congressional mandate, Professor William Z. Ripley of Harvard submitted to the ICC a plan which grouped all of the railroads into twenty-one systems.¹⁷ After alteration, the plan finally was approved by the ICC in 1929,¹⁸ but its rigidity proved to be too great. As a result, little merger activity followed. During the depression the financial plight of the railroads again led Congress to become interested in consolidations. The Emergency Railroad Transportation Act of 1933¹⁹ authorized the ICC to approve mergers found to be in the public interest and in harmony with the overall plan of consolidation under the 1920 act.

In the Transportation Act of 1940,²⁰ Congress abandoned two provisions that were in the previous statutes. First, the Commission was relieved of its duty to promulgate a national consolidation plan, leaving the power to initiate mergers entirely to the carriers.²¹ Second, the specific reference to the "preservation of competition whenever possible" was removed from the statute. In place of these provisions Congress admonished the ICC to give weight to the following considerations, among others: (1) the effect of the proposed transaction upon adequate transportation service to the public; (2) the effect upon the public interest of the inclusion of, or failure to include,

¹³ "The major issue facing Congress then was to prevent a complete breakdown of the railroad transportation system because of the precarious financial condition of the weak roads." Doyle Report, *op. cit. supra* note 4, at 233.

¹⁴ The theory was that such mergers would allow equal rates to be charged on a fair basis. It was felt that in the absence of such a program, a rate providing the sound roads with a reasonable return would destroy the weaker ones. On the other hand, rates providing weak roads with reasonable returns would give the stronger companies excessive returns. Doyle Report, *op. cit. supra* note 4, at 234.

¹⁵ Transportation Act of 1920, ch. 91, § 407, 41 Stat. 482 (now 49 U.S.C. § 5 (11) (1958)). "[A]ny carriers . . . participating in a transaction approved or authorized under the provisions of this section shall be and they are hereby relieved from the operation of the 'antitrust laws' . . ."

¹⁶ Transportation Act of 1920, ch. 91, § 407, 41 Stat. 481.

¹⁷ Consolidation of Railroads, 63 I.C.C. 455 (1921).

¹⁸ Consolidation of Railroads, 159 I.C.C. 522 (1929).

¹⁹ 48 Stat. 211 (1933), as amended, 49 U.S.C. § 5 (1958).

²⁰ 54 Stat. 898 (1940) (codified in scattered sections of 49 U.S.C.).

²¹ 54 Stat. 905 (1940), 49 U.S.C. § 5(2)(b) (1958).

other railroads in the region in the proposed transaction; (3) the total fixed charges resulting from the proposed transaction; and (4) the interest of the carrier employees affected.²² These tests were qualified by the National Transportation Policy found in the preamble to the act.²³ Unfortunately, this policy statement is even more vague than the criteria specified in the statute.

In 1922, the immunity clause was upheld in the courts.²⁴ And as early as 1932 in *New York Cent. Sec. Corp. v. United States*,²⁵ the ICC's approval of a merger of parallel competing lines was upheld. However, definitive treatment of the proper Commission approach to competition did not occur until 1944 in *McLean Trucking Co. v. United States*.²⁶ In *McLean*, which upheld a merger of trucking firms under section 5(2) of the Interstate Commerce Act,²⁷ the Court stated:

In short, the Commission must estimate the scope and appraise the effects of the curtailment of competition which will result from the proposed consolidation and consider them along with the advantages of improved service, safer operation, lower costs, etc. to determine whether consolidation will assist in effectuating the over-all transportation policy. . . . "The wisdom and experience of that Commission," not of the courts, must determine whether the proposed consolidation is "consistent with the public interest."²⁸

²² 54 Stat. 905 (1940), 49 U.S.C. § 5(2)(c) (1958). With respect to employees, § 5(2)(f) requires that they not be in a worse position after the merger than before it for a minimum period of four years.

²³ It is hereby declared to be the national transportation policy of the Congress to provide for fair and impartial regulation of all modes of transportation subject to the provisions of this Act, so administered as to recognize and preserve the inherent advantages of each; to promote safe, adequate, economical and efficient service and foster sound economic conditions in transportation and among the several carriers; to encourage the establishment and maintenance of reasonable charges for transportation services, without unjust discrimination, undue preferences or advantages, or unfair or destructive competitive practices; to cooperate with the several States and the duly authorized officials thereof; and to encourage fair wages and equitable working conditions; —all to the end of developing, coordinating, and preserving a national transportation system by water, highway, and rail, as well as other means, adequate to meet the needs of commerce of the United States, of the Postal Service, and of the national defense. 54 Stat. 899 (1940).

²⁴ The Supreme Court originally ordered dissolution of a railroad merger, *United States v. Southern Pac. R.R.*, 259 U.S. 214 (1922), but the merger was upheld after the parties obtained ICC approval. *Control of Central Pacific by Southern Pacific*, 76 I.C.C. 508 (1923), *aff'd sub nom. United States v. Southern Pacific R.R.*, 290 Fed. 443 (D. Utah 1923).

²⁵ 287 U.S. 12 (1932). "The fact that the carriers' lines are parallel and competing cannot be deemed to affect the validity of the authority conferred upon the Commission. . . . The question of whether the acquisition of control will aid in preventing injurious waste and in securing more efficient transportation service is committed to the judgment of the administrative agency upon the facts developed in the particular case." *Id.* at 25-26.

²⁶ 321 U.S. 67 (1944).

²⁷ 24 Stat. 379 (1887), as amended, 54 Stat. 905 (1940), 49 U.S.C. § 5(2) (1958).

²⁸ *McLean Trucking Co. v. United States*, 321 U.S. 67, 87-88 (1944).

In a dissent, however, Justice Douglas reasoned:

Congress did not give the Commission *carte blanche* authority to substitute a cartel for a competitive system. It may do so only when that step will be consistent with the public interest. . . . But since the "public interest" includes principles of free enterprise, which have long distinguished our economy, I can hardly believe that Congress intended them to be swept aside unless they were in fact obstacles to the realization of the national transportation policy.²⁹

This case touched off a debate which is still lively today.³⁰ If under the Supreme Court's test the "'wisdom and experience of the Commission,' not of the courts, must determine whether the proposed consolidation is 'consistent with the public interest,'" the ICC's approach in defining the public interest and the relative weight given various criteria which make up the public interest become highly significant.³¹

²⁹ *Id.* at 94.

³⁰ A more recent Supreme Court case which simply reaffirmed the principles espoused by the majority in the *McLean* case is *Minneapolis & St. L. Ry. v. United States*, 361 U.S. 173 (1959). The case has little significance from an antitrust standpoint because the line absorbed had only 225 employees and was only 234 miles long. In addition, the Commission required that all present channels be kept open and that the line continue operations under independent management.

Agency decisions of today discuss competition in the language of the Clayton Act, 38 Stat. 730 (1914), 15 U.S.C. §§ 12-27 (1958). The phrase in § 7 (49 U.S.C. § 18), "substantially lessen competition," actually looks to future consequences and is tailored for the merger situation. The exemption power under 41 Stat. 482 (1920), 49 U.S.C. § 5(11) (1958) also includes the Clayton Act, however; thus, it is useful only as a statement of policy and as a tool for determining the competitive effects of a merger. See *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963); *Pan American World Airways v. United States*, 371 U.S. 296 (1963); *California v. FPC*, 369 U.S. 482 (1962); Beverly, *Railroad Mergers: The Forces of Intermodal Competition*, 50 A.B.A.J. 641 (1964).

³¹ In 1926 the Commission denied an application of the Norfolk & Western to control the Virginian by lease because the transaction would substantially lessen competition. *Control of Virginian Ry. by Norfolk & W. Ry.*, 117 I.C.C. 67 (1926). Thirty-three years later the Commission did an about face and approved a merger between these very companies, even though they were two of the most profitable lines in the country. *Norfolk & W. Ry.—Merger—Virginian Ry.*, 307 I.C.C. 401 (1959). The two roads are not parallel, but it was estimated that savings of 12 million dollars per year would be achieved during a five-year period because of coordination of yards, shops, and terminals; integration of administrative accounting and soliciting; better use of facilities; and better movement of eastbound coal. The Commission commented:

Conditions and circumstances existing today, some 34 years after the lease proposal, make our decision in the control case inapposite. . . . [T]he situation in which railroads find themselves now is hardly that of 1925. Then the railroads were a virtual monopoly; now they are struggling to exist against mounting competition. Then there were few roads and no organized intercity motor carriers of consequence; now we have a network of fine intercity highways and a thriving motor carrier industry.

The railroads are also facing constantly increasing competition from inland waterways operators. *Id.* at 417.

In 1957 the ICC approved the acquisition of the Nashville, Chattanooga & St. Louis Railroad by the Louisville & Nashville Railroad. *Louisville & N.R.R. Merger*, 295 I.C.C. 457 (1957). These companies estimated that the merger would result in savings of 3¼ million dollars per year within five years. Actually, the applicant companies had long

Uncertainties exist in this field because neither Congress nor the Commission ever has indicated at what point the preservation of competition becomes more essential to the public interest than proposed advantages of a merger. Indeed, there is confusion even over what approach the Commission should utilize in assessing the anti-competitive effects of merger. Although generalization is difficult, the ICC apparently regards the following considerations as important in proposed mergers: (1) proximity of intermodal competition, (2) savings which can be achieved, and (3) financial condition of the carriers. Perhaps one other observation needs to be made. Although the companies whose mergers have been approved range from the relatively small to the medium-large (the Minneapolis & St. Louis had 2,400 employees while the Louisville Nashville had 22,000),³² some of the mergers now pending before the ICC involve the financial giants of the industry. The extent to which this factor will weaken the case for approval is unknown.

II. THE REGULATORY SCHEME—AN ECONOMIC VIEW

The issues involved in merger litigation are meaningful only if viewed within the context of the regulatory philosophy and its practical application. The extent to which regulation achieves its objectives in daily practice is important because of the complex effects the policy in one area may have on other areas of agency concern. For example, the present rate making process and the abandonment policy enforced by the ICC may have a significant effect, indeed it may be the motivating factor, on a railway company's decision to

worked together, but the merger, by increasing diversification, created a more balanced traffic pattern, thus permitting more effective competition with other modes and a more efficient one-line service. Objections that Nashville would become a "one-railroad city" were given little weight by the Commission because of vigorous intermodal competition from pipelines, water transport, trucks, and airlines. *Id.* at 467-68.

Other acquisitions and mergers recently approved by the Commission: Norfolk & Western-New York, Chicago & St. Louis Merger, — I.C.C. —, Finance Docket No. 21510, (June 24, 1964); Great Northern-Northern Pacific-Chicago, Burlington & Quincy Merger, — I.C.C. —, Finance Docket No. 21478 (August 1964); Georgia & Fla. Ry.—Acquisition—Georgia & Fla. R.R., 317 I.C.C. 745 (1963) (union of strong and weak to preserve service); Southern Ry.—Control—Central of Ga. Ry., 317 I.C.C. 557 (1962); Delaware, Lackawanna & W.R.R.—Erie R.R., 312 I.C.C. 185 (1960), *aff'd sub nom.* Brotherhood of Maintenance of Way Employees v. United States, 366 U.S. 169 (1961) (both lines in financial trouble with estimated annual saving of 13 million dollars after 5 years); the Minneapolis & St. L. Ry.—Chicago & No. W. Ry., 295 I.C.C. 523 (1957), *aff'd sub nom.* Minneapolis & St. L. Ry. v. United States, 361 U.S. 173 (1959) (estimated savings of 3 million dollars per year, acquisition unopposed).

The only significant proposal which the Commission turned down in recent years was the St. Louis-San Francisco Railway's request to control the Central of Georgia Railway. Central of Ga. Ry.—Control, 295 I.C.C. 563 (1957). The refusal was based on violations of § 5(4) in purchasing stock before obtaining Commission approval. 54 Stat. 905 (1940), 49 U.S.C. § 5(4) (1958).

³² Healy, The Effects of Scale in the Railroad Industry 746 (1961).

merge. Because of the inter-relationship, a re-evaluation of the rate making process and the abandonment policy as well as of the merger policy would be sensible at a time of feverish railroad concentration. In other words, if basic policy changes in other areas will provide the benefits anticipated from a general policy favoring railroad consolidations, without the disadvantages, those changes deserve serious consideration.

In both railway and government circles, it is agreed that the industry must undergo fundamental change if it is to prosper in the future. The problem may be caused by the present industry structure—a problem that can be cured by merger. On the other hand, there is substantial evidence to indicate that the financial problems of the railroads can be traced to the regulatory legislation as administered by the ICC. In a Message from the President of the United States Relative to the Transportation System of our Nation, President Kennedy voiced the sentiment as follows:

The regulatory commissions are required to make thousands of detailed decisions based on out-of-date standards. The management of the various modes of transportation is subjected to excessive, cumbersome, and time-consuming regulatory supervision that shackles and distorts the managerial initiative. Some parts of the transportation industry are restrained unnecessarily; others are promoted or taxed unevenly and inconsistently.³³

The effect of operating under outmoded regulatory legislation has been severe in the railroad industry. For instance, although railroads once virtually monopolized the carriage of freight in the United States, other modes, particularly the trucking industry, now carry freight which once could be shipped most economically by rail.³⁴ The most important reason for this dislocation is the calculation of rates without using cost as a base. This absence of cost-pricing is

³³ H.R. Doc. No. 384, 87th Cong., 2d Sess. 2 (1962).

³⁴ Percentage distribution of intercity ton miles by transport agency:

Year	Rail	Motor vehicle	Inland waterways ^a	Pipeline
1939	62.3	9.7	18.7	10.2
1943	71.3	5.5	13.7	9.5
1947	65.2	10.1	14.4	10.3
1950	56.1	16.3	15.4	12.2
1954	49.5	19.0	15.5	15.9
1960	43.8	22.2	16.2	17.7

^a The inland water percentages include Great Lake freight movement which declined from 11% to 7% between 1947 and 1960.

Meyer, Peck, Stenason & Zwick, *The Economics of Competition in the Transportation Industries* 240 (1960). (Air freight is not included as it has always been negligible.)

illustrated by (1) the rate bureau, (2) value-of-service rates, and (3) abandonment policy.

A. *The Rate Bureau*

The rate bureau, legislatively sanctioned,³⁵ is a cooperative association composed of all railroad companies in a particular region. It exists primarily to set uniform rates for its members. Before a rate adjustment proposed by an individual railroad becomes effective, it must grind through the several levels of the bureau for approval. If the adjustment fails to win bureau approval, the proposing company may file the rate individually with the ICC. This procedure, however, rarely is utilized.³⁶ The private administrative agency's ability to maintain uniform rates has the dual effect of generally higher prices being posted³⁷ and, because advance notice of proposed rate adjustment is given, prevention of individual companies' gaining competitive advantages through decreases in rates.³⁸ Those who favor the rate bureau technique argue that, even in the absence of the bureau, rates in competing markets would be identical because of the oligopolistic nature of the industry. Moreover, they argue, collective action is necessary to establish joint rates for long hauls. Finally, the expense of computing rates would burden individual companies unduly. Generally, these arguments can be answered quite simply. First, the existence of an oligopolistic market structure does not compel the conclusion that rate bureaus are desirable (*e.g.*, automobile industry). Second, collective establishment of joint rates should not prevent experiments with rates for hauls entirely within one system. Third, although the expenses per company might materially increase, this addition should be weighed against the disadvantages (cost and otherwise) arising from the inherent inertia of the bureau system.³⁹ The time-consuming process involved in making

³⁵ The Reed-Bulwinkle Act, 62 Stat. 472 (1948) 49 U.S.C. § 5b (1958), exempts from the operation of the Sherman Act those bureaus authorized by the ICC.

³⁶ Rate bureaus "dampen down the frequency of [independent action] and serve as a deterrent, self-imposed and noncoercive, to the freedom of rate making." Conclusion of Lloyd Garrison sitting as special master in *Georgia v. Pennsylvania R.R.*, 324 U.S. 439 (1945) reported in 17 ICC Prac. J. 864, 869 (1950). "Although the Reed-Bulwinkle Act protects the individual carriers' right to deviate from the traffic bureau rates, the cost of reviewing the work of the bureau all but precludes its existence." Conant, *Railroad Consolidations and the Laws*, 14 Stan. L. Rev. 489, 492 (1962).

³⁷ Air Freight Traffic Agreement, 14 C.A.B. 424, 428 (1951).

³⁸ *Id.* at 430.

³⁹ The fact that "rate committees in practice operate on nearly unanimous rather than majority decisions" indicates the difficulty a company might experience in attempting major changes in rate policy. Meyer, Pech, Stenason & Zwick, *The Economics of Competition in the Transportation Industries* 210 (1960).

rate adjustments not only destroys intramodal competition, it also prevents flexible reaction to competition from other modes. The result is an effective throttling of aggressive marketing policies by rate bureau machinery.⁴⁰

B. Value-Of-Service Rate-Making⁴¹

The value-of-service method of determining rates originated and developed during the period of rail monopoly of transportation facilities. Because of the high ratio of fixed cost to variable cost in a railroad operation, it was profitable for a railroad to charge a different rate for each commodity commensurate with the product's ability to pay. Thus, because transportation expenses constituted only a minor portion of the total cost of high value goods, they were made to bear high rates. The railroads then could profit by accepting lower value products (bulk commodities) at any rate which covered more than the marginal cost of carriage. Even though the railroads no longer enjoy a monopoly position, this method of rate-making survives today largely because of historical accident and ICC sanction.

The inherent evil in a pricing system which does not reflect cost lies in the misallocation of resources which may occur. In other words, if under the value-of-service method of setting rates business is not necessarily allocated to the "low cost" carrier, transportation resources are wasted. The following analysis of carrier costs indicates that this is precisely what has occurred. The cost comparisons between the different transportation modes are presented in the traditional categories of (1) bulk commodities, (2) high value goods, and (3) passenger service.

(1) A comparison of rail and water costs for transporting *bulk commodities* reveals that the cost of water carriage by cargo ship, tramp freighter, or barge is substantially less than rail long-run marginal line-haul cost.⁴² Provided suitable commodities can be found in sufficient quantity, pipelines may have costs as low as one-eighth of rail line-haul cost for the same service.⁴³

(2) For *high value goods*, data indicate that piggyback line-haul cost with a Clejan type car generally will equal only about one-third

⁴⁰ This may be one reason why the railroads are unable to attract sufficient managerial talent.

⁴¹ This section draws heavily from Meyer, *op. cit. supra* note 39, at 145, 168.

⁴² These conditions would prevail even if the rail carrier obtained loads per car of 60,000 to 70,000 pounds for the back haul and if the water carrier completed the back haul empty. *Id.* at 148.

⁴³ *Id.* at 149.

the line-haul cost for trucks.⁴⁴ The all rail line-haul cost per carload likewise is less than the representative cost for trucks.⁴⁵ In addition, line-haul cost alone for carrying by boxcar loads in excess of 40,000 or 50,000 pounds is less than if carried by piggyback.⁴⁶ A comparison of rail and water carriage cost of transporting high value goods indicates that railway transport has a substantial cost advantage.⁴⁷

(3) With the exception of short-haul, high density lines, rail marginal cost (generally less than average cost) for *passenger carriage* is much higher than average cost for automobile travel and somewhat above average cost for intercity bus travel. Air carriers, which offer obvious service benefits, have costs that are competitive with both first class and coach rail costs.⁴⁸

The foregoing examination suggests that the railroads definitely serve an economic purpose in our transportation system. The data indicate that if railroads were allowed to exploit their cost advantage by pricing closer to marginal cost, a substantial amount of traffic in

⁴⁴ Comparative line-haul expenses for truck and piggyback transport:
(cents per revenue ton-mile)

Load per trailer (pounds)	Piggyback costs Clejan type car ^a	Highway Truck ^b
10,000	1.408	5.46
15,000	1.041	3.64
20,000	0.857	2.73
30,000	0.673	1.82

^a Piggyback costs are long-run marginal (in 1952-1955 prices) and include allowances for the variable portions of general overhead costs (also, efficiency in this technique is reducing cost further through side loading of only the trailer box).

^b Highway truck costs are based on out-of-pocket (ie., roughly above average variable) line haul vehicle mile costs of 27.3 cents, reported for American Middlewest Common Carriers in 1953. *Id.* at 151.

⁴⁵ A comparison of long-run marginal line-haul costs of truck, piggyback, and carload rail operations (1952-1955 cents per revenue mile).

Load per shipment (pounds)	Truck	Carload ^a	Piggyback (Clejan car)
20,000	2.73	1.161	0.857
30,000	1.82	0.878	.673
40,000	2.73 ^b	.738	.857 ^b
50,000	2.18 ^c	.653	.747 ^c
60,000	1.82 ^d	.598	.673 ^d
70,000	2.34 ^e	.555	.778 ^e

^a These cost estimates are based on average figures per gross ton mile of rail operations as reported at the end of Chapter III. Train, general, traffic, line-haul, switching, maintenance, and depreciation costs are included.

^b Assumes shipment is broken down into two 20,000 pound trailer loads.

^c Assumes shipment is broken down into one 20,000 and one 30,000 trailer loads.

^d Assumes two 30,000 pound trailer loads.

^e Assumes two 20,000 and one 30,000 pound trailer loads. *Id.* at 152.

⁴⁶ *Ibid.*

⁴⁷ *Id.* at p. 156.

⁴⁸ *Id.* at 158.

high value goods would be taken from trucks. For instance, over ninety per cent of common carrier truck ton miles and over fifty-one per cent of private and exempt truck ton miles occur in hauls of over 200 miles, a distance at which the railroads have a decided cost advantage.⁴⁹ These figures take on added significance from the fact that the shippers who utilize this service are informed industrial enterprises that are eager to minimize expenses.

The perpetuation of the value-of-service method of rate making stems from difficulties in measuring costs in railroad operations, the policy of choosing the low cost carrier on the basis of fully distributed cost, and the Commission's failure to appreciate fully the changed environment in the transportation industry. The first two explanations represent very real problems. On the other hand, the Commission's refusal to adjust to technological development, *e.g.*, the ascent of the motor carrier, appears inexcusable. A more rational allocation of transportation resources could be obtained by permitting railroads to lower prices.

C. *Abandonments*

There are general indications that railroads, if allowed to do so, would abandon much of their trackage as unproductive. While several restrictions on an abandonment program would be necessary,⁵⁰ many such moves might produce an overall net economic gain. For example, abandonment of rail passenger service might put bus operations on a paying basis. The substitution of piggyback operations for spur lines could provide excellent service to the shipper at a lower cost to the railroad. Where abandonment is complete, innocent parties would be left without rail service. Nevertheless, if abandonment is proper economic policy, it should not be postponed indefinitely. The availability of substitutes for rail service and the use of phasing out plans makes abandonment feasible in many cases.

D. *Summary*

Under the present regulatory scheme, the railroads often are forced, though sometimes they choose, to deviate from policies which would result in higher profits and in savings from increased efficiency. The critical financial condition of many railroads indicates that fundamental changes in regulatory policy may be necessary, but it is

⁴⁹ *Id.* at 194-95.

⁵⁰ Such restrictions would be as follows. (1) Users of an unproductive line must not be willing to bear the additional expense of making the line productive. (2) If the introduction of new technology would put the line on a paying basis, abandonment would be restricted. (3) In places in which industrial development indicates that the market will become a profitable one, abandonment should not occur. *Id.* at 252-53.

essential that these policy revisions be directed at the disease rather than at its symptoms. One source of the railroads' problems is the regulatory legislation under which they operate. The problems are aggravated by the Commission's failure to take the initiative in proposing reform. Specifically, a more liberal abandonment policy would allow the railroads to reduce fixed costs by scrapping inefficient capital equipment. Rates for profitable routes no longer would have to include an element of subsidy for unprofitable routes; thus, one element of non-cost pricing would be removed. Acceptance of a system of rates based upon cost would contribute to proper allocation of transportation resources. Downward shifts in rates for high value commodities is justified easily. First, on an average total cost basis, railroads are often the cheaper form of transportation. For instance, thirty-seven per cent more revenue ton-miles can be handled by rail than by truck at identical cost.⁵¹ Second, because of the downward shift, the trucking industry would be forced to devote more of its resources to shorter hauls, where it appears to be the "low cost" carrier. On the other hand, a cost approach to rate setting would result in the railroads' loss of much of their traffic in bulk commodities to barges and pipelines which can provide the same service at lower cost. Where these forms of competition are not present, rates based on cost could prove prohibitive for the shipper.⁵² In this situation some discrimination would have to be preserved to allow movement of these goods by railroad.

In the absence of such reforms the railroads have turned to merger to strengthen their financial base. Generally, proponents of merger claim that material contributions will be made in returning railroads to profitable operation. In each case, the specific objectives of merger (*e.g.*, a more efficient operation between Dallas and Houston due to consolidation of dual and unproductive facilities) should be examined by the ICC to determine whether these objectives best can be achieved by merger or whether merger will produce the desired results merely because it is the best practical alternative under an outmoded regulatory system that prevents direct adjustments. The soundness of such a "practical" or indirect approach to railroad problems also should be examined to ascertain whether it actually solves the problems to which it is directed.

⁵¹ *Id.* at 165.

⁵² Notice that in such areas rail mergers may have the effect of reducing what is essentially a duopoly or oligopoly to a monopoly, *i.e.*, one railroad company being the only form of transportation available to shippers. Such a situation undoubtedly would create a tendency toward more pervasive regulation as well as increase the importance of the ICC's role as a watchdog.

III. THE RATIONALE OF MERGER—ARGUMENT FOR

Today, there exists an unparalleled harmony between the industry and government in an acceptance of the government's long standing policy favoring rail consolidations. The records of official debate concerning the railroads are replete with statements supporting consolidation programs, many of which favor compulsory consolidations;⁵³ and Congress has acted three times to promote consolidations. The most recent semi-official policy statement on railroad mergers may be found in the Doyle Report:

The first consideration of national policy should be to remove the legislative obstacles so far as possible and at the earliest possible moment. Such concepts as "preserving competition as far as possible" or "avoiding a substantial lessening of competition" and the "preservation of existing trade routes" must be abandoned in light of the intensive competition of other modes and a national need for revamping the traffic flow along direct main routes.⁵⁴

The industry's approach to merger seems to be presented fairly by James M. Symes, Chairman of the Pennsylvania Railroad: "If someone asked me what I consider the most important single thing the railroads can do to get the industry back up to its healthy and vigorous status of 30 years ago and ready to take a progressive place in the transportation of tomorrow you have been talking about, I would answer in one word—mergers."⁵⁵

Those who favor merger divide their argument into four categories: (1) cost reduction, (2) service improvement, (3) optimum utilization for the national defense, and (4) reduction of difficulties in regulation. A fifth category comprising answers to those opposing merger is included in this analysis.

A. Cost Reduction

Railroads seeking merger consistently have listed the reduction of cost as one of the primary motives.⁵⁶ Gilbert Burck estimated potential

⁵³ Staff of Senate Comm. on Interstate and Foreign Commerce, 87th Cong., 1st Sess., Preliminary Draft of Report on National Transportation Policy 229-72 (Comm. Print 1961) [Doyle Report].

⁵⁴ Doyle Report, *op. cit. supra* note 53, at 267.

⁵⁵ Doyle Report, *op. cit. supra* note 53, at 229. Remarks at Southern Research Institute Conference on Tomorrow's Transportation, Birmingham, Alabama, Sept. 30, 1960.

⁵⁶ Indeed, the magnitude of the estimated savings is astounding.

<i>Companies</i>	<i>Estimated Savings per year</i>
Mobile & Ohio-Gulf, Mobile & Northern	\$700,000
Louisville & Nashville-Nashville, Chattanooga & St. Louis	\$3.5 million
Norfolk & Western-Virginian	\$12 millions (before tax)

(Continued on page 453)

savings of one billion dollars annually if the railroads were unified in four regional systems,⁵⁷ although he admitted these savings could not be attained in the early years following combination. The efficiency of the resultant entity may depend on the type of merger pursued. For instance, unification of parallel and competing lines may offer an opportunity to reduce expenses radically by destruction of dual trackage and facilities such as repair shops and terminals. On the other hand, the potential savings in an end to end type consolidation may come from the ability to provide through service.⁵⁸

The savings with respect to *operating expenses* could be achieved by (a) reduction of interchange of locomotives and cars at major terminal areas, allowing better use of power and crews and maximizing the mileage between service stops; (b) modernization of joint classification yards, reducing the large cost of this operation; (c) making up through trains which can use the most efficient route; (d) introduction of one way tracks where parallel lines now exist; (e) simplification and centralization of car repairs, resulting in fewer cars returning home for repair and a decrease in the cars necessary for operations; (f) consolidation of schedules to achieve adequate service with a minimum number of cars; and (g) standardization of signals, ruling grades, and operating rules.

Although the savings to be obtained through *unified management* are not as large as those in operating expenses, they are more certain: (a) the number of employees involved in traffic solicitation, advertising, public relations, and accounting would be reduced; (b) many offices could be abandoned; (c) computers would perform much work now duplicated; (d) cars would be purchased on a volume basis; and (e) management could be decreased.

The *financial advantages* are: (a) consolidation of terminal facilities and dual trackage enabling a reduction in real estate investment and the taxes imposed thereon, and (b) more adequate long range financial policies and the improvement of the industry status in the financial markets.

(Continued)

<i>Companies</i>	<i>Estimated Savings per year</i>
Atlantic Coast Line & Charleston- Western Carolina	\$300,000
Erie-Delaware, Lackawanna & Western	\$13.5 million

Hearings on Rail Merger Legislation Before the Senate Subcommittee on Antitrust and Monopoly, 87th Cong., 2d Sess. 893-98 (1962).

⁵⁷ Burck, *A Plan to Save the Railroads*, Fortune, Aug. 1958, p. 82.

⁵⁸ The type merger involved is an important determinant of the extent to which competition will be destroyed. In mergers of parallel competing carriers, the saving is accomplished by actions that destroy competition, *i.e.*, abandoning dual facilities and tracks.

B. *Service Improvements*

Railroad freight service has deteriorated in recent years both in frequency of service and dependability of delivery. Timely delivery is made virtually impossible because of long delays in interchanging cars. Efforts to economize by operating fewer, but longer, trains have resulted in crowding at intermediate and terminal yards, often not equipped to handle the situation. Because many companies may handle a particular shipment, the initial railroad is unable to guarantee delivery time. The evils attending the division of responsibility if several railroads handle a single shipment would perish in an extensive consolidation program. Service and delivery time could be guaranteed. More frequent service between major areas would be provided in economically sized trains. Greater speed in long-haul service would be possible. Branch and feeder lines could be geared into fast main-line schedules. The better service provided in a consolidated system would enable railroads to reclaim lost profits by competing more effectively with trucks. Less-than-carload business would be more profitable under a unified system. And finally, piggy-back operations should prosper with the general service improvement.

C. *National Defense*

In the event of war, it would be necessary to mobilize the railroads into a working unit with a minimum of time. This could be accomplished more easily with fewer firms.

D. *Reduction Of Difficulties In Regulation*

Consolidations might transform the almost impossible job of regulating over 500 railroads into a very reasonable task. Less administration of routing regulations and the division of rates along with the reduction of tariffs to be approved would lift burdens from the Commission. Also, the volume of litigation would decrease.

E. *An Answer To The Critics*

Those who decry railroad consolidations on the ground that competition would be destroyed are mistaken in two respects. First, effective intraindustry competition does not exist. The railroads are notorious for their friendliness toward collective action.⁵⁹ Rate com-

⁵⁹ In 1947, Robert R. Young, President of the C. & O., spoke out against William T. Faricy, President of the Association of American Railroads as follows:

Mr. Faricy argues that if the roads did not practice deliberate slowdowns so that each road has the same schedule, they might have to run shorter trains and more of them. . . . Mr. Faricy would deplore having what he calls freight "speed wars" (on trains now averaging 20 miles per hour)—just as a little while ago some of the roads deplored "quality wars" when they voted to suppress air conditioning. What is wrong with "quality wars" and "service wars"? *Railway Age*, Aug. 23, 1947, p. 335.

petition is all but prohibited because of the bureaus. Service improvements are rare;⁶⁰ when forthcoming, they are the product of collective action, not of intraindustry competition.⁶¹ Innovation seldom is profitable in the railroad industry because of the requirement of standardized equipment.⁶² Second, the reasons for past concern over preserving competition have vanished. Although it is true that some towns would be served by only one railroad, effective interindustry competition is so intense that the public would be protected.⁶³ Competition through piggyback services from small towns into large centers would constitute additional protection. Actually, fierce interindustry competition keeps management on its toes and calls forth efficient service.⁶⁴ Finally, in the areas in which true monopoly conditions exist (*e.g.*, bulk commodities), the Commission is empowered to protect the public interest.

IV. THE ARGUMENT AGAINST MERGER

The arguments against a general policy favoring railroad consolidations are almost as varied as the sources from which they come. It is not uncommon to find labor unions, cities, states, other railroads, non-profit organizations, and the Department of Justice all opposing a merger because of legitimate interests each has. The arguments range from a fear of financial giants, to belief in a competitive railroad system, to doubts of the functional efficiency of large systems.

A. *Economies Of Density And Scale*⁶⁵

Many of the hopes of solving the financial problems of railroads through mergers are based on the notion that economies can be

⁶⁰ "We haven't improved the service enough in the last 40 years to stick in your eye." McGinnis, *Radical Cures for Railroad Ills*, Commercial and Financial Chronicle, Nov. 7, 1957, p. 2013.

⁶¹ Conant, *Railroad Consolidations and the Antitrust Laws*, 14 Stan. L. Rev. 489, 492 (1962).

⁶² *Ibid.*

⁶³ "In view of the virtually overwhelming competition the railroad finds for the preponderance of its valuable traffic, the adherence to this bias [intraindustry competition] is most unjustified and is not in line with a proper conception of public interest." Doyle Report, *op. cit. supra* note 55, at 260. "With the growth of alternative modes of transportation, intramodal competition between railroads should become less important and the idea of railroad monopolies at many service points will be no longer repugnant." Tucker, *The Public Interest in Railroad Mergers*, 29 ICC Prac. J. 342, 347-48 (1961).

⁶⁴ The introduction of more powerful engines which provide faster freight trains and the design for specialized types of freight cars were the result of motor truck rivalry. Barriger, *Super Railroads to Meet Post-War Rivalry*, Railway Age, Oct. 18, 1941, p. 610. Lighter, streamlined passenger trains were the result of airline and bus rivalry. Kelly, *Re-Making Transport Package*, Railway Age, Feb. 17, 1940, p. 330.

⁶⁵ The conclusions suggested under this heading are drawn from Healy, *The Effects of Scale in the Railroad Industry* (1961) and Healy, *The Merger Movement in Transportation*, Am. Econ. Rev., May, 1962, p. 436.

achieved by eliminating parallel trackage and terminal facilities. The rationale is that the density of traffic over one line would increase substantially, thereby reducing the cost of providing service over that line. Professor Healy discovered that in some cases economies in fact can be achieved by mergers of parallel lines. Once annual revenue per mile of road reaches 50,000 dollars, however, the ability to produce savings through merger appears very doubtful. Professor Healy could find no relation between density and any measure of performance for the large Eastern roads whose revenues generally are above this level.⁶⁶

Quite another matter is the optimal size at which a railroad can operate. Here, Professor Healy found that economies of scale can be achieved in a railroad with up to 5,000 employees; diseconomies of scale set in at above 10,000 employees.⁶⁷ Comparisons of companies which have 80,000 employees with those having 10,000 suggest that the return on capital for the latter is at least three percentage points higher, more than double that of the larger companies.⁶⁸ (These conclusions take into account the effect of traffic density.) There are several explanations for this behavior. First, larger companies are not able to increase the size of their operating units. Merged companies would use the same centralized traffic control, locomotives, passenger and freight cars that they now do. Second, smaller lines attract business because of better communication, faster response, and the understandings they are able to reach with shippers. Friction, inertia, and lack of individual initiative are characteristic of the larger firms and cannot be located as easily as they might in a manufacturing enterprise where quality control over products serves as a test. The combination of poor morale and inability to check on employees is significant because in the railroad industry wages usually are equal to fifty per cent of revenue.

B. A Competitive Rail System

With the advent of intense competition from water carriers in the shipping of bulk commodities and from trucks in the shipping of

⁶⁶ Healy, *The Effects of Scale in the Railroad Industry* 3 (1961). The Pennsylvania, New York Central, and Baltimore & Ohio are already well over the 50,000 dollar annual revenue per mile figure.

⁶⁷ *Id.* at 8. The large Eastern roads each employ more than 10,000.

<i>Company</i>	<i>Number of Employees</i>
Pennsylvania	103,000
New York Central	82,000
Baltimore & Ohio	46,000
Seaboard Air Line	15,000
Atlantic Coast Line	19,000

⁶⁸ *Id.* at 3. Compare Table 1 (railroads ranked by number of employees) and Table 7 (railroads ranked by return on capital). *Id.* at 8, 37.

high value goods, it is argued that interindustry competition complemented by Commission supervision would be sufficient to protect the public interest. Reliance upon this form of competition, however, involves several assumptions. First, the various transportation industries have different cost characteristics which provide each with certain sheltered markets.⁶⁹ In such circumstances the threat of ICC action would be the only force which could be relied upon to protect the public interest. Second, many markets are not served by other modes which are effective substitutes for railroads. This would be particularly true in bulk commodity items in areas where water transportation is not available. Again the only solution would appear to be reliance on the regulatory body to insure "good service at reasonable rates."

Such a solution is hardly consistent with the approach outlined by President Kennedy in a statement to Congress: "It [adequate transportation at the lowest possible cost] means greater reliance on the forces of competition and less reliance on the restraints of regulation."⁷⁰ Neither is such an approach in harmony with what shippers consider protection. The Department of Justice listed the following examples in its brief in the Atlantic Coast Line-Seaboard Airline merger:

Thus, the Dixie Plywood Company of Tampa stresses the importance of alternate rail service. Its representative testified that competition makes for better service, pointing out, for example, that a railroad is more apt to abide by its schedules if there is competing rail service.

Similarly, the traffic manager of Burnett Bros. of Tampa testified that competitive rail service means better and faster service.

The St. Regis Paper Company vigorously opposed the merger, pointing out the various ways in which a competitive rail service, such as is now provided by the SAL-ACL, results in a more adequate transportation system. In fact, it is the company's policy in selecting a site for a major mill to choose a location served by more than one railroad, because its experience at three major plants where it is served by a single railroad has been that the rail service is considerably inferior to

⁶⁹ Even if interindustry competition were sufficient to protect all the public interests, intraindustry competition has certain unique characteristics. It is only in competition between firms in the same industry that each competitor has similar cost structures and products, so that each can come close to duplicating a rival's prices and services. In contrast, interindustry competition must always be limited, for the differences in cost structure from one industry to another provides sheltered markets in which one industry has an inherent advantage over all rivals. For this reason, competition within an industry is considered necessary in both the literature and economics and the interpretations of the antitrust laws in order to provide the competitive pressures necessary to fully promote efficiency, progress, and lower prices. Meyer, *op. cit.* *supra* note 39, at 240-41.

⁷⁰ Message from the President of the United States Relative to The Transportation System of Our Nation, H.R. Doc. No. 384, 87th Cong., 2d Sess. 3 (1962).

that at its plants where there is competitive rail service. . . . [T]he elimination of this two line service could severely jeopardize the operations and adversely affect the company, its employees, and the general public.⁷¹

The President of Virginia Carolina Chemical Corporation, a fertilizer company, testified that: "For a number of years, the company's mines were served by only one railroad, but since joint service has been available, service has improved, and the carriers have been very cooperative. It has been possible under two line service to obtain better equipment, better switching service, and better car supply."⁷²

Mr. Stan Thomas, General Solicitor of the Atchison, Topeka, & Santa Fe, in a speech before the Southeastern Association of Railroad and Utilities Commissioners, noted that "regulation alone cannot insure the aggressive and continuing development of the transportation service which is essential to our economy."⁷³ He added further:

There are real advantages to the public from competition between railroads. Aggressive competition between individual railroads has a direct relation to the pricing of service generally, to rate innovations, to the faster improvement of service, to the furnishing of equipment, to the provision of accessorial services—to name only a few items. This is evidenced by the general preference of shippers to locate plants where they can be served by more than one railroad.

Such competition has also furthered the efforts of the railroads to meet the competition of other forms of transportation. For instance, if one railroad decides the best way to meet competition is to install piggyback service with reduced rates between two points, other railroads must go along if they want to remain competitive. In this and in many other ways, the initiative of many individual railroads produces developments which might not otherwise have taken place as quickly or perhaps not at all.⁷⁴

C. *Other Objections On The Merits*

Other objections not discussed here are the increased power merged companies would have in the Association of American Railroads, the loss of jobs for union members, the injurious effect on community growth, the possible abuse of power in control situations, possible abuses in the securities markets, and the risk of financial ruin leading to nationalization of the railroads.

D. *Soundness Of The Railroads' Approach To Merger*

Although none of the foregoing objections relate to mergers of

⁷¹ Railway Labor Executives' Association, *Railroad Merger Mania: Its Causes and Cure* 107 (1962).

⁷² *Id.* at 108.

⁷³ *Id.* at 69.

⁷⁴ *Ibid.*

smaller companies, particularly those in need of financial assistance. the soundness of the entire merger movement may be questioned because of the approach taken by the railroads. One example, which certainly is not atypical, should suffice.⁷⁵ In 1956, James Symes, now chairman of the Pennsylvania, approached Young and Perlman of the New York Central with a proposal for a gigantic merger. The Central stated that it did not believe such a huge system would be in the public interest, but agreed to study the suggestion. The studies indicated annual savings of one hundred million dollars, but the New York Central avoided any direct move toward consolidation. Instead, it referred the matter to the Eastern Railroad Presidents' Conference for consideration of the feasibility of creating three or four balanced systems in the East. When nothing came of this, Perlman of the New York Central proposed a three way merger to the Pennsylvania and the Chesapeake & Ohio. Touchy of the Chesapeake & Ohio felt that his railroad could not maintain its four dollar dividend payments or its financial strength in a merger with both roads, and suggested that the Chesapeake & Ohio unite with the Baltimore & Ohio before entering the proposed merger. Such a move, however, would have left the New York Central holding the bag. The Pennsylvania with its affiliated roads and the B & O-C & O would have comprised two large eastern systems which could have damaged the New York Central. Specifically, the New York Central depended on the C & O for coal traffic which probably would have been diverted to the B & O. When proposals that the ICC investigate the entire merger situation failed (delay tactics), in self defense the Central attempted to better the C & O offer to the B & O. A wild affray erupted to enlist the support of the B & O shareholders, which the C & O interests eventually won. The highlight of the campaign was an attempt by each company to enlist the support of Swiss bankers who held over twenty per cent of the B & O shares. The Central later attempted to block the B & O-C & O union in the ICC, but was forced to withdraw in self defense because in the meantime it had opened negotiations with the Pennsylvania, and Central did not wish to be placed in the anomalous position of opposing merger one day and proposing it the next.

The truth is that merger begets merger. Once the movement begins, companies are forced to look for suitable merger prospects. Otherwise, they may find their traffic diverted to other roads or they may be squeezed into a merger at an unfavorable exchange rate.

⁷⁵ This material is taken from Burck, *Mating Time for the Railroads*, Fortune, Jan., 1961, pp. 119-21.

Because of the size of the companies involved, ill-considered mergers could have serious effects. More penetrating regulations, perhaps to compel favorable realignment, would be necessary. And, of course, the failure of the eastern mergers could lead to nationalization of the railroads.

Under the present regulatory scheme the ICC does not take the initiative in proposing mergers.⁷⁶ The Commission does have the power to determine its own procedure,⁷⁷ however, and consideration of the cases on a regional basis would seem preferable since the Commission appears willing to allow consolidation. This method would insure that the same criteria would be used to test all merger applications and would prevent the Commission from being compelled to approve later mergers because of the situation created by earlier approvals. Finally, the Commission has the power to institute an inquiry on its own motion,⁷⁸ a power that could be used to investigate the merger proposals generally.

V. SPECIFIC CASES

The focus of this Comment heretofore has been general, its purpose to picture the railroad industry in its regulatory scheme and to etch the framework within which the Commission considers merger applications. Two recent merger decisions will now be placed within that framework and examined to determine the role antitrust legislation plays in the application of the National Transportation Policy to mergers. In December of 1962, the ICC approved the Chesapeake & Ohio Railway's purchase of control in the Baltimore & Ohio Railroad.⁷⁹ One year later the Seaboard Air Line Railroad-Atlantic Coast Line Railroad merger was approved.⁸⁰ The C & O-B & O union combined firms with assets valued at over two billion dollars, and the Seaboard-Atlantic Coast merger produced a new company with over one billion dollars in assets. These decisions are important not only as isolated cases, but as precedents which will control in the multitude of merger proposals now scheduled for hearing in the ICC.⁸¹

⁷⁶ *St. Joe Paper Co. v. Atlantic Coast Line R.R.*, 347 U.S. 298, 305-06 (1954).

⁷⁷ 54 Stat. 913 (1940), 49 U.S.C. § 17(3) (1958) permits the Commission to determine its own procedure under any provision of law in such manner as best will promote the proper dispatch of business and the ends of justice.

⁷⁸ 54 Stat. 910 (1940), 49 U.S.C. § 13(2) (1958).

⁷⁹ *Chesapeake & O. Ry.—Control—Baltimore & O.R.R.*, 317 I.C.C. 261 (1962), *aff'd sub nom. Brotherhood of Maintenance of Way Employees v. United States*, 221 F. Supp. 19 (E.D. Mich. 1963).

⁸⁰ *Seaboard Air Line RR.—Control—Atlantic Coast Line R.R.*, — I.C.C. —, Finance Docket No. 21215 (Dec. 2, 1963).

⁸¹ In the narrow and literal sense, the transaction proposed was the control of the B & O by the C & O. What these parties actually propose, however,

A. *The C & O-B & O*

The C & O-B & O combination was characterized by the majority opinion as an alliance of a "weak" and a "strong" road. The B & O's net income had decreased steadily from a profit of twenty-four million dollars in 1957 to a deficit of thirty-one million dollars in 1961. Because of its financial deterioration, the normal overall maintenance program had been neglected. In addition, its car fleet had become seriously inadequate. The C & O had the financial strength to aid the B & O and had completed a study of B & O's weakness which resulted from the C & O's proposal to help its affiliate with a five-year program directed at the modernization of its entire plant.⁸² The majority held that "a complete rehabilitation program must be completed to reduce maintenance expenses"⁸³ and that "unless maintenance expenses are reduced, B & O will be in no position to increase its earnings."⁸⁴ The Commission's conclusion that "the record clearly reflects the complete inability of B & O by itself to improve its financial position"⁸⁵ actually sealed the case. The C & O rehabilitation plan, which will cost 232 million dollars over the next five years, eventually will net the parties estimated savings of forty-five million dollars as well as make the B & O a stronger carrier. The Commission concluded by noting that because the carriers were generally complementary, there would be no material lessening of competition and the transaction would assist in effectuating the overall transportation policy.

Although the C & O-B & O case is important in several respects,⁸⁶ this analysis is devoted exclusively to the antitrust issues presented.

is to become one of three giant rail systems in the East. The proposed three-rail system in the East, together with merger negotiations and proposals involving other regions, presents one fundamental issue: What kind of railroad system should the present generation leave to the generations that follow? *Chesapeake & O. Ry.—Control—Baltimore & O.R.R.*, 317 I.C.C. 261, 298, *aff'd sub nom. Brotherhood of Maintenance of Way Employees v. United States*, 221 F. Supp. 19 (E.D. Mich. 1963).

⁸² A five-year program of building and repairing freight cars; improving freight yards and tunnel clearance; modernization of coal and ore handling facilities; installation of traffic control systems; and improvements to track and bridge structures, roadway machinery, and system servicing facilities was proposed. *Id.* at 275.

⁸³ *Id.* at 278.

⁸⁴ *Ibid.*

⁸⁵ *Id.* at 279. In addition to the above mentioned problems of B & O was the fact that current liabilities exceeded current assets by 24.9 million dollars. A 15 million dollar bank note due in May, 1962, had been extended only to the end of 1967, and the B & O had practically no unencumbered assets to offer as security for long term loans. *Ibid.*

⁸⁶ First, the decision rejected the suggestion that all of the merger cases for the eastern region be consolidated for hearing to prevent the initial cases from prejudicing those still pending. Second, it authorized the union of two companies with assets totaling over 2 billion dollars, which apparently sets the stage for large scale consolidation in the East. Third, the approach involved indicates the Commission's willingness to rely on regulation by the agency as opposed to reliance on competition.

It is noteworthy that neither the majority opinion nor the dissent devoted more than one page to antitrust issues as such. The explanation is that the C & O and the B & O cannot fairly be called competitors. Further, the antitrust issues are hidden under the cloak of diversion of traffic from other roads. For instance, the New York Central depends on the C & O for a substantial amount of coal traffic. Since the Central is competitive with the B & O, Central reasonably feared that the C & O would divert traffic then going to the Central to the B & O, its new subsidiary. The majority avoided this issue by accepting the C & O-B & O estimates of traffic diversion, which indicated that of the 66,485 cars interchangeable with the Central, only 2,192 or about three per cent would be diverted. The dissent accepted the Central estimate that forty-one per cent of its traffic would be diverted, enough to cause eventual financial ruin.

Although it is impossible to tell which estimate is correct, it is certain that some parts of the market now open to the Central will be foreclosed. The B & O serves forty and the Central thirty-nine of the forty-three major cities to be served by the C & O-B & O system. In cases where the C & O presently routes traffic to these cities on either the B & O or the Central, it is reasonable to expect that competition will end. This conclusion is buttressed by the nonexistence of rate competition in these areas. The initial blow to the Central's revenue may have long range effects (the majority said no, the dissent yes), such as depriving the Central of funds necessary to maintain facilities. On the other hand, portions of the Central's forty-one per cent traffic diversion results are based on the supposition that the B & O would attract the Central's business because of better service.

An approach to the competition issue through the antitrust laws yields an analogy to vertical integration cases under the Clayton Act.⁸⁷ For instance, if one of two competitors purchased control of the only supplier within reasonable shipping distance, the purchasing market for the other business might be eliminated.⁸⁸ Such a purchase would be condemned under the Clayton Act. On the other hand, the antitrust laws generally are not violated by vigorous competition, even though harmful to other businesses. The distinction drawn by the antitrust laws is important because it aims at achieving a rational allocation of resources.

⁸⁷ 38 Stat. 730 (1914), 15 U.S.C. §§ 12-27 (1958).

⁸⁸ This hypothetical situation assumes that the supplier can continue to dispose of a large percentage of its output to companies not competitive with its parent.

B. *Seaboard Air Line Railroad Company—Merger—Atlantic
Coast Line Railroad Company*

Unlike the C & O-B & O combination, the proposal in this case concerned the merger of two profitable roads whose lines were parallel and competing. During the years 1955 to 1962, Seaboard's annual net income averaged 16.4 million dollars. In 1961, Seaboard earned a net income of 14.6 million dollars, representing a return of 3.84 per cent on the depreciated value of property used in transportation operations, plus cash and the cost of materials and supplies.⁸⁹ The Company's net income for 1962 was 18.1 million dollars and the corresponding return was 4.65 per cent.⁹⁰ The average net income for Atlantic Coast during the same eight-year period up to 1962 was 11.3 million dollars.⁹¹ Net income for 1961 was 10.8 million dollars, a return of 2.39 per cent, but in 1962 the Company earned 16.1 million dollars, increasing its return to 3.52 per cent.⁹² The Commission concluded that "both Seaboard and Coast Line have enjoyed a moderate degree of prosperity over the past several years and each railroad is currently in a relatively healthy condition."⁹³

The Commission dealt with the competition issue by specifically holding that "the reduction of rail competition caused by the proposed merger will not be substantial. . . ."⁹⁴ However, implicit in the foregoing statement is that some competition would be forfeited and the opinion so held. The applicants served 121 common points over a six-state area. The merged company had over fifty-four per cent of the total rail mileage in this area, while the Southern Railway, its nearest competitor, had about thirty-four per cent. In Florida, the new Company owned approximately eighty-one per cent of the rail mileage. The effect of the consolidation was to end competition between the two on one-third of their combined total tonnage, but over half of this amount remained competitive with other railroads.⁹⁵ The areas in which the merger created a monopoly comprised only fifteen per cent of the retail business and ten per cent of the wholesale busi-

⁸⁹ Seaboard Air Line R.R.—Control—Atlantic Coast Line R.R., — I.C.C. —, Finance Docket No. 21215, App. VIII (Dec. 2, 1963).

⁹⁰ *Id.* at 35. See also *Id.* App. VIII.

⁹¹ *Id.* at 36. See also *Id.* App. IX.

⁹² *Ibid.*

⁹³ *Id.* at 36.

⁹⁴ *Id.* at 62.

⁹⁵ [O]f a total freight traffic of 1,859,863,046 hundred pounds, 620,757,508 hundred pounds, or 33.4 percent of their total tonnage was competitive between the applicants. Of the total Seaboard-Coast Line competitive traffic, 366,060,076 hundred pounds or 19.7 percent of their total tonnage would remain competitive with other railroads after the merger, and rail competition would be eliminated after the merger on 254,697,432 hundred pounds, or about 13.7 percent of their combined total freight tonnage. *Id.* at 56.

ness. The average population of cities outside of Florida deprived of competitive rail service was only 6,500, and every city with a population in excess of 200,000, except Tampa, was still served by at least two roads.

On the issue of competition, the Commission characterized its task as one of accommodating section 5⁹⁶ and the antitrust laws.⁹⁷ What actually occurred is more accurately expressed by the Commission as follows: "Our primary task is to reconcile the objective of 'preventing injurious waste and in securing more efficient transportation service' . . . with the *general concern of Congress* 'that tendencies toward concentration in industry are to be curbed in their incipency'"⁹⁸ One fundamental issue is presented: "Are the antitrust laws and the decisions which give them meaning a specific consideration in merger deliberations before the ICC?" The policy implications in the answer to this question are immense. This was the first merger proposal to face the Commission in which both companies had prospered under competition. The decision in this case should determine to some extent the future of the railroad industry in the United States. Thus, there was a pressing need for a comprehensive definition of the role competition is to play as an element in the National Transportation Policy.

Unfortunately, the Commission answered the question in the negative by default. First, the phrase "consistent with the public interest" was interpreted to mean not contradictory or hostile to the public interest.⁹⁹ Notwithstanding prior decisions, it is submitted that something more is required in this case and the many other railroad merger proposals which will follow. This decision forfeited competition on traffic which yielded revenues of 130 million dollars annually. Certainly, even under a vague notion of Congressional concern for the preservation of competition, substantial benefits are needed to justify such action. The justification for the decision lay essentially in the estimated twenty million dollars annual savings before taxes.¹⁰⁰ The Com-

⁹⁶ See note 15 *supra* and accompanying text.

⁹⁷ Seaboard Air Line R.R.—Control—Atlantic Coast Line R.R., — I.C.C. —, Finance Docket No. 21215, at 113 (Dec. 2, 1963).

⁹⁸ *Id.* at 9. (Emphasis added.)

⁹⁹ *Id.* at 10. Patently, this statement is meaningless as a legal proposition because it ignores definition of the crucial term "public interest." It is significant, however, because it indicates the attitude of the Commission toward merger proposals.

¹⁰⁰ The net saving before taxes as a result of the merger was estimated by the applicants to be over 38 million dollars annually. This cost reduction was to be achieved by abandoning track; abolishing jobs; eliminating duplicate passenger service; pooling equipment; consolidating stations, terminals, and offices for management; and abandoning unnecessary repair shops. *Id.* App. X. The Commission estimated savable expenses to be a minimum of 20 million dollars before taxes, thus setting the stage for a holding that the merger would assist in "the avoidance of injurious waste and the development of a more

mission held that "it is axiomatic that the elimination of wasteful and unnecessary facilities and services will eventually redound to the public generally."¹⁰¹ However, this axiom begs the essential question for it assumes that regulation can be so effective that the need for competition is lessened substantially. If this correctly states the approach or the attitude of the Commission, and it was characterized as such by the dissent,¹⁰² then one might predict the eventual consolidation of the railroads into a few regional monopolies. Two additional facts lend support to this possibility. First, the Commission retained jurisdiction of the merger for five years to allow the "weak lines" (which are also the smaller lines) to petition to be included in the transaction. These weak lines include some of the same lines which opposed the merger on the ground of traffic diversion. Second, the majority drew what the dissent termed an "anomalous analogy" between railroads and utilities (gas, electric, telephone). The majority opinion noted that "a single company frequently serves large metropolitan areas and often even significantly larger geographic or market areas"; that "*under regulation*, their services, as a general rule, are efficient and reasonably priced despite absences of competition"; and finally that "*as railroads have the basic economic characteristics of public utilities and are subject to regulation in the public interest* at both the federal and state levels, it is not realistic to insist that intramodal rail competition must be preserved at all places, at all times and under all circumstances."¹⁰³

The Seaboard decision held that the proposed merger would not substantially reduce *rail competition*. Yet the decision devoted considerable energy to prove the proposition that: "With the development of intense competition in recent years from other modes of transport, the preservation of intramodal rail competition has lost much of its significance in the furtherance of the overall national

efficient transportation system"; *Id.* at 112, and therefore would be consistent with the national transportation policy. Actually, the holding considered all of the criteria in 54 Stat. 905 (1940), 49 U.S.C. § 5(2)(c), and made specific holdings with respect to protection of the employees involved, as required by 54 Stat. 905 (1940), 49 U.S.C. § 5(2)(f), and for inclusion of other "weak" roads in the merger if they so desire during the next 5 years in which the Commission will retain jurisdiction. *Id.* at 113.

¹⁰¹ *Id.* at 114.

¹⁰² The report exaggerates the efficacy of regulation. Regulation, in my opinion, would collapse of its own weight if it were not for the existence of substantial competition. It is competition, not the Interstate Commerce Commission, which is the prime regulator of *railroad rates and charges and the principal deterrent to discriminatory practices*. In any event the Commission's excessive reliance on regulation flies in the teeth of the policy expressed by the Supreme Court in *United States v. Philadelphia Nat'l Bank*. . . . *Id.* at 137-38. (Emphasis added.)

¹⁰³ *Id.* at 61. (Emphasis added.) Notice the extreme conflict with the position taken by Professor Healy with respect to economies of scale in railroads. See note 65-68 *supra* and accompanying text.

transportation policy."¹⁰⁴ The decision actually attempted to "cover" the transportation service market in both its broad and narrow aspects. But the Commission never designated the relevant service market to be either rail transportation service or transportation service generally. With respect to the entire transportation industry, the Commission made several general findings about the development of modes other than railroads in the six-state area,¹⁰⁵ then in two sentences made its essential holding:

Additionally, motor carriers are increasing their long haul business *and are capable of handling practically any type commodity*. For example, in 1958, long haul movements by truck in excess of 100 miles constituted, *in various sections of the applicants' territory*, more than 19% of the total of such movements in the case of fertilizers, 30% of building materials, 59% of foodstuffs and beverages, 92% of paper mill products, 82% of cotton and cloth products, 68% of meal and 74% of miscellaneous products.¹⁰⁶

Certainly this brief statement cannot be interpreted as defining the relevant service market and the relevant geographical market. Yet on the basis of the examples offered, the Commission suggested that truck and rail service are almost perfectly interchangeable.¹⁰⁷ The facts are contrary.¹⁰⁸ First, each of the railroads' most important freight is phosphate rock, which the majority opinion was forced to characterize as "essentially a commodity normally handled by

¹⁰⁴ Seaboard Air Line R.R.—Control—Atlantic Coast Line R.R., — I.C.C. —, Finance Docket No. 21215, at 60 (Dec. 2, 1963).

¹⁰⁵ The Commission noted that between 1948 and 1959 truck registrations increased from 900,000 to 1,490,000 (66%); truck ton miles increased 147% (compared with 3% for the railroads); passenger miles increased 380% and those on inland waterways by 24% (compared with a 44% decrease for railroads); and that in the transport of crude petroleum, pipeline carriage had tripled, and truck carriage had increased from 6% to almost 25%. *Id.* at 36-39.

¹⁰⁶ *Id.* at 39-40 (Emphasis added.)

¹⁰⁷ The majority held that trucks are capable of handling any type commodity. *Id.* at 39. The dissent suggested that a "twilight" zone existed in which other modes were not competitive with the railroads (e.g. heavy-loading, low value bulk and unfinished goods and various piggyback plans) and that it constituted a submarket under the Brown Shoe doctrine. *Id.* at 145. See *Brown Shoe Co. v. United States*, 370 U.S. 294 (1962).

¹⁰⁸ The nine major commodities, in terms of tonnage handled by the two roads, are as follows:

<i>Seaboard</i>	<i>Coast Line</i>
Phosphate Rock	Phosphate Rock
Stone and Rock	Stone and Rock
Pulpwood	Pulpwood
Bituminous Coal	Bituminous Coal
Gravel and Sand	Gravel and Sand
Fertilizers, NOS	Fertilizers, NOS
Cement: natural and portland	Cement: natural and portland
Paperboard, Fiberboard and Pulpwood	Paperboard, Fiberboard, and Pulpwood
Bentonite	Products of Agriculture, NOS

Seaboard Air Line R.R.—Control—Atlantic Coast Line R.R., — I.C.C. —, Finance Docket No. 21215, at 150 (Dec. 2, 1963) (dissenting opinion).

rail."¹⁰⁹ Most of the other products which are significant were not specifically mentioned. The categories which were itemized *might be* broad enough to include some of the various products (*i.e.*, building materials might include stone and rock or paperboard, fiberboard, and pulpwood), but the Commission did not venture an estimate of the extent to which this was true. Fertilizer was the only product specifically considered which was an important item of carriage to both roads, but trucks account for only eighteen per cent of that traffic. The reference to "various sections of the applicant's territory"¹¹⁰ is too vague to have meaning. Much of the opinion focused on the six-state area and to some extent on Florida, which may constitute the geographical market in this case. But it is impossible to tell how much of that territory is encompassed in the area considered by the Commission.

Although definition of these markets would not be an easy task,¹¹¹ the alternative is to make an indecisive holding on the antitrust issue. The predicted savings then appear very attractive and the path is reasonably clear for a finding that the merger is "not contradictory or hostile to the public interest." This amounts to merger by default.

Thus, the Commission's apparent policy to favor concentration (and the necessary corollary, more extensive regulation) and its failure to define relevant markets creates a situation in which definitive treatment of the antitrust issues, in terms of the relevant statutes and case law, only serves to weaken the case for merger. In an effort to support its "general" approach to the competition issue, the Commission cited the *McLean* case¹¹² for the authority that the ICC need not base its conclusion as to whether competition will be materially lessened on the specific concepts developed in antitrust law. "Thus, here, the Commission has no power to enforce the Sherman Act as such. It cannot decide definitively whether the transaction contemplated constitutes a restraint of trade or an attempt to monopolize which is forbidden by that Act."¹¹³ This language does not support the proposition for which it is offered. The conflict in the *McLean* case was substantive, involving the *weight* which should be

¹⁰⁹ *Id.* at 39.

¹¹⁰ See text accompanying note 106 *supra*.

¹¹¹ The geographical market might be the six-state area, but ideally the submarkets would comprise the routes between two points. The service market then would have to be defined as intramodal or intermodal. If it is intermodal, it must be examined on several levels with respect to the type product handled. For some of these products in the bulk commodity class, the traffic would undoubtedly be competitive only among the rails. The definition of these markets in terms of products would be fantastically complex. Computers would ease this problem if they can be adapted for this purpose. Otherwise the technique of sampling which is now used in antitrust cases would be the best solution.

¹¹² *McLean Trucking Co. v. United States*, 321 U.S. 67 (1944).

¹¹³ *Id.* at 79.

placed on the effect on competition of a proposed merger. The issue presented in the Seaboard case was what *method or procedure* the Commission should adopt to properly assess the anticompetitive effects involved. This issue was not presented in the *McLean* case. In that case, there was no disagreement about the method of measuring the effect on competition. Moreover, at that stage in the development of the antitrust law, such terms as "the relevant market" were unknown, and it is improbable that the present controversy over the *technique* of determining the effects on competition ever would have arisen.¹¹⁴

If the Commission is going to consider the anticompetitive effects at all, then it must do so within some frame of reference which provides an opportunity for meaningful conclusions. The concepts developed in antitrust litigation are the only instruments available for this task and certainly provide more reliable standards than "the general concern of Congress that tendencies toward consolidation in industry are to be curbed in their incipiency."¹¹⁵ If the concepts of antitrust law are used, then the adverse effects can be weighed against the potential benefits, and the Commission can balance the conflicting interests to reach a rational decision. Any other method of accommodating section 5 and the antitrust laws¹¹⁶ is meaningless because any conclusion reached on the issue of competition would have no rational basis.

The statutes¹¹⁷ which govern this area do not begin to suggest the proper role of competition in the transportation industry. The Commission's duty is *to consider* the anticompetitive effect, but the framework or policy within which this issue is to be considered is completely lacking. To say that the competitive effects must be *weighed* against other public benefits is insufficient when the relative importance of these conflicting goals is uncertain. One possible answer is that Congress entrusted the development of such a policy to the Commission. Assuming the validity of such a presumption,

¹¹⁴ Another argument for the specific application of the concepts developed under the antitrust law exists with respect to the Clayton Act, 38 Stat. 730 (1914), 15 U.S.C. §§ 12-27 (1958). The Commission has the authority under § 11 of the Clayton Act to enforce § 7 where applicable. Even the logic used in reaching the conclusion that the *McLean* case directs the Commission to apply general standards does not suggest that *McLean* foreclosed considerations of the issues in light of the Clayton Act (the *McLean* opinion refers specifically only to the Sherman Act, 26 Stat. 209 (1890), 15 U.S.C. §§ 1-7 (1958)). However, this argument is only technically valid because the question presented by the Clayton Act is essentially the same as that presented by the Sherman Act: "Are the antitrust laws (and the decisions which give them meaning) the proper standard for assessing the anticompetitive effects of a proposed merger?"

¹¹⁵ *Brown Shoe Co. v. United States*, 370 U.S. 294, 346 (1962).

¹¹⁶ See note 15 *supra* and accompanying text.

¹¹⁷ See notes 4-23 *supra* and accompanying text.

however, this policy has not been forthcoming. Thus, the reason for making an accurate estimation of competitive effects disappears because there is no meaningful framework within which they may be considered.

The consequences of Congressional failure to provide the ICC with a precise policy in this area have been twofold. First, it has placed the entire responsibility for such policy decisions upon the ICC, which usually avoids having to weigh the conflicting positions by simply holding that the lessening of competition is not substantial (e.g., the *Seaboard-Coast Line* case).¹¹⁸ Second, if the Commission avoids weighing the various positions, attack on appeal is almost impossible because of the nebulous way in which the competition issue has been approached.

Because the companies involved were large and prosperous and fairly could be called competitors, the *Seaboard-Coast Line* case offered an excellent opportunity for the Commission to reveal a comprehensive and definite policy on the place of competition in the industry. Instead, the Commission indicated its indifference to the precise facts which made this merger different from any other approved to date. The Commission conceded that: "There . . . is no provision in the act which expressly or by implication prohibits the merger of financially strong railroads. The act draws no distinction as between the strong and the weak, or between the competitive and non-competitive railroads."¹¹⁹ This statement cannot be challenged in the abstract, but it misses the point, for certainly the financial health of a railroad is a material factor in determining whether a merger proposal is in the public interest. For instance, it long has been the policy of the Commission to look with favor upon voluntary alignments between weak and strong roads. The purpose of such a policy is to permit integration with a stronger system to insure survival and to provide an opportunity for achievement of a profitable operation. Because a railroad's existence is at stake, the public "benefits" in securing its continued operation are substantial. On the other hand, the "public interest" becomes a highly nebulous term when applied to gigantic mergers of prosperous, competing companies. The Commission must face the delicate task of weighing the destruction of beneficial competition against increased efficiency in operation, then balance them in terms of the public interest. In such a situation, the ICC should, to fulfill its duty, make a conclusive holding on the competition issue based on concepts adapted

¹¹⁸ *Seaboard Air Line R.R.—Control—Atlantic Coast Line R.R., — I.C.C. —, Finance Docket No. 21215 (Dec. 2, 1963).*

¹¹⁹ *Id.* at 10.

from the antitrust laws. The extent to which competition would be diminished then would become a dominant consideration in merger hearings in which the benefits were uncertain or slight. This will occur more often, of course, in mergers between successful companies.

VI. THE OBJECTIVES OF MERGER

The parties proposing mergers today base their claims of public benefit on substantial economies to be achieved through consolidation, thus allowing railroads to compete more effectively with other modes of transportation. Generally, the first step after preliminary merger negotiations is to hire consulting engineers to make extensive studies, which are to indicate both the method and amount of the probable savings. Although the Commission re-examines the estimates, most applicants feel that these studies are indispensable in dealing with the ICC because of the aura of independence which surrounds them. The purpose of this section is to examine these estimates to determine if alternative ways short of consolidation exist which would accomplish similar savings. As is apparent, the section adopts the spirit of the *McLean*¹²⁰ dissent. That is, before granting the antitrust exemption to proposals which lessen competition, the agency should be satisfied that the proposed measures are necessary and that reasonable alternatives to attain these objectives do not exist.

Applicants in the C & O-B & O proceeding¹²¹ submitted estimates of over thirteen million dollars annual savings over a five-year period. Over ninety per cent of these savings were attributed to the consolidation of offices, pooling of equipment, and consolidation of stations and terminals. The dissent stated that "clearly those savings which are expected to stem from the coordination projects could be obtained just as easily through cooperative agreements."¹²² Equipment pooling (accounting for one-fourth of total savings) already had been started prior to the decision on control and fairly could not be said to be a result of it. Furthermore, coordinated terminal and station operations already existed between the C & O, the B & O, and the New York Central, so no further savings could be achieved in this area (over one-half of total savings).

Applicants in the Seaboard-Coast Line merger had a detailed esti-

¹²⁰ 321 U.S. 67, 92 (1944).

¹²¹ *Chesapeake & O. Ry.—Control—Baltimore & O.R.R.*, 317 I.C.C. 261 (1962), *aff'd sub nom. Brotherhood of Maintenance of Way Employees v. United States*, 221 F. Supp. 19 (E.D. Mich. 1963).

¹²² *Id.* at 307.

mate of over thirty-eight million dollars annual savings.¹²³ Significantly, the pooling of equipment and consolidation of stations and terminals also were to achieve large estimated savings in this case. Presumably, these could be handled in a fashion similar to that suggested in the C & O-B & O case. This technique also could be extended into other areas, *e.g.*, the elimination of duplicate lines and the consolidation of heavy repair facilities. Although these techniques fall short of merger, their primary purpose is to accomplish economies through the direct destruction of competition. The advantage of such an approach over merger is that the Commission can consider specific proposals. If the business level does not warrant another independent carrier in a particular market, then an application should be approved. On the other hand, if the market can support several efficient carriers, coordination programs should be discouraged.

Another objective of merger is to abandon lines and reduce the number of employees. Indeed, it appears that because of the Commission's restrictive policies the carriers feel the reshuffling incident to a merger is the only way to accomplish such economies. Needless to say, direct action is preferable when possible. Many abandonments would not be possible without merger, but, with the piggyback development in serving low density areas, a more liberal abandonment policy is justified. Companies thus would be allowed to combat the disease rather than its symptoms, which mergers attempt to attack. The same reasoning applies to reducing the number of employees, although the ICC would not have jurisdiction except in merger cases.

Another facet of this problem lies in the rate structure as enforced by the ICC. A reason frequently used to justify the consolidation of railroads into large regional systems is that a merger allows them to compete effectively with other modes. The underlying theory is that the fixed cost of larger companies is lower and justifies reduced rates. Although this argument runs directly counter to Professor Healy's

¹²³ List of selected important items:	<i>In Thousands</i>
Consolidation of stations and terminals	\$ 4,485
Elimination of duplicate lines	7,465
Effects of consolidation on lines retained	5,126
Duplicate freight service	1,413
Duplicate passenger service	1,234
Consolidation of offices, departments and divisions including off line offices	10,266
Effect on income of shorter and more economical routes	2,553
Effect on income of solicitation of freight for longer hauls	4,910
Pooling of equipment	2,216
Consolidation of heavy repair facilities	2,228
Effect of consolidation on property taxes	1,000
Seaboard Air Line R.R.—Control—Atlantic Coast Line R.R., — I.C.C. —, Finance Docket No. 21215, App. X (Dec. 2, 1963).	

findings on economies of scale,¹²⁴ the disagreement is academic under present regulatory policy. In some cases, railroads are prohibited from pricing down to fully distributed cost. The value-of-service method of determining rates and present levels of minimum rates may be the source of this problem. If so, perhaps a more desirable solution than large scale merger would be a re-examination of policies with an eye toward more competitive rail rates.

VII. CONCLUSION

Three aspects of the present merger movement make it unique. First, practically all major railroads are considering merger or are engaged in merger litigation, with the development of regional systems a very real possibility. Second, the railroads' general motive is the achievement of large savings through reduction of fixed cost. Third, the ICC seems willing to achieve the estimated gains at the expense of competition among the railroads.

The present movement has exposed several severe and pressing problems in the railroad industry which require immediate Congressional attention. Much of the legislation under which the ICC operates is out-moded to the extent that it creates problems in the industry. Two of the most important areas are the rules which govern abandonment procedures and those which sustain pricing through the rate-bureau technique. These problems suggest that a complete re-examination of the present legislation is desirable.

Even more damage has resulted from Congress' failure to provide the ICC with any meaningful statement of the national transportation policy as it applies to the role competition should play in the transportation industry. From the present regulatory legislation, one might conclude that the benefits or detriments derived from preserving competition are essentially the same in any regulated industry. However, the economic facts do not support such a conclusion. Congress should provide a more specific standard than the "public interest" for the ICC to consider in merger applications.

Although Congress is at fault for failure to provide the ICC with standards to apply to transportation mergers, the ICC has contributed to the confusion by its nebulous approach to the issue. If the preservation of competition is an important consideration in determining the public interest, then the ICC is under a duty to explore fully methods of achieving maximum benefits consistent with the basic policy of preserving healthy competition. Realizing that certain

¹²⁴ Healy, *The Effects of Scale in the Railroad Industry* (1961). See text following note 65 *supra*.

goals may clash with notions of preserving competition, the ICC is under a further duty to develop a policy which specifically assigns some weight to the competition issue relative to other benefits in a proposed merger. These obligations have not been fulfilled. The absence of such a policy has had the result of making a precise determination on the competition issue in terms of the antitrust laws unnecessary. This follows because even if antitrust concepts yield an estimate of the anticompetitive effects of a merger, no identifiable standard exists to evaluate the desirability of allowing merger notwithstanding the ascertained effects.

A great deal of the savings sought through merger could be accomplished in other ways, such as pooling agreements. The other objectives sought to be obtained by merger reduce to an attempt to avoid the unfortunate burdens imposed by out-moded regulatory law. Such mergers are aimed only at the symptoms rather than at the disease. The indication is that under a regulatory scheme which had a more liberal abandonment and rate policy, certain mergers might not be necessary or even desirable. Under present conditions, however, railroads appear to have no alternative other than merger to avoid difficult financial troubles.

In summary, while the basic source of policy should be Congress, the ICC, to the extent that policy decisions have been delegated to it, should attempt more precise holdings on the issues presented. A recommendation which is directed to the development of a clearer merger policy and more specific holdings is as follows:

- (1) Congress should direct the ICC to deny all merger applications which would substantially lessen competition unless it is satisfied that the specific benefits of that merger are absolutely necessary in the public interest and cannot reasonably be accomplished by alternative measures.
- (2) Congress should require the ICC to make a specific finding based on the antitrust laws and the cases under them to determine whether competition has been substantially lessened. The decision as to whether intermodal or intramodal transportation service constitutes the relevant market should be made on a case by case basis under the antitrust concepts.

The adoption of such legislation would place a heavy burden on the ICC. Measurement of the effects a merger will have on various markets and submarkets often will present complex problems. Another difficulty exists with respect to a determination of the type and amount of benefit which justifies substantial reduction of competition. However, the objective sought is that the vital questions at least be asked at the Commission level. Although the Commission

will continue to draw on its expertise in answering these questions, this approach has the value of exposing the Commission's weighing process to judicial as well as public scrutiny. Furthermore, periodic Congressional re-examination of transportation policy could be more meaningful if the issues developed by the Commission were clearly presented.