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## St. Louis and O'Fallon Railway Cases

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## COMMENTS

### ST. LOUIS & O'FALLON RAILWAY CASE

At last we have the decision of the United States Supreme Court in the celebrated case of the United States v. St. Louis & O'Fallon Railway Company;<sup>1</sup> but the decision is not what many had hoped it would be either from the standpoint of substance or from the standpoint of form, that is, as to what it decided or how it decided it.

In this much advertised case there was presented to the Supreme Court an opportunity to give a final and authoritative answer as to what is the correct rate base for the regulation of public utilities. In a number of preceding cases this same question had been presented to the Supreme Court; but the Supreme Court had not given what was regarded as the final answer to the question, although, beginning with *Smyth v. Ames*<sup>2</sup> where it announced as the rate basis "fair value"—a composite of a number of mutually exclusive factors, one which was reproduction cost—it had more and more been emphasizing reproduction cost, until with *McCardle v. Indianapolis Water Company*<sup>3</sup> it seemed to go over entirely to this theory, because it chose this as the basis of determining "fair value" to the exclusion of everything else.<sup>4</sup> The Interstate Commerce Commission had looked at the matter differently, and in spite of the prior attitude of the United States Supreme Court, when the St. Louis and O'Fallon Railway case came before it, it considered reproduction cost and used it in its split inventory method to determine the value of the property in 1914 and as to values of land, additions and betterments since 1914; but it refused to apply present reproduction cost to values before 1914, and turned aside to point out the economic fallacies of reproduction cost and the advantages of prudent investment as a standard of value for rate making purposes.<sup>5</sup> Consequently when the case was finally appealed to the Supreme Court it was hoped that the Supreme Court would either agree with the Interstate Com-

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<sup>1</sup> (1929) 49 Sup. Ch. 384.

<sup>2</sup> (1898) 169 U. S. 466.

<sup>3</sup> (1926) 272 U. S. 400.

<sup>4</sup> (1927) 3 Indiana Law Journ. 225-232.

<sup>5</sup> Excess Income of St. Louis & O'Fallon Railway Company (1927). 124 I. C. C. 4.

merce Commission, or if it disagreed would meet its arguments and take a position which would finally settle the matter.

Instead of doing either one of these things, the Supreme Court by a six to three decision took a third position. It did not undertake to answer the arguments of the Interstate Commerce Commission against reproduction cost. It did not expressly adopt reproduction cost as the exclusive rate base. It merely decided that the Interstate Commerce Commission had not given enough weight to reproduction cost. It took this position because paragraph 4, Section 15a of the Transportation Act of 1920 "directs that, in determining values of railway property for purposes of recapture, the Commission 'shall give due consideration to all the elements of value recognized by the law of the land for rate making purposes,'" and because it held that the elements of value recognized by the "law of the land" for rate making purposes had been pointed out by the Supreme Court in a long line of decisions, citing *Smyth v. Ames*,<sup>6</sup> *Wilcox v. Consolidated Gas Co.*,<sup>7</sup> *Minnesota Rate Case*,<sup>8</sup> *Southwestern Bell Telephone Co. v. Public Service Commission*,<sup>9</sup> *Bluefield Water Works v. Public Service Commission*,<sup>10</sup> *McCardle v. Indianapolis Water Co.*,<sup>11</sup> of which it specifically emphasized *Smyth v. Ames*, and *Southwestern Bell Telephone Co. v. Public Service Commission*, and that in these elements of value reproduction cost was included. Therefore, it concluded that reproduction cost was an element of value which had to be considered by the Interstate Commerce Commission, that it had not done this and therefore that its decree had to be reversed.

The answer to the majority opinion of the Supreme Court is threefold. First, as pointed out by Justice Brandeis and Justice Stone in their dissenting opinions, the Interstate Commerce Commission did give due consideration to reproduction cost as an element of value.

Second. Reproduction cost had not at the time of the passage of the Transportation Act in 1920 become recognized by the law of the land, as either the sole element of value of such

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<sup>6</sup> (1898) 169 U. S. 466.

<sup>7</sup> (1909) 212 U. S. 19.

<sup>8</sup> (1913) 230 U. S. 352.

<sup>9</sup> (1923) 262 U. S. 276.

<sup>10</sup> (1923) 262 U. S. 679.

<sup>11</sup> (1926) 272 U. S. 400.

paramount importance as one element, that the Interstate Commerce Commission could not itself decide what weight it should give to it when directed to consider all the elements of value recognized by the law of the land, even if Congress had otherwise been silent as to its intention. The McCardle Case was not decided until six years after the passage of the Transportation Act, and Congress could not, therefore, have had that decision in mind. Even the Southwestern Bell Case, and the Bluefield Water Works Case (cited by the majority opinion) were decided after the Transportation Act, and could not have helped to make reproduction cost any part of the "law of the land" to which the Act of Congress referred. *Smyth v. Ames* and the Minnesota Rate Case did not put reproduction cost in any such exalted position. *Smyth v. Ames* adopted as the rate base fair value, but in ascertaining fair value named as matters of consideration a number of mutually exclusive elements one of which only was "present as compared with the original cost of construction." The Minnesota Rate Case continued to wallow in the uncertainties of the kaleidoscopic rule of *Smyth v. Ames*. It follows that it was not only necessary but that it was contrary to its own prior decisions rendered before 1920 for the Supreme Court to read the meaning it did into the phrase "law of the land." How could the Supreme Court say that reproduction cost, as an element of value for rate making purposes, was a part of the law of the land in 1920 when neither it nor anyone else knew what was the law of the land on this point at that time?

Third. Congress was not altogether silent as to the meaning it intended to be given to the phrase "law of the land," for the Transportation Act itself shows that Congress intended no such meaning for the phrase as the Supreme Court read into it. If Congress itself had substituted for the phrase "law of the land" the phrase "reproduction cost"—as apparently the Supreme Court has done in practical effect, or "prudent investment"—as the Interstate Commerce Commission would do, the Supreme Court perhaps might conceivably have held that either of such actions was not due process of law, (although it probably would not and should not have done so); but it certainly could not have held that one as much as the other was not a part of the law of the land or that either had become permanently a part of the law of the land (as this phrase was used

in the act). The phrase was evidently used by Congress from superabundance of caution to make the act constitutional. Hence, Congress refrained from definitely naming the rate base in order not to raise the question of depriving the railroads of their property without due process of law, and simply said it should be whatever was the "law of the land." However, provided it was constitutional and if the only question was a matter of intention, Congress elsewhere in the act indicated very clearly that is desired as the rate base something more than reproduction cost, either alone or as the decisive factor. Justice Brandeis has fully developed this point.<sup>12</sup> Since the majority opinion did not raise a due process point but merely interpreted the meaning of the phrase "law of the land" as used by Congress, it would seem that it pursued a strange course to ascertain the intention of Congress; and, instead of finding the intention of Congress, found what would have been its own intention, if it had been Congress, and then made this the intention of Congress.

From the standpoint of form the majority opinion of the Supreme Court seems weak. Its own argument is illogical. It does not meet the argument of the opposing dissenting opinions nor that of the Interstate Commerce Commission opinion. From the standpoint of substance the opinion is unsatisfactory. It does not directly make reproduction cost the rate base for rate regulation, although it indirectly almost seems to have this practical effect; but it theoretically leaves the question of what is a proper rate base where it was left by *Smyth v. Ames*. This means that we do not have much of anything decided by the *St. Louis and O'Fallon Case* but must look for another case to settle the point which has remained unsettled so long. As a consequence at the present time as a result of this decision we have for the rate base either reproduction cost or a congeries of all the diverse elements in the rule of *Smyth v. Ames*. If the rate base is reproduction cost we have a rule unfair either to the public or the public utility, uncertain in result and impractical in operation. If the rate base is the composite of all the mutually exclusive elements enumerated in *Smyth v. Ames*, we have again to traverse the route that leads away from this impossible decision.<sup>13</sup>

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<sup>12</sup> (1929) 49 Sup. Ch. 392-406.

<sup>13</sup> (1927) 3 Indiana Law Journal 224-232.

Of course the immediate and practical result of the decision is to give the railways and all other public callings a right to more earnings and the railways a power to prevent the recapture of what formerly were regarded as excess earnings. This would give them the right to higher rates to enable them to earn a reasonable return on the higher rate base given them. However, there has not been and may not be any sudden and great increase in railway rates. The economic situation is such at the present time, because of the development of motor transportation, as to make this not possible. But since the technical legal right has been established there will always be a possibility of such increase in rates should the economic situation be changed so as to permit it, and meanwhile the electric power companies, laboring under no such handicap as the railroads, are taking advantage of the decision and entrenching themselves in a position from which they may never be driven.

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