Railroad Mergers: Competition, Monopoly and Antitrust

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RAILROAD MERGERS: COMPETITION, MONOPOLY, AND ANTITRUST

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The American railroad industry is undergoing a significant change in structure due to mergers. While mergers are not new to the industry, three characteristics distinguish the present merger movement from former ones. Firstly, the railroad industry is no longer a natural monopoly. Indeed, railroads are engaged in strong competition with other modes of transportation: with trucks and barges for freight and with airlines, busses, and private cars for passengers. Secondly, the present merger movement is voluntary, i.e., the initiative for mergers is coming from within the industry. Faced with declining earnings and traffic,[1] confronted with growing competition, and operating within a different legal environment, the current motivation is largely financial, based upon a desire to increase efficiency. In turn, mergers tend to reduce the roads' heavy fixed costs, and hence total costs, thereby increasing their potential competitive position in the trans-

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[1]The industry's rate of return on net investment averaged 3.6% for the decade of the 1950's, but fell to 2.13% in 1960—the lowest since 1938. The industry ranked at the bottom of the list of some 70 major industrial groups with respect to profit ratios, and was well under the traditional 6% rate of return allowed or earned by other regulated industries. A total of 27 Class I railroads, 19 of them in the East, turned in deficits for 1960.

The trends of freight and passenger traffic indicate a similar situation. Freight business amounted to 30.4 million carloadings in 1960, down from 41.3 million in 1946 and 52.8 million in 1929. In contrast, truck loadings in 1960 were 3 1/2 times the 1946 level and barge traffic almost doubled between those years. The railroad share of total intercity freight traffic declined from 67% in 1946 to under 50% in 1959; the share of commercial intercity passenger traffic from 66% to about 25% in the same period.

As a result of this traffic loss, net income in 1960 of $445 million was the lowest since 1949 and less than half what it was in 1929. Railroad employees have also been affected by the traffic decline: the railroads had 780,000 employees in 1960, down 43% from 1946.

portation industry. Thirdly, in the past few years, the attitude of the Interstate Commerce Commission toward mergers has become favorable—in fact, permissive.

The railroads were actively encouraged by the Federal Government, between World War I and World War II, to work out merger plans. Several plans for combining the roads into a limited number of systems were presented. Numerous obstacles, however, prevented the adoption of any one plan. With so many plans proposed, no agreement as to the best one could be reached. The weak and strong problem was, and still is, a major hindrance: the stronger lines were reluctant to merge with the unprofitable weaker lines. The Interstate Commerce Commission was not even sure that mergers should be encouraged. And, perhaps of more importance, railroad management showed little enthusiasm for, or cooperation about, mergers. As a result, only a few mergers were forthcoming.

Opposition to railroad mergers, of course, is still strong, as it was in earlier years. The most vocal foe is the Railway Labor Executives Association, composed of the leaders of the nation's twenty-three railroad unions. The Association, worried about the jobs that would be eliminated by mergers, has adopted a policy of opposing all pending mergers. Without naming the Interstate Commerce Commission, the Association recently stated that merger approvals should be the responsibility of "an agency that is not ridden with bureaucratic incompetence and dominated by the interests they are supposed to regulate."[2] Nor are the unions the only obstacle faced by merger-minded railroads. Numerous Congressmen and state officials have announced they will intervene before the Interstate Commerce Commission to try to block such moves.[3] The Department of Justice has disclosed it is looking closely at rail mergers with antitrust action in mind.[4] Even

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[2]Wall Street Journal, December 27, 1960, p. 2, cols. 2 and 3. March 27, 1961, p. 17, col. 1; and April 6, 1961, p. 1, col. 6.

[3]Two resolutions, for example, were introduced in the last session of Congress dealing with railroad mergers. Both H.J. Res. 371 (introduced by Congressman Rhodes) and S. Res. 150 (introduced by Senator Humphrey, on behalf of himself and eighteen other Senators) were aimed at slowing down ICC approval of pending mergers until Congress could review the problems arising from the merger movement. Neither resolution was acted upon during the session.

[4]The Justice Department's first statement of position on the merits of a proposed railroad merger was filed with the ICC on October 31, 1961, in the Seaboard Air Line and Atlantic Coast Line case. The Department stated that the proposed merger would "flagrantly contravene" the antitrust laws because it would "destroy the vigorous competition" that exists between the two lines. In addition, the brief argued that the merger would "jeopardize the existence of several small railroads" in the Southeast, would injure some communities and shippers who would be left

railroads are intervening to oppose the mergers of other railroads, fearing the increased competition which is sure to come from combined operations and not wishing to be left "outside."[5] And a Northern Pacific Railroad conductor, who owns sixteen shares of the line's stock, recently engaged in a proxy fight to get elected as a director so as to oppose a proposed merger with two other lines.[6]

The present article is a summary and evaluation of pubic policy toward railroad mergers. The first two sections are historical: the first deals with the role played by antitrust policy in earlier railroad mergers and the second with various consolidation plans presented between the two world wars. The third section discusses the present statutory provisions concerning railroad mergers and their interpretation. The economics of mergers are outlined in the fourth section, followed by a discussion of public interest. Finally, the question must be asked: can mergers "save" the railroad industry?

I. *Railroad Mergers and Antitrust*

Late in the 1890's a nationwide railroad merger movement began. Even at this early date, railroad combinations were not new, as our largest railroad systems had been built by the combination of numerous independent companies. The New York, New Haven & Hartford Railroad, for example, was a combination of 203 separate companies, the Chicago, Burlington & Quincy Railroad of approximately 200 different companies, and the Pennsylvania Railroad system of over 600.[7] Between 1884 and 1888 alone, there were 425 consolidations.[8] The mergers of the nineties, however, were not so much for the purpose of building up railroad systems as for the purpose of eliminating competition. Two examples of the more important combinations of the period will indicate the extent to which competition was being eliminated.

In the Eastern Territory, two large systems had developed prior to 1900: The New York Central and the Pennsylvania. Between 1900

with reduced rail service, and would "impair adequate transportation." Quoted in Wall Street Journel, November 1, 1961, p. 4, col. 3.

[5]For example, two roads, the Southern Pacific Co. and the Atchison Topeka, and Santa Fe Railway Co., are fighting for control of the Western Pacific Railroad, a small but financially healthy line that operates between San Francisco and Salt Lake City. Because of the strategic location of Western Pacific's tracks, ten carriers are involved in the battle. See Wall Street Journal, July 14, 1961, p. 22, cols. 1-3; "Mating Time for the Railroads," Fortune, January, 1961, pp. 115-21, 142-49a.

[6]Wall Street Journal, April 17, 1961, p. 10, col. 2.

[7]Locklin, Economics of Transportation 298 (5th ed. 1960).

[8]1889 ICC Ann. Rep. 77-79.

and 1902 the Pennsylvania bought a significant amount of stock in the Baltimore & Ohio Railroad, the Chesapeake & Ohio Railway, and the Norfolk & Western Railway. The New York Central already had a large interest in the Chesapeake & Ohio. The Reading Railroad and the Central Railroad of New Jersey came into the system when the Reading Company, which controlled both of these railroads, was acquired partly by the Baltimore & Ohio and partly by a subsidiary of the New York Central. Many smaller lines were also held individually or jointly by the New York Central and the Pennsylvania or their subsidiaries. These combinations left the New York Central and the Pennsylvania in control of the major lines in the Eastern Territory and Pocahontas Region.

In the West, two important combinations were formed. The Union Pacific Railroad, under the control of Harriman, controlled the Oregon Short Line and the Oregon Railroad & Navigation Company. In 1901, the Union Pacific acquired a large stock interest in the Southern Pacific Company, which in turn controlled both the Central Pacific Railroad and the Pacific Mail Steamship Company. Subsequently the Union Pacific acquired a 50 per cent interest in the San Pedro, Los Angeles & Salt Lake Railroad, and about 13 per cent of the stock of the Atchison, Topeka & Santa Fe Railway. To the north of this system were the Hill and Morgan lines—the Great Northern Railway and the Northern Pacific Railway. These two lines, totaling about 9,000 miles, were parallel and competing across the continent between the Great Lakes and the Pacific. Early in 1901, the Great Northern and the Northern Pacific purchased nearly 97 per cent of the stock of the Chicago, Burlington & Quincy Railroad. Thereafter, in November of the same year, the two lines were brought together by the creation of the Northern Securities Company—a holding company which obtained control of both roads by exchanging its stock for the shares of the Great Northern and the Northern Pacific. The Harriman, and the Hill-Morgan interests thus dominated the major western lines.

Under such circumstances, antitrust policy was used in an attempt to maintain competition among the nation's railroads. In 1904, the Supreme Court ordered the dissolution of the Northern Securities Company.[9] In 1912, the Court held that the ownership by the Union Pacific of 46 per cent of the stock of the Southern Pacific violated the Sherman Antitrust Act.[10] A further dissolution of the Harriman com-

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[9]United States v. Nothern Securities Co., 193 U.S. 197 (1904).

[10]United States v. Union Pac. R.R., 226 U.S. 61 (1912). It should be noted that in the Northern Securities case, the assets, consisting of Northern Pacific and Great Northern shares, were distributed to the stockholders of the holding company. The

bination was required in 1922, when the Court ordered the breaking up of the control of the Central Pacific by the Southern Pacific.[11] Threatened antitrust prosecution resulted in the dissolution of the New Haven monopoly in New England, as the railroad agreed to surrender control of the Boston & Maine Railroad, in addition to disposing of its holdings of stock in various trolly lines and steamship companies. In 1929, the Baltimore & Ohio, the New York Central, and the New York, Chicago & St. Louis Railroad (Nickel Plate) were ordered under the Clayton Act to dispose of stock of the Wheeling & Lake Erie Railway.[12] In 1930, the Pennsylvania Company and the Pennsylvania Railroad Company were ordered to divest themselves of their holdings of the stock of the Lehigh Valley,[13] and the Baltimore & Ohio was ordered to dispose of stock of the Western Maryland.[14]

During most of this period the railroad industry had a virtual monopoly of transportation in the United States, with pipelines providing the only important competition. Intercity truck transportation did not begin until 1918; modern barge transport on inland waterways did not begin until the 1920's; and commercial air transport until 1926. Consequently, during this period public policy sought to protect consumers against excessive railroad rates by promoting competition among carriers. Said the Interstate Commerce Commission in 1907, "Competition between railways as well as between other industries is the established policy of the nation."[15] In many cases before the Court, the wisdom of trying to enforce competition between carriers was questioned, but the Court considered this a question for Congress to decide. Said the Court in the Northern Securities Case:

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same stockholders, therefore, controlled both railroads and dissolution did not immediately restore competition between the two systems. In the Union Pacific case, however, the Supreme Court refused to permit the railroad to distribute its Southern Pacific shares to its stockholders, because it would leave the Union Pacific stockholders in control of both railroads. United States v. Union Pac. R.R., 226 U.S. 470 (1913).

[11]United States v. Southern Pac. Co., 259 U.S. 214 (1922). The decree was never carried out, however, as the Southern Pacific obtained the permission of the Interstate Commerce Commission to retain control of the Central Pacific under the provisions of the Transportation Act of 1920. 76 I.C.C. 508 (1923).

[12]Interstate Commerce Comm'n v. Baltimore & Ohio R.R., 152 I.C.C. 721; 156 I.C.C. 607 (1929).

[13]Interstate Commerce Comm'n v. Pennsylvania R.R., 169 I.C.C. 618 (1930). The Commission's order was subsequently set aside by the courts, Pennsylvania R.R. v. Interstate Commerce Comm'n, 66 F.2d 37 (3d Cir. 1933), aff'd by an equally divided Court, 291 U.S. 651 (1934).

[14]Interstate Commerce Comm'n v. Baltimore & Ohio R.R., 160 I.C.C. 785 (1930), 183 I.C.C. 165 (1932).

[15]Consolidations and Combinations of Carriers, 12 I.C.C. 277, 305 (1907).

> "Whether the free operation of the normal laws of competition is a wise and wholesome rule for trade and commerce is an economic question which this court need not consider or determine. Undoubtedly, there are those who think that the general business interests and prosperity of the country will be best promoted if the rule of competition is not applied.... Be all this as it may, Congress has, in effect, recognized the rule of free competition by declaring illegal every combination or conspiracy in restraint of interstate and international commerce. As in the judgment of Congress the public convenience and the general welfare will be best subserved when the natural laws of competition are left undisturbed by those engaged in interstate commerce, and as Congress has embodied that rule in a statute, that must be, for all, the end of the matter, if this is to remain a government of laws, and not of men."[16]

The policy of prohibiting railroad merger during this period was subject to much criticism. As early as 1890 the New Hampshire Supreme Court recognized that railroad competition might become ruinous in character.

> "While, without doubt, contracts which have a direct tendency to prevent a healthy competition are detrimental to the public and consequently against public policy, it is equally free from doubt that when such contracts prevent an unhealthy competition, and yet furnish the public with adequate facilities at fixed and reasonable rates, they are beneficial, and in accord with sound principles of public policy. For the lessons of experience, as well as the deductions of reason, amply demonstrate that the public interest is not subserved by competition which reduces the rate of transportation below the standard of fair compensation; and the theory which formerly obtained that the public is benefited by unrestricted competition between railroads has been so emphatically disproved by the results which have generally followed its adoption in practice that the hope of any permanent relief from excessive rates through the competition of a parallel or rival road may, as a rule, be justly characterized as illusory and fallacious."[17]

At the same time, the powers of the regulatory bodies over railroad rates and practices were insufficient to prevent the railroads from exercising their monopoly power. The public, therefore, was unwilling to give up the protection afforded by competition among roads. Gradually regulatory control over the railroads was strengthened. In turn public policy toward railroad competition and mergers was

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[16]193 U.S. 197, 337-38 (1904).

[17]Manchester & Lowell R.R. v. Concord R.R., 20 Atl. 383, 384 (1890).

modified. Beginning with the Transportation Act of 1920, consolidation[18] was actively encouraged.

II. *Consolidation Plans*

The railroads were operated by the Federal Government during World War I. By the Transportation Act of 1920, the roads were returned to private ownership. In addition, the Act sought to bring about the consolidation of railroads into a limited number of systems, and provided for the exemption of the carriers from state and federal antitrust laws when necessary to effect any combination authorized by the Commission. The Commission was directed to formulate a plan for consolidation, which was to be designed: (1) to preserve competition as fully as possible, (2) to maintain existing routes and channels of trade wherever practicable, and (3) to develop systems of approximately equal earning power under a uniform level of rates.[19] "As a result of the enactment of the Transportation Act of 1920, consolidation of the railroads of the country, in the interest of economy and efficiency, became an established national policy, and the effective consolidation of the railroads in conformity to the provisions of the Act and to the plan of consolidation which the Commission was directed to prepare became a matter of public interest."[20] It should be noted, however, that the Commission was "to preserve competition as fully as possible" when drawing up a plan of consolidation. Congress clearly intended that the limited number of systems to be created were to be competitive.[21] Moreover, consolidation under the Act was to be voluntary.

After much debate and dispute, the Commission published, in 1929, a plan for consolidating the nation's railroads into twenty-one independent systems,[22] and in 1932 an extensive revision of the plan for

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[18]Consolidation means to form a new corporate entity out of two or more corporations which are extinguished in the process. Merger is the process by which one corporation absorbs another, the latter ceasing to exist. For purposes of this paper, the two terms are used synonymously.

[19]41 Stat. 456, 481-82. Under the provisions of the Act, two or more railroads might consolidate if: (1) the Commission found the consolidation to be in the public interest, (2) the consolidation was in conformity with the Commission's plan, and (3) the stocks and bonds of the new company did not exceed the value of the consolidated properties as determined by the Commission under the Valuation Act of 1913.

[20]United States v. Lowden, 308 U.S. 225, 232 (1939).

[21]See Green, Preliminary Report of Study of Railroad Consolidation and Unification, 71st Cong., 3d Sess., Part I at 15-24 (1931).

[22]In the Matter of Consolidation of the Railway Properties, 159 I.C.C. 522 (1929). A tentative plan, based upon the work of Professor William Z. Ripley, was issued

the Eastern Territory was announced.[23] Not one of these systems has ever materialized. During the next few years, other unification plans were formulated, but again none was accepted.[24] In general, these plans were either "regional" or "competitive" consolidated systems. The former sought to have one railroad serve a particular geographic area; the latter attempted to preserve competition by having at least two roads serve a major region of the country. Each had its disadvantages. "With regard to a regional plan, many thought that elimination of competition from an area would not better serve the public interest because the complete dependence of a territory upon the monopoly of one carrier would not provide more efficient service nor lower transportation charges. The competitive plan was regarded as faulty in that it failed to recognize the fact that large segments of certain regions were at the time served by only one railroad."[25] In addition, the severe financial plight of the whole economy, including the railroads, during the thirties made any giant merger plan all but impossible.

The National Transportation Committee, in 1933, issued a report recommending compulsory consolidation.[26] However, Congress, in the Emergency Railroad Transportation Act of 1933,[27] rejected this recommendation, but did tighten the Commission's control over proposed mergers. The Act established the office of Federal Coordinator of Transportation to investigate transportation problems and to make recommendations. In his 1936 report it was said, "[W]hile a plan of enforced consolidation, or other species of unification, into a very few systems is not deemed desirable, there are many situations where the amalgamation of railroad companies will accomplish good results and should be encouraged."[28]

In 1938, President Roosevelt appointed three members of the Interstate Commerce Commission as a "Committee of Three" to study

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by the Commission in 1921. The report, however, was less than two pages. See In the Matter of Consolidation of the Railroad Properties, 63 I.C.C. 455 (1921).

[23]Consolidation of Railroads, 185 I.C.C. 403 (1932).

[24]These plans are outlined in "Consolidations and Mergers in the Transportation Industry," Association of American Railroads, 35-37 (February, 1960) (mimeographed).

[25]Id. at 9. In 1938, Commissioner Miller of the Interstate Commerce Commission urged the unification of the nation's railroads into a single system under private ownership. See Miller, A Suggested Plan for the Solution of the Railroad Problems, 1938 (mimeographed).

[26]Report of National Transportation Committee, February 13, 1933. For complete text, see New York Times, February 15, 1933, pp. 38-39.

[27]48 Stat. 211.

[28]Report of Federal Coordinator of Transportation 48 (January 21, 1936).

the railroad problem. This committee recommended new legislation giving the Commission authority to require a unification where it is sought by at least one carrier.[29] Because the proposal was opposed by the railroad unions, the President appointed another committee consisting of three railroad executives and three representatives of railroad labor to make a further study of the problem. In its report of 1938, that "Committee of Six" observed, "No objection could be urged today against consolidation that could not have been urged with much greater force against the actual consolidations of the past. Yet without the consolidations of the past there would be no major rail systems of today. The progress and accomplishments of the past are indicative of the possibilities of accomplishments of the same sort that may be realized in the future."[30]

Following this report and after extensive hearings in Congress, the Transportation Act of 1940[31] was enacted. Under the Act, the Commission was relieved of the obligation of formulating a national plan of consolidation. The Act stated that the initiative for mergers rests with the railroads, and that the Commission's function is to pass upon the merits of applications under the standards provided in Section 5(2).

III. *Statutory Provisions and Recent Mergers*

Section 5(2) of the Interstate Commerce Act, as amended by the Transportation Act of 1940, provides for the initiation of applications for consolidations by railroads and for the approval by the Commission of those mergers that are found to be in the public interest. In determining whether a proposed consolidation is in the public interest, four factors should be taken into consideration. These factors are: "(1) the effect of the proposed transaction upon adequate transportation service to the public; (2) the effect upon the public interest of the inclusion, or failure to include, other railroads in the territory involved in the proposed transaction; (3) the total fixed charges resulting from the proposed transactions; and (4) the interest of the carrier employees affected."[32]

In addition of these general considerations, the Commission is given power to impose, as a condition to approval, the inclusion of another railroad which has requested such inclusion and which is sit-

[29]H.R. Doc. No. 583. 75th Cong., 3d Sess. 36-39 (1938).

[30]"Consolidations and Mergers in the Transportation Industry," op. cit. supra note 24 at 11.

[31]54 Stat. 898 (1940).

[32]54 Stat. 906 (1940).

uated in the territory involved. No consolidation may be approved if the total fixed charges are increased, unless a finding is made that such an increase is not contrary to the public interest. The Commission is also given authority to attach conditions to an order of approval in order to protect the job rights of railroad employees affected by a consolidation. However, in attaching terms and conditions, the Commission must make sure:

> "[T]hat during the period of four years from the effective date of such order such transaction will not result in employees of the carrier or carriers by railroad affected by such order being in a worse position with respect to their employment, except that the protection afforded to any employee pursuant to this sentence shall not be required to continue for a longer period, following the effective date of such order...."[33]

In the post-World War II period the Commission has been called upon to interpret the merger provisions of sections 5(2) in over ninety cases.[34] The majority of these cases involved absorptions of subsidiaries. The principal consolidations are listed and briefly summarized below:

(1) The acquisition of the Nashville, Chattanooga & St. Louis Railroad by the Louisville & Nashville Railroad in August 1957.[35] The merger involved two railroads that had a very close and cooperative relationship for many years, including a broad program of interchange and routing agreements, and the avoidance of competition in the soliciting of traffic. The carriers estimated that savings of $3¼ million a year would be realized by 1962. Although opposed by railroad labor and the City of Nashville, the latter claiming that the merger would reduce Nashville "to a one-railroad community,"[36] the Commission based its favorable decision on the operating advantages that would follow. Among these were the development of a more balanced traffic pattern, increased diversification which would provide increased competition to water and motor carriers, savings in solicitation, a more efficient and economical one line service, a more adequate car supply, and better promotion of industrial development. In addi-

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[33]54 Stat. 906, 907 (1940).

[34]The Commission's annual reports summarize its disposition of applications under this section.

[35]295 I.C.C. 457 (1957). See also Stot v. United States, 154 F. Supp. 389 (S.D.N.Y. 1957), aff'd per curiam sub nom. City of Nashville v. United States, 355 U.S. 63 (1957).

[36]The City of Nashville's opposition was carried as far as the U.S. Supreme Court, but it was unsuccessful. City of Nashville v. United States, 355 U.S. 63 (1957).

tion, the Commission took note of the development of a better competitive position in relation to other major trunk lines in the area.

(2) The acquisition of the Virginian Railroad by the Norfolk & Western Railway in October 1959.[37] The lines are two of the most profitable in the country. Nevertheless, in approving the merger, the Commission was impressed by the operating advantages which it offered. Both were heavily dependent on coal for revenue—over 85 per cent for the Virginian and 66 2/3 per cent for the N & W—but the coal fields served by the two roads were different and, therefore, complementary in operation. The former generally tapped mines producing steam coal for utilities, and its business was mostly eastbound to Hampton Roads for coastal shipping and export. The road had been unable to develop westbound merchandise traffic while its westbound coal traffic was essentially a short-haul operation. The latter's major traffic is bituminous coal shipped to Middle Western steel mills. In their application to the Commission, the roads said that savings of $12 million a year would result in five years from coordinated operation of yards, shops, and terminals; from the integration of administrative accounting, soliciting and other activities; from better use of facilities; and from a better movement of east-bound coal. The Commission said, "Merger of the Norfolk & Western and Virginian will plainly result in a larger, stronger company, better able to meet the challenges faced by the railroad industry and better able to attract and hold competent management personnel."

(3) The acquisition of the Delaware, Lackawanna & Western Railroad by the Erie Railroad in September 1960.[38] This merger was between two lines in financial trouble: the D L & W lost $3.9 million in 1958, $4.3 million in 1959, and $4 million in 1950, while the Erie lost $3.7 million, $5.7 million, and $8 million in the same years. The D L & W depends heavily upon bridge and local traffic (bridge traffic is that which both originates and terminates on other railroads); the Erie on service to the Cleveland, Pittsburgh, and Youngstown steel areas. Again in this case, the Commission was convinced that the merger would result in greatly improved operating conditions.[39] Several railroads intervened, stressing the importance of preserving joint routes, interchange arrangements, and switching practices. The Commission, in response, placed several restrictions on the lines in approving the merger. In addition, very strong opposition came from

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[37] 307 I.C.C. 401 (1959).
[38] Erie R.R.-Merger-Delaware, Lackawanna & Western R.R. (1960).
[39] "Will Merger Cure Their Troubles?," Business Week 62-64, October 8, 1960.

the Railway Labor Executives' Association, which will be discussed below. The two roads estimated that savings will reach $13 million annually after five years.

(4) The acquisition of the Minneapolis & St. Louis Railway by the Chicago & North Western Railway in October 1960.[40] The two lines connect at several points, such as Minneapolis, Des Moines and Peoria. The Commission said that the acquisition would permit direct single line service and routes between such points at Duluth-Superior, Minneapolis-St. Paul and Chicago, St. Louis and Peoria, thereby reducing time-consuming and costly interchanges, providing greater flexibility in rate-making "all to the benefit of the public generally." While both roads have taken steps in recent years to modernize their properties, the Commission pointed out that the M & S T L "lacks the size and volume sufficient to realize the maximum advantages from the efforts." The M & S T L is handicapped by light traffic, poor diversity and a lack of sufficient specialized equipment. The property rights acquired include the motor carrier operations of the M & S T L, which will permit the merged system to develop a piggyback service. Savings of $3 million a year are expected. There was no opposition to the merger.

(5) The merger of the Minneapolis, St. Paul and Sault Ste. Marie Railroad, the Wisconsin Central Railroad, and the Duluth, South Shore & Atlantic Railroad to form a new rail system called the Soo Line Railroad Co. in December 1960.[41] All three of the railroads are controlled by the Canadian Pacific Railway. The merger is expected to result in savings of $1.2 million a year. As the three lines do not serve exactly the same areas, little will be saved by combining duplicate tracks. However, the Commission said that the railroads will be able to reduce expenses by consolidating executive and supervisory offices, maintenance facilities and purchasing offices. The merger also will "permit more efficient use of motive power, result in improvement of car supply through the unified system and increase the efficiency and economy of the system's overall operations."

The only significant unification the Commission has turned down in recent years was the St. Louis-San Francisco Railway's proposal to control the Central of Georgia Railway.[42] Although the proposed merger seemed to offer important advantages of an end-to-end type of merger, the Commission rejected the plan on the grounds that stock

[40]Chicago & N.W. Ry.-Merger-Minneapolis & St. Louis Ry. (1960).
[41]Wall Street Journal, Dec. 5, 1960, p. 8, col. 3.
[42]Central of Ga. Ry. Control, 295 I.C.C. 563 (1957).

control of Central of Georgia had been acquired by the Frisco through a voting trust without prior Commission approval, thereby violating section 5(4) of the Interstate Commerce Act. The decision allowed the Frisco to retain beneficial interest in the stock, but transferred it to a corporate trustee.

As of March 15, 1962, there were eight merger applications pending before the Commission:

(1) Pennsylvania Railroad to acquire the Lehigh Valley Railroad;
(2) merger of the Atlantic Coast Line Railroad into the Seaboard Air Line Railroad and the establishment of a new company called the Seaboard Coast Line Railroad;
(3) bid by both the New York Central Railroad and the Chesapeake & Ohio Railway to acquire control of the Baltimore & Ohio Railroad;
(4) Southern Railway to acquire the Central of Georgia Railway;
(5) bid by both the Southern Pacific Company and the Atchison, Topeka & Santa Fe Railway for control of the Western Pacific Railroad;
(6) Norfolk & Western Railway's merger with the New York, Chicago & St. Louis Railroad (Nickel Plate), acquisition of of the Sandusky Line, and lease of the Wabash Railroad;
(7) consolidation of the Great Northern Railway, the Northern Pacific Railway, and the Chicago, Burlington & Quincy Railroad, and lease of the Spokane, Portland & Seattle Railway, to form a new system called the Great Northern Pacific & Burlington Lines; and
(8) merger of the Pennsylvania Railroad and the New York Central Railroad and the formation of a new company to be called the Pennsylvania New York Central Transportation Company .

In addition, several other lines have announced that they are continuing to make studies concerning possible mergers, although formal applications have not as yet been made to the Commission.[43]

[43]There two studies underway are significant. (1) Norfolk & Western Railway and Erie-Lackawanna Railroad. Later in October of 1961, The Erie-Lackawanna agreed to change its stand and support N & W's merger plans. At the same time, it was announced that the N & W had agreed to consider the Erie for inclusion in the proposed system if the Commission approves N & W's current plans. See Wall Street Journal, October 25, 1961, p. 2, col. 2. (2) Norfolk & Western Railway and Akron, Canton & Youngstown Railroad. Early in December of 1961 the directors of A C & Y agreed to sell its outstanding stock to the N & W. The A C & Y also agreed to withdraw its position for inclusion in the proposed unification of the N & W, the Wabash and the Nickel Plate. The proposal is contingent upon acceptance by the holders of 80% of A C & Y's common stock, and on the pending N & W merger plans now before the Commission. See Wall Street Journal, Dec. 8, 1961, p. 8, col. 2.

IV. *The Economics of Mergers*

The advantages of railroad mergers can be grouped into three major catgories: (1) reduction of costs, (2) improvement in service, and (3) efficiency of regulation.

Reduction of Costs. As discussed above, the reduction of costs has been the advantage that has received the most attention and largely explains the recent trend toward more railroad mergers. One observer estimates that if the railroads were unified into four noncompetitive regional systems the potential savings would reach $1 billion annually.[44] According to the estimates made in the five mergers recently approved, savings of approximately $32.5 million are expected within five years.

These cost reductions are expected from savings in administrative expenses, operating expenses, and financial costs. The savings in administrative expenses, while not the major area of savings, are substantial: reduction and consolidation of hundreds of general offices, elimination of top level management personnel, and simplified car accounting. In addition, savings in purchasing (due to advantages of volume purchases), traffic solicitation, advertising, public relations, and accounting would be large because one-fifth of the present personnel of the railroads is engaged in these activities.

The savings in operating expenses are potentially the most important to be achieved from mergers. These include the elimination of duplicate facilities and services, reduction in switching and interchange at major terminal areas of origin and destination, better utilization of power and crews, concentration of long-haul traffic on the more direct and efficient routes, and a more intensive use of the most favorably located lines. All of these advantages may accrue in either an end-to-end merger or a parallel line merger, but not to the same degree.

Mergers may result in several financial advantages to the roads concerned. As investment in real estate, especially in urban areas, runs into the millions, savings would result from the consolidation of terminal properties. "In Chicago terminal areas alone this could amount to many millions of dollars."[45] The elimination of trackage

[44]Gilbert Burck, "A plan to Save the Railroads," Fortune, August, 1958. The author estimates $400 million would be saved in terminal operations, $100 million in reduced maintenance and operation of abandoned trackage, $300 million from improved routing and utilization of equipment, and at least $200 million from savings in purchasing, centralization in repair shops, and reorganization in less than carload traffic operations.

[45]National Transportation Policy, Preliminary Draft of a Report prepared for

and terminal facilities, in addition to the connected real estate, would also bring about a reduction in the tax burden which bears so heavily upon the entire railroad industry.[46] Greater flexibility in the use of existing physical facilities might well reduce the capital required by the roads to provide for regained traffic.

Improvement in Service. While mergers offer substantial savings in costs to the railroad industry, equally important are their effects upon service to the economy. As stated by a recent congressional report:

> "The time has passed when railroads can expect shippers to give them their freight without assurance of dependable delivery time. The amount of interchange required in major terminal areas is such that for most shipments this is impossible. The time required after arrival in the inbound yard of the trunkline carrier to the actual spotting of the car may exceed the total elapsed time of moving the car half way across the country. Furthermore, there is substantial evidence that the quality of service for general freight (exclusive of the expedited freight train service for perishables, etc.) has deteriorated rather than improved in recent years, not only in terms of the frequency of freight train service, but also in terms of delivery time. This development arises from the effort to maximize the economy of individual train movements through larger and larger trains to handle a given quantity of freight over a route. This has meant fewer trains with more cars to be handled at intermediate yards and terminal areas which have not been revamped to accommodate them."[47]

Mergers, especially end-to-end mergers, tend to reduce costly delays incident to interchange of both route and terminal operations by facilitating single line freight. A more dependable scheduled service should be the result. Moreover, unification of less-than-carload shipments, as well as pickup and delivery service, would greatly benefit this merchandise traffic. In short, mergers offer several advantages to railroad users, and hence to the total economy.

Efficiency of Regulation. At the present time there are more than 500 operating railroads—110 Class I railroads, some 300 Class II lines, and more than 200 switching and terminal companies. The Interstate Commerce Commission faces a gigantic task in carrying out its regulatory duties. Mergers, which would reduce the number of operating

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the Senate Committee on Interstate and Foreign Commerce, 87th Cong., 1st Sess. 246 (1961).

[46]See Phillips, "The Railroads' 'Four Freedoms' and Regulations," 6 8Public Utilities Fortnightly 73-88 (1961).

[47]National Transportation Policy, op. cit. supra note 42, at 246.

companies, would simplify the task of regulation. The many cases involving the division of rates would be reduced, thereby eliminating much litigation. "Other advantages in regulation include: simplification of providing access to terminal areas; administration of routing regulation; ... the establishment of service standards; the reduction of tariffs to be approved; and reduction of suspension cases."[48] Mergers, however, are not the most important method of facilitating regulation. This problem will be discussed in section VI.

V. *The Public Interest*

In acting upon a railroad merger proposal, the Commission must decide whether the consolidation will be "consistent with the public interest." What standards should the Commission use in making such a determination? What, in other words, is the public interest? To answer the latter question, four factors stand out: the role of competition; the weak-strong railroad problem; the effect upon railroad employment; and the benefits which will accrue to the public. Each will be examined in turn.

1. *The Role of Competition.* Much confusion and uncertainty still exist concerning the desirability of preserving competition in the railroad industry or of abandoning it in favor of monopoly. Historically, as earlier outlined, mergers were halted by government intervention through the antitrust laws and then were actively encouraged between 1920 and 1940. Today's mergers, however, are taking place in a different business and political atmosphere and under new conditions and pressures than have prevailed in previous large-scale merger attempts. These conditions were stated by the Commission in the Louisville & Nashville case as follows:

> "With the construction of new highways, referred to by some as 'expressways' and others as 'freightways,' the competition of the railroads from motor carriers will be enhanced. Without doubt, the possibility of faster trunkline schedules will disadvantageously affect the ability of the railroads to compete with them, particularly with respect to the more lucrative traffic. It is common knowledge that established airlines are taking a large share of the passenger traffic formerly handled by the railroads.... The foregoing reflects how imperative it is for the railroads to do everything in their power to enhance their competitive situation through all possible economies and efficient operations. The proposed merger is designed to accomplish that result."[49]

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[48] Id. at 243.

[49] 295 I.C.C. 457, 468 (1957).

And, in the recent Norfolk & Western merger decision, the Commission stated:

> "The monopoly status enjoyed by the railroads in the nineteenth and early twentieth centuries has now disappeared completely with the emergence of strong and growing competitors.... While there may be some slight lessening of competition as a result of the proposed merger, we do not regard that fact as of controlling importance. The evidence establishes that, after the merger, strong competition will still be afforded by other forms of transportation. We conclude that the public interest would not be adversely affected by any lessening of competition which may result from the proposed merger."[50]

The Commission seems to feel that it may authorize consolidations which would run counter to the antitrust laws if the advantages of a proposed consolidation outweigh the disadvantages of possible elimination or lessening of competition. Decisions of the Supreme Court in 1944 and 1959 make it clear that the Commission will be supported.[51] Moreover, the Commission seems to be going one step further by pointing out that so long as the public has a choice of transportation, the elimination of inter-railroad rivalry cannot be equated with the elimination of competition. In the majority of cases railroads do not compete with each other. Rates, for example, are set in rate bureaus. As a result, competition tends to be inter-modal rather than intra-modal and this type of competition is steadily increasing. Given these factors, antitrust policy and the maintenance of competition among railroads should not dominate Commission policy towards mergers. Intra-modal competition should only be preserved where traffic justifies two or more efficient railroad systems.

2. *The Weak-Strong Problem.* The primary purpose in the provisions for consolidation in the Transportation Act of 1920 was that of solving the weak-strong railroad problem. It was felt that this was the best way to establish a rate level for a given region of the country which would permit the weak roads to earn a fair rate of return without permitting the strong roads to earn an excessive return. The problem, of course, is still present. There are nearly 225,000 miles of railroad in the country. Ten per cent of that mileage or 23,000 miles, carries 50 per cent of the intercity rail freight traffic. At the other end, 30 per cent of the total mileage, or about 67,000 miles, carries less than 2 per cent of all intercity rail freight traffic. Excess capacity

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[50] F.D. 20599, Sheets 20 and 21 (1959).

[51] McLean Trucking Co. v. United States, 321 U.S. 67 (1944); Minneapolis & St. Louis Ry. v. United States, 361 U.S. 173 (1959).

is especially serious in the eastern part of the country, where there are 43 Class I railroads.

Many of these lines are no longer needed and cannot be economically justified. They should be discontinued. As for the others—those that are necessary to the industry—the Commission has the authority to make sure that reasonable safeguards are given to protect them when mergers of parallel or competing lines are approved. The Commission also has the authority to include other lines in the territory involved in any merger proposal. To date, however, the Commission has shown no willingness to use this power,[52] although it has been reported that the Commission is currently undertaking a comprehensive study of the nation's railroad needs which will include "regional studies of which railroads should merge with which.... The new policy reflects recognition of Congressional, public and union opposition to any hasty, indiscriminate approval of railroad-proposed mergers that might cut jobs and hurt service—along with a continuing insistence that savings possible through marriage still represent the best long-range hope of railroad salvation."[53]

The voluntary mergers already pending or under study indicate a pattern for the future. Eventually the nation may have 8 or 9 major systems: a single system for New England, two linking the East and the Midwest, one or two Southern routes, one between the Midwest and the Southwest, and three connecting the Midwest and the West Coast. Experience shows, however, that voluntary mergers are the best means of achieving economies in the industry. As one railroad executive recently answered when asked how many systems we need: "I don't think anybody can answer that question at this time.... It's obvious that we've got too many—way too many. Now, whether we ought to have two or three systems in the East, or possibly four, I don't think can be decided definitely or accurately at this time. We can talk in those terms, but it's going to be a gradual process, as I see it, rather than one that will develop overnight."[54]

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[52]In June, 1960, the Commission refused the New York Central's request that the Commission consolidate into a single hearing the merger application of the C & O-B & O and the merger application of the N & W-Nickel Plate. The Commission also refused the request of the Erie-Lackawanna to consolidate the Pennsylvania's application to control the Lehigh Valley with the N & W-Nickel Plate proposal. Both the New York Central and the Erie had hoped to convince the Commission that it should order the other railroads to include them in their merger plans. Wall Street Journal, June 8, 1961, p. 1, col. 1.

[53]Wall Street Journal, June 8, 1961, p. 1, Col. 1.

[54]Interview with Stuart Saunders, President of the Norfolk & Western, U.S. News & World Report, May 15, 1961, p. 78. Some indication that the voluntary approach is the correct one can be seen in recent developments. In the eastern

At the same time, voluntary mergers present several perplexing questions. Unless the Commission has a plan outlining the future structure of the industry in mind, can it logically continue to approve railroad mergers on a case-by-case basis? If voluntary mergers are largely among the stronger carriers, might not the Commission be faced with a future structure of strong roads on the one hand and numerous weak roads on the other? From an economic point of view, it would be better to deal with the weaker roads now rather than to wait and let them go bankrupt. Apparently this was the fear of the Department of Justice and its reason for reportedly favoring a merger of the New York Central, Chesapeake & Ohio, and Baltimore & Ohio to balance the alleged future plans of the Norfolk & Western to merge with the Pennsylvania system.[55] But without mandatory authority to compel mergers, any proposed Commission plan might well bring the current voluntary merger movement to a sudden halt. It would seem, however, that the Commission must have such a plan in order to deal adequately with the voluntary mergers under consideration. The plan should be tentative, flexible, and perhaps unannounced, but only in this way can the weaker roads have some assurance that their problems are being considered. And when a road, considered necessary to the industry and the economy, is being excluded from a proposed merger, the Commission will have to exercise its power and order its inclusion in the merger.

3. *Railroad Employment.* Under the Transportation Act of 1940, the Commission must provide that during a period of four years from the date of an order allowing a merger no employee of any involved railroad shall be placed "in a worse position with respect to . . . employment," subject, however, to any agreement the carriers and the employees reach as to other provisions for employee protection. For

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part of the country, where excess capacity is the greatest, three large systems seem to be developing. The first is a combined Pennsylvania-New York Central system. The second is a Chesapeake & Ohio-Baltimore & Ohio system. The third is a Norfolk & Western-Nickel Plate-Wabash system, which may possibly include the Erie-Lackawanna. Should this pattern materialize, the smaller lines, many already allied with one of these major lines, would be included in the combines. For example, the B & O owns 42.85% of the Western Maryland and 42.22% of the Reading Co. In turn, the latter owns 56.6% of the Central R.R. Co. of New Jersey. The C & O also owns 7.31% of Western Maryland.

[55] Wall Street Journal, June 22, 1961, p. 13, cols. 1 & 2. The Pennsylvania owns approximately 35% of the Norfolk & Western's stock. The Department of Justice's concern, however, was premature. In their formal application filed with the Interstate Commerce Commission, the Pennsylvania stated its willingness to transfer its N & W stock to an independent voting trustee "pending ultimate disposition" of the stock "within a reasonable time in an orderly manner." Wall Street Journal, March 12, 1962, p. 7, cols. 2 & 3.

years the Commission has interpreted this provision as meaning that economy dismissals could be made as long as compensation is provided for displaced workers. Two railroad unions recently challenged the Commission's approval of the Erie-Lackawanna merger, which called for abolishing nearly 2,000 jobs and transferring more than 2,000 others over five years. Severance pay for those laid off and compensatory pay for those switched to jobs with lower salaries were included in the merger plan. The unions argued that the law forbids firings for four years, and that provisions for compensating displaced workers did not meet the requirements of the Act.

But the Supreme Court upheld the Commission's interpretation. Writing for the majority, Chief Justice Warren said: "We are unwilling to overturn a long-standing administrative interpretation of a statute, acquiesced in by all interested parties for 20 years, when all the signposts of Congressional intent... indicate that the administrative interpretation is correct."[56] Justice Douglas, the lone dissenter, declared: "The toll which economic and technological changes will make on employees is so great that they, rather than the capital which they have created, should be the beneficiaries of any doubts that overhang these legislative controversies when they are shifted to the courts."[57]

The reduction of jobs is not, of course, the direct objective of mergers. The railroads had 780,000 employees in 1960, down 43 per cent from 1946. Mergers accounted for an insignificant percentage of this decline. It is well known that the industry continues to suffer from various featherbedding practices, estimated to be costing the carriers nearly $500 million annually. Approximately one-half of this amount is currently being paid to firemen and helpers on diesel locomotives. With employment dropping, as well as freight traffic, the long-run interests of labor would seem to be served by a strengthening of the nation's railroads through mergers. The Commission's interpretation of section 5(2) seems to provide ample protection to labor displaced by progress.

4. *Public Benefits.* Enough has already been said to indicate that the public will benefit from fewer, but stronger railroad systems. Increased efficiency will result in lower rates and greater capital expenditures for better service. Moreover, a strong and efficient railroad system is vital to the national defense.

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[56]Brotherhood of Maintenance of Way Employees v. United States, 366 U.S. 169 (1961).

[57]Id. at 921.

VI. *Concluding Considerations*

Public policy toward railroad mergers has passed through three distinct periods. From 1890 to 1920, public policy sought to maintain competition among the nation's railroads. In the period 1920 to 1940, consolidation was encouraged, with the plan of ending up with several well-balanced railroad systems. The third period began with the Transportation Act of 1940, which permits voluntary mergers if they are consistent with the public interest.

Within the past five years, a significant merger trend has started, encouraged by the permissive attitude of the Interstate Commerce Commission. Nor is it mere speculation to suggest that the trend will continue in the future. It has been argued above: (1) that mergers offer substantial benefits to both the railroads involved and to the public; (2) that antitrust policy should have an insignificant role in the present merger movement; (3) that while voluntary mergers offer the best solution toward achieving a more balanced railroad system in the United States, the Interstate Commerce Commission should have a tentative and flexible plan outlining the future structure of the industry in mind against which it can approve merger plans as they are submitted; (4) that competition in the transportation industry is largely inter-modal, with the result that public policy toward railroad mergers should recognize that effective intra-modal competition should be preserved only where traffic justifies two or more efficient systems; and (5) that present law provides ample protection for employees displaced by consolidations. And yet, an essential question remains: can mergers save the American railroad industry?

That the United States needs a modern, up-to-date system of transportation, and one that is efficient and economical, is quite obvious. While more controversial, today's system is handicapped by a tremendous amount of surplus capacity, particularly in the railroad industry. Mergers offer perhaps the best means, short of nationalization, of achieving a more balanced and efficient railroad system. Under the conditions earlier examined, mergers among the nation's railroads will neither lead to monopoly nor result in the exploitation of the public. On the contrary, as competition within the transportation industry is largly inter-modal, mergers will lead to greater competition if a more efficient railroad industry is built. The present merger movement clearly has this as its primary aim.

At the same time, mergers are not a panacea for the nation's railroad problems. The potential public benefits of a stronger, more efficient railroad industry will be lost unless aided by several basic changes in public policy toward the industry. In addition to excess capacity, the industry is subject to antiquated regulatory concepts and procedures; it is the victim of discriminatory local and state taxation; it operates under wasteful, and expensive, labor practices; and it faces increasing competition from other modes of transportation, which are heavily subsidized by the public.[58] All of these problems must be dealt with if the railroad industry is to survive under private ownership. And in making the necessary changes, it must be remembered that the railroad problem is but one aspect of the broader problem of how transportation as a whole can be improved, so as to give better service, more efficiently, at the lowest possible rates.

[58]These problems are discussed at length in "The Railroads' 'Four Freedoms' and Regulations," op. cit. supra note 43.