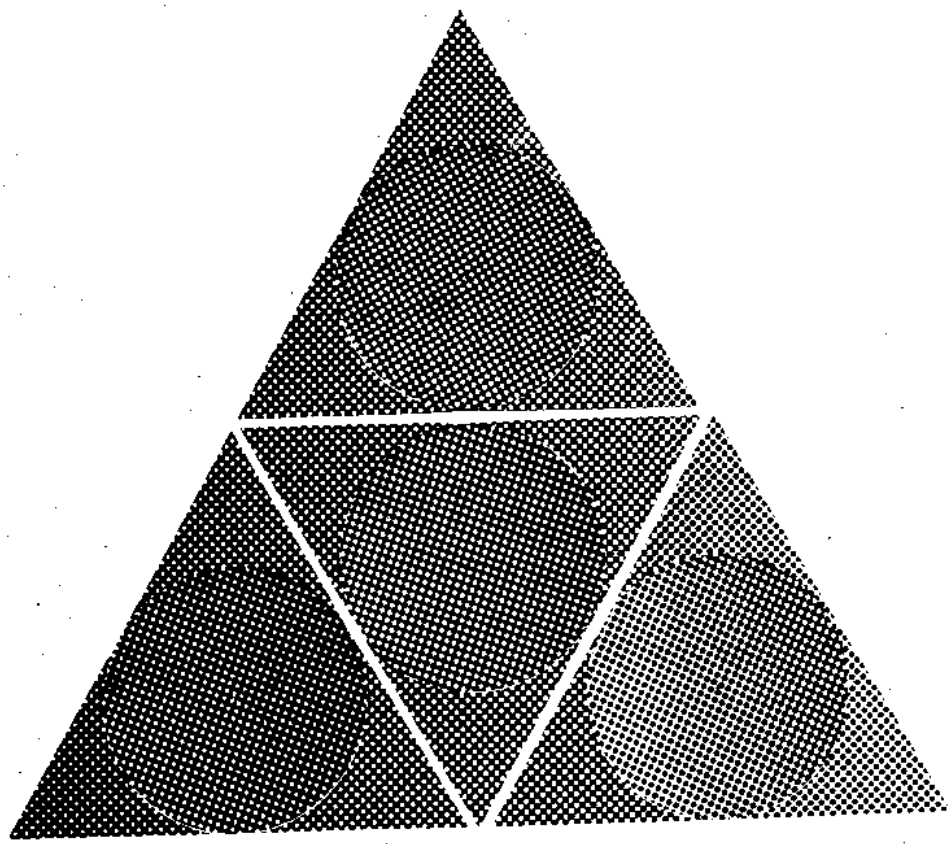
Revenue and Cost Allocations: Policy Means and Ends in the Railroad and Telecommunications Industries

Robert Carson Godbey

Program on Information Resources Policy



Center for Information Policy Research

Harvard University

ACKNOWLEDGMENTS

Special thanks are due to the following persons who reviewed the study plan, supplied data, or who commented critically on drafts of this report. These persons and the Program's affiliates are not, however, responsible for or necessarily in agreement with the views expressed herein, nor should they be blamed for any errors of fact or interpretation.

Harry J. Breithaupt

C. Barry Schaefer

James L. Tapley

A. Scheffer Lang

William Malone

A publication of the Program on Information Resources Policy

REVENUE AND COST ALLOCATIONS: POLICY MEANS AND ENDS IN THE RAILROAD AND TELECOMMUNICATIONS INDUSTRIES.
Robert Carson Godbey
Publication No. P-79-2
July 1979

The Program on Information Resources Policy is jointly sponsored by Harvard University and the Center for Information Policy Research.

Printing 5 4 3

Contributors

Abt Associates Inc.
Action for Children's Television
American Broadcasting Companies, Inc.
American District Telegraph Company
American Telephone & Telegraph Co.
Arthur D. Little, Inc.
Auerbach Publishers Inc.
Automated Marketing Systems
A.H. Belo Corporation
Beneficial Management Corporation
Boston Broadcasters, Inc.
The Boston Globe
Booz-Allen Hamilton
Business Information Publishing Co.
Canada Post (Canada)
CBS Inc.
Central Telephone & Utilities Corp.
Citibank N.A.
Codex Corporation
Communications Workers of America
Computer & Communications Industry Assoc.
Continental Cablevision, Inc.
Continental Telephone Corporation
Copley Newspapers
Cox Enterprises, Inc.
Department of Communications (Canada)
Des Moines Register and Tribune Company
Direction Générale des Télécommunications (France)
Doubleday, Inc.
Dow Jones & Co., Inc.
Drexel Burnham Lambert Inc.
Dun & Bradstreet
Economics and Technology, Inc.
Elsevier Science Publishers (Netherlands)
Equifax Inc.
Exxon Enterprises, Inc.
Federal Reserve Bank of Boston
First National Bank of Boston
First National Bank of Chicago
France Telecom (France)
Frost & Sullivan
Gannett Co., Inc.
General Electric Company
General Telephone & Electronics
Hallmark Cards, Inc.
Hambrecht & Quist
Harte-Hanks Communications, Inc.
Hazel Associates
Honeywell, Inc.
Hughes Communication Services, Inc.
IBM Corporation
Information Gatekeepers, Inc.
International Data Corporation
International Resource Development, Inc.
Irving Trust Company
Knight-Ridder Newspapers, Inc.
Knowledge Industry Publications, Inc.
Kokusai Denshin Denwa Co., Ltd. (Japan)
Lee Enterprises, Inc.
Lockheed Missiles and Space Co., Inc.
MCI Telecommunications, Inc.
McGraw-Hill, Inc.
Mead Data Central
Minneapolis Star and Tribune Company
MITRE Corporation
Motorola, Inc.
National Association of Letter Carriers
NCR Corporation
National Telephone Cooperative Assoc.
New York Times Company
Nippon Electric Company (Japan)
Norfolk & Western Railway Company
The Overseas Telecommunications Commission (Australia)
Pearson Longman Limited (United Kingdom)
Pitney Bowes, Inc.
Public Agenda Foundation
Reader's Digest Association, Inc.
Research Institute of Telecommunications and Economics (Japan)
Reuters Limited (United Kingdom)
St. Regis Paper Company
Salomon Brothers
Satellite Business Systems
Scaife Family Charitable Trusts
Scott & Fetzer Company
Seiden & de Cuevas, Inc.
Source Telecomputing Corporation
Southern Pacific Communications Company
Sprague Electric Company
Standard Shares
Swedish Television (Sweden)
Telemation Management Group, Inc.
Time Inc.
Times Mirror Co.
Times Publishing Co.
Transamerica Corporation
The Toronto Star (Canada)
The Tribune Company
United Parcel Service
United States Government:
- Central Intelligence Agency
- Department of Commerce:
  - National Technical Information Service
  - National Telecommunications and Information Administration
- Department of Energy
- Federal Communications Commission
- Internal Revenue Service
- National Aeronautics and Space Admin.
- National Security Agency
- United States Postal Rate Commission
- United States Postal Service

United Telecommunications, Inc.
Voice of America
Warner Amex Cable Communications Inc.
The Washington Post Company
Western Union

PREFACE

Cost and revenue allocations are widely thought to be important elements in attaining or even in defining public and private policy goals for the telecommunications industry.

The long history of jurisdictional cost separations and of inter-company division of revenues and settlements has been analyzed in an earlier Program publication.* Increasing competition not only within the telecommunications industry, but within the broader industries based on compunications (computers-and-communications) technologies is calling into question the applicability of traditional means to future ends. Bills before the 96th Congress, for instance, contemplate some alternatives to the traditional separations and settlements processes.

In this paper, Bob Godbey sketches how revenues are divided within the railroad industry, points out how problems similar to those in the telecommunications industry have been addressed by different means, and suggests that as the telecommunications environment comes to resemble more closely the railroad environment, experience in the latter may help guide the evolution of policy for the former.

Anthony G. Oettinger

* Sichter, James, W. Separations Procedures in the Telephone Industry: The Historical Origins of a Public Policy, Program on Information Resources Policy, Harvard University, Cambridge, MA., January 1977.

I. INTRODUCTION

Both the railroad and telephone industries offer interstate service involving more than one company, and each industry has developed different techniques to distribute the revenue from such services between the companies involved.

In the traditional telecommunications industry for example, the provision of long distance interstate toll service will typically involve several companies. The local operating company where the call begins provides the originating exchange service, AT&T Long Lines provides the interstate long distance trunking, and another local operating company provides the terminating exchange service. Similarly in the railroad industry, when a shipper ships a commodity interstate it may first travel over a small local feeder line, then over one or another major competing trunk line, and finally to its ultimate designation on a different small line. In both cases the rate the customer has paid must be apportioned between the participating carriers.

In apportioning revenues, one might wish merely to ascertain the costs each company incurred in providing the service, and to allocate the revenues accordingly. This alone can be quite complex; there is great latitude in assigning joint and common costs to one service or another. On the other hand, one might wish to support services for equity reasons which, by economic standards alone, should not be supported. For example, one might wish to support weak local service providers from the economies of scale enjoyed by major trunk lines. If local providers are essential

for a healthy nationwide communications or transportation network, and in need of financial support, appropriate division of revenue would allow the cost of such support to be internalized within the industry and borne by the aggregate of industry customers. This might be preferable to providing such support from the nation's general tax revenue. Financial support through division of revenue could come from the techniques used to allocate the costs of the provision of services, or it could be provided through more forthright mechanisms. Both the railroad and the telephone industries have confronted the division of revenue problem at various points in their histories, and have evolved different philosophies and techniques for coping with it.

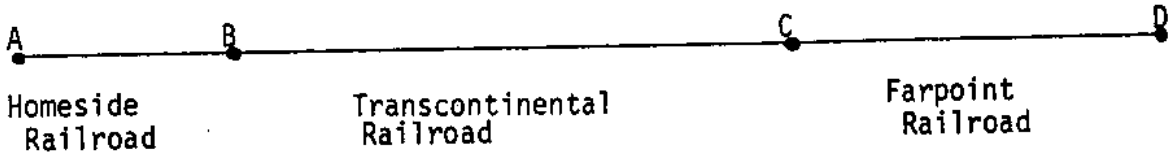
James Sichter has explored the evolution of jurisdictional separations of costs and intercompany settlements of revenues in the provision of toll service in the traditional telecommunications industry. This paper will trace the development of the analogous mechanisms for division of revenue in the railroad industry. The discussion will center on the histor of the divisions of joint and combination rates, and will touch upon the subject of trackage right agreements.* Then, drawing from Sichter's work and others', the paper will consider some of the similarities and differences in the techniques of the two industries.

---

* While trackage rights agreements are not strictly speaking a technique for dividing revenue, they do allow the provision of service involving more than one company, and are potentially a mechanism for cost allocation and/or revenue transfer among carriers.

This paper is limited in scope and merely traces the history and development of the mechanisms for division of revenue available to the railroad industry. It does not reflect the relative utilization of those mechanisms. Much research in this area remains to be done. Nor does this paper consider the intricacies of basic rate making, on which there is already an abundant literature. With these caveats, however, perhaps some interesting insights can be gleaned by comparing what have been the very different division of revenue mechanisms of the two industries. These insights may become all the more useful as the structure of the telecommunications industry changes with the growth of competition. For example, a bill (S.611) before the 96th Congress provides for the establishment of through rates in a restructured telecommunications industry with characteristics increasingly resembling those about to be described for the railroad industry.

II. DEFINITIONS



- Figure 1 -

Within the railroad industry, a local rate is a rate established by a carrier for carriage between two points on its own line, and must be made available to all shippers.[1] For example, Homeside Railroad will ship a commodity from point A to B, entirely on its own line, for the local rate. A through route is an arrangement, express or implied, between connecting railroads for the carriage of goods from an originating point on the line of one carrier to a destination point on the line of another, shipping from A to D for example. Through carriage generally implies a through rate.[2] The through rate may be an aggregation of separately established rates fixed independently by the several carriers forming the through route, or it may be a joint rate.[3] A joint rate is a single charge for a through route, which is published by the carriers involved in a joint tariff. Homeside Railroad, Transcontinental Railroad, and Farpoint Railroad may have a joint rate for the shipment of a commodity from A to D. The establishment of a joint rate and the division of the rate, or proportion which each line receives for its share of the through haul, may be determined by agreement among the participating carriers or prescribed by the ICC.[4] If no joint rate for the through route is established, the rate is the aggregate of the separately established rates of the several carriers involved. This type of rate may be referred to as a separately

established rate or as a combination rate. A combination rate may be the sum of the local rates involved, or it may be the sum of rates established by the carriers which differ from the corresponding local rate.

A carrier may acquire trackage rights over a railroad line or lines owned by another carrier. Such trackage rights resemble an easement of way in that the arrangement by which they are acquired is a lease agreement instead of a division of rates. For example, Intercontinental Railroad might lease from Farpoint Railroad the right to carry certain freight from C to D. Under these conditions, Transcontinental's rate for such carriage is entirely its own.

III. JOINT AND COMBINATION RATES

Combination rates and joint rates differ both conceptually and legally. A joint rate for a through route is established by the concurrence of connecting carriers, and the carriers party to the joint rate are jointly and severally liable for damages caused by the joint rate (excessive charges, for example). In a combination rate, where each separately established rate is independently set by the carrier involved with that portion of the through rate, each connecting carrier is liable only for its own acts. The next section will deal with the history of joint and combination rates together, however, to reflect the similarities that have developed in the mechanisms available to the Interstate Commerce Commission for the regulation of the two techniques.

A. The Hepburn Act of 1906

1. Joint Rates

At the turn of the century under the original Interstate Commerce Act, the division of joint rates was accomplished by private bargaining between the carriers involved and could be fixed at an arbitrary amount.[5] The large lines battled among themselves for divisions, and often serious disputes arose between the carriers involved. Short lines with more than one trunk line connection could play one connecting line against the other to attempt to negotiate a fair division. A short line with only one outlet, however, was at the mercy of the connecting line.[6]

The Hepburn Act of 1906 vested in the Interstate Commerce Commission authority to prescribe divisions of joint rates upon the complaint of an interested carrier after private bargaining had failed.[7] The Hepburn Act amended then existing provisions of the Interstate Commerce Act to provide that:

> "Whenever the carrier or carriers, in respect to joint rates, fares, or charges, shall fail to agree among themselves upon the apportionment or division thereof, the Commission may after hearing make a supplemental order prescribing the just and reasonable proportion of such joint rate to be received by each carrier party thereto, which order shall take effect as part of the original order."[8]

Thus, though private bargaining was still the preferred means for reaching a division of joint rates, the Commission could now intervene upon request of a party when negotiations had failed.

When prescribing divisions, the Commission sought to find a "just and reasonable" division between the parties involved; only those factors which affected a fair division of the specific through rate were considered. Such concerns as the financial needs of the carriers involved or the public interest were ignored, on the basis that "the division of a through rate was not a matter of concern to the public."[9] This was in part because the rate section of the Commerce Act was founded on the common law definition of a reasonable individual rate. In the common law, the financial position of the carriers involved had never been regarded as significant in determining the reasonableness of rates. The establishment of a rate for a particular route was regarded as having no legal relation to the aggregate rate equation or to the transportation industry as a whole.[10]

A "just and reasonable" division was not necessarily perceived as directly relating to any argument about apportionment of costs. The most common technique for dividing joint rates under the Commerce Act was probably the mileage basis, with each carrier receiving a share of the joint rate proportionate to its share of the total distance. Mileage was not the exclusive standard for fair division of rates, however, and other considera-

tions such as terminal service and origin of traffic were also considered. Even the strategic bargaining advantage of one carrier over another was occasionally considered.[11]

Although in reaching a division of joint rates the Commission generally intervened only upon request of a party after negotiations had failed, the Hepburn Act also empowered the Commission to intervene in rate setting whenever "any regulations or practices whatsoever of such carrier or carriers affecting such rates are unjust or unreasonable, or unjustly discriminatory, or unduly preferential or prejudicial."[12] Thus, even in the absence of a complaint from an involved party, the Commission could invoke this authority on its own initiative to compel the abandonment of certain discriminatory practices, such as preferential treatment given to one of two similarly situated railroads or excessive divisions in favor of a branch line owned by an industrial shipper (which amounted to a rebate to the shipper).[13] The Supreme Court said in 1915 that this authority was not merely discretionary, but that the law makes it the duty of the Commission "to make orders which shall nullify such practices resulting in rebating...if the division of joint rates are such as to amount to rebates or discriminations."[14]

2. Combination Rates

The Hepburn Act of 1906 also affected the handling of combination rates. The Act amended Section 1 of the Commerce Act to require every carrier "to establish through routes and just and reasonable rates applicable thereto." It also amended Section 6 to read in part: "If no joint rate over

the through route has been established, the several carriers in such through route shall file, print, and keep open to public inspection as aforesaid, the separately established rates, fares, and charges applied to the through transportation." Thus, while carriers were required to establish through routes, there was no requirement that they establish a joint rate. Any one carrier or combination of carriers could maintain a separately established rate for their portion of a combination rate without the consent or agreement of other carriers in the through route. A primary source of separately established rates was transit arrangements by which a commodity, such as a raw material, could be shipped to a point, unloaded, then reloaded, often as a finished product, and shipped to the final destination, all at one rate generally less then the sum of the locals.[15]

B. The Transportation Act of 1920

Limitations in the Commerce Act hampered the Commission in dealing effectively with growing problems in the railroad industry. The philosophy of the Act was committed to the competitive principle,[16] and the Commission had no power to prescribe minimum rates.[17] Thus the Commission could not prevent cut throat competition, even when it was to the detriment of the national system. The common law origins of the Act encouraged an independent assessment of rates for each route. This orientation discouraged consideration by the Commission of the aggregate effects of rate setting and divisions of rates on the individual carriers involved, or on the transportation industry as a whole.

Problems began to develop with the general credit position of the industry and from the coexistence of strong and weak railroads.[18] The

difference in earnings between prosperous and weak railroads was often due to the territory served, not to the efficiency of the management of the roads,[19] but the limited perspective of the Commission did not allow consideration of this factor or of the growing financial difficulties of the industry.

It was within this context and the advent of World War I that the Transportation Act of 1920 found its origins. The government seized control of all railroads on March 21, 1918 under the authority of the Federal Control Act. When the Director-General of the Railroad Administration subsequently proposed a five-year continuation of government control of the railroads, widespread disapproval of his proposal led to numerous alternative plans to regulate the industry. In 1919 the Senate Committee on Interstate Commerce, chaired by Albert B. Cummings, produced Senate Bill 3288, which included the section on the division of joint rates which was later incorporated in the Transportation Act. The House Committee on Interstate and Foreign Commerce, chaired by John J. Esch, included the Senate proposal in later versions of its Bill 10453. The Esch-Cummins Act, an integration of these bills and of many of the ideas proposed by the diverse interests affected, became the basis of the Transportation Act of 1920.

On September 3, 1919, the House Committee heard the representatives of the shortline railroads. The American Shortline Railroad Association referred to the portion of the Senate bill dealing with division of joint rates as "our amendment"[20] and requested that the House also include it in their bill "to meet the situation of the short and weak lines."[21] Roughly, their argument was that shortlines are necessary as feeder or producer roads for the through lines and that short lines are more expensive to run than

through lines. Thus, through lines which get benefit from the short lines should be required to support the short lines, just as they would be required to support their own branch lines if they were relying upon them as feeder lines.

The Transportation Act of 1920 included the shortline amendment which was incorporated into the bill as paragraph 6 of Section 15. Section 15(6) read (and still reads today, 49 U.S.C. §15(6)(a)):

> "Whenever after full hearings upon complaint or upon its own initiative, the Commission is of opinion that the divisions of joint rates, fares, or charges, applicable to the transportation of passengers or property, are or will be unjust, unreasonable, inequitable, or unduly preferential or prejudicial as between the carrier parties thereto (whether agreed upon by such carriers or any of them or otherwise established), the Commission shall by order prescribe the just, reasonable, and equitable divisions thereof to be received by the several carriers, and in cases where the joint rate, fare, or charge was established pursuant to a finding or order of the Commission and the divisions thereof are found by it to have been unjust, unreasonable, or inequitable, or unduly preferential or prejudicial, the Commission may also by order determine what (for the period subsequent to the filing of the complaint or petition or the making of the order of investigation) would have been the just, reasonable, and equitable divisions thereof to be received by the several carriers and require adjustments to be made in accordance therewith. In so prescribing and determining the divisions of joint rates, fares and charges, the Commission shall give due consideration, among other things, to the efficiency with which the carriers concerned are operated, the amount of revenue required to pay their respective operating expenses, taxes, and a fair return on their railway property held for and used in the service of transportation, and the importance to the public of the transportation services of such carriers and also whether any particular participating carrier is an originating, intermediate, or delivering line, and of any other fact or circumstance which would ordinarily, without regard to the mileage haul, entitle one carrier to a greater or less proportion than another carrier of the going rate, fare, or charge."

The inclusion of this section reflects the shift from the previous common law emphasis on the prevention of exorbitant rates and the protection of shippers and carriers against discrimination to the broader regulatory purpose of the Transportation Act of 1920. The Act sought to secure a sound national transportation system and recognized a corresponding economic necessity for the financial support of the weak roads by the strong lines. The last sentence of §15(6) provided a yardstick for the Commission to use in determining appropriate division of rates. Additionally, the Commission was now authorized to prescribe divisions upon its own initiative, and thus could intervene in situations where a weak road might be unwilling to antagonize a powerful through line by complaining about unjust or unreasonable divisions. This provision was in itself a recognition of the subordination of private contract rights to a public interest standard.

C. Subsequent Development in Division of Joint Rates

In the New England Divisions case of 1922,[22] the Commission granted the New England roads a blanket increase in freight divisions with all connecting lines due to the special operating handicaps and serious financial difficulties of the New England roads. The Commission stated that:

> "[W]e are of the opinion that our power over divisions is founded upon the public interest; that the carriers are mutually dependent parts of the transportation system; that the public interest requires that all essential parts be maintained, so far as possible, in effective working condition; that the relative amount and cost under economical and efficient man-

> agement of the service rendered is a prime factor in determining the fair and equitable share of joint revenue which each carrier shall receive; and that included in such cost is a due proportion of the burden of maintaining the financial integrity and credit of the carrier." [23]

The Supreme Court in affirming the Commission's ruling declared that the Commission properly considered the importance to the public of the weak carriers and in directing divisions solely to support them was acting in a manner intended to effectuate Congress's purpose of insuring adequate transportation service for the whole country.[24] In U.S. v. Abilene (1923),[25] the Supreme Court again held that the Commission could give a division larger than merely justice between the two carriers involved would demand, if the financial needs of the weaker road and the public interest required it, but emphasized that the share left to the other carriers must be adequate to avoid a confiscatory result. This requires considerations of cost.

In the New England Divisions case the Commission stated that "a paramount consideration in determining the equitable share of the joint revenue which any carrier shall receive must be the relative amount and cost of the service which it renders."[26] However, the Court in U.S. v. Abilene subsequently said "Relative cost of service is not the only factor to be considered in determining just division."[27] Numerous factors influencing costs may be considered, such as the fact that a carrier is an originating or delivering road or that fuel supplies are located off the carrier's line, or specialized services, or unfavorable climatic conditions, or light loads, or shortness of haul, branch line movements, unfavorable terrain, low density of traffic. Factors weighing against a higher division may also be considered, such as population increases, expanded agricultural, industrial, or mineral production in the territory served by the road and other factors which tend to show an

advantageous operating condition.[28]

While the Commission may consider various criteria other than those listed in 15(6), such as the prior history of rates and divisions,[29] the Court has held that the Commission must consider all the criteria delineated in section 15(6).[30] The Court has also held, however, that there "is no requirement that the Commission specify the weight given to any item of evidence or fact or disclose mental operation by which its decisions are reached."[31]

Although the Commission may make its determinations on an individual line basis, or even on an individual commodity basis,[32] the Commission has great flexibility in grouping carriers to simplify the rate division process. In affirming the Commission's ruling in the New England Divisions case,[33] the Supreme Court sanctioned group division of joint rates and reliance upon evidence typical of the carriers involved, without inquiry into the effect of the division upon each carrier. The practical necessity of making divisions of joint rates on a group basis, which must have been contemplated by the drafters of the Transportation Act, has inclined the courts to accept such divisions except in the event of manifest unfairness.[34] A carrier which believes that it is being unfairly treated by a group division may petition the Commission independently for reconsideration of its particular division. In 1930, the Supreme Court stated that "The Commission may make the required divisions between groups of carriers in the respective territories upon evidence which it reasonably may deem typical."[35] In 1967, the Supreme Court reversed a district court ruling which held that the Commission must make affirmative findings not only as to the groups of

railroads involved, but also with respect to each carrier affected by said group.[36] The Court commented that over 40 years of consistent administrative practice, beginning with the New England Divisions case, reflected that such individual findings were not necessary.[37]

Although the use of average figures is acceptable in establishing divisions of revenues, these averages must bear an appropriate relationship to the questions being considered by the Commission. In 1968, the Supreme Court held that averages used in establishing costs of service should not include costs associated with surburban commuter service when such costs could be shown to be totally unrelated to the inter-territorial divisions under consideration. The Court stated that such costs would be appropriate if the Commission were considering the revenue requirements of the carriers involved, but since the Commission was basing its decision purely on costs, having found no greater revenue need in either group, the inclusion of commuter costs was inappropriate.[38]

D. Subsequent Developments in Division of Combination Rates

The regulation of combination rates after the Hepburn Act tended more and more to resemble the regulation of joint rates. This tendency was influenced more by the courts than by the legislature. The limitation of a participating carrier's liability to only that portion of the rate established by that carrier remained a distinction, however.

After the Hepburn Act the Commission vacillated between considering the reasonableness of a portion of a combination rate independently of the total through rate, and in evaluating its reasonableness only in light of the reasonableness of the whole rate.[39] The Supreme Court settled the controversy in 1928.[40] The Court held that the ICC's power to declare rates

unreasonable extends to all rates, be they joint, local, or combination. In controversies involving combination rates, it may, if it sees fit, deal with one factor only of the combination rates which make up the total through rates.[41]

In 1934, the Court considered a case in which two railroads, one Canadian and the other American, set up a combination rate. The American line's proportion was found to be excessive, but the total through rate was not found to be excessive. The Court held that the shippers had not been deprived of their property, since the whole rate was not excessive and that while the Commission could order a reduction in the excessive portion, it could not order payment of damages by way or reparation without finding that the amount charged for the whole route was unjust and unreasonable.[42]

The Supreme Court held in 1917 that the Commission can require carriers who have established a through route to substitute a joint rate for through combination rates already in existence.[43] In 1940 Section 15(4) of the Transportation Act was amended to read, "No through route and joint rate applicable thereto shall be established by the Commission for the purpose of assisting any carrier that would participate therein to meet its financial needs." The Supreme Court subsequently held in 1952 that although the Transportation Act as amended forbids the Commission to establish a through route for the purpose of assisting a participating carrier to meet its financial needs, the Commission may prescribe a joint rate for an existing through route in place of a combination rate with a view to an apportionment of revenue which will assist the financially weaker carrier.[44]

In 1927, the Supreme Court considered a case in which the ICC had ordered a shift in a transfer charge from the rate of one group of lines in a combination through route to the rate of another group of lines.[45] The Court held that "the same considerations apply in determining the reasonableness of the apportionment of revenues derived from combination rates as govern the divisions of joint rates. The merits of the changes made by the order cannot be determined without a consideration of facts substantially similar to those specified in ¶(6) of §15 relating to the division of joint rates."[46]

IV. TRACKAGE RIGHT AGREEMENTS

Trackage right agreements are an alternative to the preceding division of revenue approaches for providing a service which utilizes facilities involving more than one carrier. A trackage right agreement essentially establishes a landlord-tenant relationship and involves "continuing or permanent easements or licenses granted to a foreign carrier to operate over the tracks and right of way of another carrier.[47] The extent of privileges granted under such agreements may vary. The establishment of such agreements again brings into question the potential for cost allocation and/or revenue transfers between carriers.

The 1940 amendment of the Transportation Act gave the ICC express authority over trackage agreements. The Transportation Act of 1940 amended then existing Section 5(2)(a)(ii) to read:

> "It shall be lawful with the approval and authorization of the Commission...for a carrier by railroad to acquire trackage rights over, or joint ownership in or joint use of, any railroad line or lines owned or operated by any other such carrier and terminal incidental thereto."

The Courts have subsequently described the limits of the Commission's authority and the factors on which it may base its decisions. In 1946, the Supreme Court stated that, at least in cases concerning abandonment of lines, a "major concern of Congress in dealing with this problem was that neither inadequate rentals nor extortionate nor unreasonable exaction would be made for trackage rights. (citation omitted) Those questions intimately relate to the financial strength of carriers."[48] The Court found that the Commission's authority extended to fixing terms and conditions of the trackage agreement, including rentals, and that the financial strength of the carriers concerned was a relevant and appropriate consideration.

Although approval of the Commission is required to institute or dissolve a trackage agreement,[49] and although the Commission has wide latitude in consideration of such agreement and can in effect prescribe such elements of the agreement as the rental rate, the Commission's powers over trackage agreements are limited. In 1963, a federal district court held that interpretation of a trackage agreement was an issue of contract law and that the complaining carrier's rights arise, if at all, from a breach of contract.[50] The court found that no statuatory violation was involved because no mandatory order of the ICC was involved. "Although the...connection and the joint trackage agreement could not legally be undertaken without ICC approval, 49 U.S.C.A. §5(2)(a)(ii), its approval was permissive only."[51] The appeals court upheld the ruling and said, "The fact that such permission was required does not have the effect of making the Commerce Act a part of the contract insofar as the respective rights of North Western and T.P. & W. are concerned."[52]

The Commission has further limited itself by declaring that it lacks authority to require a railroad to enter into a trackage agreement.[53] However, the Commission may decide to agree to the consolidation and merger of two lines only if certain trackage agreements are made to provide a competitive route to one created by the merger.[54]

V. SUMMARY OF RAILROAD METHODS

The railroad industry thus has several methods for providing services involving more than one company. Trackage right agreements, for example, might be the method used in situations where one railroad can advantageously utilize a relatively short portion of another carrier's track. One line might wish to connect two segments of its own track, and might enter into a trackage agreement with another line, rather than constructing a connecting link. In a U.S.-Canadian through route, a combination rate might be the most effective method of providing servive. Within the U.S., most traffic involving more than one line probably moves on joint rates. All three methods discussed limit consideration of the ICC to the lines involved in the specific routes at issue. All three methods allow at least some consideration by the ICC of the financial strength of the carriers concerned.

In trackage right agreements the ICC has authority to fix the terms and conditions of the agreement, and this authority extends to consideration of the financial strength of the carriers involved.

In the division of joint rates, the Transportation Act of 1920 states that the ICC shall give due consideration not only to the cost of providing the service, but also to the revenue requirements of concerned carriers, their importance to the public, and the other elements delineated in §15(6). The court has held that the "same considerations apply in determining the reasonableness of the apportionment of revenues derived from combination rates as govern the divisions of joint rates."[55]

The Supreme Court has found "cost of service" to refer to the out of pocket expenses directly associated with a particular service, and "revenue needs" to refer to funds in excess of out of pocket expenses, including funds

for new investments.[56] The Court has held that costs unrelated to a division at issue can be considered in evaluating the revenue needs of the concerned carriers, but not in evaluating the costs of providing the specific service at issue.[57]

Ambiguities in ascertaining which costs are associated with which services may be manipulated to provide support to certain carriers, but whether such manipulation does occur in the railroad industry is beyond the scope of this paper. The ICC has more direct methods of providing support to weak lines, however, in the additional criteria of §15(6) of the Act. Indeed, the Supreme Court has interpreted the Act to require that the Commission must consider all criteria delineated in §15(6) in reaching its decisions.[58]

However, the court has held that there "is no requirement that the Commission specify the weight given to any item of evidence or fact or disclose mental operations by which its decisions are reached."[59] This gives the Commission great latitude in considering the relative financial needs, efficiency, etc. of the concerned companies. Again, it is beyond the scope of this paper to investigate the actual weight accorded these considerations by the Commission. However, in Chicago & N. W. v. Atchinson, T. & S. F. (1967),[60] (with 11,200 pages of ICC hearings) the ICC based its decision on cost of service and revenue needs only, finding efficiency and the importance to the public equal for all groups of concerned carriers. And in Baltimore & Ohio v. Aberdeen & Rockfish (1968),[61] the ICC based its decision entirely upon costs, finding all other factors equal for all groups concerned, including revenue needs. Since both of these cases are group division cases, they may not reflect the considerations of the ICC in divisions between individual carriers.

The present troubled financial situation of the railroad industry may imply few strong railroads able to help support weak lines. The Railroad Revitalization and Regulatory Reform Act of 1976[62] reflects Congress' concern with the overall level of railroad earnings. The Act may also reflect Congressional concern with the procedural complexity of division cases. In addition to the 11,200 pages of ICC hearings mentioned above, consider the Official-Southern Division,[63] with proceedings instituted in 1947 and litigation continuing into 1968. The division of revenue mechanisms themselves are of interest, however, and in the next section, we shall compare them with the very different mechanisms in the traditional telephone industry.

VI. COMPARISON OF RAILROAD AND TRADITIONAL TELECOMMUNICATIONS INDUSTRY METHODS

Both the railroad industry and the telecommunications industry provide interstate services that may depend on more than one company. In the railroad industry this is typically a route involving more than one line; in the telephone industry it is typically a toll call involving two or more companies. The division of revenue from these services has been approached in different ways by the two industries.

The railroad industry has sought to divide revenues on a route by route basis. The telecommunications industry has pooled the nationwide revenues generated by cooperative interstate services, and distributed them to participating companies according to the relative investment and expenses incurred by the companies in providing the services.

The goals of universal service in the telephone industry, and of an adequate national transportation system in the railroad industry are very similar. Both require a broad local system feeding a strong trunk line system. In seeking these goals, both industries have considered the question of whether to support feeder lines from the economies of scale enjoyed by the trunk lines. Providing support through the division of revenues allows the internalization of the cost of such support to within the industry.

In the railroad industry a strong incentive to support feeder lines from the economies of scale of trunk lines exists lest the small feeder lines be driven out of business and the national system suffer as a result. In the telecommunications industry the goal of universal service and the political pressure of the many small users provide the incentive to keep

local rates low by supporting them from the economies of scale enjoyed by the high density long distance trunks.

Although the problems the two industries have faced are similar, the industries' differing structures and histories have influenced the development of different approaches to the division of revenue. There are also different mechanisms within those approaches for supporting weak companies through the division of revenue, when such support is necessary.

A. The Telecommunications Industry[64]

The telecommunications industry distributes its interstate toll revenues by dividing the aggregate revenues among the participating companies. All revenues generated by interstate toll services are pooled and then redistributed to the participating companies on the basis of the revenue requirements associated with the portion of their investment allocated by the jurisdictional separations procedure to interstate toll service.

The principle of nationwide rate averaging necessitates this pooling and division of revenues. The interstate rates are set to satisfy the revenue requirements of the total network, not of individual routes. Thus, the revenues from a low density route may cover only a portion of the costs associated with the provision of that service, and the revenues from a high density route may exceed the costs associated with the provision of that particular service. The revenue pool first covers all participating companies' out-of-pocket expenses associated with interstate service, and the remainder is then apportioned to the companies according to their investment and expenses. Thus, the division of the revenue pool is not directly

related to the amount of revenue generated either by a specific company or by a specific route.

The separations and settlements procedures can be used to support intrastate local and toll services by the interstate toll service. Some local plant investment and expenses are allocated to interstate toll in a proportion related to the relative use of the plant in that service. The mechanisms by which this occurs can be manipulated to allocate more or less local plant costs to interstate toll service. The revenue requirements associated with the portion of the local plant investment and expenses allocated to interstate toll are met from the national pool of revenue generated by all such traffic. Thus, only the revenue requirements associated with the remainder of the local plant investment must be covered by intrastate toll and local revenues.

Many factors led to this arrangement. The Supreme Court's decision of Smith v. Illinois Bell[65] required that some local exchange costs be allocated to the interstate toll jurisdiction on the basis of use. The joint cost characteristics of the local plant made any allocations of costs to either local service or toll essentially arbitrary from a practical standpoint. The economies of scale which the evolving technology created in the high density toll routes made feasible financially support of local service by interstate service. The goal of universal service and the associated need to place basic telephone service within the financial reach of as many people as possible created an incentive to support the local service. In this environment separations and settlements increasingly became the tools by which the industry and the regulators sought to support local telecommunications service by interstate toll service.

B. The Railroad Industry

The railroad industry approaches the problem of distributing the revenues generated by cooperative interstate services on a route by route basis, rather than on a pooling basis. In both joint and combination rates for through routes the rate itself is apportioned among the carriers participating in the route. Each carrier "owns" a portion of the through rate, and the industry seems to view the process of establishing these proportions as a division of the rate, from which the appropriate apportionment of revenues naturally flows.

There is no principle in the railroad industry analogous to that of nationwide rate averaging in the telecommunications industry. Railroads must face both competition from other railroads, and intermodal competition from other forms of transportation, such as trucking or water transportation. Thus the rate for each route is established individually (in theory, although in practice rate setting by groups of lines is often utilized) after consideration of cost, competition, the total financial condition of the carrier (or group of carriers), and other relevant factors. Without nationwide rate averaging, there is no need for nationwide revenue pooling. The revenue from each route is divided only among participating carriers, and carriers will have a separate agreement for each route in which they participate.

The railroad industry has also developed different mechanisms from those of the telecommunications industry to allow the support of feeder lines from the economies of scale enjoyed by the high density trunk lines.

While the problem of allocation of joint costs has often appeared in the railroad industry, there is apparently no history there of viewing the cost of a feeder line as a joint cost of providing local and through service. In the railroad industry there was no single trunk line entity analogous to AT&T Long Lines, and the trunk lines were not dependent upon the local feeder lines to offer their services: railroad trunk lines often offer service originating or terminating at points on their own lines. In contrast, AT&T Long Lines relies upon the local networks to provide its service, which makes the cost of providing a local loop appear to be a cost shared jointly by local and toll service.

The telecommunications industry and its regulators utilized the ambiguity of allocation of joint costs to further their policy goals. It provided a convenient vehicle to allow support of the local lines by the trunk lines. The railroad industry was forced to confront the problem more directly. The Shortline Railroads lobbied successfully to have the Transportation Act of 1920 include a section empowering the ICC to prescribe the division of joint rates. The Commission was explicitly instructed to consider among other things:

> "...the efficiency with which the carriers concerned are operated, the amount of revenue required to pay their respective operating expenses, taxes, and a fair return on their railway property held for and used in the service of transportation services of such carriers, and the importance to the public of the transportation services of such carriers, and also whether any particular participating carrier is an originating, intermediate, or delivering lines, and of any other fact or circumstances which would ordinarily, without regard to the mileage haul, entitle one carrier to a greater or less proportion than another carrier of the going rate, fare or charge." (49 U.S.C. 15(6))

The courts and the ICC interpreted this as authorization to consider the importance to the public of the weak carriers and to direct divisions solely to accommodate the financial needs of the weaker roads. The Supreme Court in 1927 extended much of this authority to combination rates. Thus, while the telecommunications industry developed arcane formulas to divide a national revenue pool, the railroad industry confessed to the need to support weak lines and proceeded on a route by route basis to divide rates to accomplish this goal.

VII. CONCLUSION

The history and structure of the telecommunications industry, particularly its commitment to nationwide rate averaging and the powerful unifying presence of AT&T, have led to nationwide pooling of revenue from cooperative interstate services. This revenue pool is then divided among participating companies in a manner which reflects the cost and utilization of their plant. With nationwide rate averaging and the associated revenue pooling, the rate for a high density trunk route must not only cover the costs directly associated with that route, but also help support both feeder service and the low density trunk routes.

The route by route approach of the railroad industry for dealing with division of revenue evolved in an environment of competition. It allows the rate for each route to be established separately from the rate for other routes. The railroads have also cleared the political hurdle of confessing to the potential necessity of subsidizing weak lines by strong lines, and have delineated specific criteria to assist in doing this.

If the environment of the telecommunications industry continues to change with the introduction of more and more competition, the question arises whether the present separations and settlements procedure will remain the best way to effectuate the division of revenues from interstate toll services. Recent legislation, such as S.611, in the 96th Congress (March 12, 1979), suggests that the railroad approach may serve as an instructive model in the continuing debate over the restructuring of the industry. The telecommunications industry and its regulators

may be reluctant to leave the concealing complexity of the joint cost ambiguity, but as their environment changes, they may be forced to abandon their established division of revenue practices.

FOOTNOTES

[1]New York, N.H. & H.R. Co. vs. Platt, 7 I.C.C. 323 (1897).

[2]St. Louis S.W.R. Co. v. U.S., 245 U.S. 136, 139 n.2 (1917).

[3]Ibid.

[4]"Division of Joint Rites and the Baltimore and Ohio Case," 46 Yale Law Journal 811 (1937).

[5]St. Louis S.W.R. Co. v. U.S., 254 U.S. 136, 139-140 n.2 (1917).

[6]46 Yale Law Journal at 812

[7]Hepburn Act §4, 34 Stat. 590 (1906).

[8]24 Stat. 384 (1897).

[9]Board of Trade of Chicago v. Atlantic City R. Co., 20 I.C.C. 504, 508 (1911).

[10]Johnston, Forney, "The Transportation Act, 1920," 6 Virginia Law Review 482, 485 (1920).

[11]46 Yale Law Journal at 814.

[12]34 St. 589 (1906).

[13]46 Yale Law Journal at 813.

[14]O'Keefe v. U.S., 240 U.S. 294, 297-298 (1915).

[15]Berry, C.W., "A Study of Proportional Rates," 10 I.C.C. Practioners Journal 545, 550 (1943).

[16]Sharfman, I. Leo, The American Railroad Problem (1921).

[17]Dixon, Frank H., Railroads and Government 255 (1922).

[18]Sharfman, supra.

[19]Dixon, supra at 234.

[20]Hearings of the House Committee on Interstate and Foreign Commerce, Sept. 3, 1919, p. 1964.

[21]Ibid at 1965.

[22]66 I.C.C. 196, 261 U.S. 184 (1922).

[23]66 I.C.C. at 199.

[24]261 U.S. 184.

[25]265 U.S. 274, 284 (1923).

[26]66 I.C.C. at 168.

[27]265 U.S. at 284.

[28]33 Yale Law Journal at 819-820.

[29]Baltimore and O.R. Co. v. U.S., 194 I.C.C. 729, 298 U.S. 349 (1936).

[30]Brimstone R. & C. Co. v. U.S., 276 U.S. 104 (1927).

[31]298 U.S. at 359.

[32]298 U.S. 349.

[33]261 U.S. 184.

[34]44 Harvard Law Review 471, 472 (1931).

[35]Beaumont, S.S. & W. v. U.S., 282 U.S. 74, 83 (1930).

[36]Chicago & N.W.R. Co. v. Atchinson, Topeka and Santa Fe R. Co., 238 F. Supp. 528, 387 U.S. 326, reh. den. 398 U.S. 892 (1967).

[37]387 U.S. 326.

[38]Baltimore & Ohio v. Aberdeen and Rockfish, 3931 U.S. 87, reh. den. 393 U.S. 1124 (1968).

[39]Berry, supra at 552-564.

[40]Atchinson, Topeka & Santa Fe v. U.S., 297 U.S. 768, 771 (1928).

[41]279 U.S. at 776.

[42]Great Northern Railway Co. v. Sullivan, 294 U.S. 458 (1934).

[43]St. Louis S.R. Co. v. U.S., 245 U.S. 136 (1917).

[44]U.S. v. Great Northern, 343 U.S. 562 (1952).

[45]Baltimore & O.R. Co. v. U.S., 277 U.S. 291, reh. den. 277 U.S. 404 (1927).

[46]277 U.S. at 301.

[47]Chicago, R.T. & P.R. Co. v. Chicago, B. & O.R. Co., 437 F.2d 6, 10, cert. denied 385 U.S. 457 (1966).

[48]Thompson v. Texas Mexican R. Co., 328 U.S. 134, 148 (1946).

[49]Chicago & N.W.R. Co. v. Chicago, M., St. P. & P.R. Co., 562 F.2d 193 (1974).

[50]Chicago & N.W.R. Co. v. Toledo, P. & W.R. Co., 217 F. Supp. 64, 324 F.2d 936 (1963).

[51]217 F. supp. at 69.

[52]324 F.2d at 938

[53]Baltimore & O.R. Co. Operations, 261 I.C.C. 535, 544 (1945).

[54]Louisville & Nashville R. Co. v. U.S., 369 F. Supp. 621, affirmed 414 U.S. 1105.

[55]277 U.S. at 301.

[56]387 U.S. at 333-334.

[57]393 U.S. 87, reh. den. 393 U.S. 1124 (1968).

[58]276 U.S. 104.

[59]298 U.S. at 359.

[60]387 U.S. 326, reh. den. 398 U.S. 892 (1967).

[61]393 U.S. 87, reh. den. 393 U.S. 1124 (1968).

[62]90 Stat. 31 (1976).

[63]325 I.C.C. 1 (1965).

[64]See generally Sichter, James W., Separations Procedures in the Telephone Industry: The Historical Origins of a Public Policy, Program on Information Resources Policy, Harvard University, Cambridge, MA, January 1977.

[65]282 U.S. 148 (1930).