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Vol. III Pages 605-916
(In Three Volumes)

Record No. 7425

In the Supreme Court of Appeals of Virginia at Richmond

NORFOLK AND WESTERN RAILWAY COMPANY

v.

COMMONWEALTH OF VIRGINIA, ET AL.

FROM THE STATE CORPORATION COMMISSION OF VIRGINIA

RULE 5:12—BRIEFS

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HOWARD G. TURNER, Clerk.

page 1240 } Chairman Catterall: You gave no consideration whatever to going-concern value?

A. No, Sir.

Chairman Catterall: The Commission will recess for five minutes. 2:59 P. M.

3:06 P. M. The Commission resumes its session.

Mr. Riely:

Q. Mr. Younger, you did for Norfolk and Western just about what you did for the other utilities; you took eighty per cent of the original cost, is that correct?

A. Well, what I did, Mr. Riely, on these major utilities through maintenance, our assessment was really not made and certified until August; and that was when I went out on the road to make a study to tie in with the figures at which I had arrived.

Q. Yes, and that trip was made in May and June, I believe.

A. Yes, Sir.

page 1241 } Q. And did you make field notes of your inspection trip?

A. Yes, Sir.

Q. When was the last previous inspection trip that you made over the Norfolk and Western for this purpose of observing the conditions?

A. For the purpose of roadway and track, it is the first one I have made over it.

Q. Well, this trip in May and June merely confirmed your evaluation you had made in February, isn't that correct?

A. I wouldn't say confirmed it, no. I came up with the figure slightly less, which when rounded off amounted to it.

Q. You didn't change the Febraury determination?

A. No, Sir.

Q. Now on page twenty-three, you state that in your "judgment, upon giving consideration to the various classes of property and the information pertaining to them, the overall operating condition would be 80%." You are referring to the Norfolk and Western's tracks?

A. Roadway and track.

page 1242 } Q. Roadway and track. Now what do you mean by "operating condition" as you use it in that sentence, Mr. Younger?

A. Well, the "operating condition," which is in place, per-

mits it to bear the load and the speeds of the trains that operate over it.

Chairman Catterall: Why didn't you follow what the Epes letter said? He said it was one hundred per cent. Do you remember that statement in Judge Epes' letter?

A. Ninety per cent, did you say?

Chairman Catterall: He said a hundred per cent.

A. In my judgment, it was not a hundred per cent.

Mr. Riely:

Q. Why was it eighty and not seventy?

A. Because my calculations came up to seventy-eight point something, and it was rounded off to eighty. We assess in steps of five per cent as far as allowance for depreciation is concerned.

Q. Now you used eighty per cent conditions for all railroads in Virginia?

page 1243 } A. No, Sir.

Q. What railroads did you use another per cent condition for?

A. I used different per cents for railroads that are not an applicant in this case.

Q. Well, what railroads did you use another condition per cent for rather than eighty per cent?

A. This eighty per cent that developed was to derive at a factor to apply to the 1967 unit assessed value per mile for the various classifications of track and spread uniformly throughout over all classes of traffic.

Q. Now, wait a second. I'm getting confused, Mr. Younger. Excuse me. You took the 1967 assessments for all railroads except the Pennsylvania and the Southern, and you applied a one point fifty-five factor to that to get the 1968 one hundred per cent. Is that correct?

A. Let me see if I can explain it clearer. I developed a one point fifty-five factor as the depreciated original cost basis.

Q. And that was developed from the Norfolk and Western?

A. That was developed from the Norfolk and Western in relationship to the fair market value for the

page 1244 } year 1967.

Q. Right.

A. That is how I developed my factor.

Q. Right.

A. And then, using the 1967 unit value per mile for the

various classifications of track, I multiplied those by the factor to arrive at the 1968 unit value per mile for the various classifications of track.

Q. So you did not use a condition per cent for any railroad except the Norfolk and Western, is that true? You took eighty per cent off the original cost of the Norfolk and Western to develop your one point fifty-five factor?

A. Yes, Sir.

Q. But you did not use any condition per cent for the RF&P?

A. No, the RF&P didn't furnish me with any figures.

Q. So you used the only three railroads that you had to use a condition per cent for, were the Norfolk and Western, the Southern and the Pennsylvania? Is that correct?

A. The only railroads—

page 1245 } Q. Which had furnished you the information.

A. —who had furnished me the information, I used a different factor.

Q. You used an eighty per cent on the Norfolk and Western?

A. Yes, Sir.

Q. What per cent did you use on the Pennsylvania, do you recall?

A. It was several per cent. I have forgotten just which they were.

Q. Were they less than eighty per cent?

A. One of them was.

Q. And the other two were greater than eighty per cent?

A. No, the other was eighty per cent.

Q. Eighty per cent. What did you use for the Southern?

A. Eighty which arrived at a factor of one point three something.

Q. One point three something?

A. Yes, Sir.

Q. Now did you make an inspection trip on

page 1246 } the Southern?

A. No, Sir.

Q. Did you make an inspection trip on the Pennsylvania?

A. No, Sir. Well, not at this time, but I made, but I had made one recently.

Q. When did you make that?

A. That was made about two years ago while inspecting the buildings and the track.

Q. And did that inspection confirm you in the use of the percentages that you used on the Pennsylvania?

A. Yes, Sir.

Q. Now on page twenty-three, you further say, "On mass items of property, such as transmission lines of power companies and pipelines of transmission companies, we arrive at an overall percent condition and apply this percent condition to the original cost of the existing property in place."

Now as to power companies and natural gas pipeline companies, you also use the eighty per cent condition, did you not?

A. Well, it depends on the property. We have
page 1247 } pipeline companies who their property we are carrying in ninety per cent condition.

Q. Ninety per cent condition. Do you use less than eighty per cent on any pipeline company?

A. I do not know any transmission company that we use less than eighty per cent on.

Q. Do you use less than eighty per cent on any electric, light, and power company?

A. On a transmission line, we use eighty per cent.

Q. Eighty per cent. How did you develop this for the transmission line of Appalachian, say, for example?

A. That was developed some time ago through studies of replacements and maintenance and items of that nature and the property.

Q. And what condition did you find on the Pennsylvania, for example, that resulted in an operating condition in par of less than eighty per cent?

A. What conditions did I find?

Q. Yes, were they physical conditions?

A. Yes, physical conditions, yes, Sir.

Q. What were they? Was it track or was it
page 1248 } the ties?

A. The track and ties and also the movement of loads over the track.

Q. Now, does it have anything to do with tonnage, the amount of tonnage that is carried over the rail?

A. Weight, yes, Sir.

Q. Did you study that? Did you get figures from the Pennsylvania on that?

A. Yes, Sir.

Q. Did you get any figures from the Norfolk and Western on the tonnage?

A. I developed some.

Q. What was the source of your development?

Lee B. Younger

A. From the register, the equipment register, as to the capacity of their cars and so forth.

Q. But you didn't develop any information as to the number of times that the cars passed over the track?

A. No, Sir, the weight is only there one time momentarily.

Q. Did you inspect the tracks on the Pennsylvania, you did I believe you said?

page 1249 } A. Over on the Eastern Shore, yes.

Q. Now, have you made an inspection of any railroad tracks within the past two years other than the Pennsylvania and the Norfolk and Western?

A. No detailed inspection, no.

Mr. Carter: If your Honors please, I am a little confused. Are we trying the Norfolk and Western Case here, or are we trying all—

Chairman Catterall: I thought this was a test case.

Mr. Carter: Sir?

Chairman Catterall: I thought this was a test case.

Mr. Riely: Well, if your Honors please, this is a test case; but we agreed, I believe, in the order that the principals decided here would be applicable in the other cases insofar as they could possibly be made applicable, and this is the reason for my bringing in these other railroads from time to time.

Chairman Catterall: Well, I guess it won't do any harm, except it takes more time than it otherwise

page 1250 } would.

Mr. Carter: It takes a lot of time, and it looks like we are trying a different case to me.

I will withdraw my objection. It takes more time on objections than you do on questions.

Mr. Riely:

Q. And do you inspect these facilities of the transmission facilities of electric power companies?

A. Yes, Sir.

Q. How often do you do that?

A. I try to do it as often as we can with the personnel I have available.

Q. Have you—when you do this, do you inspect all of their transmission facilities?

A. Now that is a physical impossibility, Mr. Riely, as you know.

Q. You just go through some of them, is that correct?

Lee B. Younger

A. I make spot checks.
Q. Do you try to do this every year for each company?
A. That is an impossibility.
Q. How often do you get around say to Appalachian, once every five years?
page 1251 } A. I would say—

Mr. Carter: Appalachian is certainly not in this case, it it your Honors?
Chairman Catterall: Well, we do this for the railroad right-of-way every forty years, and Mr. Riely wants to bring out that we do it more often for the other utilities.
Mr. Carter: All right.

A. Would you mind repeating your question?

Mr. Riely:
Q. How often do you *inspection* Appalachian transmission property, maybe once every five years?
A. I would say I've been over spot checking while making land studies and so forth within that period of time.
Q. And you try to do that every five years?
A. Well, there is not set—
Q. No set pattern?
A. That is right.
Q. How about natural gas transmission pipelines? How often—they are sort of hard to inspect aren't they?
A. Yes, Sir.
page 1252 } Q. How do you determine that they are in eighty per cent condition or ninety per cent condition?
A. Well, Mr. Riely, in the *ad valorem* tax purposes, it is not only your physical dollars, it is age of the dollars that have been installed and that has a very important part in the assessment of the *ad valorem* tax purposes.
In other words, if you had a utility that had a big expenditure in one year for a certain plant account, that property is only one year old; certainly influences the value on the remaining property for the time it has been in.

Chairman Catterall: When the Surry Plant goes into operation, are you going to assess it at a hundred per cent?
A. No, Sir, we start off with ninety and hold it until the period of time it has depreciated below the ninety to offset the earlier consideration.

Mr. Riely:

Q. And that would be true in the natural gas pipelines, too, I judge?

A. Yes, Sir.

page 1252-A } Q. So that the Atlantic Seaboard Line that came over mountains in the middle 1930's would get a lower per cent condition than the ones that have been built more recently in this decade, is that right?

A. Yes, in relationship to the cost.

Q. Well, do you take certain transmission lines and give them certain percentage and other transmission lines and give them other percentage?

A. No, Sir. As I stated here we treat it as a mass item of property. Just like we would do the track of the railroad, and we arrive at a condition for the entire—for all transmission lines, and then that is spread back to the various localities, the same as we do for the railroads.

Q. So you give an over-all evaluation—

A. Yes, Sir.

Q. —for these mass accounts?

A. Yes, Sir.

Q. And I judge that they are ninety per cent for some pipelines and eighty per cent for electric companies and for the Norfolk and Western?

A. Well, it just depends now. For example,

page 1253 } you might say that Colonial Pipeline Company and the Plantation Pipeline Company, which were installed about 1965, I believe, we are carrying those at a ninety per cent condition, which is practically almost reproduction cost new value.

Q. And how about Transcontinental, for example?

A. We have theirs as far as the main line. It is not below eighty, and some of their branch lines, we have at ninety.

Q. Some of their branch lines at ninety. Do you go below eighty for electric companies?

A. Not on—

Q. Not on mass accounts?

A. Not on that type of property, no, Sir.

Q. How about for the gas transmission lines? Do you go below eighty per cent?

A. Not on the transmission lines.

Q. Now, let's see on page twenty-seven, you state and I quote, "Upon inspecting the tracks and roadway property of the Norfolk and Western, I concluded that the track and roadway was in an overall 80% operating condition."

Lee B. Younger

Now this conclusion was confirmatory of your
page 1254 } previous conclusion to use the eighty per cent?
A. Yes. As I said earlier from my inspection I came up with a slightly lower figure and which was rounded off to the nearest five.

Mr. Riely: Your Honors, excuse me for a minute. I believe I can shorten this examination somewhat.

Q. Let me ask you just a little bit about your inspection trip. How far did you go?
A. I walked quite a few miles. We started out in Norfolk and continued to Petersburg on the first day.

Chairman Catterall: Who is we?
A. The representatives of an engineer with the Commission and at all times at least three representatives of the Norfolk and Western were along.

Mr. Riely:
Q. How often did you stop, Mr. Younger?
A. When we started our journey at Norfolk, I asked the representatives of the Norfolk and Western, who is generally the engineer of that division or the superintendent, to stop whenever along a line that in his opinion was an average
section of the line. All stops were made at the
page 1255 } decision of the Norfolk and Western, either the
division superintendent or someone else. I relied entirely on his selection as to an average section.
Q. Well, did you stop on the average of once every ten miles, every fifteen miles, every five miles, every twenty miles? Do you remember?
A. I wouldn't know. I mean I do not recall, except unless without referring to my notes here, (indicating); just where the stops were made and how many miles we walked and so forth.
Q. And you did measure the rails with an instrument, I believe?
A. Yes, Sir. A representative of the Norfolk and Western did the gauging, and I took down the recording of the gauge.
Q. How about ties? How many ties did you examine?
A. How many ties—
Q. At each stop?
A. Well, in most cases, we walked a half mile or a mile checking ties, at the same time checking the rail and the

date of the rail and so forth; so sometimes
page 1256 } we double-tracked, we would walk up one track
for a quarter of a mile and move over to the other track east bound and west bound.

Q. What did you do about ballast? Did you do anything more than observe the surface of the ballast—the rain-washed surface of the ballast?

A. Well, I didn't dig into the sub-grade if that is what you mean.

Q. That is what I mean, yes.

Chairman Catterall: You didn't even have a shovel with you, did you?

A. No, Sir.

Mr. Riely:

Q. How about bridges? Did you examine any bridges?

A. As I recall, two of the stops were at mileposts where there were bridges. On the other bridges, I might say riding a high-rail car over those bridges, you don't go at a very fast pace and I was able to get a general idea.

Q. Did you go down underneath the bridges, the two
bridges once you stopped there?
page 1257 } A. No, Sir. I checked them at the abutments.
Q. At the abutments?

A. I did not check any of the details that you asked former expert witnesses.

Q. I was going to ask you about the vertical stiffness, but I do not think I will.

Where did you go after you left Petersburg?

A. I might add, Mr. Riely, my memorandum of notes was furnished to the Norfolk and Western in June of 1968. They have a copy of them.

Q. Yes. Did you continue west from Petersburg?

A. Yes, Sir.

Q. And I believe you went all the way to Bluefield, did you not?

A. That is one of the places we spent the night, yes, Sir.

Q. Did you go up the Shenandoah Division toward Hagerstown?

A. Yes, Sir.

Q. Did you go on the Durham Division, from Lynchburg
down?
page 1258 } A. No, they kind of gave me a fast one there.

Lee B. Younger

I went from Brookneal towards Lynchburg. I didn't pick up the traffic from the Virginian.

Q. Did you go down to Norton?

A. Yes, sir. Again, I was brainwashed. I mean someone had been brainwashed.

Q. Did you make a conclusion as to percent condition by account one for ties, one for rails, one for ballast?

A. Yes, sir.

Q. Could you give me those?

A. Yes, sir. I have a pencil here. I can read them off to you.

Q. Why don't you read them off by accounts?

A. All right, sir. I would like first to clarify my figures. In preparation of these figures, I have followed the same method as other utilities in that I have prorated engineering to each individual account.

Q. Yes.

A. I prorated that down. I have not set it up as a separate figure. In other words, my engineering is carrying the same percent condition as the account to which

page 1259 } it has been applied.

Q. I am delighted to hear that, Sir.

A. And I have also prorated track laying and surfacing to the proper accounts to which that applies to and not plan a general percentage because I didn't know how you could arrive at a percentage for labor.

Q. So that would give you eight, nine, ten?

A. That would give me five, six, eight, nine, ten, eleven, and thirteen.

Q. Five, six, eight, nine, ten, eleven, and thirteen?

A. Yes, Sir.

Q. All right, Sir, would you give me your—

A. Tunnels, ninety-five.

Q. Tunnels, ninety-five.

A. Bridges and trestles, eighty-five.

Q. Eighty-five.

A. Ties, fifty.

Q. Fifty.

A. Rails, eighty.

Q. Eighty.

A. Other track materials, eighty.

Q. Eighty.

page 1260 } A. Ballast, eighty-five.

Q. Ballast, eighty-five.

A. Fences, snow sheds, and signs, seventy-five.

Q. Yes.

A. Which gave me an over-all seventy-eight point zero three average which as I stated was used in multiples of five and I raised it to eighty.

Q. Now you have, of course, considered the age of the rail that was in place in connection with the study.

A. I considered everything that I thought would influence my condition percent.

Q. You could determine the age of the rail, could you not, by reading the rail?

A. Well, no. I only made spot checks on the ages.

Q. You didn't—

A. I didn't list every section of rail and put down age. No, sir.

Q. You just made spot checks. You didn't make any effort to make a statistical summary of ages of the rail you saw.

A. Of all the rails in the system?

Q. Yes.

page 1261 } A. No, sir.

Q. All right, sir. Now let's go back to your exhibit LBY-1. If you applied the one point fifty-five factor for the Norfolk—that you determined from the Norfolk and Western to the RF&P and the C&O, they would have the same assessments per mile of mainline track for 1968 that the Norfolk and Western got. Isn't that correct?

A. Yes, sir.

Q. So, it is your view that the fair market value or the fair cash value on the average of a mile of the RF&P's mainline track is the same as that of C&O and of the Norfolk and Western.

A. What I have done is I have taken that one fifty-five factor and extended uniformly among the unit value that has previously been used.

Q. And you did not consider earnings or the variations and earnings between these railroads and making any determinations?

A. No. Earnings, going concerns, franchise, or anything else.

Q. So you relied really on the original cost figures supplied to you by the Norfolk and Western.

A. Yes, sir.

page 1262 } Q. Now I would like to turn briefly, Mr. Younger, to the method you used by the Commission in assessment of land belonging to the railroad. You're familiar with that method, are you not?

A. Yes, sir.

Q. How is it done? The way the Court described it this morning and what I read to Professor Priest?

A. I do not recall them.

Chairman Catterall: It is all described in great detail in the case up at Alexandria. The one about the—

Mr. Riely: But that is not in this record, if your Honor please.

Chairman Catterall: I mean it is described in that Potomac Yard Case and you could file a copy of that as an exhibit if you would like.

Mr. Riely: Let me ask him what he does here, because I have a specific purpose in this. It relates to this case.

Chairman Catterall: Go ahead.

Mr. Riely: Don't you compare the values of adjacent parcels of locally assessed land?

A. Locally appraised land. Yes, Sir, giving
page 1263 } consideration for any difference in contour.

Q. —or topography.

A. Topography such as cuts and fills in a case of a railroad.

Q. Now you take locally assessed land that is comparable to the land of the railroad when you make your land assessment. Isn't that correct? If you can find it.

A. We take the land that is adjacent on both sides and then give consideration where there is a case in cuts and fills to lower the value of the railroad land.

Q. And you take land that is adjacent and comparable to the railroad land as it now exists, isn't that correct?

A. I take the value of the land adjacent to the railroad land the appraised value and then adjust that to the conditions of the railroad lands which will be reduced due to the cuts and fills.

Q. Well, let's take the Norfolk and Western yard at Lambert's Point in Norfolk. You know that property, do you not,

A. Yes, sir.

Chairman Catterall: Now none of this land that we are talking about is involved in this case.

page 1264 } A. No, sir.

Mr. Riely: Indirectly, if your Honor please.

Chairman Catterall: Even indirectly?

Lee B. Younger

A. No, sir. It is not involved indirectly as I can see it.

Mr. Riely: May I continue my examination?

Chairman Catterall: You many continue. I just wanted to get the record clear because somebody might think land was involved in this case.

Mr. Riely: It is involved indirectly in my view.

Q. Do you know what the Lambert's Point land looked like before the Norfolk and Western moved in?

A. No, sir. I do not.

Q. Did your people assess the land at Lambert's point in its original condition before Norfolk and Western moved there on its present condition?

A. If the Norfolk and Western improved that land and built it up and made it flat comparable to the adjoining land, then it carried the adjoining land value.

Q. So the value of grading at the Lambert's Point land and I hope your Honor will now see the relevancy at last is included in the assessed value of the land, is it not?

page 1265 } A. There is no grading there to my knowledge; unless it is just making level for the track. It is not like a cut or a fill.

Q. But there is—you don't know whether the Norfolk and Western carries in its grading account any amount for the Lambert's Point Yard.

A. You mean so far as bringing it up to present conditions?

Q. Well, we have had a lot of talk about the *orifinal* cost of grading in this case and as part of that original cost do you know or do you not know, Mr. Younger, whether part of that original cost of grading is because of the Lambert's Point Yard?

A. No, sir. I do not. The only thing I can say where there are cuts and fills consideration is given to the value we put on the railroad land and it is a lesser value than the adjoing land.

Q. Would you value the Lambert's Point Yard the way the adjoining land was if the adjoining land was comparable to the way that the Norfolk and Western land is now?

A. I do not know, offhand. I do not know how the value was arrived on that, Mr. Riely. I do not recall.

page 1266 } Q. And you do not know whether there is any investment in grading in the Lambert's Point Yard.

A. I do not know the details on Lambert's Point Yard. The

only thing I know when we make our reassessment on land, where there are cuts and fills, we have a lower value giving consideration to that on the railroad land than if those cuts and fills were not there.

Q. You mean the adjoining railroad land.

A. Yes, sir.

Chairman Catterall: Not the land under the tracks.

A. No, Sir.

Q. Don't the yards have a lot of grading in them? It is not just cuts and fills on the main line is it?

A. I do not, offhand. I do not know of any. I think your big dollars in my opinion is your cuts and fills in your mountainous country.

Chairman Catterall: Do you include the tunnel as a cut or is it a separate unit?

A. Sir?

Chairman Catterall: Do you include the tunnel as a cut or as a separate unit?

A. That is a separate unit. They own the land above the tunnel and mineral—undeveloped mineral rights

page 1267 } in the land and land below the tunnel.

Mr. Riely: Now let me turn to Page Forty. You say, I believe, that the number of ties in the Norfolk and Western system in 1928 was thirteen million, nine hundred sixty-four thousand, eight hundred sixty-four on the first line of that exhibit. Is that not correct?

A. Page Forty, did you say?

Q. Yes, sir. Number of ties—

A. You are referring to exhibit LBY-E?

Q. Yes, sir. I was referring to your testimony because the figures I had in mine are right there on that page.

A. That is the number of ties based on the total number in the system prorated from mileage furnished by Form A that is always available to get any type of a proration for us to use on a mileage basis to system ties in Virginia are not furnished to us. We hope to develop—

Q. This is a reasonable—Excuse me—

A. —a means of getting such information.

Q. This is a reasonable estimate of the ties in Virginia in 1928. Is it not? Do you feel?

A. Based on a mileage proration.

Lee B. Younger

Q. Yes. Now from 1928 through 1958 there
page 1268 } were replaced or laid thirteen million, four hundred thirty-nine thousand, four hundred forty-three ties. Is that correct?

A. Yes, sir. Based on this tabulation.

Q. Is that about ninety-five percent of the tie count that turned over in this thirty-year period. Is that right?

A. I do not know sir. I will accept the figure.

Q. Isn't thirteen million, four hundred thirty-nine about ninety percent?—

A. It is practically the same as the 1928 figure, yes, sir.

Q. And the largest replacement occurred in the first part of this period from 1928 to 1937. Five million, six hundred seventy-one. That is almost forty percent of the thirteen million ties. Isn't that correct?

A. Yes, sir.

Q. So relatively speaking, the Norfolk and Western must have an awful lot of old ties on its own track? Wouldn't you agree with that? Isn't that probably true? On the bais of these figures?

A. Well, Mr. Riely, unfortunately, your operating reports on railroads do not furnish us the details that
page 1269 } you can normally develop; that is, by going on the basis first in first out starting with your latest year until you come up to your balance which we can do with other utilities so this is the only method to develop any kind of a picture at all.

Q. That shows that nearly all the ties were replaced in thirty years. Isn't that correct?

A. That is correct.

Q. And that the nature—that forty percent of them were replaced in the first ten years of the thirty year period.

A. Yes, sir.

Q. All right, sir. Now I think there is one little mistake on Page Forty-Six of your testimony. A typographical error which I thought we might correct. The second line, the five point seven miles, I think, should be five point seventeen miles. If you will look at your exhibit LBY-H.

A. That is correct. Thank you.

Chairman Catterall: Five point seventeen?

A. Five point seventeen.

Chairman Catterall: Does that throw out the
page 1270 } comparable figures?

Lee B. Younger

Mr. Riely: No. This figure of the exhibit, the mathematics are correct. It is five point seventeen.

Q. Now you used a word on this page Forty-Six that confuses me a little bit. What do you mean by the word benefit in the sixth line on Page Forty-Six. Is it a benefit to give up a branch line?

A. If you can get consideration for income taxes and it is not a line that is paying off, I would say that it is a benefit to you.

Q. Well, does that mean that when you abandon a line that has been unprofitable, your earnings will be increased and your *ad valorem* taxes will be reduced. Is that correct?

A. Well, your *ad valorem* taxes will be reduced.

Q. Well, if the line has been unprofitable, your earnings would be increased. Isn't that right?

A. Yes, sir.

Q. That means if you went out of business entirely, you might make money on it. Is that correct?

A. Yes, possibly.

Q. Well, let's turn to page Seventy-seven.

Chairman Catterall: Suppose we adjourn un-
page 1271 } til tomorrow morning.

Mr. Riely: Thank you, your Honor; I appreciate your courtesy in adjourning at this somewhat early time. I would like to point out that I have a very few questions for Mr. Younger.

Chairman Catterall: Well, he will be fresh and eager to answer them tomorrow morning.

Mr. Epps: Ten o'clock?

Chairman Catterall: Yes. We will adjourn until ten o'clock tomorrow morning. 3:41 P. M.

page 1272 } April 23, 1969
10:00 A. M.

The Commission resumes the hearing in Case No. 18629.

Mr. Riely:

Q. Mr. Younger, in your testimony of yesterday, as I understand it, you established on your trip over the Norfolk and Western a percentage condition for each of the accounts of five through thirteen and the weighted average of them came up to seventy-eight zero three percent which you ad-

justed to the nearest five percent to be eighty percent. Is that correct?

A. Yes, sir.

Q. And that was confirmatory of your previous action in February of using eighty percent of the original cost as the full assessed value of the track. Is that correct?

A. Yes, sir.

Q. Now on Page Seventy-seven of your testimony, you state that your determination of eighty percent, the same

page 1273 } percentage as the operating condition of the Norfolk and Western signal and interlocker equipment was derived from observation made during your inspection of the Norfolk and Western road and track. What sort of inspection did you make? Did you stop and look at the signals?

A. I did at the points where we stopped and also went along and made a study of the annual operating reports Form A in the Virginia Supplement which is filed with the Commission and made a check there as a guide and I also observed.

Q. Well, now. Let's take what you observed first. How many signals did you stop and look at?

A. I wouldn't know. I wouldn't know the count.

Q. Were there ten or a thousand?

A. I wouldn't know the count.

Q. You wouldn't know whether it was closer to ten or closer to a thousand?

A. Well, you gave me a right broad range there.

Q. I did that on purpose. But I may narrow it.

A. Well, if you want to narrow it down.—

Commissioner Hooker: You went from the minimum to the maximum, didn't you?

A. Yes, sir.

page 1274 } Chairman Catterall: That is close enough between ten and a thousand.

Mr. Riely: Between ten and a thousand.

A. A number of times we stopped when the calls were made back and by one of the members of Norfolk and Western and in passing your gates, crossing gates, and things like that.

Q. Did you go inside any of the signals, look at the relays, the electrical equipment?

A. No, sir.

Lee B. Younger

Q. This was purely examination of—

A. —examination and also from reading an article in the Norfolk and Western magazine on the—it didn't affect my—at the time of my trip, but on the highly trained technical skill and the amount of maintenance that the Norfolk and Western puts into their signal equipment which they keep through their own department, parts replacements and all. I would be glad to show you that article if you would like to see it.

Q. I guess we can find it. I hope the Norfolk and Western knows what is in their magazine.

A. No, I would like for you to see it person-
page 1275 } ally. I think you would be very much influenced.

Q. I would like to read it. Let me ask you this.

Chairman Catterall: Do you have a copy you can put in the records?

A. Yes, sir.

Chairman Catterall: Anytime you find the Norfolk and Western boasting, you can put it in the record.

Mr. Shannon: I hope you gentlemen haven't embarrassed me here. I hope I have it.

Chairman Catterall: I was pleased to see in this morning's paper that Norfolk and Western is making more money than they used to.

Mr. Shannon: They usually publish that, your Honor, when they come over for a rate increase case, don't they?

Chairman Catterall: Well, I don't know how it got in the paper. It was in this morning's paper.

Mr. Riely: I don't know, your Honor. I haven't had time to read the paper.

Chairman Catterall: Can you find that article?

Mr. Shannon: Yes, sir.

page 1276 } Chairman Catterall: It will be received as Exhibit No. 21.

Mr. Carter: Would you like to see it, Mr. Riely?

Mr. Riely: I would like to see it.

Chairman Catterall: Just tear out the page. We don't need to put the whole magazine in.

Mr. Shannon: That you say, your Honor, will be marked as Exhibit No. 21?

Chairman Catterall: Yes, Exhibit No. 21.

Mr. Shannon: All right, Sir.

Lee B. Younger

Chairman Catterall: All right, just go ahead and file the whole thing. The record is so fat now anyhow.

Mr. Riely:

Q. Mr. Younger, are you an expert in signals?

A. It depends on what you call an expert.

Q. I mean, could you maintain the signal system of the Norfolk and Western or supervise its maintenance?

A. No, Sir.

Q. How did you happen to arrive at the eighty per cent conslusion?

page 1277 } A. I saw it—in my judgment from the observation and also in my testimony, certain guides are used in relating to my observed depreciating condition from the additions and retirements in that account which is, fortunately, broken down, we can relate it to Virginia only.

Q. That is what you used the Form A Virginia Schedule for to see the additions and retirements to the signal account?

A. Yes, sir. As a supplement.

Q. As a supplement. Form A Virginia Supplement.

A. Yes, sir.

Q. And did you use the Form A Virginia Supplement for any other purposes?

A. It couldn't be—the other accounts due to their system of accounting, you couldn't use it.

Q. Now, did you just say there were other considerations that you mentioned in your testimony about signals?

A. I said it was from the observed and using the Form A information as to the dollars that went in the various years and all and age dollars and present worth as a guide to arrive at three different figures, I used

page 1278 } eighty percent.

Q. And did you assign a percent condition to any particular signal.

A. No, sir.

Q. And you arrived at the eighty percent condition on the basis of the examination that you have now outlined?

A. I arrived at the eighty percent as I said before from the observed physical and also using as a guide the age dollars and also the present worth method as guidelines.

Q. And that was the same percent condition that you came up with on the tracks.

A. Yes, sir.

Q. Now—

A. Excuse me. I treated the whole thing as a mass item.

Q. The whole thing.

A. Rather than individual items of property.

Q. Well, the signals were folded into the track components. Is that correct?

page 1279 } A. No, I didn't treat each individual signal independently. I took the total of the account and treated that eighty percent.

Q. But you treated that separately from the track account.

A. Oh, yes.

Q. And you arrived at the same percent condition on both.

A. Yes, sir.

Q. Could you tell me the percent condition at which you arrived on the Pennsylvania for signals?

A. No, sir. I cannot.

Q. You don't know whether it was eighty percent or a different percentage.

A. No, I do not.

Q. Do you know what you did on the Southern?

A. No, sir. Offhand, I do not.

Q. But you used an eighty percent condition on the track of the Southern.

A. Yes, sir.

Q. Now Mr. Younger, on Page Seventy-Eight of your testimony, about the middle of the page, you say the value of

page 1280 } property other than land and roadway and track accounts has been assessed on the basis of original cost less depreciation. That is the way that the roadway and track accounts were assessed, too, isn't it, original cost less depreciation.

A. For 1968?

Q. Yes.

A. Yes.

Q. All right, sir. Now on Page Eighty of your testimony, you stated "in the thirty-five years I have been with the Commission never to my knowledge has any consideration been given to going concern or franchise value in assessing the property of public service corporations for *ad valorem* taxation." Did you exclude franchise value from the value that you found for the track of the Norfolk and Western in 1968?

A. I did not exclude it because it was never put in.

Q. It never got in?

Lee B. Younger

A. No, sir. I only used the bare labor and material cost plus the engineering.

Q. But you didn't exclude it. It never got in it the way you computed it.

page 1281 } A. I did not even consider it. It was never involved.

Mr. Riely: Will the Commission excuse me for just a minute?

Q. Let me ask you one thing about signals, one more thing. When you said you looked at the Form A Supplement to determine the additions and retirements of signals account, did you make any study as to the life of the signals.

A. I used the life as set up on the accrued depreciation of the Form A which gave the—using their annual composite factor for life of signals.

Q. Does that give you a service life for signals?

A. Yes, sir.

Q. What is the service life for signals?

Note: Witness reviewing papers before him.

A. It has a composite rate of—it is two point nine three.

Q. That is the depreciation rate.

A. Yes, sir.

Q. As applied to the signal account under the

page 1282 } ICC system of accounting?

A. Yes, sir.

Q. What does that give you as a life cycle roughly?

A. Well, it would give you thirty-some odd years.

Q. About thirty-five years. Would you agree with that?

A. Yes, sir.

Q. But to make that useful to you you would have to know the average age of the signals in the account.

A. The present signals?

Q. Yes.

A. Well, that is what I did in my age dollars.

Q. What is the average age of signals in the Norfolk and Western system?

A. In my calculations?

Q. Yes.

A. The oldest dollars show that sixteen years old.

Q. What is that, Mr. Younger?

A. It is my schedule LBY-P.

page 1283 } Mr. Riely: Now that is going to take a little finding.

Mr. Shannon: It is pretty near at the end, Mr. Riely, about three or four exhibits from the end of the red book.

Mr. Riely: I have got LBY-O. That makes me hopeful, but the next one is LBY-2.

Mr. Shannon: It follows LBY-J.

Mr. Riely: It follows LBY-J?

Mr. Shannon: Naturally.

Mr. Riely: As any fool can plainly see.

So the first dollar investment in signals that is still in the account of the Norfolk and Western was invested in 1952. Is that correct?

A. That is correct, working on a first in and first out basis.

Q. Now did you allow anything for obsolescence in signals?

A. What I have allowed here, as I said, the observed depreciation and set up on this age dollar value—age dollar basis and also the present worth.

Q. Didn't the Norfolk and Western have an
page 1284 } awful lot of old alternating current signals that are being replaced with direct current signals?

A. Not to my knowledge. From talking with them, I have always felt they had one of the best up-to-date signal communication systems in the railroad business.

Q. Well, did you take into account salvage in determining this depreciation?

A. No, sir.

Mr. Riely: I have no further questions of Mr. Younger.

Chairman Catterall: Any questions, Mr. Epps?

Mr. Epps: Yes, sir.

CROSS EXAMINATION

By Mr. Epps:

Q. Mr. Younger, you heard Mr. Tipton's testimony and you are familiar with his work papers which are now Exhibit No. 17 in here. (Indicating)

A. Yes, sir. I have.

Q. You are familiar with the fact, I believe, that the trended cost figure of some one hundred seventy-seven million dollars was the figure which you used based on the Haskins and Sells or the Tipton report as a step
page 1285 } off base for your original cost figure?

A. Yes, sir.

Q. You also heard Mr. Tipton describe before you that they had made a mistake of ten million dollars and that a hundred seventy-seven million should be one hundred and eighty-seven million dollars.

A. Yes, sir.

Q. If you had had that information, would you have started with one hundred and eighty-seven million instead of one hundred and seventy-seven million?

A. Yes, sir.

Q. Now, you also heard Mr. Strouse testify that he had not read the statute and so he did not know that he was supposed to report—

Mr. Riely: If it please the Commission, Mr. Strouse did not testify that he had not read the statute and I object to that question.

Mr. Epps: Excuse me, I thought he did say that.

Mr. Riely: He did not say that.

Mr. Epps: But I will change the question if it offends Mr. Riely.

Mr. Riely: It does.

page 1286 } Mr. Epps:

Q. You heard Mr. Strouse say for reasons which he assigned, he did not include in his report of property value to you in spite of the fact that the statute required it, cuts, fills and excavations.

A. Yes, sir.

Q. Now suppose you were to take the ten million dollars which was a mistake and the cuts and fills and excavations which were omitted and using that as a figure come out at a final percentage and I won't say percentage of condition because I am coming at it the other way around but suppose you took those two figures and added to the one hundred seventy-seven million and then made a proportion or a percentage with your present assessment, what would be your percentage?

A. If I understand your question correctly, had Mr. Tipton's corrected figures been used and grading included—

Q. Yes, sir.

A. And relating that to my hundred and forty-two million value—

Q. Yes, sir.

page 1287 } A. What would the relation—what would that have been?

Lee B. Younger

Q. As a percentage. Yes, sir.
A. It would be fifty-nine point forty-seven.
Q. Percent?
A. Percent.
Q. Thank you.

Chairman Catterall: You would round that out to sixty, I take it.
A. Sir?
Chairman Catterall: You would round that out to sixty for convenience?
A. Yes, sir.

Mr. Epps:
Q. Now you have heard Mr. Tipton's testimony that he included, I believe, no overheads, so called.
A. That is correct.
Q. In your taxation of other utilities, the power company and so forth, do you or do you not include overheads in arriving at your cost basis upon which you arrive at your assessments.

page 1288 } A. We use the original cost as carried for each plant account and the annual operating report filed with the Commission showing the balance at the beginning of the year or at the ending of the year, whichever way you want to make it and these plant accounts include all overheads and it is quite a long list of those that are included which is in accordance with the uniform system of accounts prescribed by this Commission.

Q. And, therefore, if I understand you correctly overheads are embraced in your taxation of other utilities.
A. Yes, sir.
Q. Now as a matter of fact, doesn't the Epes letter itself speak specifically of adding interest during construction?
A. Yes, sir. As I remember.
Q. Now you heard the testimony that crossing signal values were omitted from the report of the N and W. This statute requires that crossings be reported, too. Is that correct?
A. Crossings is one of the items listed in the statute.

page 1289 } Q. Right. Do the figures that you have have the values for crossing? The figures that the N and W furnished you?
A. Yes. The ones that they furnished upon request by letter.

Lee B. Younger

Q. I see. And they are in your present assessment.
A. Yes, sir.
Q. What about in competing utilities such as pipelines. Do you fix the tax assessments for them?
A. Yes, sir.
Q. Is such things as grading included in those assessments by you?
A. There is no such account as grading as such.
Q. Try to—I recognize it but, do you have anything that is comparable in those competing utilities?
A. I would say that your trenching pipelines would be the hole for power and telephone lines the hole themselves and possibly you might say the excavation for a well for a water company.
Q. All right, sir.
Do these items go in your assessments for those utilities?
A. Yes, sir. Definitely.
page 1290 } Q. In dealing with the assessments with the other utilities, do you come into this so-called betterment accounting or do you have to capitalize account depreciation?
A. No. In all the other companies under the Uniform System of Accounts as prescribed by the State Corporation Commission, Federal Power Commission, the Federal Communications Commission and the Interstate Commerce Commission sofar as petroleum lines, all additions for the like and kind are charged directly into the plant account.
Q. So that you do not have to go through this betterment accounting to get that original cost?
A. The only one I know of is the Uniform System for Railroads prescribed by the ICC.
Q. Now the method which has been employed of relying on original cost has been employed for how long in Virginia?
A. For—
Q. Railroads.
A. Railroads?
Q. Yes, Sir.
page 1291 } A. The original cost?
Q. Yes.
A. Well, on—
Q. I use that in quotes because we have been through the proposition that we know that back in the dim dark past, we can't get it but the best evidence of original cost.
A. Well, prior to 1968, other than land and non-carrier property, and roadway and track of railroads. All other

items of property to my knowledge for railroads have always been on original cost.

Q. Now during your time in the tax office, has there been complaint as to this method from the railroad and specifically from the Norfolk and Western?

A. No, sir. None that I know of.

Q. In your studies of the assessments, have there been any appreciation in the value assigned to these—this category of railroad properties over the past forty years?

A. There has when we have determined any additions such as the structures and items like that. Yes, sir.

Q. What about the properties in question
page 1292 } here without additions?

A. No, sir. None that I know of.

Q. And do you believe that 1968 assessment of the Norfolk and Western in your best judgment is a fair and equitable assessment?

A. Well, I would say yes, up until the time that receiving the revised figures of Mr. Tipton and also with the addition to grading to what was done in 1968.

Q. And those two pieces of information, would they incline you to raise your assessment or lower it?

A. Naturally it is more value. I would have to raise it.

Q. Does that make your existing assessment fairer from the point of view of the railroad or more unfair to them?

A. I would say it gives them a lower assessment.

Q. Mr. Riely inquired of you of the so-called grouping of the railroads. The more or less east-west roads. The N&W, the C&O, and the RF&P as one group and the coastal roads are the Seaboard Airlines and the Atlantic Coast as the other. Do you recall that?

A. Yes, sir.

page 1293 } Q. And does grouping occur in ICC records—
ICC classifications?

A. There is a grouping on the indices cost that have been used in exhibits and also is used in arriving at the original cost that the Norfolk and Western furnished me as to the original cost value.

Q. And in the State of Virginia has there been a grouping?

A. Yes, in the indices cost the grouping is the Pocahontas Region, which consists of the Norfolk and Western and the C&O; and I believe the RF&P. And those index costs, they have all been grouped together.

Q. And weren't these groupings made based on the cost dif-

ferential between the tracks and road properties of the railroads?

A. Yes, Sir.

Q. Now I hand you a report dated 1947, headed "Taxation of Public Service Corporations in Virginia, Report of Public Service Taxes Study Committee."

Note: Above-mentioned Report being passed to Mr. Riely for examination and in turn passed to witness.

page 1294 } Mr. Epps:

Q. Are you familiar with this document?

A. Yes, I am. I have a similar copy.

Q. I ask you if you will turn to, I believe it is page Nineteen of that report and read into the record what that report says about the groupings of the railroads.

Mr. Riely: Why don't you point out what you want read?

Mr. Epps: All right. Let's go in the record a little more. Who is the author of that report?

A. James W. Martin, Director, Bureau of Business Research, University of Kentucky.

Q. All right. If you will look at Page Roman Five, you will find the derivation of the report. You will find, I believe, that this is prepared as the result of a House Joint Resolution and adopted by the General Assembly. Will you give us the date?

A. Yes, sir. It is House Joint Resolution No. 72, dated Richmond, Virginia, November 15, 1947.

A. And is that also the date of the report from which you are reading?

page 1295 } A. Yes.

Q. Now would you turn to Page Nineteen and tell us what it says about the groupings of the railroads.

A. It is one sentence which reads "But the same value per mile is applied to each mile of the same type of track wherever located."

Mr. Riely: If Mr. Epps would show him the sentences that he wants read, we might save a little time.

Mr. Epps: I would be glad to.

Will you start reading here, Mr. Younger.

A. "Beginning in 1926, the State Corporation Commission used the Interstate Commerce Commission estimates of cost

less depreciation for various dates prior to 1920 as a basic factor for railroad valuation. These data were used particularly in estimating the values per mile. After these estimates were made, the values, with few changes, have continued to the present time. Some grouping occurs for roads traversing similar territory. For example, the north and south lines such as the Atlantic Coast Line and the Seaboard have the same values per mile of track. Sometime after 1930, these values were set at fifteen thousand dollars per

page 1296 } mile of main line single track and twenty-six thousand dollars per mile of main line double track. In 1938 these values were reduced to thirteen thousand dollars per mile of single track and twenty-four thousand dollars per mile of double track and have remained at that figure ever since. The east and west lines, such as the Chesapeake and Ohio, Norfolk and Western, and the Virginian, have had constant values since 1930 of twenty-three thousand dollars per mile of single track and thirty-eight thousand dollars per mile of double track. The Southern, which is in the same group, also had the same values until 1938 when the double-track value per mile was reduced to thirty-five thousand dollars and again to its present value of thirty-three thousand dollars per mile in 1940. The Richmond, Fredericksburg and Potomac Railroad Company has the same value per mile of track as the east and west lines of twenty-three thousand dollars for single track and thirty-eight thousand dollars for double track."

Do you want me to stop here?

Q. That is fine. Thank you.

Mr. Epps: Could we have this—

Chairman Catterall: Did you want to put it

page 1297 } in the record as an exhibit?

Mr. Epps: How about a photostat of that particular page. Would that be all right?

Chairman Catterall: You have read it over so it is in the record.

Mr. Shannon: Let Mrs. Simpkins have it to copy into the record.

Mr. Epps: (to Reporter) would you like to have this to copy?

Reporter: Yes, sir.

Mr. Riely: It probably has Mr. Masten's signature on it. It ought not be put away forever.

Lee B. Younger

Mr. Epps:

Q. You heard the cross-examination of Mr. Dunn by Mr. Pasco about various branch lines that he might have seen and did not see. Do you recall that?

A. Yes, sir. I was also asked a question in regard to that line.

Q. How long is the Knitting Mill Branch, how many miles? Do you know?

A. Was that the Knitting Mill Branch you asked me about?

Q. Knitting Mill Branch.

page 1298 } A. It is one Mile.

Q. And how about the City Point Branch?

A. Three point eight three miles.

Q. What about the Roanoke Belt Line?

A. Three point six nine miles.

Q. Catawba Branch?

A. Four point thirty-nine miles.

Q. How about the Salem connection?

A. One point seventy-five miles.

Q. How about the remaining portion, the unabandoned portion of the Blacksburg Branch.

A. Three point six-four miles.

Q. Kingston Branch?

A. Point six one miles.

Q. Pott's Valley?

A. Three point three three miles.

Q. Pocahontas Branch.

A. Point nineteen miles.

Q. The Western Branch.

A. Three point three eight miles.

Q. The Radford Branch?

page 1299 } A. Four point seventeen miles.

Q. How about the distance from Damascus to the State line.

A. I couldn't find any mileage in our tax report to identify that.

Q. What about the West Leg "Y"?

A. Point twenty-six miles.

Q. How about the Hurricane Branch?

A. Two point seventy-three miles.

Q. Russell Creek Branch.

A. Point six nine miles.

Q. How about the Little Tom Creek Branch?

A. Point six five miles.

Q. *Bit* Tom Creek Branch?

A. Two point four six miles.
Q. And the Jacobs Fork Branch?
A. Point two two miles.
Q. Thank you.

Mr. Epps: I have no further cross-examination.
Mr. Shannon: I have no re-direct examination.
Mr. Riely: I have a few more questions.
Chairman Catterall: I was sure you would.
page 1300 } Mr. Riely: I thought that you would be sure that I would.

RE-CROSS EXAMINATION

By Mr. Riely:
Q. As a matter of interest, these branch mileages—were you reading from an exhibit introduced by Mr. Caywood.
A. I was identifying the branch lines and I inserted the miles in pencil on that exhibit.
Q. Yes, on Mr. Caywood's exhibit.
A. Yes, that is correct.
Q. Now you testified that the grouping of railroads was on the basis of cost differential. Is that correct?
A. I said the index used in arriving at original cost the trended was based on a grouping of the railroads in the Pocahontas Division for those cost indices.
Q. Well, the C&O and Norfolk and Western and RF&P and formerly the Virginian were in the Pocahontas Division, the Pocahontas District. Is that correct?
A. Region. Pocahontas Region.
Q. Region. Yes, sir. And the Coast Line and
page 1301 } the Seaboard were in the Southeastern Region.
A. Is it the Southeastern or Southern? I thought it was the Southern; I may be wrong.
Q. Well, I am no expert. You are probably right.

Mr. Shannon: I think it is Southern Territory, your Honors.
Chairman Catterall: I thought the Southern Territory began in Norfolk.
Mr. Shannon: For the sake of ICC classifications— and even though the territory between Official and Southern divides Virginia for rate-making purposes for ICC evaluation purposes, they are in Southern Territory.

Chairman Catterall: I see.

Mr. Riely:

Q. Now do you have any basis for saying that the Virginia portion of the Coastline and the Seaboard were put in the Southern Territory rather than the Pocahontas Territory because of cost differential; that is the real question I am after. The report that you read didn't say anything about cost differential by grouping on the basis of cost differential, as I read it.

page 1302 } A. Which report is that?

Q. This Taxation of Public Service Corporation in Virginia (Indicating).

A. I do not know. I read that direct from the book.

Q. Yes, but it did not say anything about groupings on the basis of cost differentials that I recall.

A. My reference to grouping was that the ICC indices cost which were used in furnishing me the original cost was based on grouping of the railroad in the Pocahontas Division which takes in Virginia and West Virginia. The grouping of the Norfolk and Western made up from the Norfolk and Western, the Virginia and the C&O and the RF&P.

Q. Those three rails are in the Pocahontas Division and different multipliers applied to them than rails in the Southern.

A. The same multiplier is applied to them.

Q. But the multipliers that are applied to railroads in the Southern Territory are different multipliers.

A. That is correct.

Q. Even though these rails—

page 1303 } A. I assume that I have never made use of those tables.

Q. Yes, but you do not know of any study on cost differentials between the Coast Line and the RF&P in Virginia limited to Virginia, do you?

A. No, sir, I do not.

Q. Now, signal crossings. Signals and public crossings. Were you not aware that prior to 1968 those signals—the original cost of those signals were not included in the amounts reported by the railroads to you?

A. Yes, sir.

Q. And that had been the practice for a number of years prior to 1967.

A. I do not know how many years, Mr. Riely, but—

Q. You were aware in 1967?

A. Yes, sir.
Q. And you were aware in 1966?
A. Well, yes, to the exact number I don't know.
Q. But for a number of years prior to that?
A. Yes, sir.
Q. So the failure to include the value of signals in public crossings was known to the Commission and the
page 1304 } Commission had not done anything about it until 1968. Isn't that correct?
A. To what extent it was known to the members of the Commission, I do not know.
Q. I mean to your office.
A. Apparently so.

Chairman Catterall: Everything that you know, we know.
Mr. Riely: I thought so. The doctrine of *respondent superior* applies in that situation.
Commissioner Hooker: It is our responsibility.
Chairman Catterall: Yes.
Mr. Riely: Now, you were present when Mr. McCarthy testified, were you not?
A. Yes, sir.

Q. And I wonder if you would look at Exhibit MJM-1—Can you show him that, Preston?

Mr. Shannon: Yes.
Mr. Riely: Thank you.

Q. He has a column there entitled original cost on books.
A. Yes, sir.
page 1305 } Q. And you know what he means by that after hearing him testify. That is, what is on the book.
A. Yes, sir.
Q. That wasn't the original cost that you asked the railroad to supply you, was it?
A. No, sir.
Q. You wanted the track accounts grossed up to be accounted for as if they were being accounted for in a ratable depreciation method.
A. I wanted the original cost of the accounts that make up the roadway and track of items in place as of December 31, 1966.
Q. On the same method of accounting that the railroads used for buildings.

A. Yes, sir.

Q. Now let me see if I understand you this. If you had known that Mr. Tipton's original schedule which shows one hundred seventy-seven odd million dollars—

A. Yes, sir.

Q. —should have shown a hundred eighty-seven odd million dollars?

A. Yes, sir.

page 1306 } Q. And if you had focused on the fact that grading was excluded which is about another fifty million dollars, I believe, you would have increased the one hundred seventy-seven million by sixty million dollars to about two hundred and thirty-seven million, would you not?

A. Well, I would have allowed some depreciation on the grading.

Q. But would you have put the grading in at the hundred percent before you took off your eighty percent before you reduced it to eighty percent.

A. I would compute it as I gave the other day. Each account separately and I would have allowed some depreciation for grading.

Q. All right. Well, you allowed twenty percent depreciation for the whole track account, did you not?

A. Well, that was a composite. I don't know as the grading would have—to what extent it would have affected that eighty percent.

Q. Do you think it may have been more or less?

A. Well, I would think it would be more because the grading would not be put in eighty percent condition. I would put it in a higher percent condition.

page 1307 } Q. In a higher percent condition.

A. Yes, sir.

Q. So that it might raise the eighty percent.

A. Yes, sir.

Q. But you would have then taken the original cost, applied the percent condition that you determined after the study of the grading as a composite rate and used that figure as the full value for the track in Virginia by which to assess the Norfolk and Western.

A. Yes, sir.

Q. And instead of getting one point fifty-five, you would have gotten something else.

A. Yes, sir.

Q. And you would have started with that original cost figure.

Lee B. Younger

A. In fact, I think with grading I would have used grading instead of one point fifty-five, it would have come out, I believe, as I have—it is two point something.

Q. But then you would have been using grading at eighty percent, would you not?

A. Yes. Well—

page 1308 } Q. You would have been allowing the same depreciation if you had included grading as if you had not included grading.

A. The way I arrived at my figure, I used the eighty percent on those others as I did.

Q. Yes.

A. And then adding the grading to the original cost side—

Q. Yes.

A. —and putting grading in as ninety-five percent condition coming up with that figure and then getting those two totals together and relating it to the total of a side.

Q. How did you determine that grading was in ninety-five percent condition?

A. That is from my observation and I might say that we do not use it except as a guide. The book reserve for grading puts it in a, about a ninety-eight percent condition.

Mr. Riely: I have no further questions.

Chairman Catterall: You may stand aside, sir.

Witness Stood Aside.

page 1309 } Mr. Shannon: Mr. Younger's testimony and exhibits have—I assume they have all been received...

Chairman Catterall: Oh, yes, they are in the record by stipulation.

Do you have any other witnesses?

Mr. Riely: The last witness is Mr. Koncel, isn't it?

Mr. Epps: Yes, sir.

Mr. Riely: Are you ready for him?

Mr. Epps: Yes, sir.

Mr. Riely: Mr. Koncel, come around please.

Chairman Catterall: Which book is he in?

Mr. Riely: He is in the black book, sir.

Chairman Catterall: The black book is the railroad book.

Mr. Riely: The black book is the railroad book.

Mr. Epps: They are the black guys.

Mr. Riely: The Commission is red-eyed.

Edward F. Koncel

Mr. Epps: Hats. Black Hats.

DIRECT EXAMINATION

By Mr. Riely:

Q. Mr. Koncel, your name is Edward F. Koncel?

A. That is right.

page 1310 } Q. And you reside in Chicago, Illinois.

A. Yes, sir.

Q. And you are the Mr. Koncel whose testimony consisting of nineteen pages and one exhibit has been submitted already in this case?

A. Yes, sir.

Mr. Riely: May it please the Commission in order to facilitate matters, I would like to do one little numbering job.

Chairman Catterall: You may do it.

Mr. Riely: If you will turn to Exhibit No. 1 EFK there are sixteen pages following that and it is very difficult to refer to them unless they are numbered and I am sorry that we overlooked numbering them, but Mr. Koncel's testimony had to be prepared with some speed.

Mr. Shannon: Semi-pagination. Is that right?

Chairman Catterall: Now where do we find Mr. Koncel—

Mr. Riely: Mr. Koncel's exhibit follows Mr. Koncel's testimony.

page 1311 } Note: Conversation held off record regarding insertion and numbering of Mr. Koncel's exhibit.

Chairman Catterall: The Commission will recess for ten minutes. 10:51 A. M.

11:01 A. M. The Commission resumes its session.

Mr. Riely: Mr. Koncel is tendered for cross-examination.

page 1312 }RESUME OF TESTIMONY OF E. F. KONCEL

Mr. Koncel will testify that the fair market value of all the property of the Norfolk and Western in Virginia, including its franchise, computed in accordance with accepted practices, produces a full value substantially less than the full value which the State Corporation Commission determined for the properties of Norfolk and Western in Virginia ex-

cluding the franchise. He will further testify that the fair market value so determined by him, when allocated to the track accounts, is substantially less than the full value for the track accounts determined by the State Corporation Commission for 1968. He will testify as to the means by which he made these computations.

page 1313 }

* * * * *

TESTIMONY OF EDWARD F. KONCEL
ON DIRECT EXAMINATION

Q. Please state your name and address.

A. Edward F. Koncel, Chicago, Illinois.

Q. By whom are you employed and what is your present position?

A. I am Executive Assistant and Supervisor of Common Carrier Assessments for the Department of Revenue of the State of Illinois.

Q. How long have you held this position?

A. Ten years.

Q. During all of these years with the Department of Revenue were you involved with the assessment of railroads?

A. Yes.

Q. How many railroads do you have to assess in the State of Illinois?

A. Presently, I assess 60 railroads.

page 1314 } Q. In this regard, how does Illinois compare with other states?

A. Illinois has more railroads operating in it than any other state. Operations of the Illinois railroads extend into almost all other continental states.

Q. Briefly, what are your duties as Supervisor of Railroad Assessments?

A. It is my duty to prepare report forms for the railroads operating in Illinois and to issue instructions to these railroads as to the manner of preparing the report. It is also my duty to analyze these reports and other financial and statistical information concerning these railroads and to make assessments against their property.

Q. Prior to your present employment, what was your occupation?

A. I was Assistant General Tax Attorney, General Tax

Edward F. Koncel

Attorney, and Land and Tax Commissioner for four railroads. These railroads were the Chicago & Eastern Illinois; the Chicago Heights Terminal Transfer; the St. Louis & O'Fallon; and the Jefferson Southwestern.

Q. How long did you hold that position?

A. For 33 years.

Q. What were your duties with those railroads?

A. My duties were to handle tax and valuation matters.

Q. Then for the past 43 years you have been directly involved in the problems of assessing railroads for *ad valorem* tax purposes?

A. That is right.

page 1315 } Q. Have you ever appeared as a witness on behalf of the State of Illinois in litigation involving the taxation of railroads?

A. Yes, on numerous occasions.

Q. Have you ever appeared as a witness on behalf of various railroads at tax hearings?

A. Yes, a number of times.

Q. Have you ever appeared as a witness for both sides in a lawsuit concerning the taxation of railroads?

A. I have testified a number of times in that capacity in railroad litigation in the State of Illinois.

Q. Were you ever called by a State to appear as an expert witness in the field of railroad taxation, while you were employed by railroads?

A. Yes, on three different occasions.

Q. Have you appeared in cases involving railroad taxation in States other than the State of Illinois?

A. Yes, I have appeared as an expert witness in Florida, Indiana, and Iowa.

Q. What is your educational background, Mr. Koncel?

A. I have attended the University of Chicago and Northwestern University. I have a Law Degree from the University of Chicago and I am licensed to practice law in Illinois.

Q. To what professional organizations do you belong?

A. I belong to the International Association of Assessing Officers, the National Tax Association, the National Association of Tax Administrators, the Chicago Tax Club, the American Right of Way Association, and several appraisal associations.

page 1316 } Q. Have you had experience in appraising non-railroad property?

A. Yes. I am the senior member of an appraisal firm

known as Appraisal Associates. I am frequently called upon to make appraisals of all types of property.

Q. Mr. Koncel, do you assess the property in Illinois of the Norfolk and Western Railway Company?

A. Yes. That is one of the railroads under my jurisdiction.

Q. Mr. Koncel, have you formed an opinion as to the Fair Market Value of the property of the Norfolk and Western Railway Company in Virginia?

A. Yes.

Q. In your opinion, what is that value?

A. In my opinion, the maximum Fair Market Value of this property, as of January 1, 1968, would be $387,403,724.

Q. Does this include the franchise value of the railroad?

A. Yes, this would include all of the franchise value, that is the right to operate a railroad and all of the good will and going concern value inherent in the Norfolk and Western's property.

Q. Of the valuation you have established, how much is attributable to the franchise value?

A. There is no precise way to separate the franchise value from the total value of this property. In my opinion, however, at least 50 percent of the total valuation I determined would be franchise value.

Q. Of the total valuation you determined, which is $387,403,724, how much of that is attributable to the tracks in Virginia?

page 1317 } A. Approximately $72,083,173.

Q. That valuation would include what property?

A. That valuation includes the property in Account 1—Engineering; Account 5—Tunnels and Subways; Account 6—Bridges, Trestles and Culverts; Account 8—Ties; Account 9—Rails; Account 10—Other Track Material; Account 11—Ballast; Account 12—Track Laying and Surfacing; and Account 13—Fences, Snow Sheds and Signs.

Q. How much of this value would be attributable to franchise value?

A. At least 50 percent of this value would be attributable to franchise.

Q. In enumerating the track property by I.C.C. accounts you did not mention Account 3—Grading.

A. That is correct. Grading in most instances becomes an integral part of the land and is an element in the valuation of the land. If I were to include the investment in grading along with the investment in the other I.C.C. accounts

mentioned the Fair Market Value of $72,083,173 would be increased to $99,992,051.

Q. How much of this latter figure would be attributable to franchise value?

A. Here, again, it is my opinion that at least 50 percent of this value represents franchise or going concern value.

Q. Mr. Koncel, I would like you to tell us how you go about valuing railroad property.

A. Illinois uses the unit method, which is the best and most common way to determine the full fair market value of a railroad's operating property. By this method the

page 1318 } value of the entire railroad property, including franchise value, in a particular state is determined.

Q. Does Virginia use this method?

A. I understand that Virginia does not use this method. Instead, an inventory and appraisal method is used.

Q. Mr. Koncel, should the total fair market value of property differ depending upon which method is used?

A. No. Fair market value is the same in both cases.

Q. How many approaches to the valuation of property are there?

A. Basically, there are three approaches to valuation: income, market, and cost.

Q. How is income used?

A. Income is one of the most important ways of determining the market value of income-producing property such as railroad property. Investors in such property are interested in how much money they can make. In the case of railroads, it is the almost universally accepted practice to take a five-year average of net railway operating income and capitalize it at some appropriate rate.

Q. How do you determine the net railway operating income for a railroad?

A. This is set forth each year in the Annual Report of the Railroad to the Interstate Commerce Commission.

Q. Do you use the net railway operating income figure shown in the income account for the year involved?

A. No. That figure is frequently distorted because of special Federal Income Tax treatment accorded

page 1319 } the railroad. Therefore, this figure frequently does not represent the actual earning capacity of the property.

Q. Is there any way to adjust this figure using the Annual Report to the Interstate Commerce Commission?

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A. Yes. In Schedule 350-C of the ICC Report there is an analysis of Federal Income Taxes. This analysis shows adjustments which should be made both upward and downward in order to normalize the net railway operating income.

Q. Will you explain please just what you mean by normalizing the net railway operating income?

A. One factor in the computation of net railway operating income is the accrual for Federal income taxes. This tax accrual, however, is computed as provided by the Uniform System of Accounts for Railroad Companies; and that computation does not sufficiently recognize certain tax related adjustments. Because of this omission, in almost every instance, net railway operating income, without further adjustment, does not accurately reflect the true effect of Federal taxes on current income as recorded on the corporate books. The adjustments produced by special Federal tax treatment may decrease or increase the amount of tax charged to operating expense. This sometimes occurs because of adjustments applicable to prior years and in other cases because of the current recognition, through reduced accruals, of Federal tax deductions in excess of those recorded on the corporate books. An example is the excess depreciation allowance resulting from use of accelerated methods
page 1320 } and lives shorter than those used for depreciation in the corporate accounts. This results in a deferral of substantial amounts of tax liability to future years. Unless an adjustment, reflecting this deferral, is made in the income portion of the unit valuation formula, the value produced by that formula will be distorted.

Q. What capitalization rate did you use against net railway operating income?

A. Seven percent.

Q. Is this capitalization rate generally used?

A. Yes. Seven percent is the capitalization rate now most commonly used in the valuation of railroad property. Although a higher capitalization rate could be justified, I used 7% as being conservative.

Q. You mentioned the market approach to valuing railroads. How is this done?

A. Railroads are seldom sold, so that there are no comparable sales available to the assessor. Because of this, it is customary to use the stock and debt approach to market value.

Q. How is this done?

A. The normal procedure is to take the market value of

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the stock in the hands of the public and the amount of the outstanding debt of the railroad and add them together. The stock value will represent the railroad's equity in its property and the debt will represent the property owned by the railroad but not yet paid for.

Q. How is the market value of the stock determined?

page 1321 } A. The usual method is to use the average of of the monthly high and low market quotations for the year involved. In those few cases where the stock is not traded, a different approach is required. Capitalized income, purchase price, or shareholders equity are frequently used indicators of value in such cases.

Q. Are adjustments to this stock and debt value required in the assessing process?

A. Yes. It is my opinion that current and deferred liabilities should be added to this value since they represent interests in the property. Additionally, since the railroads have investments in other companies, which investments have no relationship to the tangible property being assessed, and since these investments are reflected in the market value of the railroads outstanding stock, it is essential that the market value of these non-operating intangibles be deducted from the gross stock and debt value.

Q. The third and final approach to valuation you mentioned was the cost approach. Will you explain this please.

A. Cost is probably the most unreliable of the three approaches to value in the case of railroads. This is because of the great amount of *obsolescense* present in most railroad property, particularly in the road property. With proper allowances for *obsolescense* and depreciation, cost is, however, a proper element to be considered in the valuation process.

page 1322 } Q. What do you mean by road property, Mr. Koncel?

A. A railroad's property falls into two broad classifications—road property and equipment. Road property is the fixed situs property, which is carried on the books of the railroad in Interstate Commerce Commission Accounts 1 through 45. It includes, generally speaking, all of the railroad's investment except for equipment. Equipment includes the railroad's rolling stock.

Q. How is the cost basis for the rolling stock or equipment determined?

A. There are a number of ways to get at this. The method used by the Virginia State Corporation Commission is prob-

ably the most common and is one that produces a reasonably accurate cost basis.

Q. How does the Commission go about this?

A. The investment of the railroad in its equipment, including leased equipment, is depreciated according to the age of the equipment. In Virginia the depreciation allowed is 5% a year on freight cars and 6% a year on locomotives. These are generally accepted depreciation rates which, in my opinion, produce a reasonably accurate result. The maximum depreciation allowed by the Commission is 75%.

Q. The result of this computation would include equipment for the entire Norfolk and Western system, would it not, Mr. Koncel?

A. Yes.

Q. How do you determine how much of this value is attributable to Virginia?

page 1323 } A. The fairest and most commonly used method of allocating equipment cost to a state is by the use of car and locomotive unit miles. This mileage of the railroad in a particular state is divided by the railroad's car and locomotive unit mileage for the entire system. This percentage is then multiplied by the system equipment cost to get a state figure.

Q. Mr. Koncel, in determining an investment figure for the N&W in Virginia, have you followed the same method used by the Virginia State Corporation Commission?

A. Yes.

Q. How did you determine the cost of the road property in Virginia?

A. The Norfolk and Western Railway Company, like other railroads, is able to determine its investment by ICC Accounts for its road property in any particular state.

Q. This would be an undepreciated figure, would it not?

A. Yes. This does not include any depreciation or any allowance for *obsolescense.* Most of the *obsolescense* in a railroad's plant will be found in its road property.

Q. How much should the investment be reduced to cover depreciation and *obsolescense?*

A. In my opinion, the investment figures for road property must be reduced at least 50% to cover depreciation and *obsolescense.*

Q. Mr. Koncel, in the case of capitalized income and in the case of the market value of stock and debt, it is necessary that the assessor allocate a portion of those values to the

particular state with which he is involved. Is that not correct?

A. Yes.

page 1324 } Q. How is this done?

A. An allocation factor can be developed through a comparison of state operating statistics with system operating statistics.

Q. Which statistics do you use?

A. I use five sets of statistics or factors. The first one is traffic units. This includes ton miles and passenger miles. I determined the percent of these miles run in Virginia. Next, I considered all track miles and determined the percent of the system mileage that is in Virginia. Third, I considered the percent of operating revenue in Virginia. Fourth, I determined the percent of investment in Virginia. Fifth, I determined the percent of originating and terminating tons and cars in Virginia.

Q. In other words, for each of these five statistics or factors you determined the percent in Virginia?

A. That is right.

Q. What did you do next?

A. I added together the five percents and divided the total by 5. This gave me an allocating percent, which I applied against capitalized income in order to determine the amount attributable to Virginia and against the system stock and debt value, also to determine the amount attributable to Virginia.

Q. You told us that you developed an income value attributable to Virginia, a stock and debt value attributable to Virginia, and an investment value attributable to Virginia. How did you then arrive at a total maximum fair market value for Virginia?

page 1325 } A. The three separate values which I determined were added together and divided by three.

Q. Mr. Koncel, is the valuation procedure you have just described the same one you use in assessing railroads in Illinois?

A. Yes. This approach is basic and, with minor variations, is used in most of the States.

Q. Now, Mr. Koncel, I would like to have you tell us exactly what you did in arriving at the Fair Market Value of the Norfolk and Western property in Virginia.

A. Certainly.

Q. How was your income factor arrived at?

A. The average of the net railway operating income of the

Norfolk and Western Railway System for the years 1963 through 1967, after adjustment, is $1,185,873,243. I allocated 28.29% of that value to Virginia. This produced an income value for Virginia of $335,483,540.

Q. How did you determine the allocation factor of 28.29%.

A. I found that 33.16% of the ton and passenger miles of the N&W system for the year 1967 was in Virginia. I found that 19.72% of the N&W all track miles was in Virginia as of the end of 1967. I found that 28.02% of the operating revenues of the N&W for the year 1967 were derived from Virginia. I also found that as of the end of 1967 28.23% of the N&W's investment in its plant was in Virginia. Finally, I determined that in 1967 of the cars and tons of freight originating on line and terminating on line for the N&W system 32.32% was in Virginia. The average of these five percents or factors is 28.29%.

page 1326 } Q. How did you determine a stock and debt value for Virginia?

A. I determined the net Market Value of the stock and debt of the N&W system as of the end of 1967 to be $1,686,000,000. Of this, 28.29% is $476,969,400, which is the portion properly attributable to Virginia.

Q. How about investment?

A. First I took the depreciated cost of the N&W equipment allocated to Virginia, which was determined as of the end of 1967 by the Virginia State Corporation Commission. This figure is $204,308,989. To this I added $145,377,243, which is 50% of the total investment of the N&W in Virginia road property. These two figures totalled $349,758,232.

Q. What did you do next?

A. I added the three figures—$335,483,540 for income, $476,969,400 for stock and debt, and $349,758,232 for investment—and got a total of $1,162,211,172.

Q. Then what did you do?

A. I divided this total by three in order to get an average. The average is $387,403,724.

Q. That then, Mr. Koncel, is your estimate of the Fair Market Value of the N&W Railway Company's property in Virginia?

A. Yes. That would be the maximum fair maket value. Were I actually assessing the property in Virginia, I would probably make some further formula adjustments which would produce a somewhat lower total value. Also, if I had the opportunity to inspect the N&W's plant in Virginia, I might discover situations which would justify an even lower value.

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Q. Mr. Koncel, you previously testified that
page 1327 } at least 50% of this total fair market value
represents franchise or going concern value,
didn't you?

A. Yes. As I previously mentioned, it is very difficult to make a precise determination of the amount of franchise value included in my total valuation. There are several ways this franchise value could, however, be estimated.

Q. Would you describe one of the methods please?

A. Yes. Norfolk and Western Railway Company paid a Franchise Tax to the State of Virginia for 1968 of $2,025,010. In order to produce this much tax, at the N&W's average local property tax rate, which I understand is 3.4816%, you would have to have an assessed valuation of $58,163,203. At the N&W's equalization ratio of 36.829%, this would produce a full value of $157,927,728.

Q. How else might we exclude the franchise value?

A. In the formulaic unit approach to value I just described at some length, I included income, which is attributable almost entirely to franchise value, and stock and debt, of which at least 50% is attributable to franchise value. Without a franchise to operate a railroad there would be no significant operating income. Likewise, without a franchise to operate a railroad there would be no significant stock value. By using a zero factor for income and by reducing the stock and debt value by 50%, I would arrive at a fair market value, exclusive of franchise value, of approximately $196,000,000.

Q. How else might the value of this property, exclusive of
franchise value, be determined?

page 1328 } A. Well, without a franchise to operate a rail-
road, the market value of this property would
be its liquidatin[illegible] age value.

Q. M[illegible] d you go about determining what
[illegible] t value for the N&W property in
[illegible] the track?

[illegible] mine what part of this value is
[illegible] perty. Based on the depreciated
[illegible] 8.43% of the property value in
[illegible] 1.57% is road property.

[illegible] f $387,403,724 in order to deter-
[illegible] of the road property in Virginia?

[illegible], and the answer I got is $161,043,728.

[illegible] uld you then allocate a portion of that to the track
accounts?

A. The total investment in Accounts 1, 5, 6, 8, 9, 10, 11, 12,

and 13 is 44.76% of the total investment in the road accounts, that is accounts 1 through 45. So, 44.76% of the road valuation of $161,043,728 produces a fair market value for the track accounts of $72,083,173.

Q. This allocation does not include any investment in Account 3—Grading, is that right?

A. That is right. If the investment in Account 3 is added to the investment in the other accounts I mentioned, it produces a total investment which is 62.09% of the total investment in Accounts 1 through 45.

Q. Applying that percentage against the total fair market value for the road property gave you a value of how much?

A. It gave me a value of $99,992,051.

page 1329 } Q. Mr. Koncel, have you prepared statements showing computations of value about which you have just testified?

A. Yes.

(Counsel will introduce these statements as Exhibit 1—EFK.)

Q. Mr. Koncel, do you have a professional opinion as to the validity of using cost alone in the determination of the fair market value of railroad properties?

A. Yes. As I previously said, cost by itself is a very unreliable indicator of value. Although cost should be considered in the valuation of railroad property, it must be used with considerable care. Cost is included in the railroad assessment formulas in many states primarily as a *stablizing* factor.

Q. Would you explain what you mean by a *stablizing* factor.

A. This factor tends to fluctuate less from year to year than do capitalized income or stock and debt values. By use of a cost factor, a state tax administrator is able to avoid drastic changes in the valuation level from year to year.

Q. Would what you have just said about the use of cost alone in the determination of the fair market value of railroad property apply equally to the determination of the fair market value of the tracks of the Norfolk and Western Railway Company in Virginia?

A. Yes. What I have said applies particularly to the valuation of such property.

Q. Now Mr. Koncel, let me ask you again about the Virginia property of the N&W which is covered by the track

accounts you previously discussed. Would 80% of the undepreciated original cost of this property ap-
page 1330 } proximate the property's fair market value exclusive of franchise value?

A. By no means. Such a procedure would result in a valuation much higher than the fair market value of this property, either with franchise value included or without it.

Q. On what do you base this opinion?

A. There are several things wrong with the procedure you described. First of all, experience has taught me that original cost is almost always much higher than the fair market value of track property. Furthermore, the procedure you referred to would reduce this cost figure by only 20% to cover depreciation and obsolescense. This is unrealistic. It is well known that most railroad tracks have gone through at least one life cycle and are maintained on a rather uniform basis. As a result, the average railroad track will have about half of its useful life gone. In other words, railroad tracks are in approximately a 50% condition. In my opinion, depreciation of about 50% should be allowed. Also, there is some functional or economic obsolescense in a railroad's tracks. Something should be allowed for this. In addition, the valuation procedure that you described would subtract nothing for franchise value. In my opinion at least half of the fair market value of railroad tracks is franchise or going concern value.

Q. Are you aware of Mr. Caywood's testimony in this hearing that the fair market value, exclusive of franchise value, of the Norfolk and Western's Virginia tracks, track structures, and track appurtenances, but not including signal equipment, is $33,248,754?

A. Yes.

page 1331 } Q. Are Mr. Caywood's findings consistent with your valuation?

A. Yes, they are. My estimate of the maximum fair market value, including franchise value, of the tracks is $72,083,173. I have also stated my opinion that at least 50% of this amount is franchise value. Thus, the fair market value exclusive of franchise value would not exceed $36,000,000, which is very close to Mr. Caywood's valuation.

Q. Can you summarize briefly for me then your findings as to the fair market value of the property of the Norfolk and Western Railway Company in Virginia?

A. Yes. In my opinion, as of January 1, 1968, the maximum fair market value of all of the property in Virginia, both

road property and rolling stock, was $387,403,724. I estimate that of this amount $72,083,173 is attributable to the track accounts. With the inclusion of grading, that is Account 3, this amount would not exceed $99,992,051. It is also my opinion that approximately 50% of this value represents franchise or going concern value. In the case of tracks, the franchise or going concern value would be in excess of 50% of the total fair market value.

Q. Thank you, Mr. Koncel.

A. Thank you.

page 1332 } I hereby certify that the answers given to the foregoing questions are true and correct to the best of my knowledge and belief.

Edward Koncel

Subscribed and sworn to before me this 18th day of March, 1969.

A. J. O'Gallagher

My commission expires: Jan. 16, 1973

page 1333 } CROSS EXAMINATION

By Mr. Shannon:

Q. Where is your office located, Mr. Koncel?

A. Chicago, Illinois.

Q. Are you a full time employee of the State of Illinois?

A. Yes.

Q. What are your duties as Executive Assistant and Supervisor of Common Carrier Assessments for the Illinois Department of Revenue.

A. I supervise the assessments of all railroads, pipelines and also the general office which has to do with the assessment of those companies.

Chairman Catterall: Isn't the Department of Revenue separate from the Illinois Commerce Commission?

A. Yes, sir.

Chairman Catterall: No connection?

A. No, sir.

Chairman Catterall: It is not like the Virginia set-up.

Mr. Shannon:

Q. How is railroad property assessed for *ad valorem* taxation in Illinois?

page 1334 } A. It is assessed under the statute as a unit.

Q. And would you elaborate on it a little, if you will, please?

A. We use three factors. We use five years average net railway operating income; we use five years average—

Chairman Catterall: You'd better be a little bit louder and face the reporter so she can read your lips.

A. —Did you get the first?

Reporter: Yes, sir.

A. Five year average market value stock and bonds, and ICC, I believe it is the ICC, cost of reproduction less depreciation and any other factors that we feel are pertinent to the assessment.

Q. What do you mean by other factors that you would feel pertinent to the assessment?

A. Well, there are many others—well, how shall I put it—We take in—we do not use these factors straight but we take into consideration the age of some of this property and we also include in the market value certain factors that the statute does not specifically point out and we make certain deductions in connection with that market

page 1335 } value.

Q. Do you assess the property of Norfolk and Western Railroad in Illinois for *ad valorem* taxation?

A. I do.

Q. How long has the Norfolk and Western actually operated in Illinois, Mr. Koncel?

A. As a merged company since 1964.

Q. Prior to 1964, it was the Nickel Plate and the Wabash, I believe.

A. That is right.

Q. The N and W had no operation of its own in Illinois—

A. No, sir.

Q. —or any part of Illinois prior to 1964. Is that correct?

A. No, sir.

Q. Are the work papers you prepared in connection with the assessment of railroad property in Illinois generally open for public inspection?

A. They are not.

Q. They are not. Now, are you appearing in this proceeding in behalf of the State of Illinois?

A. No, sir.

page 1336 } Q. Then do I understand that you are ap-

pearing in the behalf of the N and W as a hired expert?

A. That is right.

Q. Are you taking a day of vacation today, Mr. Koncel?

A. That is right.

Q. In other words, you are not being paid by the State of Illinois while you appear here.

A. No, sir.

Q. Do you appear regularly in State tax cases in support of railroads, seeking corrections of their tax assessments?

A. I do.

Q. In what other states have you appeared?

A. I have appeared in Florida, Iowa, Wisconsin, Tennessee, and been consulted in Indiana and South Dakota.

Q. What railroads did you represent in those states.

A. I represented the states and then I represented railroads—one railroad in Tennessee; I represented several railroads in Indiana; and the railroad—and the Tax Commission in Wisconsin.

Q. And how about in Florida?

page 1337 } A. Florida, I represented the State of Florida.

Q. And, then, I understand that you are responsible for assessment of property of some of these railroads in Illinois, is that correct, some that you have represented outside of Illinois.

A. That is right.

Q. Now, what other states besides Florida have you appeared in support of state tax assessments?

A. Iowa—

Q. That is in behalf of the state's local assessing authority.

A. Iowa and Wisconsin and consulted in Indiana. I wasn't employed. I was merely consulted *gratis*.

Q. Mr. Koncel, isn't it difficult sometime to maintain your objectivity in assessing railroad property in Illinois since you testify in behalf of so many of these railroads outside of Illinois?

A. No, sir.

Q. You can maintain that even though you are taking the railroad's cause outside of the State, arguing against the local assessment?

A. I do it very scrupulously.

page 1338 } Q. Now were you a full time employee of the Chicago and Eastern Illinois Railroad, the C

and EI, I mean the Chicago and Eastern Illinois Railroad. Is that correct?

A. That is right.

Q. Were you a full time employee of that?

A. I was.

Q. For how many years?

A. Some forty years.

Q. And what was your position with that carrier?

A. Well, I had several positions. I was at one time general tax attorney and later the land and tax commissioner and attorney.

Q. How long were you general tax attorney?

A. That might have been a three or four year interval there.

Q. How long ago has that been? What period?

A. That was some eighteen years ago.

Q. Yes.

A. Eighteen years ago.

Q. When did you leave the C and EI?

A. I left the C and EI ten years ago last February.

page 1339 } Q. And then when you left the C and EI, did you take this full time position with the State of Illinois?

A. That is right.

Q. What is the Chicago Heights Terminal Transfer, Mr. Koncel?

A. It is a switching line in the City of Chicago Heights which is twenty-five miles south of Chicago.

Q. Does it operate outside of the State of Illinois?

A. It does not.

Q. Now, how about the St. Louis and O'Fallon I believe you said railroad.

A. St. Louis and O'Fallon again is another switching line which—

Q. Where is that?

A. —operates in the counties of St. Clair and Madison across the river from St. Louis.

Q. Is that in Illinois?

A. That is in Illinois.

Q. And it doesn't operate outside of Illinois?

A. No.

Q. And what was your position with the St. Louis and O'Fallon?

page 1340 } A. Same position I had with the C and EI.

Q. Was that a subsidiary of the C and EI?

A. That is right.

Q. And was the Chicago Heights Terminal Transfer a subsidiary of the C and EI.

A. That is right.

Q. What about the Jefferson Southwestern Railroad?

A. That is a coal railroad operating only in Jefferson County owned equally by the C and EI, Missouri Pacific and Illinois Central.

Q. Did you work full time for it or did you serve it in parttime?

A. I served it in the time that our business required it.

Q. While you were in the tax department—law department of the C and EI.

A. That is right.

Q. And in what states does the C and EI operate?

A. Presently the C and EI operates in Illinois and Indiana?

Q. Then practically all of your experience as a tax attorney then has been in Illinois. Is that right?

page 1341 } A. Illinois and Indiana.

Q. Are you a member of the Illinois Bar?

A. That is right.

Q. When were you admitted to practice law in Illinois?

A. 1927.

Q. Do you belong to the Bar of any other state?

A. No, sir.

Q. And are you currently actively engaged in the practice of law?

A. No, sir.

Q. Now, in these state proceedings in which you appeared on behalf of certain railroads for taxing—before the state taxing authorities, did you appear as an attorney or in some other capacity?

A. I appeared as a witness.

Q. I note from your qualifications that you attended the University of Chicago and Northwestern University. Is that correct?

A. That is right.

Q. Did you graduate from Northwestern?

A. No. Just took some courses over there back in the twenties.

page 1342 } Q. How many hours did you actually take at Northwestern?

A. I must say I am an athletic bum and I used to take leave of absence to go to school and try to earn—and ath-

letically I was earning money to try to go through law school. Whenever I found time, I attended Northwestern and several other schools. As a matter of fact, and then finally ended up in the University of Chicago.

Q. Well, now, how many months did you attend, or semesters did you attend?

A. Well, several times I attended about three or four full semesters and a lot of this was done at night time.

Q. I see. So you actually were not carrying the full semester load.

A. No. And in addition I was being tutored.

Q. When was this, Mr. Koncel?

A. Back in the twenties.

Q. In the nineteen twenties? What was your major course of study at Northwestern?

A. Law.

Q. I see.

page 1343 } Commissioner Hooker: What subject in law?

A. All subjects.

Commissioner Hooker: Complete law course?

A. Complete law course. Whatever they were giving at the time. I was trying to make up—complete my law course.

Q. Now you were not awarded a degree in law from Northwestern, were you?

A. No.

Q. And you did not pursue any other course of study at Northwestern, did you?

A. Oh, I took some accounting at Northwestern.

Q. You took accounting? How many hours?

A. Not too many.

Q. Two or three?

A. Oh, no. About six I think.

Q. Now, what course of study did you pursue at the University of Chicago?

A. I pursued a general law course.

Q. Is that the only course you pursued?

A. That is right.

Q. When did you go to Chicago?

A. In the twenties.

page 1344 } Q. In the twenties?

A. Yes, sir.

Q. How long did you attend the University of Chicago?

A. About two and one-half years.

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Chairman Catterall: Can you hear this witness?
Reporter: Yes, sir.
Mr. Carter: Can you, Judge.
Chairman Catterall: I can hear him but I am closer.

A. I have a foghorn voice. I can talk louder. I am trying to keep my voice down.
Q. Talk to the judges, not to me.
A. All right.

Commissioner Hooker: The trouble is you are revolving around in your chair.
A. I beg your pardon. I will sit still.

Q. Then I take it you certainly don't hold yourself out as an accountant.
A. No, sir.
Q. And I take it you have never studied engineering.
A. No, sir.
page 1345 } Q. You don't hold yourself out as an engineer?
A. No, sir.
Q. Have you studied economics?
A. Such as I have studied since I have been out in the field.
Q. Where did you study?
A. Well, general study of economics from pamphlets and so forth, not as a course.
Q. You never pursued a course?
A. No, I never pursued a course in economics. No.
Q. Then you certainly do not purport to be an economist, do you?
A. No, sir.
Q. Now, Mr. Koncel, I note from your testimony you say that you are a senior member of Appraisal Associates. Is that correct?
A. That is correct.
Q. What is Appraisal Associates.
A. Well, there are several of us that appraise all kinds of property in the State of Illinois or any other places, railroads, buildings, homes; it is a general appraisal of real property.
page 1346 } Q. Are you a part owner of Appraisal Associates?
A. That is right. I am the senior member of it.

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Q. And how many other associates are there?
A. Two others.
Q. And are they full time employees of Appraisal Associates or do they hold other positions?
A. No, sir.
Q. What other positions do they hold?
A. One works for the County of Cook and one works for another railroad.
Q. What railroad?
A. The Illinois Central.
Q. Does Appraisal Associates appraise railroad property for tax purposes in the State of Illinois?
A. No. They have not done any as yet.
Q. Would they do any?
A. They would do it if they were called upon.
Q. Would there be a conflict there if they appraised property and then appeared before you with their assessments?
A. Well, they wouldn't—if they were—there would be a semblance of a conflict true. If they were to
page 1347 } do this and then appear before me, but in a case of that sort, I could very readily abstain from hearing the particular railroad and let one of my assistants carry on.
Q. One of those people that work for you?
A. That is right.
Q. Then I take it that Apprasial Associates is a sideline with you since you are fully engaged by the State of Illinois.
A. That is right.
Q. Now, on Page Four I believe it is in your testimony, you say that "I am frequently called upon to make appraisals of all types of property."
Do you mean in your capacity with Appraisal Associates?
A. That is right.
Q. I think you have answered that earlier by saying that you do not confine yourself strictly to railroad but it is all types of property whether it be a house or rail property or a building or what else it might be.
A. That is true.
Q. Now, Mr. Koncel, do you appear in Illinois before—assessment officials in support of assessment you make in the name of Appraisal Associates for taxpayers
page 1348 } contesting such assessments?
A. I have done so on occasion.
Q. Have you appeared before other state agencies?
A. The local, not state agencies.

Q. City agencies.
A. —not city either, it is county.
Q. County.
A. We have a county system there.
Q. I believe Chicago is in Cook County. Is it not?
A. That is right.
Q. Could you be a little more specific? Before what bodies would you appear?
A. Well, the Cook County Assessor or a Board of Assessors which we have in St. Clair County or supervisor assessments as we have them throughout the State of Illinois in the individual county seats.
Q. Mr. Koncel, when were you first employed by the N and W to determine the fair market value of N and W property in Virginia?
A. I believe it was in January, 1969.
Q. January, 1969?
A. That is right.
page 1349 } Q. What N and W official hired you in connection with this Virginia case.
A. Mr. Mel Strouse.
Q. Have you known Mr. Strouse for some time?
A. Yes, I have.
Q. How long have you known him?
A. About ten years.
Q. And you had worked with him, I take it, I believe he said he came from the Nickel Plate Railroad.
A. That is right.
Q. And had you worked with him when he was with that carrier?
A. That is right. That is how I got to know him when he was representing the Nickel Plate Railroad.
Q. Now, do you have a copy of the instructions furnished you by the N and W.
A. No, sir.
Q. How were they given to you?
A. This was done verbally.
Q. What did they instruct you to do, Mr. Koncel?
A. They instructed me to—they furnished me with figures and instructed me to make a unit assessment of the properties of the N and W system-wise and also
page 1350 } statewide as far as Virginia is concerned and also go into the question of cost.
Q. What figures did they furnish you?
A. Well, they furnished me with market value figures in-

come but those same figures were also the figures that I had available in the Illinois schedule.

Q. Do you have the figures pertaining to Virginia operations in your Illinois schedule.

A. No. Some of them I do. In our recap schedule.

Q. And what do you mean—

A. And that is as to allocation and that is all.

Q. That is, that would probably be the general information that is set forth in the Form A. Is it not? That is filed with the Interstate Commerce Commission.

A. Some of it. Yes.

Q. And isn't it substantially the same form filed with the Illinois Commission.

A. Same form is filed with the Illinois Commission.

Q. Were you furnished any of the study papers or data developed by the DeLeuw, Cather and Company or by Mr. J. A. Caywood?

page 1351 } A. No, sir.

Q. You were not?

A. No, sir.

Q. Were you furnished anything prepared by Mr. Strouse?

A. No, sir.

Q. What about Mr. William E. Kelly of Luria Brothers?

A. No, sir.

Q. Mr. Fred B. McWhinney of Gillis and Company?

A. No, sir.

Q. Were you furnished any figures prepared by Mr. R. D. Tipton of Haskins and Sells?

A. No, sir.

Q. What about Mr. D. L. Kiley or Mr. E. L. Butler?

A. No, sir, nothing.

Q. I believe you state on Page Eighteen of your testimony that you were aware of Mr. Caywood's testimony concerning the thirty-three million two hundred and forty-eight thousand seven hundred fifty-four dollar value of N and W That is the net salvage value that he arrived at. Is that correct?

page 1352 } A. That is correct.

Q. When did you become aware of that, Mr. Koncel?

A. Oh, about a month ago.

Q. Just about a month ago?

A. I think.

Q. Well, approximately, give me—you say you were

engaged in January. What part of January were you engaged.

A. I don't remember what part of January, sir.

Q. Do you remember what date then that you became aware of Mr. Caywood's figures?

A. No. I do not remember that either.

Q. Were you furnished copies of the pertinent sections of the Virginia Constitution or the Virginia Tax Code?

A. Yes, I was.

Q. Have you read them?

A. I have.—I might say I have read at them because of my business in Illinois, I try to read at it as I could at night time or weekends but to say that I studied them, I must admit that I did not.

Q. Then I guess your answer to my next question will be no. I was going to ask you do you fully under-
page 1353 } stand them.

A. I have got to say no.

Mr. Riely: If he does, he is the only one.

Mr. Shannon: They are very simple, Mr. Riely, very simple.

Q. Then I take it you are not familiar with the tax laws of Virginia including the requirements pertaining to the *ad valorem* assessment of roadway and track properties of railroads operating in this state.

A. No, sir.

Q. Have you ever appeared in a tax proceeding of any other nature whatsoever in Virginia.

A. I have never appeared in Virginia in any proceeding.

Q. Have you been to Virginia before?

A. I have been to Virginia but never in a tax proceeding.

Q. When was your last time here, Mr. Koncel?

A. About—passing through about a year ago.

Q. About a year ago. Have you inspected the Norfolk and Western line of railroad in Virginia?

A. No, sir.

Q. Well, then, is it a fact that you have never
page 1354 } seen the N and W's road and track properties in Virginia?

A. That is true.

Q. And is it a fact that you have determined the value of N and W's road and track properties on the basis of a for-

mula you derived and worked out back in your office in Chicago?

A. That is right.

Q. I believe you testified earlier, Mr. Koncel, that Illinois follows the unit method of determining the fair market value of property. Is that correct?

A. That is right.

Q. And you don't—do you know for a fact that Virginia does not follow this unit method.

A. I understand it does not.

Q. Does Illinois publish an assessor's manual for the benefit of assessment officials and tax payers?

A. For local taxpayers it does.

Q. That would not apply to railroad assessments.

A. No, sir.

Q. It would not. When was that manual published?

A. The last manual was published in 1967.

Q. Do you have a copy of that?

A. I do not.

page 1355 } Q. Mr. Koncel, I am handing you a copy—

Mr. Riely: May I see it, please?

Mr. Shannon: Yes, yes, you may. Let me identify it first, if I may.

Mr. Riely: All right, sir.

Mr. Shannon: This is an Illinois Assessors' Manual, 1942, and it says that "This Manual Is Published by the Tax Commission Pursuant to its Policy of Improving Assessments, Illinois Tax Commission, Philip W. Collins, Chairman, Richard J. Lyons, Paul C. Rosenquist, "and it is dated March, 1952, "Printed by the authority of the State of Illinois."

Mr. Riely: May I ask Mr. Koncel whether he was affiliated with the Tax Commission in 1942.

A. I was not.

Mr. Riely: Then I object to the reference to this document, if your Honors please.

Chairman Catterall: Objection overruled.

Mr. Shannon: Q Mr. Koncel, you were in 1942 engaged in the business of assessing railroad property, were you not? At least that was part of your duty as a tax attorney and as a real estate assessment man.

page 1356 } A. I was representing railroads in the assessment.

Q. That is right.
A. I was not making the assessments.
Q. Now Mr. Koncel, I would like for you if you would to read me just the first two sentences in the preface of this Illinois Assessors' Manual. Right there sir. (Indicating)
A. "This Manual has been prepared for the benefit of assessment officials in Illinois and taxpayers of the state. It is designed for use rather than for a dusty shelf or the waste basket. Its purpose is to make the task of property assessment easier by presenting clearly the methods which have proved effective elsewhere and by stating clearly the law relative to assessments in Illinois."
Q. All right, sir. That's fine.

Note: Witness returning Illinois Assessors' Manual to Mr. Shannon.

Chairman Catterall: Did you put your copy in the wastebasket?
A. That is obsolete.
Mr. Shannon: Q. Has the method of assessing property, Mr. Koncel, been substantially changed in Illi-
page 1357 } nois?
A. Quite a bit. We have had a half dozen manuals since that time.

Q. Do you have the latest manual with you?
A. I do not.
Q. Could you make it available to me?
A. I will try to get you one, but—yes I will try to get you one.
Q. I would appreciate it if you would.
A. We don't issue them in the State of Illinois. It is done by an outside concern.
Q. Well, this particular one—
A. —at about twenty-five dollars per copy.
Q. Well, I am sure we could afford twenty-five dollars although Virginia is not as rich as Illinois.
A. I will get you one and you won't have to pay for it.
Q. Mr. Koncel, what is your understanding of fair market value or fair cash value; whichever you prefer to call it.
A. The fair cash value in my humble opinion is what a property would bring where there is a willing seller and a willing buyer.
page 1358 } Q. Now Mr. Koncel, I am going to hand you

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the same manual that was earlier identified and hand to you Page Twelve and ask you—Mr. Riely, do you want to come around here and look at this?

Mr. Riely: I would like to object first. The witness testified that this manual is obsolete. There have been six manuals published since and it is not used in the State of Illinois at all.

Chairman Catterall: You put this witness forward as an expert.

Mr. Riely: Yes, indeed. Very much so.

Chairman Catterall: Well, this is proper examination of an expert.

Mr. Riely: Very well, sir.

Mr. Shannon: Q. Mr. Koncel, will you refer to Page Twelve, Chapter Two of the Illinois Assessors' Manual for 1942, and will you commence reading at the bottom of Page Twelve under the section headed "Fair Cash Value" You don't have to read the footnotes if you don't want to and read down here to the middle of Page Thirteen.

A. "The law requires the assessors to determine the 'fair cash value' of all real and personal property
page 1359 } assessed by them (secs. 501, 502, 532 and 643).[1]
The law further states that "fair cash value" shall be estimated "at the price it would bring in a fair voluntary sale" (sec. 501). It is sometimes asserted by those who seek to evade the law that "fair cash value" means the price property would bring at the junkyard, the pawnshop, or the sheriff's sale. Nothing could be further from the truth. Not only does the law require the assessor to swear that he will assess property "at what the property would bring at a voluntary sale in the due course of business and trade" (sec. 488), but both the Illinois Supreme Court and the United States Supreme Court have often declared that property shall be valued at the price it would bring in its "highest and most productive use." (See *Adams Express Co.* v. *Ohio,* 165 U. S. 194.) The Illinois Supreme Court has declared: "The statute requires that property must be assessed at its fair cahs value—not the price that the property would bring at a forced sale but at a voluntary sale, where the owner is ready, able, and willing to sell but not compelled to, and they buyer is ready, able, and willing to buy but not forced to, as of April 1 in the year in which the assessment is made. Early in the history of this state the court stated that one of the methods of consider-

page 1360 } ing what was the value of property for taxation purposes was to consider what a prudent man would give for the property as a permanent investment, with a view to present and future income." (*People* v. *Gillespie,* 358 Ill. 40, at p. 46, See also *People* v. *Wilson,* 367 Ill. 494, at p. 496)."

Q. Do you agree with that statement?

A. I do.

Q. Now Mr. Koncel, what is the franchise value?

A. Franchise value in my humble opinion—franchise first is difficult—

Q. Before we get—we will come into that later, but just what is your undertanding.

A. Well, franchise is a privilege to operate and it becomes the dominant factor value in any property because without it the physical property, we will say, becomes functionally useless and worth no more than salvage.

Q. Well, now, just speaking, what is franchise value then. What would you put it in your own terms as?

A. Franchise value is the privilege of doing business.

Q. Now, Mr. Koncel, in making assessments of railroads and other properties in Illinois, do you abide by the definition, the statement of fair cash value which

page 1361 } you just read on Pages Twelve and Thirteen of the Assessment Manual?

A. I abide by the statute covering the assessments of railroads.

Q. Well, now, I believe you said you agree with this statement of fair value, did you not?

A. That's right.

Q. And do you assess property of railroads, that is the track and roadway property in Illinois on the basis of the net salvage value.

A. I do not assess railroads by segments in Illinois.

Q. Well, how about all the track property in Illinois. You don't assess that, do you?

A. No, sir.

Q. Separately—

A. No, sir.

Q. That is included in the whole under your unit system.

A. It is included in the unit.

Q. Mr. Koncel, isn't it a fact that as long as a piece of property is in use and is actually serving the purpose that

page 1362 } it was intended for, it has a value in excess of scrap or salvage value regardless of its age.

A. I think it would in certain cases.

Q. Now what do you mean by certain cases?

A. Well, I will withdraw the certain cases and say that it does.

Q. All right, I would like to refer you again to page two seventy-one of your Illinois Assessors' Manual for 1942 and ask you to read at the middle of the page in the middle of the paragraph where I have checked here (indicating). Would you read from here down to the end of that paragraph, please?

A. "As long as a piece of property is in use and is actually serving its purpose it has a value in excess of its scrap or salvage value regardless of its age. In no instance, whatsoever, should property being used in the ordinary operation of the business be listed at junk value. (See page 13 in this Manual.)"

Q. Go ahead. Read the rest of it.

A. "Where a doubtful situation arises, the assessor should call for outside help."

Q. Then I take it you agree with that statement.

A. I would say so.

Q. Now on page four of your testimony, you state that in your opinion the maximum fair market value of this property, and I assume you mean, the N & W property in Virginia, as of January 1, 1968, would be three hundred eighty-seven million four hundred three thousand seven hundred twenty-four dollars. Do you not?

page 1363 }

A. That is right.

Q. How was this figure determined?

A. It is as shown in the first exhibit, page one, or whatever you want to call it in these series of exhibits.

Q. That was taken then by—would you explain that exhibit. I will let you do it. It would be easier than for me to try it.

A. I take the system income factor of one billion one hundred eighty-five thousand eight hundred seventy-three two hundred forty-three dollars and apply thereto the allocation for the State of Virginia of nine point twenty-nine percent to arrive at three hundred thirty-five million four hundred eighty-three thousand five hundred forty dollars. Then for they system stock and debt factor, I use one billion six hundred eighty-six million and apply again the same Virginia

factor of—allocation factor of twenty-eight point twenty-nine percent to arrive at four hundred seventy-six million nine hundred sixty-nine thousand four hundred dollars.

Q. How did you develop your Virginia fac-
page 1364 } tor.

A. That is shown in the second exhibit.

Chairman Catterall: Before you leave that, do you get the Wall Street Journal once a year and raise and lower this stock factor to follow the stock market?

A. I do not get the full—

Chairman Catterall: I am trying to understand system stock factor. Do you get that from the Wall Street Journal on market prices.

A. That was explained—we get that from the schedule filed by the railroad which of course reflects prices on Wall Street and that is figured on the monthly highs and lows average for the year and usually obtained from the Financial Chronicle rather than the Wall Street Journal.

Chairman Catterall: So if there was speculation in the Norfolk and Western stock, it would cause it to double in value on Wall Street. You would raise their tax assessment because of what Wall Street thought.

A. It would be reflected but would have to be given some very strong consideration because of the—probably the inflationary trend of the market due to, we'll say, the mergers and what have you. It would have to be ad-
page 1365 } justed in some manner.

Mr. Shannon: O. Mr. Koncel, do you have your work papers underlying this sixteen page exhibit?

A. No. This is the only thing I have.

Q. They are the only work papers you have.

A. That is all.

Mr. Shannon: Your honors, it makes it difficult to understand how he prepared a lot of this—

Chairman Catterall: I don't know why you continue this cross-examination after we have reached this point.

Mr. Shannon: May I continue in another aspect of it then?

Chairman Catterall: Yes, but I don't see much point.

Mr. Shannon: I don't see much point either; he doesn't have the work papers so I am not able to—

Mr. Riely: Excuse me. We have proper work papers.

Chairman Catterall: Even if you had the work papers, I can't see how this could throw light on our problem.

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Mr. Shannon: Q. Do I understand you to say that the franchise value includes such factors as the right to operate a railroad, good will and going concern.

page 1366 } A. That is right.

Q. What part of franchise value consists of the right to operate a railroad.

A. Well, if you don't have the franchise to operate a railroad, the railroad won't operate.

Q. How do you get a franchise?

A. You get it from the state, by charter.

Q. What does it cost in Illinois to charter a railroad corporation.

A. I couldn't tell you because none have been chartered in many years and I have not been involved in any aspect of that kind.

Q. And is it also a fact, Mr. Koncel, that you have to get a certificate of public convenience and necessity from the Interstate Commerce Commission if you are going to engage in an interstate operation?

A. That is right.

Q. Do you have any idea what that costs?

A. No, sir.

Q. Now, what amount of value do you assign to right to operate a railroad. That is, when you've computed the franchise value.

A. I did it in two ways: I have shown on

page 1367 } Exhibit No. 15—

Q. Do you mean Page Fifteen?

A. No, it is Exhibit No. 15. Supplemental—Call it that if you want to.

Q. Are we referring to this by pages?

Mr. Riely: No. It is Page Fifteen.

Mr. Shannon: Of Mr. Koncel's exhibit one?

Mr. Riely: Yes, of Mr. Koncel's exhibit one.

Mr. Shannon: All right.

Q. But you don't have it broken down there what you assign to the right to operate a railroad, do you?

A. No, sir.

Q. And the same would be true of going concern, would it not?

A. That is right.

Q. What is the difference, Mr. Koncel, between going concern and good will?

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A. Well, going concern is the manner in which a railroad is operated and producing revenue where as good will is something they build up with communities, patrons, and what have you.

Q. Yes, sir. Now continuing on Page Four of your direct statement, I believe you state that at least—let

page 1368 } me find it, I don't want to misquote you, sir. "At least fifty percent of the total valuation I determined would be franchise value."

Did you make that statement?

A. That is right.

Q. How did you reach this conclusion, Mr. Koncel?

A. Well, as I said a minute ago, I felt that the franchise is a privilege and becomes a dominant factor of value in any property and so that without it the physical property becomes functionally useless and no more than salvage. Therefore, as one depends on the other, franchise onto the property—the property onto the franchise, in my humble opinion fifty percent is a fair and reasonable division of the property of the value.

Q. Why is it fair and reasonable?

A. Well, I feel that maybe franchise itself could be valued at more because if you do not have the franchise, you do not operate.

Q. Isn't it true if you don't have a line of railroad, you don't operate either?

A. That is true.

page 1369 } Q. Now is this conclusion of fifty percent borne out—I understand you don't have any work papers, but is it borne out in anything shown on the sixteen pages of your Exhibit No. 1?

A. It is shown on sixteen.

Q. Page Sixteen?

A. Yes.

Q. That just simply shows the method in which you computed what you contend to be the franchise value. Is that correct?

A. That is right.

Q. And how did you do that?

A. As it is shown there.

Q. And how is it—you took the Virginia franchise tax, did you not, and—which is fifteen—

Mr. Riely: Sixteen, I believe.

Mr. Shannon: Would you tell me just how—

Edward F. Koncel

A. Well, if you have no franchise, you've got no income and I took—and to be realistic—I took half of the stock and debt value.

Q. Why half?

A. Because of no franchise is probably worth probably about half and then I took the investment and

page 1370 } averaged the three and arrived at one hundred ninety-six million, eighty thousand, nine hundred and seventy-seven dollars and applied that to the three hundred eighty-seven million, four hundred and three thousand, seven hundred twenty four dollar fair market value and that I arrived at to produce fifty point sixty one.

Q. And you gave the income factor the rate of zero.

A. Yes.

Q. Mr. Koncel, aren't there circumstances when according to your method when the franchise value could be say less than fifty percent, thirty percent, twenty percent?

A. Its possible.

Q. Now at the top of page five of your testimony you state that of the total figure of three hundred eighty-seven million, four hundred three thousand, seven hundred twenty-four dollar valuation you determined N and W's Virginia property to be worth seventy-two million, eighty-three thousand, one hundred seventy-three dollars as attributable to N and W tracks in Virginia. Is that correct?

A. That is right.

Q. How is this determined?

A. That is as shown on—

page 1371 } Q. Which page?

A. Page One of the exhibit.

Q. Now, on that exhibit I note you say portions for accounts one—I take it that is engineering?

A. That is right. ICC.

Q. These are the ICC accounts. Is that right?

A. That is right.

Q. One, five, six, eight, nine, ten, eleven, twelve, and thirteen. What designation or allocation did you make for each of those accounts? How much of—let me put it this way. How much of the seventy-two million plus figure is allocated to each of the primary ICC accounts?

A. I did not make that division.

Q. In fact, you never went to the accounting records of the carrier at all in this.

A. No, sir.

Edward F. Koncel

Chairman Catterall: Why the forty-four point seventy-six instead of the forty-five percent.

A. That is shown—the computation shown on Schedule Fourteen, or I should say Page Fourteen of the exhibit.

Chairman Catterall: Forty-four point seventy-six. I just wonder how you got that to hundreds of one

page 1372 } percent.

Mr. Shannon: Q. Where did you go, Mr. Koncel, for these undepreciated investment figures shown on Page Fourteen?

A. They were furnished me by Norfolk and Western.

Q. Who furnished those?

A. Mr. Strouse.

Q. Mr. Strouse?

A. Yes, sir.

Q. When did he furnish those?

A. I think sometime in February. I don't know exactly when it was.

Q. And isn't it true that much of the other data as used in this sixteen page exhibit was furnished by N and W?

A. That is true. Some of it, of course, is the same data that I have in my files—

Q. In your—

A. —in Illinois.

Q. In your annual report?

A. That is right.

Q. Well, then, as I understand it, you don't have the seventy-two million dollar figure broken down

page 1373 } by the primary accounts. Is that correct?

A. I do not, no.

Q. Yes, sir. Now, Mr. Koncel, how do you conclude that fifty percent of the seventy-two million, eighty-three thousand, one hundred seventy-three dollars which you ascribed to track property in Virginia, how did you conclude that fifty percent of that should be attributed to franchise value?

A. I did not make any computations as to that.

Commissioner Hooker. Did Mr. Strouse give you that information?

A. He did not give me information of that sort at all.

Mr. Shannon: Q. Look at Page Five of your testimony. You say "If I were to include investment and grading" Well, now, first of all let me ask you this. This seventy-two million dollars doesn't include grading, does it?

A. It does not. No.

Q. Well, now, you testified there, do you not, that if you were to include the investment and grading, that the seventy-two million dollar figure would be increased to ninety-nine million dollars, do you not?

page 1374 } A. That is correct.

Q. Now is my—now, do you see down there in the next answer you say "Here again in my opinion that at least fifty percent of this value represents franchise or going concern." Now, when you say this value, you are referring back I suppose to the seventy-two million dollars and the ninety-nine million dollars.

A. That is right.

Q. Well, now, my question is how did you conclude the fifty percent of this figure should be attributed to franchise value?

A. The same way I concluded that franchise value being a privilege and the property was not worth much without it, I—depending one on the other, I concluded that a fair and reasonable division would be fifty percent.

Q. In other words it was an arbitrary allocation.

A. It was a judgment.

Q. And it was a judgment based on what?

A. On conclusions reached after examining a lot of the figures.

Q. Well, now, I believe you said you were not an evaluation engineer and you were not an accountant and you are not an economist. It is strictly a judgment based

page 1375 } on your experience as an Illinois tax assessor.

A. Not only an Illinois tax assessor, but my long experience of some forty years or so in this railroad assessment field.

Commissioner Hooker: You just had to take what was left after you gave it franchise, didn't you?

A. That is right.

Mr. Shannon: Q. Mr. Koncel, are you familiar with the Interstate Commerce Commission Uniform System of Accounts for Railroads?

A. To a certain extent, yes.

Q. Isn't it a fact that account two covers land for transportation purposes and account three grading? I will be glad to show you a copy if you do not recall.

A. I've got it—it shows here on this—

Edward F. Koncel

Q. Just to differentiate here, sir, here is a—I am showing the witness the Uniform System of Accounts for Railroad Companies. I believe this has already been indentified in the record as—let me show you the one in the record Exhibit EPJ-1. I am referring the witness to the primary property accounts, account two is headed what, Mr. Koncel?

A. Land for transportation purposes.

page 1376 } Q. And what does it say there? The first sentence?

A. "This account shall include the cost of land of necessary width acquired for roadway."

Q. Now I refer you to account three. What is the heading of that?

A. Grading.

Q. What does it say and what is that first sentence.

A. "This account shall include the cost of clearing and grading the roadway and of constructing protection for roadways, tracks, embankments, and cuts."

Q. Yes, sir. Thank you. There is no doubt in your mind that the ICC then makes a distinction between land for transportation purposes and grading.

A. That is right.

Q. Are you familiar with the ICC's evaluation report for railroads?

A. Those that are furnished me, I am familiar with, but I am not an evaluation engineer and never gone into the evaluation reports furnished.

Q. So you just have a general knowledge of it?

A. General knowledge of it in connection

page 1377 } with assessment work.

Q. Now, I believe you testified earlier that this seventy-two million dollar figure specifically seventy-two million, eighty-three thousand, one hundred seventy-three dollars that you determined by your computations is attributable to N and W tracks in Virginia, excludes grading.

A. That is correct.

Q. Is that a part of your testimony?

A. Yes, sir. That is right.

Q. Let's continue on Page Five of your direct statement. You stated that if you added grading in, it would raise that figure to ninety-nine million, nine hundred ninety-two thousand, fifty-one dollars.

A. That is right.

Q. All right, then. If my arithmetic is correct Mr. Koncel, that would mean that you have added twenty-seven million,

eight hundred eight thousand, eight hundred seventy-eight dollars to cover the value of grading of N and W's line in Virginia.

Mr. Riely: I don't think your arithmetic is correct.

page 1378 } Mr. Shannon: Well, the difference between seventy-three and ninety-nine, I may have made a mistake, but it would be—

A. Twenty-seven million, nine hundred nine thousand, eight hundred seventy-eight dollars.

Mr. Riely: Twenty-seven thousand, nine hundred and eight thousand—

Mr. Shannon: Well, I made a slight error—I did it quickly. I apologize, but basically it is—

A. We all do it.

Chairman Catterall: These are approximate figures are they not?

A. That is right.

Chairman Catterall: So it would be easier to deal with them if we call ninety-nine million, nine hundred ninety-two thousand, fifty-one dollars a hundred million dollars. It would still be an approximate figure, and within your range.

A. That is right.

Chairman Catterall: Let's call it a hundred million dollars.

Mr. Shannon: Q. Mr. Koncel, what was the source of this twenty-eight million dollar grading figure?

page 1379 } A. This is shown in Page Fourteen of the exhibit.

Q. Where is it shown there, Mr. Koncel?

A. We arrived at a percentage of sixty-two point zero nine of the total undepreciated investment in road accounts one to forty-five which was two hundred and ninety million. seven hundred fifty-four thousand, four hundred eighty-five dollars and applied that to this road portion of the assessment. As I have computed it of one hundred sixty-one million, forth-three thousand, seven hundred twenty-eight dollars and produced a figure of ninety-nine million, nine hundred ninety-two thousand fifty-one dollars.

Q. Did Mr. Strouse furnish you those figures?

A. By those figures, what—

Q. The ones that are on the second line there. (Indicating) Total undepreciated investment in road accounts. One, three, five, six, eight, nine, ten, eleven, twelve, and thirteen.

A. Yes, he did.

Q. Did Mr. Strouse tell you that under the Virginia law in the determining the average value per mile of road and track property that you include the value, cuts, fields, excavations, tunnels, and so forth?

A. Repeat that, I didn't get it.

page 1380 } Q. Did Mr. Strouse inform you when he gave you those figures that under the Virginia statute in determining the average value per mile of the line of railroad such as the N and W has in issue here that you would take into account not only the value of the track and track structures but also the value of the excavation, cuts, fills, and tunnels?

A. I do not believe he did.

Q. Well, then. This twenty-eight million dollar grading figure that you referred to as far as you are concerned, that was not taken from the N and W books of accounts from account three.

A. Repeat that again please. I was trying—

Q. As far as you are concerned, as far as your knowledge goes, the twenty-eight million dollar grading figure that you used and increasing the value from seventy-two million to ninety-nine millon of the track property, that was not taken from the N and W's books of accounts.

A. No, it was the result of the computations as shown on Exhibit, Page One of the exhibit.

Chairman Catterall: Where is this twenty-eight million on Page One of the exhibit?

page 1381 } Mr. Shannon: I am rounding off, Judge Catterall. The twenty-seven million doesn't show. To get it you have to take ninety-nine million, nine hundred ninety-two thousand, fifty one dollars which he said would be the value of the roadway and track property if you included grading and then excluding grading, he shows the value of seventy-two million, eighty-three thousand, hundred and seventy-three dollars.

Chairman Catterall: Where did the twenty-eight million dollars come from?

Mr. Shannon: That is the difference.

Mr. Riely: The difference.

A. That was a mathematical subtraction.

Chairman Catterall: Well, you start off with seventy-two million and then you got it up to a hundred million—

A. Seventy-two million from ninety-nine million—

Mr. Riely: That is including grading.

Chairman Catterall: And then you add twenty-eight million to the seventy-two million.

Mr. Riely: Well, that is not the way it was done, your honor.

page 1382 } A. It wasn't added. It was a result of a computation which is shown on percentage computations shown on Sheet Fourteen of this exhibit.

Chairman Catterall: Well, that doesn't say anything about twenty-eight million dollars.

A. No, it doesn't, but it does give a percent of total undepreciated investment at sixty-two point zero nine percent of the total investment in road accounts one to forty-five and then I take that percentage of the road portion of the assessment as computed by me which was the road *protion* was a hundred and sixty-one million, forty-three thousand, seven hundred twenty-eight dollars and after applying that, sixty two point zero nine, I arrived at this approximate one hundred million dollar figure.

Chairman Catterall: Well, I will study this in due course. I cannot hope to take it in now.

Mr. Shannon: My whole purpose is simply to show that, well, I think that I can do it with this next question here, your honor.

Q. Mr. Koncel, I would like to refer you to Exhibit LBY-M.

Mr. Riely: What does that follow, Mr. Shannon?

Mr. Shannon: That follows the graphs.

page 1383 } Mr. Riely: That follows the graphs.

Mr. Shannon: Yes. The first one following the series of graphs.

Mr. Riely: Well, that follows Exhibit LBY-L. I see.

Mr. Shannon: I want to refer you now to Sheet Two. This is the listing of the primary property accounts the value of primary property accounts assigned to N and W property in Virginia. Now there is account three, grading. And what is the value there.

A. Forty-nine million, seven hundred eighty-three thousand, three hundred and ninety-four dollars.

Q. All right, now, you didn't use that figure.

A. No, sir.

Q. Yours was a computed figure.

A. For this computation, yes.

Q. Yes, sir. And then I could have asked you the same question with respect to each one of the other accounts. They wouldn't have been in harmony the way you computed them with what is shown in schedule six-eleven which I just referred you to. Is that correct?

A. I do not do that individually. I did it as a total.

Q. Yes, sir.

page 1384 } A. On a percentage basis.

Q. Now Mr. Koncel, on Sheet Six of your testimony, you state that basically there are three approaches to evaluation income, market, and cost. Is that correct? About the middle of the page there. (Indicating) Basically, there are three approaches.

A. Right. Here. That is right.

Q. Which of these methods does the Interstate Commerce Commission use?

A. For—

Q. Evaluation.

A. —what purpose?

Q. For evaluating railroad property.

A. They use cost.

Q. Now, are you saying then, Mr. Koncel, I believe you stated that the least reliable of these is the cost method in your testimony. Did you state this?

A. That is right. I did.

Q. Then are you stating that the ICC's method of valuing rail property since 1913 is not as good as the system you use in Illinois?

A. Well, I use the system in Illinois pre-

page 1385 } scribed by the statute which is three factors which includes cost furnished by the Interstate Commerce Commission, but that cost is adjusted very substantially downward.

Q. Yes, sir. Would you say then that the cost prepared by the ICC Section of Evaluation or section of evaluation now, I believe, are important in railroad assessment formulas?

A. It is important to the extent that it indicates values and is not value itself.

Q. But it is indicative of value.

A. It is indicative of value.

Q. Now you make speeches throughout the country at various meetings of the tax administrators, do you not, Mr. Koncel?

A. That is right.

Q. And within the past several years, did you deliver a

speech at the seventh annual meeting of the Midwestern Tax Association Tax Administrators in Topeka, Kansas on the general subject of Railroad Physical Value Determinations and Problems relating to Senate Bill 1149.

A. I did.

Q. And what was the gist of Senate Bill 1149, or do you recall?

page 1386 } A. If my memory serves me, the gist of that bill was that the railroads in short were attempting to take away from the State Administrators the final—

Q. Let me refresh your recollection. Wasn't the purpose mandatory evaluation requirements which certain people no longer considered necessary for the ICC to perform.

A. That was one of the facets of that. Yes, sir.

Q. And didn't you go one record as being opposed to that bill's enactment?

A. I did.

Q. Now Mr. Koncel, are original costs generally lower than reproduction costs new less depreciation?

A. Yes.

Q. And is it your belief that a fairer indicator of value would be reproduction cost less depreciation rather than original costs?

A. Well, I used it in Illinois because it is statutory, but then I adjusted sufficiently that it—in a lot of instances, almost reflects original costs.

Q. In what respect?

page 1387 } A. By giving credit for uneconomic branches, public improvements, and obsolescence.

Q. Is that again a judgment factor?

A. That is a judgment factor, yes, Sir.

Chairman Catterall: Do you mean your statute requires reproduction costs?

A. That is right, your honor.

Chairman Catterall: And you temper the weighing of the shorn lamb to bring it down substantially to the original costs.

A. That is right.

Q. Then I take it your opinion that to determine the current costs of reproduction—determine the current cost of railroad, it would be more logical to use the reproduction cost figures less depreciation rather than original cost?

A. Reproduction less depreciation adjusted.

Q. Adjusted the way you adjust it in Illinois.

A. Yes, sir. That is right.

Q. Now, would you please turn to Page Seven of your testimony. You referred to Schedule Three fifty (c) of the ICC reports and you say "this analysis shows adjustments which would be made both upward and downward in order to normalize the net railway operating income." You refer here to normalizing. You are asked to explain what you mean by normalizing, but I'm not so sure I understand it. Would you elaborate a little bit on what you mean by normalizing?

page 1388

A. As the ICC accounting rules require the railroads to report net railway operating income without the benefit of these accelerated credits, the credits that are now allowed under the federal income tax rules and in order to say normalize that net railway operating income which will be high without giving consideration to these credits, you've got to look at these credits and in giving them their proper consideration that brings the net railway operating income downward from what is reported as in our case we call it Schedule Eleven which is the income account or it is as reported in here. (Indicating) I have forgotten what page that is in the Form A of the ICC.

Q. Well, then, as I understand your answer, the ICC does not allow rapid depreciation, just normal straight line depreciation on certain depreciable accounts. Is that correct?

A. That is right.

Q. And then as I understnad the ICC allows no depreciation on track accounts. Is that correct?

page 1389

A. That is right.

Q. Now, over on Page Nine, you state that there is a great amount of obsolescence present in most railroad property, particularly in the road property. What do you mean by obsolescence?

A. Obsolescence—by obsolescence I mean that road property *per se* is not renewed; it is in place at all times and with the competition that railroads are encountering today, from highways, airplanes, water carriers, and what have you, even the private automobile and the truckers the local truckers, a certain amount of that road property is not as useful as it was when they first constructed it. Therefore, it should be—a proper amount should be made for it. Not only depreciation which is an annual depreciation or a deteriora-

tion of the property but also because of its diminution of use.

Q. Are you using depreciation and obsolescence synonymously?

A. Not synonymously.

Q. All right. Explain the difference. I am a little confused.

A. Well, I just said that depreciation is a normal depreciation, a deterioration of the property, normally,
page 1390 } and obsolescence is something over and above depreciation which diminishes or decreases the use of that property because of this competition and it would not be replaced in kind because of—

Q. I believe you said sir that you had not made an inspection of the road and track properties of the N and W in Virginia. Is that correct?

A. Yes, sir.

Q. Then you don't know whether there is any obsolescence as you define it on N and W's road and track property or not, do you? That is, in Virginia.

A. No. I would say I wouldn't know it except that knowing they have taken in some other property and probably got parallel lines, there would be a certain amount of obsolescence because of that—because those lines are no longer useful and could be dispensed with.

Q. What other property have they taken in in Virginia?

A. The one that I know of is the Virginian Railroad and I guess from what little I looked at—

Q. Have you ever seen the Virginian Railroad?

A. No, sir.

Q. You have never inspected it?
page 1391 } A. No, sir.
Q. You don't know whether there is any obsolescence there or not.

A. No, I don't.

Q. Do you have any idea, Mr. Koncel, how much the N and W spends annually on maintenance of track—

A. No, I do not.

Q. —roadway of Virginia?

A. No, I do not.

Q. You have never made the study to determine that, have you?

A. No, sir.

Q. Now Mr. Koncel, let's look at Page Twelve of your testimony. You say you used five sets of statistics of factors.

The first was traffic units. Now I want to ask you how was each determined—or how much each of these factors developed. Let's put it that way.

A. The first one was taken from the schedule nineteen, filed with my office.

Q. Schedule Nineteen? Would you elucidate on that a little bit? I am not too sure—

A. We have a schedule that requires that each railroad show traffic units, revenues, cost and several

page 1392 } other—

Q. Does that show it on a system wide basis?

A. It shows it on a system wide basis also broken down into the various states in which they operate.

Q. It is broken down into Virginia even though it is filed with Illinois?

A. That is right.

Q. And you have that available with you.

A. I had that available when I made this.

Q. Do you have it available here in the hearing room?

A. No, I do not.

Q. Could you make that available to us?

A. I think so.

Q. Would you do it?

A. I will do so.

Q. Now, what about track—

Chairman Catterall: I don't really think that would set much light on our problem. I don't want to make the witness file that unless there is a special reason.

Mr. Shannon: No, I just didn't understand how it was developed and I couldn't tell from the sixteen sheets how he developed it and I wanted—

page 1393 } Chairman Catterall: This one paragraph says exactly what he does.

Mr. Shannon: Well, yes, he has relied on a schedule that was filed in Illinois which is not—

Chairman Catterall: I don't know how he got the percent of investment in Virginia. You might explain that.

A. That is done on the—

Chairman Catterall: Number Four, percent of investment in Virginia. How did you figure that?

A. The investment in Virginia to the total investment.

Chairman Catterall: How did you figure the total investment?

A. The company broke this down into the various states in this schedule.

Chairman Catterall: In other words, the company told you.

A. They told me, in a sense, that they had it in the schedule.

Mr. Shannon: Q. They had it in Schedule Nineteen.

A. Nineteen.

page 1394 } Q. Now, continuing on Page Thirteen of your testimony, you say the average of the net railway operating income of the Norfolk and Western for the years 1963 and 1967, after adjustments, is one billion, one hundred eighty-five million, eight hundred seventy-three thousand, two hundred forty-three dollars. What adjustments were made?

I am on Page Thirteen about the middle of the page.

A. Those adjustments were the Federal Income Tax credits shown in this schedule we previously talked about and the ICC Form A.

Q. Yes. Would that include the seven percent adjustment?

A. That is right.

Q. And also, I believe, there was a National Defense credit in your answer.

A. That is right.

Q. And there is another, too, I believe.

A. Whatever the—there are three or four—whatever the Federal Government allows the companies to have that is there.

Q. Yes.

A. It may not be there every year, but it is there.

page 1395 } Q. Now Mr. Koncel, at the bottom of Page Fourteen, you state also "if I had the opportunity to inspect the N and W plant in Virginia, I might discover situations which would justify an even lower value." Conversely, if you had an opportunity to inspect N and W road and track properties in Virginia, isn't it true that you might discover situations that would justify a substantially higher value?

A. That could be.

Q. Now, earlier, and I refer you to Page Fifteen,—

Mr. Riely: Excuse, me, Mr. Shannon, what page?

Mr. Shannon: Page Fifteen.

Q. In talking about the formula that you applied—six lines from the bottom—you say "By using a zero factor for income" why did you use a zero factor for income?

A. Because if you don't have a franchise, you don't have any income.

Q. I see.

Chairman Catterall: I notice you refer to the franchise tax for 1968 as two million dollars and you draw some conclusions from that. If the actual franchise tax

page 1396 } was three million dollars instead of two million dollars, what effect would that have on your figures? Would it go up or down?

A. I do not know. I would have to compute it. I do not know off hand.

Chairman Catterall: Well, say the franchise tax was two million—

A. It would increase this third line value—that is as shown in here. It would increase the total value which is the last line of this page Fifteen of the exhibit.

Chairman Catterall: I mean ordinarily their tax is three million dollars. It just happened it was two million dollars this one year. I was trying to appraise the fact of having three million instead of having two million. Oh, yes, on Page Fifteen, suppose that figure were three million dollars instead of two million dollars. Can you tell us roughly how that would affect the other figures?

A. If the average rate would be three point forty-eight, it would increase that line—that third line—of fifty-eight million.

page 1397 } Mr. Riely: And it would also increase the bottom line.

A. And it would increase the last line of one hundred and fifty-seven million or a hundred and fifty-eight million in round figures.

Chairman Catterall: I cannot tell from this exhibit what the hundred and fifty-seven million is supposed to represent.

Mr. Riely: What is the one hundred and fifty-seven million dollars supposed to represent?

Mr. Shannon: Which sheet are you looking at, Mr. Riely?

Mr. Riely: Page Fifteen.

A. Fifteen.

Commissioner Hooker: Right in the middle of the page.

Mr. Riely: We're with the Judge.

A. If they paid a tax of two million dollars plus and the

averate rate was three forty-eight, the division of that average rate into the tax would produce—

Chairman Catterall: Oh, you mean—this is so complicated, I think I will recess this case until two o'clock. The Commission will recess until two o'clock. 12:28 PM.

page 1398 } 2:00 P. M. The Commission resumes its session.

Mr. Shannon: Your Honors, I have just a few more questions and I will complete my examination.

Q. Mr. Koncel, would you please refer to Page Eighteen of your prepared statement please, sir. About the middle of the page you say, "In other words, railroad tracks are in approximately a fifty percent condition." On what did you base this conclusion, Mr. Koncel?

A. The Interstate Commerce Commission gives—or used to furnish condition percents ranging anywhere from thirty-five to sixty percent—

Commissioner Hooker: Would you talk louder? The reporter cannot hear you.

Mr. Shannon: Did you get that question, Mrs. Simpkins?

Reporter: Would you repeat it again please, Mr. Shannon?

Mr. Shannon: Q. Mr. Koncel, referring to page Eighteen of your prepared statement about the middle of the page, you state "in other words, railroad tracks are in approximately a fifty percent condition". On what did you
page 1399 } base this conclusion, sir?

A. The ICC Bureau of Evaluation used to furnish condition percents ranging from anywhere from thirty-five to sixty percent and the ICC value—not the ICC —evaluation engineers generally consider fifty percent to be a conservative figure of depreciation.

Q. You are not an evaluation engineer, are you?

A. No, sir.

Q. Well, how do you know?

A. In my long experience I have followed the same course of—after all of going through a lot of these figures in Illinois, fifty percent was the conservative figure.

Q. Now, you say that the ICC made some sort of a determination of thirty-five to sixty percent. Is this right?

Edward F. Koncel

Sixty percent?

A. They used to furnish conditions percents ranging anywhere from—

Q. What were they furnished in, Mr. Koncel?

A. What were they furnished in?

Q. Yes.

A. They were furnished to me when I sent them a list of railroads for which I wanted condition percents.

page 1400 } Q. You didn't figure that yourself. You submitted it to the ICC.

A. No, sir.

Q. Do you know what scale or what indices or what sort of a yard stick they applied?

A. No, I do not.

Q. You did not. So you do not actually base this statement on any study that you made as to the Norfolk and Western.

A. No.

Q. And you, therefore, cannot break it down as to condition percents between ties, rails, and other materials, could you?

A. No, sir.

Q. Actually, you relied on information that was furnished you in connection with your assessments in Illinois to come up with a fifty percent conclusion for the Norfolk and Western which you haven't seen in Virginia.

A. That is right.

Q. Now, Mr. Koncel, I believe you indicated that your work papers when you make assessments in Illinois are not open for public inspection. Is that correct?

page 1401 } A. That is right.

Q. When you make your assessments in Illinois are your work papers available for deliberation for the railroads in reviewing the assessments?

A. They are not available for examination.

Q. But if the railroads requested it, would you sit down with them and review?

A. I do that all the time.

Q. You would show them your work papers?

A. I do not show them the workpapers.

Q. I see.

A. We just merely discuss.

Q. Now in recent years, Mr. Koncel, has Illinois increased the fair cash value and assessment of N and W's properties?

A. Do you mean only one year?

Q. Only one year.

Edward F. Koncel

What year was that?
A. The year before last, sir.
Q. What was that? Between 1960—you tax people refer to years differently than I do.
A. We are a year behind.
Q. A year behind, yes.
page 1402 } A. 1968-1967
Q. Between the years 1966 and 1967?
A. It is either 1966 or 1967. I do not recall which.
Q. Yes, sir.
A. I do not have any papers here with me.
Q. So that is the only year that you have actually increased the N and W.

Chairman Catterall: What was the percent of increase?
A. That I cannot tell you. It was very small.

Mr. Shannon: Q. Mr. Koncel, I have here before me and I believe it is a fact is it not, in Illinois when you make a determination of the fair cash value of the original assessment of the railroad company, you publish it in various papers throughout the state, is that right?
A. No. In one paper—in one official state paper.
Q. That is a public notice, is that right?
A. That is right.
Q. All right, sir. Now I would like to show you, sir, if I may, come around, Mr. Riely, if you will, I will be glad to show you this.

page 1403 } Mr. Riely: May I see it before you show it to him?

Note: Above mentioned papers passed to Mr. Riely.

Mr. Shannon: Don't mix them up because I will get my dates mixed up.
Mr. Riely: I wouldn't mix them up for anything in the world.
Chairman Catterall: Are you going to put these in evidence, Mr. Shannon?
Mr. Shannon: Yes, I think I will.
Chairman Catterall: We will clip them together and they will be received as Exhibit No. 22.
Mr. Shannon: Q. Mr. Koncel, I am going to ask you—I am showing you here a series of five Xerox sheets which are

headed each one of them in various capacities to show that public notice, State of Illinois, Department of Revenue; and the first one here, Sheet One, signed by Theodore A. Jones, State of Illinois, Director of Revenue.

Chairman Catterall: Director of what?

Mr. Shannon: Director of Revenue.

Q. Is that correct, sir?

A. That is right.

Q. Is Mr. Jones the Director of Revenue?

page 1404 } A. Not any more.

Q. He was at this time?

A. He was at the time.

Q. And this is dated Chicago, Illinois, November 27, 1968. Is that correct?

A. That is right.

Q. Now, this is the nineteen—is that nineteen sixty-eight?

A. Yes.

Q. What does it show for the Norfolk and Western railway company for 1968? Let me explain, sir, let me finish my question. It shows 1968 fair cash value in the first column, does it not?

A. That is right.

Q. In the second column, it shows 1968 original assessment. Is that correct?

A. That is right.

Q. All right. What does it show in the first column for the 1968 fair cash value of the Norfolk and Western?

A. Eighty-three million, four hundred thousand dollars.

Q. And then what does it show in the second

page 1405 } column under 1968 original assessment?

A. Forty-one million, seven hundred thousand dollars.

Q. And your assessment is generally fifty percent, is that right, of your fair cash value?

A. That is right.

Q. Now I want to show you the second sheet which is a public notice, State of Illinois, Department of Revenue. It is dated December 18, 1967, Chicago, Illinois, and signed Theodore A. Jones, Director of Revenue, State of Illinois. Now what does it show for the 1967 fair cash evaluation of the Norfolk and Western?

A. Eighty-three million, four hundred thousand dollars.

Q. What does it show for the year 1967?

A. Forty-one million, seven hundred thousand dollars.

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Q. Now I am going to show you Sheet Number Three, Mr. Koncel, which is entitled, Public Notice, State of Illinois, Department of Public Revenue, dated November 21, 1966. Date line, Chicago, Illinois, State of Illinois, Department of Revenue. I am going to let you pronounce this gen-
page 1406 } tleman's name—Marshall—
A. Korshak.
Q. Director of Revenue.

Mr. Riely: Suppose you spell it for the reporter.
Mr. Shannon: K-o-r-s-h-a-k.

Q. What does it show for the Norfolk and Western 1966 fair cash value.
A. Seventy-eight million, two hundred thousand.
Q. And the 1966 original assessment?
A. Thirty-nine million, one hundred thousand dollars.
Q. All right, Sir. Now I am going to show you a similar statement dated, it looks like November 18, 1965. Doesn't it, Mr. Koncel?
A. If it's sixty-six, it is—
Q. 1965, isn't it?
A. That is right.
Q. The first column again is headed 1965, fair cash evaluation, and the second column is headed 1965, original assessment. Is that right?
A. That is right.
Q. Now, what does it show under the first
page 1407 } column, fair cash valuation for 1965 for the property of the Norfolk and Western?
A. Seventy-nine million, eight hundred fifty thousand dollars.
Q. And what does it show over in the second column?
A. Thirty-nine million, nine hundred twenty-five thousand dollars.
Q. Now Mr. Koncel, I believe you testified that prior to 1964, the Norfolk and Western did not operate in Chicago-in Illinois, is that correct?
A. No.
Q. It did not operate?
A. No, Sir.
Q. You are not saying I am incorrect. You are saying it did not operate?
A. Norfolk and Western as such, no, did not operate be-

cause in 1964, I think it was, in October, 1964, that it was a three months operation.

Q. That is when it unified with the Wabash and the Nickel Plate. Is that correct?

A. That is right.

page 1408 } Q. October 16, 1964, as I recall. Is that correct?

A. Yes.

Q. Now I show you the legal notice, Public Notice, State of Illinois, Department of Revenue, and it is dated December 28, 1964, shows Chicago, Illinois, State of Illinois, Department of Revenue, and this gentleman's name is Harry L.—

A. Hulman. H-u-l-m-a-n.

Q. Was he the director of revenue at that time?

A. That is right.

Q. All right, now, would you read for me the 1964 fair cash valuation under column one for the New York, Chicago and St. Louis railroad companies.

A. Forty-three million, nine hundred ninety thousand dollars.

Q. And what was the 1964 original assessment?

A. Twenty-one million, nine hundred ninety-five thousand dollars.

Q. Now would you read me the fair cash value 1964 of the Wabash railroad company?

A. Forty-four million, nine hundred fifty thou-

page 1409 } sand dollars.

Q. And what was the 1964 original assessment?

A. Twenty-two million, four hundred seventy-five thousand dollars.

Q. Now assuming my arithmetic is correct, if I add the Wabash and the New York, let me get it in the record right now—the New York, Chicago, and St. Louis Railway Company which I believe is the Nickel Plate. Is that right?

A. That is right.

Q. All right. If you add those two together—you'd better check my arithmetic, Mr. Riely,—you come up with sixty-eight million, nine hundred forty thousand as the 1964 fair cash valuation of those two railroads.

Chairman Catterall: I thought the Wabash was forty-four and the Nickel Plate forty-three. I must have written it in wrong.

Mr. Shannon: No, the Wabash, your Honor, was forty-four nine fifty—

Chairman Catterall: Forty-four nine fifty—

Mr. Shannon: Yes, sir.

Chairman Catterall: And the Nickel Plate—

page 1410 } Mr. Riely: Forty-three nine ninety.

Mr. Shannon: I think this figure here, your Honor, it is bound to be, that is right. It is forty-four nine-fifty.

Chairman Catterall: And the Nickel Plate—

Mr. Shannon: And the Nickel Plate was forty-three nine ninety.

Chairman Catterall: You add those together and you get eighty-eight million.

Mr. Shannon: Eighty-eight million. That is right.

Q. Now isn't it a fact, sir, that between 1966 and 1967 from what you have read there for the Norfolk and Western the fair cash value of the N and W increased in Illinois by five million two hundred thousand dollars?

A. That was the tentative assessment later on in hearings why those assessments were reduced.

Q. Do you have the figures what they were reduced to?

A. No, I do not.

Mr. Shannon: I believe that is all I have, your Honors.

page 1411 } CROSS EXAMINATION

By Mr. Epps:

Q. Mr. Koncel, I thought I heard you say that you had studied law under a private tutor. Is that correct?

A. A couple of them.

Q. That is very interesting. Do you mind telling us the names of them?

A. C. B. Cardy and Homer T. Dic.

Reporter: I'm sorry. What was the first name?

A. C. B. Cardy. C-a-r-d-y. and Homer T. Dic. D-i-c.

Q And did you tell us that you got a degree from Chicago?

A. That is right.

Q. Law degree?

A. That is right.

Q. You used, I believe, seven percent to capitalize income for the N and W. Is that correct?

A. That is right.

Edward F. Koncel

Q. Do you recall previously saying that as a general rule you used six percent in previous proceedings?

A. I have used six percent in previous hearings.

Q. And you used six percent for the Florida
page 1412 } East Coast, I believe.

A. That is right.

Q. As a general rule, you did use six percent?

A. That is right.

Q. I would like to know if you subscribe to this, please, Sir. I would like to read it to you and I am quoting "I think that after a railroad assessor assembles all of the information and gets it down on paper and sees the relationship of these various factors, he then should exercise sound, mature judgment in trying to make a fair and equitable assessment looking toward uniformity of his assessment program." Do you subscribe to that?

Mr. Riely: If it please the Commission, I object to that unless the witness is advised as to the source of the quotation.

Chairman Catterall: It doesn't make any difference, does it?

Mr. Riely: I think it does.

Chairman Catterall: Assume that John Doe said those words, and do you agree with them?

Mr. Riely: I judge my objection is overruled.
page 1413 } Chairman Catterall: Yes.

Mr. Epps:

Q. Do you subscribe to that?

A. I do.

Q. As a matter of fact, they are your words, aren't they?

A. Could be, yes.

Mr. Riely: I thought that was what was going to happen.

Chairman Catterall: So that is why you objected.

Mr. Epps:

Q. You will recognize those as your words in the Florida East Coast case.

A. That is right. Yes, Sir.

Q. Now I believe your testimony in that case indicated and I will try to quote it that "the use of the economic theory that you were describing just before lunch causes values to

rise and fall like the tide." Do you remember that in that hearing?—making that reference to it?

A. If you copied it from the transcript, I guess I must have said it.

Q. It sounds familiar?

page 1414 } A. It sounds familiar; yes, Sir.

Chairman Catterall: You were against the railroad in that case.

A. Yes, Sir.

Mr. Epps: He was on the side of the state in that case.

Q. And I believe that this question was in answer occurred in your examination there. "Do you concur in Mr. Wilham's testimony that this figure of stock and debt does denote the value that the gamblers placed on the railroad" and you answered "I would say yes."

A. I would say yes.

Q. Is that still your opinion?

A. It is still my opinion.

Q. All right, Sir. Now in your testimony in the Florida East Coast, didn't you come out strongly as a stabilizing factor against these risings and fallings factors? Didn't you come out strongly for ICC reproduction cost new less depreciation as a stalizing factor in any formula?

A. I think I did, as indicated. Yes, Sir.

Q. And that is still your opinion that it is

page 1415 } still a stabilizing factor.

A. I think so.

Q. And it ought to be used.

A. I think so.

Q. And yet you did not use it in valuing the Norfolk and Western. Why didn't you?

A. Because of the fact that the Interstate Commerce Commission has discontinued these cost figures so we are in transitory period of having to go to original cost.

Q. You're saying, as I understand it, that if you had reproduction cost new less depreciation, you would have used that as a factor.

A. I would have used that as a factor, adjusted.

Q. And if this Commission has before it evidence of reproduction, cost new, less depreciation, you would tell them that they ought to use that factor.

A. With certain limitations.

Q. Yes. That judgment factor of the tax assessor is one of them, isn't it?

A. That is right. Yes.

page 1416 } Q. Now I believe that you have talked about obsolescence in your testimony and I would like to ask you—and you have also talked about depreciation, but is it not a factor, Mr. Koncel, that depreciation includes obsolescence?

A. Well, in my humble judgment, I feel that it does not. It is just merely the deterioration—the physical deterioration of the property as it is getting older.

Q. You would deny, would you or you would disagree, I do not want to say deny, but you would disagree with the proposition that obsolescence is a factor in depreciation that depreciation embraces obsolescence.

A. Well, it could be a factor.

Q. All right, sir.

Chairman Catterall: Didn't the steam locomotives become rapidly obsolete when the better locomotives were invented?

A. That is right.

Q. I think we're going to get to that.

Mr. Riely: Do you remember what Mr. Priest told about trying cases.

Mr. Epps: Yes. Please don't lose the case.

page 1417 } Chairman Catterall: You are going to discuss the canals, I assume.

Mr. Epps: Maybe.

Q. Now talking about obsolescence you have indicated that you as the tax assessor once made a very special allowance to one of your Illinois railroads. I think it was the so-called Stock Yard Railroad. The name of it was the—

A. Chicago River and the Indiana.

Q. Yes. The Chicago. Because the stock market—the stock yards moved away from them, they lost their trade. Is that right?

A. Yes. The stock yards in Chicago are practically gone.

Q. Yes, and I think you allowed them a special obsolescence factor of twenty percent. Is that right?

A. That is right.

Q. Now I believe your testimony in the Florida East Coast Case was that the reproduction cost new at that time in Florida East Coast was two hundred and one million dollars and the depreciating cost was one hundred and thirty million

dollars. Do those figures refresh your recollection as to the—

page 1418 } A. I don't recall them but if they were in the transcript, those were my figures.

Q. All right, Sir. Assume that they are those figures, then I ask you that if you had much less than a fifty percent depreciation or discount in the Florida East Coast road, didn't you?

A. I do not recall.

Q. But if those were the figures—

A. That is right.

Q. —there is that much less depreciation.

A. That is right. If they were—

Q. In other words, you got about a sixty-five percent of reproduction cost new.

A. Yes.

Q. In that testimony didn't you say that obsolescence is usually less than twenty percent in Illinois?

A. I recall saying in some cases it is less than twenty percent.

Q. In pointing out the stock yard railway case, there is an extraordinary obsolescence factor.

A. No. Where there are extraordinary cases, that is the governing factor.

page 1419 } Q. In the Florida East Coast railroad case, you thought that the method of assessment used by Florida was, and I would like to quote you, "A proper method, and I think that the Director of Taxation used common sense and mature judgment in arriving at his figure." Didn't you say that?

A. Yes, I said that if it's quoted from there.

Q. Yes, Sir. In that testimony, I would like to call your attention to this question and this answer ascribed to you and see if it's not correct. The question is "Will you consider a thirty-five percent divergence from a formula product as one that would cause a responsible taxing official to reexamine his formula?" and your answer "No, I do not think I would."

Do you recall that question and that answer?

A. I do not recall it but again if that is what I said, well—

Q. And that is still your opinion.

A. That is still my opinion. Yes, Sir.

Q. And it exist—it is your opinion today. Is that right?

A. Right.

page 1420 } Q. Can you establish the reproduction cost

new less depreciation of the Norfolk and Western railroad?

A. No, I cannot.

Mr. Carter: If your Honors please, we're trying not to ask the same question that Mr. Shannon asked is the reason for the delay.

Chairman Catterall: You are skipping the diesel locomotive. Are you willing to come in on the canals?

Mr. Epps: Well, do you remember testifying about economic obsolescence in Florida East Coast case?

A. I guess I did. Yes.

Q. Well, you made a distinction, did you not, between ordinary wearing out and I would like to call depreciation and the particular circumstance which you pointed out there and called economic obsolescence which would be the Judge's steam rail steam locomotives versus diesel or maybe a station that no longer has any use. Is that correct?

A. That is right.

Q. So you may have—you have two kinds of obsolescence. Economic obsolescence and the obsolescence which I would like to embrace in ordinary life cycle or wearing out. Is that correct?

page 1421 } A. That is right.

Q. Right. You have made no allegation of any economic obsolescence in the Norfolk and Western valuation?

A. Well, I have considered it, but—

Q. There is nothing in your direct testimony about it.

A. No. There was nothing.

Q. Right. On Page Seventeen of your testimony, you indicated that assessment based on only twenty percent of the undepreciated original cost for the depreication or eighty percent of that cost resulted in an assessment that was too great. Isn't that correct?

A. That is right.

Q. Now, why did you not think that—then why do you think that twenty percent was a liberal allowance for economic obsolescence in the Chicago River and Indiana Railroad when it lost stock market customers.

A. What was that question again. I was reading this (Indicating).

Q. I asked you first about your opinion concerning this twenty percent off cost as being a reasonable assessment and you said that you thought it was not enough or

page 1422 } that the assessment was too great and then I asked you why did you think twenty percent was a liberal allowance for economic obsolescence on the stock yard railway case.

A. Now, when it comes to that twenty percent on the stock yard railroad, the year I testified was the first year that something happened on that road that later they were granted a much greater percentage of obsolescence which practically runs seventy percent.

Q. Each year it got worse?

A. It got worse. This was just the start of it.

Q. Now I think Judge Catterall asked you that if in the use of your formula for evaluating the franchise from the taxes if the—I think he asked you if it were three million dollars whether the value of the franchise would show up.

Chairman Catterall: I am looking at Number Fifteen now.

Mr. Epps: Yes. Page Fifteen.

Chairman Catterall: I would like to ask one technical question. What is this sign with a dot over a straight line and another dot below it?

A. That is a division sign.

page 1423 } Chairman Catterall: Which is the divisor—you divide which into which?

A. You divide three forty-eight into two—whatever that figure is.

Chairman Catterall: If you divide three one hundreds into two million, it would be several billion wouldn't it?

A. No. Wait a minute. Well, it is what I put on there. Two million over into three forty-eight comes to fifty-eight.

Chairman Catterall: You are dividing by point zero three four eight?

Mr. Riely: Yes, Sir.

A. That is right.

Chairman Catterall: Let's assume to make it easier we're dividing by one—you're dividing two million by one and what do you get.

A. That would be twenty, wouldn't it?

Chairman Catterall: One in two million goes twenty times? Well, I really will have to give up. I studied arithmetic so long ago.

Mr. Riely: May I testify?

page 1424 } Chairman Catterall: Yes, please do because I don't understand that.

Mr. Riely: All right. It is two million and twenty five

divided by point zero three. Now if you divide two million and twenty five by one, you would obviously get two million and twenty five. If you divided it by point one, you would get twenty million and twenty-five. And this is a third of point one which is approximately three times twenty million which is almost sixty million. If you multiply fifty-eight million which is shown on the right by three point four eight one six percent, you come out to two million and twenty-five thousand.

A. Right.

Mr. Riely: Is that slightly clarifying?

Chairman Catterall: That equal sign I understand.

Mr. Shannon: Mr. Riely, was your third computation accurate there?

Mr. Riely: Yes, Sir.

Mr. Shannon: What was that two million twenty-five thousand ten point zero seven divided by that fraction?

Mr. Riely: Yes, Sir.

page 1425 } Chairman Catterall: Equals fifty-eight thousand.

Mr. Riely: Fifty-eight million.

Chairman Catterall: Oh, I thought it was thousand.

Mr. Riely: It's fifty-eight million.

Chairman Catterall: All you had to do was to tell me it was millions.

Mr. Riely: Well, Sir, there are eight figures there.

Chairman Catterall: I see.

Mr. Epps: You gentlemen don't lose this case for me now.

Chairman Catterall: I am trying to find out why the Virginia franchise tax is mentioned at all in Exhibit 15. That is what I want to know.

Mr. Epps: Well, I want to know—I want to get into that, too.

Chairman Catterall: Yes, get into that so maybe I can understand it.

Mr. Epps: Mr. Koncel, we have shown that the higher the franchise tax, the higher rate you can get—

page 1426 } the higher figure you get as a value of the franchise and conversely, the lower the tax, the lower you would get for the franchise the base of your calculation.

A. That is right.

Q. Do you know that the State of Virginia is every year decreasing the franchise tax for the Norfolk and Western?

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A. I do not know that. No.
Q. Under your formula, therefore, they are getting cheaper. The franchises are coming down each year. Is that right?
A. That would be so. Yes, Sir.
Q. Now how did—

Chairman Catterall: Remember in his testimony he talks about subtracting that figure from something. Can you get into that?
Mr. Epps: I am going to try to get into that right now, Sir.
Chairman Catterall: That subtracting is what baffles me.
Mr. Epps: Yes, Sir.

page 1427 } Q. Didn't this idea of capitalizing the franchise tax Mr. Strouse told you about that, didn't he.
A. That is right.
Q. And did he tell you where he got it from?
A. Not that I can recall.
Q. You're a lawyer, I believe.
A. I guess so.
Q. Did Mr. Strouse tell you or did you know from your own knowledge of the law that this method of trying to determine franchise value and subtracting it has been tried before this commission and has been disapproved?
A. No, I did not know.
Q. You did not know?
A. No, Sir.

Chairman Catterall: I did not know that it had ever been tried.
Mr. Riely: I didn't either.
Mr. Pasco: I tried it in the Railway Express case.
Chairman Catterall: Oh, yes. Of course.
Mr. Epps: Mr. Riely, would you like to see this? (Indicating)
Mr. Riely: I would love to.
page 1428 } Chairman Catterall: They had ten thousand dollars worth of property and the tax was one hundred and forty thousand dollars.
Mr. Riely: Obviously, unfair.
Mr. Epps: This is a whole matter of assessment and I just wanted to call your attention to it. You can read it all if you want to.

Mr. Riely: I don't want to do that.

Mr. Epps: But I will point out to you the point that I think is important. I am referring for the record to the matter of the assessment for taxation and taxation for the year 1937 of the property in an annual state franchise tax of the railway and canal companies in Virginia.

Chairman Catterall: That is when we had canal companies.

Mr. Epps: You said we would get to canal companies.

Q. I am referring now to a decision of this Commission dated September 18, 1937 in the matter which I just described and I would like to ask you whether you knew page 1429 } this when—

Chairman Catterall: Did you say 1937?

Mr. Epps: Yes, Sir.

Chairman Catterall: That is the old Railway Express case. Not the one—

Mr. Riely: This is not Railway Express.

Mr. Pasco: I also tried it in that case.

Chairman Catterall: That has been tried before, hasn't it?

Mr. Epps:

Q. I would like to read this to you. "It follows that Virginia's portion of the system value of the Seaboard shown in Exhibit Number 17, namely, one million, one hundred ninety-three thousand, three hundred fifty dollars includes the value of the franchise, but by its constitution and statutes, Virginia taxes a railroad franchise separately the taxes being measured by gross receipts in the state; therefore, in order to arrive at the remainder of the Seaboard property which are taxed separately and apart from the franchise it would appear that the value of the franchise should be deducted from the total value of one million one hundred ninety-three thousand, three hundred fifty dollars which includes the franchise. No Virginia page 1430 } statute prescribes any method of determining the value of this franchise. The Seaboard in the past in some of its protests has urged that the value of the franchise should be deducted from Virginia's portion of the system value and has suggested that the value of the franchise taxes capitalized at the average prevailing tax rate in Virginia. The adoption of this suggestion would produce the following startling results." Then they take the franchise tax capitalize it, subtract a system value and

come out with a property value of the Seaboard of thirty-six thousand dollars in Virginia and the opinion continues. "A suggestion that the physical properties in Virginia of a great trunkline railroad which properties are conceded by the Seaboard in Exhibit No. 14, to have a cost of reproduction value less depreciation plus additions and betterment of eighteen million dollars odd have a tax value for tax purposes of thirty-six thousand six hundred dollars is too absurd to merit further comment or consideration." Now had you known that was the position of this Commission, you would not have adopted this method, would you?

A. Well, I might have becaue it is just another
page 1431 } way of trying to figure this out.

Q. But you did not know that—

A. I knew nothing about it. No.

Chairman Catterall: Doesn't that method mean that the more valuable the property is from a money-making standpoint, the less it is worth on the ground? In other words, suppose you found the total value in your Illinois method the total value of ten million dollars for the whole property, franchise, everything—going concern, values, stocks and bonds, the absolute maximum value of everything owned by the tax payer would be ten million dollars. Then looking at your Exhibit 15, you have Virginia franchise tax two million dollars. Suppose the franchise tax was ten million dollars. By your method of computation, how much would that leave as the value of the property on the ground?

A. I cannot answer that unless I figure it.

Chairman Catterall: Could you answer it if the figures were changed? You are just subtracting the franchise value which has me baffled. What are you subtracting from what?

You take the franchise tax. You say it is two
page 1432 } million dollars. Do you subtract that from anything?

Note: No response.

Chairman Catterall: I must be way off the beam because it sounds to me as if the more money they made the less valuable the property was. That sounds uneconomical.

Mr. Riely: I don't think that is right, but I think I can develop it on redirect.

Chairman Catterall: You want to bring out what he subtracts from what?

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Mr. Riely: There is no subtraction.

Mr. Pasco: There is no subtraction.

Chairman Catterall: Well, he said so and you have been talking about subtraction in all of your witnesses.

Mr. Pasco: Not on this exhibit.

Mr. Riely: No, Sir. What he says is this is an evidence of the franchise value.

Mr. Epps: He subtracts it from the economic residual. That is what his testimony is about, Mr. Riely.

page 1433 } Chairman Catterall: Let me see if I can find the thing that brought it to my attention. That word "subtraction" has been bothering me all day. On Page Eighteen about a third of the way from the bottom, the witness is saying "In addition, the valuation procedure that you describe would subtract nothing for franchise value".

Mr. Riely: Yes, Sir.

Chairman Catterall: I want to know why the word "subtract". Are you going to bring that out?

Mr. Riely: The valuation procedure that is being here described is original cost less twenty percent depreciation and that subtracts nothing for franchise value. That is all that is being said there.

Chairman Catterall: I want to know what the franchise value is going to be subtracted from because the way we assess this local property we pay no attention to the earnings whatever the going concern, the good will, the contracts.

Mr. Riely: Well, if you will look on Page Fifteen, I think you will see that the third answer on that page—do you see that he arrives at a fair market value exclusive of franchise

page 1434 } value of one hundred and ninety-six million dollars.

Mr. Epps: But he subtracts that. It was almost three hundred and eighty some million and that is where he comes up with his residual value.

Chairman Catterall: Well, let Mr. Riely bring it out on redirect examination. We want to know what he subtracts from what.

Mr. Riely: We haven't said anything about subtracting yet, but I will be glad to bring it out.

Chairman Catterall: I thought we had been using the word "subtract" all day long from your witnesses.

Mr. Riely: I haven't.

Mr. Epps: I think we have been using the word "excluded" value meaning extract.

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Chairman Catterall: Yes. That is right. The word excluded. That doesn't mean subtract. We used the word ignore. You use the word exclude.

Mr. Riely: The Court uses the word exclude.

Chairman Catterall: This witness has used the word "subtract".

Mr. Epps: As a matter of fact, we can add to this, Judge, one of the statutes or either the constitution page 1435 } says but not the franchise.

Chairman Catterall: It is very clear that these localities get the dead bone and the skeleton of this not yet extinct animal and the State collects a gross receipts tax which, of course, depends entirely on how much money they take in and has no relations whatever to the value of the corporation.

Mr. Epps: May I pursue another—

Chairman Catterall: The taxes might be the same if they were losing money every day.

Mr. Epps: Exactly, Sir. —May I pursue this from the angle of the case on this point, Sir?

Chairman Catterall: Yes, go ahead.

Mr. Epps:

Q. Mr. Koncel—

Chairman Catterall: Don't argue the law with this witness.

Mr. Epps: No, Sir. I shan't. I asked him if he was familiar with the certain decisions you have no objection to that trend of decisions.

Q. In your experience as a lawyer involved in railroad evaluation and property, I assume you have page 1436 } come in contact with those cases which seek to establish as the end result a franchise value.

A. None that I have been in.

Q. No, but have you read and studied those cases?

A. I have read some of them, yes.

Q. Well, isn't it a fact that in trying to establish franchise value for purposes such as condemnation or wherever these things come up, isn't it a fact in deriving franchise values those cases start with property values and use the property values and allocate those and if there is anything left over, they ascribed this value to franchise value?

A. I couldn't answer that right off.

Q. You don't recall that?

Edward F. Koncel

A. I do not recall that. Of course, I—

Q. Now, can you recall a single case in which the franchise value was determined first to get to property value?

A. I have never been in any. I have never had any experience with them.

Q. Nor do you know of a decision where it
page 1437 } was done that way? Is that correct?

A. That is right, I do not.

Q. Now you are familiar with the purchase and sale of certain parts of railroads in connection with your knowledge of the railroads, I believe.

A. That is right.

Q. Didn't the Norfolk and Western purchase a line of track from the Pennsylvania known as the Sandusky Line?

A. Well, I don't know whether they did or not.

Q. You know that they now own it.

A. Oh, yes. I know that they own it.

Q. Do you know where they got it?

A. No.

Q. Do you know that they did buy it from the Pennsylvania?

Mr. Riely: If it please the Commission, the witness has answered that question "no" three times.

Chairman Catterall: As soon as the witness says he doesn't know, that is the end.

Note: Mr. Epps handed report of ICC to Mr. Riely for examination.

page 1438 } Mr. Riely: I am going to object to this.

Mr. Epps: All right. May I state my question?

Mr. Riely: Yes, Sir, You certainly may.

Mr. Epps: It is my purpose to inquire concerning three twenty four Interstate Commerce Commission Report Page Eleven from the Norfolk and Western merger case dealing with the Sandusky line to test this expert's opinion on values and purchases and sales of railroad properties.

Mr. Riely: The witness has said—

Chairman Catterall: Are you going to ask him whether he agrees with the Interstate Commerce Commission?

Mr. Epps: No, Sir. I am going to ask him what about this price relationship to his judgment, how much was it per mile—

Edward F. Koncel

Chairman Catterall: I reckon that is legitimate to examine an expert. You couldn't if you were examining a layman.

Mr. Riely: The witness has testified that he doesn't know about the purchase at all. All we're going to do is to inform the witness about the purchase by asking him page 1439 } to read what the ICC said and I suggest that this is not pertinent at all.

Chairman Catterall: Let the lawyer read what he wants to read and put it in the form of the hypothetical question and the witness can say he agrees or he does not agree.

Mr. Riely: Or that he doesn't know.

Chairman Catterall: Or that he doesn't know. He has three choices. Just like the Gallup Poll you have three choices.

Are you going to read that—

Mr. Epps: I am going to extrapolate it so it won't be so lengthy and ask him hypothetically if that is a—

Chairman Catterall: Does he agree, disagree, or no opinion.

Mr. Epps: Right.

Q. I take from this decision the fact that the Norfolk and Western purchased the Sandusky Line for a price of twenty-seven million dollars. A distance of approximately one hundred eight miles to Sandusky, Ohio. Now I should like to ask you hypothetically whether you would say page 1440 } that twenty-seven million dollars for one hundred eight miles of track was a fair price in accordance with your knowledge of railroad value.

A. I would not know.

Q. You have no opinion?

A. No.

Q. You have conversant knowledge with the tax setups in various states and I think you have mentioned California in your Florida East Coast Case, and, therefore, I would like to ask you if you have ever heard of a tax appraisal which seeks to determine the amount at which the property would be taken in payment of a just debt from a solvent debtor. Have you ever heard of that tax?

A. No.

Chairman Catterall: The Commission will recess five minutes. 2:54 P. M.

Edward F. Koncel

2:59 P. M. The Commission resumes its session.

Mr. Epps: I have no further cross-examination.
Chairman Catterall: Mr. Riely has ten questions.
Mr. Epps: I think he said one, Sir.
Mr. Riely: Oh, no.
Chairman Catterall: He said that yesterday.

page 1441 } REDIRECT EXAMINATION

By Mr. Riely:

Q. Mr. Koncel, I shall be very brief. I believe that you have testified that, I cannot find the exact page at this moment—that in your opinion at least fifty percent of the total fair market value of the Norfolk and Western in Virginia represent franchise or going concern value. Is that not true?

A. I did. Yes, Sir.

Q. And Pages Fifteen and Sixteen of your exhibit were put in to, I believe, support your conclusion. They were not the basis for your conclusion but they provide support for it. Is that right?

A. That is right.

Q. Now Judge Catterall is bothered about the computations on Sheet Fifteen if the franchise tax—the franchise tax is a tax on gross receipts. Is it not?

A. That is right. That is the way I understand it.

Q. If the franchise tax went up and the rate remains the same, the gross receipt would go up, wouldn't it

A. That is right.

page 1442 } Q. And if the gross receipts went up—if you will turn back to Page One of your exhibit, it is probable that the net railway operating income would go up. Is it not?

A. That is right.

Q. And it is possible, if not probable, that the system stock value would go up, would it not?

A. That is true.

Q. So that an increase of a gross receipts tax would probably mean an increase in your fair value determination of the Norfolk and Western.

Mr. Epps: May I inquire as to the point of understanding, please. Are you talking about an increase in taxes? You're not talking about an increase in the rate of the taxes.

Mr. Riely: No. Increase in the taxes.

Edward F. Koncel

Mr. Epps: You're talking about in the amount?
Mr. Riely: In the amount.

Q. Would it not?
A. That is right.
Q. So the franchise tax is to some extent a function of your fair market value, is it not?
page 1443 } A. I would say so.
Q. Does that clear up that point?

Chairman Catterall: It gives me enough information so that between now and July 10th I will have studied it and will understand it thoroughly. Thank you.
Mr. Riely: Thank you, Sir.
Now I will be even briefer.

Q. Now as a matter of interest the railroads in Illinois file separate tax reports the way they do in Virginia.
A. Yes, they do.
Q. Those, of course, are not the Form A report?
A. They file a Form A report also.
Q. But they are two different reports.
A. The Form A and the regular report are two different forms.
Q. Yes, Sir.
A. One is prescribed by our department and the other one is the Interstate Commerce.
Q. The Interstate Commerce Commission?
A. That is right.

Mr. Shannon: May I ask a question just to
page 1444 } clear up a point?
Are they filed together just as they are in Virginia, Mr. Riely?
Mr. Riely: I think they are filed with different agencies. Aren't they? One is filed with the Interstate Commerce Commission.
A. No. With me. They are filed at the same time.

Q. With you, and you have both of them?
A. That is right.
Q. And you have the information that is contained in both of them?
A. That is right.
Q. I think I will get to the Florida East Coast very briefly.

Edward F. Koncel

Are you acquainted with the investment quality of the common stock of the Florida East Coast?

A. Not now, no.

Q. Were you at the time that you testified?

A. Well, I did look at some figures. I don't recall them.

Q. All right. I guess we'll abandon the

page 1445 } Florida East Coast.

Mr. Epps: Will you write it all off?

Mr. Riely: No.

Commissioner Hooker: It is obsolesent.

Mr. Riely:

Q. Incidentally, you have inspected a number of these railroads in Illinois to whom you assessed, have you not?

A. I have.

Q. Physically?

A. Yes, Sir.

Q. Most of them?

A. All of them.

Q. All of them. And when you inspect, physically inspect these railroads, do you ever find obsolescence that is not reflected by the accounting figures.

A. That is right.

Q. Now that *obsolesence* is—is that obsolescence functional as well as economic?

A. It is both.

Q. It is both.

A. That is right.

Q. And there is some distinction between

page 1446 } them, is there not?

A. That is right.

Q. Now I believe you testified this morning that it would be possible that as a result of a physical inspection, the appraised value would be increased in the case of the railroad. Have you ever as a result of an inspection increased the appraised value of a railroad?

A. Never.

Q. Never.

Mr. Riely: I think that is all I have.

Chairman Catterall: You may stand aside and be excused. We thank you for coming.

Witness Stood Aside.

page 1447 }

* * * * *

TESTIMONY OF WILLIAM E. KELLY
ON DIRECT EXAMINATION

Q. Please state your name and address.

A. William E. Kelly; Solon, Ohio.

Q. Where are you employed and what is your position?

A. I am employed as an Account Executive by Luria Brothers & Company, Inc. at Cleveland, Ohio.

Q. What is the business of Luria Brothers & Company, Inc.?

A. Luria is engaged in buying and selling iron and steel scrap and reusable railroad material.

page 1448 } Q. What is your personal experience in this field?

A. I have been employed in my present position since May, 1965. Prior to that time, I had been continuously associated with railroad track work since 1936, including four and one-half years of service in various maintenance capacities with the New York, New Haven and Hartford Railroad Company; four and one-half years of Army service with the Transportation Corps, two years of which were as an officer engaged in track maintenance and construction. I worked 18 years as an Inspector and Sales Engineer for L. B. Foster Co., a large company engaged in the purchase and sale of reusable track material.

Q. What are your duties in your present position?

A. It is my responsibility to make or to have made the inspection of rail and other track material which we own or intend to buy, and from this inspection to determine the fair market value at which material should be sold or purchased. Luria frequently submits bids to buy entire railroad lines or portions of lines for removal and sale, and it is my direct responsibility to determine the cost at which

page 1449 } material can be salvaged or removed; the markets in which material can be sold; the length of time which will be required to remove and sell the material; and all other elements entering into the purchase, removal and sale of these lines and the material which is salvaged. Prior to joining Luria, I performed essentially the same work for my previous employer.

Q. How did you first become involved with this application

for review and correction of Norfolk and Western's assessment?

A. During the month of March, 1968, I made an appraisal of the market value of Norfolk and Western's track material in Virginia. This appraisal was made at the request of the Norfolk and Western.

[Counsel will introduce Exhibit 1-WEK (Statement of William E. Kelly)]

Q. Is Exhibit 1-WEK the report which you made to Norfolk and Western on your appraisal?

A. Yes, it is.

Q. What was your next contact with this
page 1450 } case?

A. In October of 1968, at the joint request of Mr. E. Q. Johnson, Chief Engineer of Norfolk and Western, and Mr. J. A. Caywood of DeLeuw, Cather, I conferred with DeLeuw, Cather personnel for the purpose of reviewing my appraisal of the lines of Norfolk and Western with DeLeuw, Cather's.

Q. How did your appraisal differ in procedure from DeLeuw, Cather's?

A. As my statement in Exhibit 1-WEK indicates, my appraisal was made in only three days by spot checking various rail sections. As Mr. Caywood's testimony indicates, DeLeuw, Cather's appraisal was an exhaustive appraisal over an extended period of time by a number of engineers who took profiles of rail at various locations. I was somewhat familiar with the Norfolk and Western trackage prior to my appriasal; I had been on Norfolk and Western property in connection with my position at Luria.

Q. Was this comparison the major purpose of your consultation with DeLeuw, Cather?

A. Not exactly. DeLeuw, Cather consulted me to verify
their procedures for grading rail as relay, re-
page 1451 } roll or scrap.

We discussed the quality of rail as well as the weights and sections as they pertain to salability of the various materials.

Q. Did you approve of DeLeuw, Cather's method of grading or rating rail?

A. Yes, the standards used both for grading rail and for estimating cost of removal were adequate and reasonable, with one possible exception.

William E. Kelly

Q. What is that exception?

A. DeLeuw, Cather, to some extent, graded rail as relay rail which I think would be of a lower quality. They did this on the basis of reuse of rail by the same railroad. This is realistic in one sense since many railroads will attempt to reuse rail which could not be sold as relay rail. On the other hand, DeLeuw, Cather's appraisal probably overstates the real market value of some of this rail by classifying it as relay and assigning to it the higher price which relay rail brings. In other words, some of the rail which DeLeuw, Cather classified as relay for valuation purposes could probably be sold only at a considerable discount from good quality relaying rail.

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Q. What types of rail are in demand for resale?

for these sections or weights. One hundred thirty pound rail with a maximum of 3/16 inch headwear is in demand. Any excessive headwear or appreicable sidewear will decrease the value for resale. One hundred thirty-one pound rail and 112 pound rail have lesser values because of a lesser demand for these sections or weights. One hundred thirty pound rail is of negligible value on the current market and probably can be sold as relay material at a price slightly above reroll rail, if it can be sold at all.

Q. Are there any other special factors which influence the market value of rail?

A. I would say that one must consider the salability of rail of any weight which is presently welded in track. Norfolk and Western has such welded rail. There is no "tried and true" method of removing welded rail; as a matter of fact, so far as I know, it has never been done extensively. All we know is that it is expensive because the rail has to be sawed—much more expensive than removing bolted rail, and we are not sure that the resulting product would be salable other than at some unknown reduction in price.

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Q. Then to the extent you would adjust DeLeuw, Cather's figures for the existence of welded rail, you would reduce the fair market value which they determined?

A. That is correct.

Q. In your opinion, is the DeLeuw, Cather appraisal, as testified to by Mr. Caywood, a reasonable and accurate appraisal of the value of the Norfolk and Western's track structure in Virginia, as it pertains to rail?

A. Yes, it is. My estimate of the value might have been slightly lower, for the reasons I have indicated, but any variation would be insubstantial.

Q. Thank you, Mr. Kelly.
A. Thank you.

page 1454 } I hereby certify that the answers given to the foregoing questions are true and correct to *to* the best of my knowledge and belief.

William E. Kelly

Subscribed and sworn to before me this 5th day of March, 1969.

Richard P. Lochner Jr.

Richard P. Lochner Jr.—My commission Expires April 6, 1969.

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* * * * *

TESTIMONY OF FRED B. MEWHINNEY ON DIRECT EXAMINATION

Q. State your name and address, please.
A. Fred B. Mewhinney; Louisville, Kentucky.
Q. Where are you employed and what is your position?
A. I am President of Gillis and Company.
Q. What is the business of Gillis and Company?
A. Gillis and Company is a wholesale dealer in railroad ties.
Q. How long has Gillis and Company been in this business?
A. Since 1892.

page 1456 } Q. What is your personal experience in this business?

A. I became a partner in Gillis and Company in 1942. Throughout my 27 years in this firm I have handled the buying and selling of hundreds of thousands of used ties from track dismantling throughout the United States. It has been my responsibility to see that track dismantling crews are instructed in grading of ties as suitable for reuse or as scrap. Our business depends on this rating since we can deal profitably only with the ties which can be relaid. Additionally, I have handled sales of these ties to railroads, industry and contractors. Each such sale requires a meeting of the minds as to the quality of ties necessary to meet the "relay" standard.

Fred B. Mewhinney

My work includes personal inspection of thousands of miles of trackage before and during dismantling operations and also includes observation of track construction in which ties are utilized.

Q. Mr. Mewhinney, Mr. Caywood of DeLeuw, Cather has testified that you assisted that firm in its appraisal of the value and condition of ties in Norfolk and Western track in Virginia. Is that correct?

page 1457 } A. Yes. In October of 1968, at the request of DeLeuw, Cather, I inspected certain Norfolk and Western trackage. After making stops at different locations where I personally observed several ties, I rated them as "relay" or "scrap," the former term referring to marketable, reusable ties. I then consulted with representatives of DeLeuw, Cather and compared my ratings with theirs. DeLeuw, Cather later correlated these findings for use in devising a rating system for the marketability of Norfolk and Western ties. I also supplied current market value for ties.

Q. Then you supplied to DeLeuw, Cather, in connection with its fair market value study, the price of $2 per tie f.o.b. in cars on the Norfolk and Western for cross ties and $60 per MBM f.o.b. in cars on the Norfolk and Western for switch timber?

A. Yes.

Q. Then you approve of the rating system and the prices for ties used by DeLeuw, Cather and testified to by Mr. Caywood?

A. Yes. In my opinion, the procedures used for rating ties was reasonable and accurate.

page 1458 } Q. Thank you, Mr. Mewhinney.

A. Thank you.

page 1459 } I hereby certify that the answers given to the foregoing questions are true and correct to *to* the best of my knowledge and belief.

Fred B. Mewhinney

Subscribed and sworn to before me this 4 day of March, 1969.

Stanley H. Jones

Notary Public

My commission expires Mar. 18, 1969.

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* * * * *

TESTIMONY OF EUGENE L. BUTLER
ON DIRECT EXAMINATION

Q. Please state your name and address.

A. My name is Eugene L. Butler and my address is Roanoke, Virginia.

Q. Please state the name of your employer and your title in your present position.

A. I am Assistant Director-State and Local Taxes for Norfolk and Western Railway Company.

Q. Please state your educational background, qaulifications, and experience.

A. I received my education at Emory and Henry College, graduating as a Bachelor of Arts in Economics
page 1461 } in 1952. As an undergraduate, I studied accounting for two years. Upon graduation from college, I joined the Norfolk and Western as an employee in the Engineering Department, in which I gained experience in engineering surveys and valuation work, and worked for 1-1/2 years as a right-of-way agent. In 1957 I transferred to the Office of Tax Commissioner in the Accounting Department, where my duties encompassed *ad valorem* tax work and insurance matters. In 1964 I was transferred to the Taxation and Real Estate Department as Manager Property Taxes for the Atlantic and Pocahontas Regions. In 1968 I entered upon my present position as Assistant Director-State and Local Taxes for the System.

Q. Mr. Butler, are you familiar with this form entitled "Norfolk and Western Railway Company-State of Virginia-Tax Year 1968"?

A. Yes, I am. I personally prepared that form, and the entries thereon were developed under my supervision.

Q. What is the purpose of this form?

A. The form has a twofold purpose. The first is to find the amount by which the 1968 Full Value for the Norfolk and Western, as established by the State Corporation Commission, exceeds the 1968 Fair Market Value, as
page 1462 } determined by Mr. Caywood and his associates of DeLeuw, Cather & Company. The second purpose of the form is to find the amount by which our 1968 assessment, based on the State Corporation Commission Full

Value, exceeds the proper 1968 assessment based on the Fair Market Value as determined by DeLeuw, Cather.

Q. How many statements on this form were required for your purposes?

A. A total of 139 of these statements has been prepared, including all taxing jurisdictions, i.e., counties, districts, cities, boroughs, and towns, in which the Norfolk and Western operates in Virginia.

Q. Then all 139 of these, added together, encompass Norfolk and Western's property in the State of Virginia which is the subject of this proceeding?

A. That is correct.

[Counsel will introduce these statements as Exhibit 1-ELB]

Q. In order to explain what these statements show, could you suggest any particular one for us to analyze?

A. The one for the City of Norfolk, because it contains so many different categories of property, is suitable for analysis.

page 1463 } Q. The first entry on the statement is "Norfolk, City of." What does this indicate?

A. This entry indicates that the statement applies to the valuation and assessment computations for Norfolk and Western property in the taxing jurisdiction of the City of Norfolk.

Q. Does this statement then include all of the Norfolk and Western's real and tangible personal property in the City of Norfolk?

A. The statement includes all such property except rolling stock, which is taxed by the state and is not involved in this proceeding.

Q. The next caption on the statement is "Roadway & Track—Class 1—Schedule 1." Please explain that caption.

A. That caption is the State Corporation Commission's designation for roadway and track, exclusive of land. It is the title of the Schedule in our annual tax report in which track mileages and values are shown by taxing jurisdictions.

Q. The first entry under Class 1, Schedule 1 is "S.C.C. Full Value—$7,369,560." What does that denote?

A. That entry denotes that the Full Value of our roadway and track in the City of Norfolk as estab-

page 1464 } lished by the State Corporation Commission and taken from its 1968 worksheets is $7,369,560.

Eugene L. Butler

Q. Have those worksheets been *introduces* as exhibits in this case?

A. Yes, they were introduced as an exhibit through Mr. Younger.

Q. The next caption is "Fair Market Value." What does that indicate?

A. That caption indicates that the values appearing thereunder represent the Fair Market Value of our property in the City of Norfolk as determined by DeLeuw, Cather.

Q. The first entry under the Caption Fair Market Value is "Single Track—M. L.—1.02 Miles @ $13,962—$14,241." Please explain that.

A. This entry indicates that the 1.02 miles of single track—main line in the City of Norfolk, as shown in our 1968 annual tax report valued at the average fair market value of $13,962 per mile as determined by DeLeuw, Cather, has a total fair market value of $14,241.

Q. Then that same procedure was followed for all of the succeeding entries under the caption "Fair Market Value"?

A. That is correct.

page 1465 } Q. What is the meaning of "Br. L." in some of those succeeding captions?

A. That is the abbreviation for Branch Lines.

Q. In all of these entries, the source of the mileage figures is your 1968 annual tax report?

A. That is correct.

Q. And the source of the average fair market value per mile of each category of track is the DeLeuw, Cather appraisal?

A. That is correct.

Q. And the final entry on each line, then, is merely the result of multiplication of the mileage by the average fair market value per mile?

A. That is correct.

Q. The next entry is "Total F.M.V. $2,816,269." What does that indicate?

A. This entry indicates that the total fair market value of our roadway and track in the City of Norfolk as determined by the DeLeuw, Cather appraisal is $2,816,269.

Q. Is that figure merely the sum of the individual track values which appear above it on the statement?

A. That is correct.

Q. The next and final entry under "Roadway & Track" is "Excess S.C.C. Value—Roadway & Track—$4,553,291." Is that the difference between the Full Value

page 1466 } as established by the State Corporation Commission and the Fair Market Value as determined by the DeLeuw, Cather appraisal?

A. That is correct.

Q. The caption on the right hand side of this statement is "Land & Improvements—Class 1—Schedule 2 & Class 2." Please explain that caption.

A. That caption is the State Corporation Commission's designation for all land used for carrier purposes and all improvements thereon. It is the title of the Schedule in our annual tax report in which locations, descriptions, and values of all carrier lands and improvements thereon are shown by taxing jurisdictions.

Q. The first entry under that caption is "S.C.C. Full Value ... $25,760,316." What does that denote?

A. That entry denotes that the Full Value of our carrier land and improvements in the City of Norfolk, as established by the State Corporation Commission and taken from its worksheets, is $25,760,316.

Q. The next entry is "Less S.C.C. Signal Value ... $605,586." Please explain that entry.

A. That entry indicates that the Full Value of our Signal Equipment in the City of Norfolk, as established by the State Corporation Commission, in the amount

page 1467 } of $605,586, is to be deducted from the preceding entry for reasons that I now explain. In my letter of June 11, 1968, to the Commission, in response to its request dated May 14, 1968, I furnished the figure $16,775,021 as our total investment in Account 27—Signals and Interlockers for Virginia as of December 31, 1967. In that same letter I also furnished the figure of $3,724,086 as the total investment in items included in the foregoing which were reported and assessed individually under Class 1—Schedule 2 and Class 2 as of December 31, 1967, but were not listed as signals under those classes. By deducting the latter figure from the former, the Commission arrived at a figure of $13,050,935, as the remaining investment in Account 27. The Commission then multiplied the $13,050,935 by 80% and arrived at $10,440,748 as the depreciated original cost of our signal equipment in Virginia. On the basis of our 1109.91 signaled road miles in the State of Virginia, the Commission computed as value of $9,400 per mile as our signal value. The Commission then applied this $9,400 per mile value to our 12.39 signaled road miles in the City of Norfolk, producing a value of $116,466. To this allocated

page 1468 } signal value, the Commission added an amount for certain retarders, interlockers, and other special signal equipment located in the City of Norfolk of $489,120. This amount is approximately 80% of the original cost of this equipment as reported to the Commission by the Norfolk and Western. The $605,586 shown on line (B) is merely the sum of $116,466 and the $489,120.

Q. Why is this amount deducted from the S.C.C. Full Value shown on line (A)?

A. Because it is only this amount shown on line (B) that is subject to contest in this case. There is no contest at this stage about the remainder of the amount shown on line (A) which is the amount of $25,154,730 shown on line (C).

Q. The next entry is "Fair Market Value Signals... $196,292." Please explain that entry.

A. This entry results from multiplying our 18.07 *total* road miles in the City of Norfolk by the DeLeuw, Cather Fair Market Value for signals of $897 per mile, which is $16,209. To this we added the $180,083 DeLeuw, Cather fair market value of retarders, interlockers, and other special signal equipment located in the City of Norfolk. In most of our taxing jurisdictions, the S.C.C. signal value shown on this statement at line (B) is the result of the simple

page 1469 } multiplication of the signaled road miles in the taxing jurisdiction by $9,400, whereas the value at line (D) is the result of the simple multiplication of the *total* road miles in the taxing jurisdiction by $897. In a number of taxing jurisdictions however, as in the City of Norfolk, additional amounts were added, representing the value of certain retarders, interlockers, or other special signal equipment located in those taxing jurisdictions.

Q. Why did you use total miles when the Commission used signaled miles in these computations?

A. It is, in my opinion, entirely improper to use signaled miles which are miles equipped with electric block signals. These are only a portion of the signal investment. Every mile of main and branch line in Virginia has signal equipment connected with it. It is therefore more accurate to relate signal investment to total miles rather than to signaled miles.

Q. The entry on line (E) is "Total Fair Market Value... $25,352,022." What does this represent?

A. That $25,351,022 is merely the sum of the Uncontested

Value on line (C) and the Fair Market Value Signals on line (D).

page 1470 } Q. The next entry is "Excess S.C.C. Value . . . $409,294." What does that represent?

A. That $409,294 is the difference between the Full Value as established by the State Corporation Commission as shown on line (A) and the Total Fair Market Value as shown on line (E). It is the excess of the signal value established by the Commission over the Fair Market Value of the signals as determined by DeLeuw Cather. It is of this excess value that the Norfolk and Western complains in this case.

Q. Let us now pass to the bottom half of this statement. On line 1 is the caption "1966 Full base."

Will you please explain the meaning of that phrase?

A. The. "1966 Full Base" is the full value which was determined by the State Corporation Commission for 1966 as shown on the Commission's work sheet introduced through Mr. Younger. The 1966 full value of the property is the figure which must be used as a basis for computing assessed values for the ensuing twenty years pursuant to Section 58-512.1 of the Code of Virginia.

page 1471 } Q. On Line 2 appears "1968 Fair Market Value" Where were these figures obtained?

A. The figure of $2,816,269 appearing in the second column under Class 1—Schedule 1 is taken from the total fair market value shown on the schedule immediately above on the left side of the top part of the sheet. The figure of $25,351,022 appearing in the third column under Class 1—Schedule 2 and Class 2 is taken from Line (E) of the schedule appearing on the right side of the top part of the sheet. The remaining entries on this line except for "Total" and "Grand Total," are taken from the Commission's work sheets introduced through Mr Younger and are the same figures as those used by the Commission. The figures under "Total" and "Grand Total" are the result of simple addition.

Q. The next caption is "Net Additions."

Will you please explain that term?

A. The 1966 Full Base provides the basis for the assessments through the year 1986 under Section 58-512.1 of the Code. The Net Additions is therefore Line 2 minus Line 1. In this case the figure is a negative one.

page 1472 } Q Then would you explain the next entry "Assessment Net Add."?

A. In accordance with Section 58-512.1, Code of Virginia, all net additions must be assessed by application of the local

assessment ratio. On this line, the local assessment ratio for the City of Norfolk of 40.9% has been inserted. The local assessment ratio is applied to the Total shown on Line 3 to reach the assessment of net additions and is shown in the Total column on Line 4. Since, however, the total of net additions is a negative number in this case, zero is entered under the Total column on Line 4. The resulting figure is the first component of the assessment for the current year.

Q. What is the second component of that assessment?

A. Line 5 provides for the application of that portion of Section 58-512.1 which specifies that a certain fraction of the property (for the Year 1968 the fraction is 2/20) shall be assessed by application of the local assessment ratio. So the local ratio for Norfolk (40.9%) is shown on this line and it has been applied to 2/20 of the 1968 Fair Market Value total shown on line 2 under the caption "Total." In other words, on this sheet the 1968 Fair Market Value total of $29,979,879 multiplied by 2/20 and then by

page 1473 } 40.9% gives $1,226,177 which is shown on Line 5 under the caption "Total." This figure is the second component of the current year's assessment.

Q. Is there a third component?

A. Yes. The third and final component is shown on Line 6, which provides for the application of that portion of Section 58-512.1 which specifies that the remainder (for the Year 1968 the remainder is 18/20) shall continue to be assessed by application of the 40 per cent assessment ratio. So the 1968 Full Fair Market Value total of $29,979,879 is multiplied first by 18/20 and then by 40% to produce $10,792,756, shown on Line 6 under the caption "Total." This figure is the third and final component of the current year's assessment.

Q. Then Line 7 is merely the total of Line 4, 5 and 6?

A. That is correct.

Q. Across the bottom half of the statement there are eight columns which provide for the insertion of dollar figures. The first column is for Class 1—Schedule 1 property, which has already been defined. The second column is for Class 1—Schedule 2 & Class 2 property, which also has already been defined. The third column provides for Class 4

page 1474 } property. Would you please define it?

A. Yes. Class 4 property, in accordance with Section 58-524 the Code, includes telegraph and telephone lines and power transmission and power distribution lines and water pipe lines (not included under other classes). It

is the title of the Schedule in our annual tax report in which the locations and values of these items are shown by taxing jurisdictions.

Q. The next column encompasses Class 6 property. Please define that.

A. Class 6 property is machinery, furniture, and equipment. It is the title of the schedules in our annual tax report in which the locations and values of these items are shown by taxing jurisdictions.

Q. The next column provides for Class 7. What does that mean?

A. Class 7 property is stores, fuel, and material and supplies. It is the title of the schedule in our annual tax report in which the locations and values of these items are shown by taxing jurisdictions.

Q. The caption of the next column is "Total." Is that merely the sum of the values of both Schedules of Class 1 and Classes 2, 4, 6 & 7?

A. That is correct.

page 1475 } Q. The next column applies to Class 3 Non-Carrier property. What is the meaning of that caption?

A. Class 3 is real estate not used for carrier purposes and improvements located thereon. It is the title of the schedules in our annual tax report in which the locations, descriptions, and values of these items are shown by taxing jurisdictions. All of this property is assessed at local ratios.

Q. The next and final column is headed "Grand Total." Is that simply the total of all the Classes which precede it?

A. That is correct. The Grand Total is comprised of both Schedules of Class 1 and Classes 2, 4, 6, 7 and 3.

Q. I note that Lines 1, 2 and 3 have been completed for all columns in accordance with the captions for those lines and columns as defined by you in your previous testimony. Lines 4, 5, 6 and 7, however, bear entries only for the last three columns. Why is that?

A. In order to fulfill the purposes of this statement—that is, to develop both the amount by which the 1968 State Corporation Commission Full Value exceeds the DeLeuw, Cather

page 1476 } 1968 Fair Market Value and also the amount by which the assessment based on the State Corporation Commission full value exceeds the proper assessment based on the DeLeuw, Cather Fair Market Value—it is necessary to complete only the "Total the "Class 3," and the "Grand Total." The "Grand Total" column

exceeds the amount of the "Total" column only by the addition of the Class 3 Non-Carrier property. This property, in itself, has no bearing on any question raised in this case, as it is assessed at the local assessment ratio.

Q. Now, Mr. Butler, as I understand it, you have reached on Line 7 a total assessment for all property other than non-carrier property of $12,018,933 and a grand total, including non-carrier property, of $13,600,696. Is that correct?

A. Yes, it is.

Q. How are these figures used to determine the assessed value by classes of the property of the Norfolk and Western lying in the City of Norfolk?

A. If you will look at the computation just below the table you will see how this is done. The total (and not the grand total) on Line 7 of $12,018,933 is divided by the total 1968 fair market value of $29,979,879 shown on Line

page 1477 } 2 to determine the percentage of 40.09000% shown just below the table.

Q. How is this percentage used to determine the assessment by classes in the City of Norfolk?

A. Well, I have not shown these figures on the exhibit. But if you applied that percentage of 40.09000% to each of the figures appearing on Line 2 and entered them in each respective column on Line 7, you would obtain the proper assessment of each class of property lying in the City of Norfolk. If you then applied the applicable City of Norfolk tax rates to each class, you would obtain the proper tax. This is merely an arithmetical operation, for the tax rates are fixed by the locality and published by the Department of Taxation. Having applied the tax rates to the proper assessment for each class of property and adding the taxes so determined, you will find what we consider to be the proper taxes that the Norfolk and Western should have paid the City of Norfolk for the year 1968. I have done this for the City of Norfolk, and the amount of tax which we should have paid aggregated $349,816.59. In fact, the taxes

page 1478 } imposed on us by the City of Norfolk were $399,554.12. It is the difference of $49,737.53 between these two figures which we seek to recover from the City of Norfolk. Similar computations can be made for all other taxing jurisdictions of the Commonwealth from these sheets using their respective tax rates.

Q. Mr. Butler, let us now go to the very bottom of this sheet and will you tell us what appears there?

A. There are three figures on the left hand side. The figure

of $38,809,854 for total 1968 S.C.C. full value is taken from the Commission's work sheets which were introduced through Mr. Younger. The next figure, opposite total 1968 fair market value, of $33,847,269 is taken from the table above on Line 2 under the heading "Grand Total." The third figure is merely the difference between the first two, that is, the excess of full value determined by the Commission over the proper fair market value that, in our opinion, should have been used by the Commission.

Q. Now, Mr. Butler, let us go to the right hand side. The first figure, under the heading "Assessment" and opposite the caption "Based on S.C.C. Value," is $15,590,197. Where did that figure come from?

page 1479 } A. This is shown in the last column on the right on Page 9 of the 1968 statement issued by the Commission showing the assessed value as of January 1, 1968 for railroad companies in Virginia. The next figure, opposite the caption "Based on Fair Market Value," is taken from the table above and is the last figure on Line 7 in the column farthest to the right. The amount opposite "Excess" of $1,989,501 is merely the result of subtraction of the second figure from the first.

Q. What do you mean by excess?

A. This is the amount by which the assessment of Norfolk and Western's properties in the City of Norfolk, made by the S.C.C., exceeds the proper assessment that should have been made on the fair market value of the company's properties in the City of Norfolk.

Q. In other words, Mr. Butler, the Commission, in your opinion, assessed the value of the company's properties in Norfolk at too high an amount by $1,989,501, which is the figure shown at the bottom of your exhibit.

A. That is correct.

page 1480 } Q. Now, Mr. Butler, as you have testified, you have one of these sheets for each taxing jurisdiction in Virginia. Is that correct?

A. Yes, it is.

Q. Have you summarized these statements?

A. Yes, I have.

Q. Mr. Butler, have you prepared another exhibit which shows a summarization of the figures contained in Exhibit 1-ELB?

A. Yes, I have prepared an exhibit of 6 pages which summarizes the material shown in Exhibit 1-ELB.

Eugene L. Butler

[Counsel will introduce Exhibit 2-ELB]

Q. Now, Mr. Butler, will you discuss what appears on Exhibit 2-ELB?

A. There are 7 columns on Exhibit 2-ELB. In the column farthest to the left is listed each taxing jurisdiction in Virginia in which the Norfolk and Western owns property. The remaining 6 columns simply contain the 6 figures shown at the bottom of each sheet of Exhibit 1-ELB. In a word, the second column shows the total 1968 S.C.C. full value. The third column shows the total 1968 fair market value and the fourth the excess.

page 1481 } Q. Does this follow through for the other three columns?

A. Yes, the other three columns show the assessment. The fifth column shows the assessment in the particular taxing jurisdiction based on the S.C.C. value. The sixth column shows the assessment based on fair market value as we have determined it and the next column shows the excess of the assessment made by the Commission over the proper assessment.

Q. Have you summarized these differences?

A. Yes, at the bottom of the last page of Exhibit 2-ELB the totals appear. You will see that the excess of full value found by the Commission over total 1968 fair market value is $118,665,042 and that the excess of the assessments made by the Commission in all Virginia taxing jurisdictions in which the Norfolk and Western operates over the proper assessments is $35,053,714.

Q. This case is an application of the Norfolk and Western Railway Company for review and correction of the assessment of its property for local taxation. What is the correction in the assessment that the Norfolk and Western considers proper?

page 1482 } A. The Commission assessed the Norfolk and Western's property at $75,016,310 as shown on the last page of Exhibit 2-ELB. The proper assessment should have been $39,962,596. The difference is 35,053,714. That difference is the erroneous assessment made by the Commission which the Norfolk and Western believes must be corrected in this proceeding.

Q. Thank you, Mr. Butler.

A. Thank you.

page 1483 } I hereby certify that the answers given to

the foregoing questions are true and correct to the best of my knowledge and belief.

Eugene L. Butler

Subscribed and sworn to before me this 8th day of March, 1969.

R. T. Anderson
Notary Public

My commission expires:
November 3, 1969

page 1484 } Mr. Riely: If it please the Commission as far as I know, we are through until the eighth of July.

Mr. Shannon: I have a point or two, if I may, your Honors. Mr. Riely has set aside—we have mutually agreed and set aside July 8th, 9th, and 10th, for rebuttal. That is correct, I believe.

Mr. Riely: Yes.

Mr. Shannon: I am wondering if Mr. Riely couldn't furnish us as soon as possible—furnish the Commission as well as the Defendant—the names of his rebuttal witnesses and I would also like to suggest that to expedite the proceedings that he file the rebuttal testimony two weeks before the scheduled July 8th continuance.

Chairman Catterall: I am sure he will agree to that.

Mr. Riely: I will do the best I can, if the Commission please, but at the moment, I have not the slightest idea who my rebuttal witnesses are going to be and I will give Mr. Shannon and Mr. Epps the rebuttal testimony if I possibly can as far in advance of the hearing as I pos-
page 1485 } sibly can, but I would not like to either make a commitment or have the Commission enjoin me to give it two weeks ahead of the trial.

Chairman Catterall: And rebuttal testimony will not repeat anything in the direct. It will be limited to rebutting what the other witnesses have said.

Mr. Riely: We shall do our best to adhere to that injunction of the Commission.

Mr. Shannon: Your Honor, if we don't get it at least a reasonably—a reasonable period in advance of the schedule, it makes cross-examination very difficult.

Chairman Catterall: It will depend entirely on what you get?

Mr. Shannon: That is correct, Sir.

Chairman Catterall: And if they can think of something new, I will be surprised.

Mr. Epps: I would, too, Sir, but there is the possibility that the subject of rejoinder or surrebuttal—

Mr. Riely: Oh, I think there is no question about that.

page 1486 } Mr. Epps: And the sooner we can get it, the sooner we can get this thing buttoned down and finished up. We might be able to use those days.

Mr. Riely: I wonder if I can ask counsel whether they anticipate rebuttal testimony.

Mr. Epps: Surrebuttal. Rejoinder or surrebuttal.

Mr. Riely: Rejoinder or surrebuttal.

Mr. Epps: We cannot do it, because as I understand the law, Judge, we don't know whether we are going to have it or not until we see what he says on rebuttal.

Chairman *Catteral*: We can't possibly decide anything except that Mr. Riely will do the best he can do.

Mr. Riely: I will do the best I can.

Chairman *Catteral*: He won't make any promises at all, but he will do the best he can.

Mr. Riely: I won't make any promises, but I will do the best I can.

Chairman *Catteral*: If you don't do the best you can, then you will be in contempt of Court.

page 1487 } Mr. Epps: Couldn't we also say that as soon as you know the names of the witnesses—

Mr. Riely: Yes, Sir.

Mr. Shannon: Well, just as long as we have time. It may be we might have to ask for a few days continuance.

Mr. Riely: I am sure that Mr. Caywood will be one of them. But I cannot give you any other names. I would like to make the list complete when I do give it to you.

Chairman Catterall: We will meet again on the eighth of July.

The Commission will rise. 3:08 P. M.

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* * * * *

Richmond, Virginia

Wednesday, July 9, 1969

The above-entitled matter came on to be heard at 10:00 o'clock, a.m.

BEFORE:

Judge Ralph T. Catterall, Chairman

Judge H. Lester Hooker

Judge Jesse W. Dillon

* * * * *

page 1489 } Chairman Catterall: This is the continued hearing on the application of Norfolk and Western Railway Company for review and correction of the assessment for taxation of its property subject to local taxation for the year 1968 and for the right to recover from local authorities excess taxes paid.

Proceed.

Mr. Epps: May it please the Court, before we proceed, I would be unmindful of my manners if I did not thank counsel and the Commission for their indulgence of counsel for the counties, cities and towns.

Chairman Catterall: We are glad to indulge you. We are pleased you were able to work until midnight the other night.

Mr. Epps: We worked until midnight two nights. That is why we are wearing circles under our eyes.

Mr. Riely and I, in working this out, ascertained that Mr. Brinner had a conflict and, by stipulation, he would not be required to appear.

We asked one question which they said they would give us the answer to; we asked for an exhibit.

Mr. Riely: The question was, whether Mr. Brinner reviewed Mr. Tipton's work on the original testimony.

Mr. Epps: Right.

page 1490 } Mr. Riely: The answer to that is, yes, and I think it is fair to say that Mr. Tipton reviewed Mr. Brinner's work.

Mr. Epps: All right. We can ask Mr. Tipton.

Mr. Riely: We can ask Mr. Tipton.

Mr. Epps: We cannot ask Mr. Brinner.

We asked also for a journal entry on the part of Mr. Brinner's testimony which was delivered to us this morning. We have not had time to examine it, but we will, at the break.

So, it is by agreement that Mr. Brinner will not appear for cross examination.

Mr. Riely: May it please the Commission, we have prepared rebuttal testimony; it is not very long. Since the Commission has not had an opportunity to read it, I should like to put it on *ore tenus,* if agreeable.

Mr. Epps: May we talk about the order of it?

Mr. Riely: I would like to put it on the way I present it.

Mr. Epps: Well, generally speaking, I should like to—I haven't checked it—you have got it alphabetically?

Mr. Riely: No, I don't.

Mr. Epps: Well, anyway—

Chairman Catterall: Have the other sides seen it?

Mr. Riely: It was delivered to them, I think, on Sunday or Monday.

page 1491 }

Mr. Epps: I got a copy at the Greenbrier on the 4th of July, 5th of July.

Mr. Riely: I don't believe the cross examination will be very intelligible unless you have heard the direct.

Chairman Catterall: That is the manner in which you have proceeded so far.

Mr. Riely: Excuse me, sir; I had this thrust at me last week, as you will recall, when we had prepared testimony in the case that I was in at that time, by the learned senior doubles champion of the Virginia State Bar Association and that testimony was read into the record.

Chairman Catterall: Well, in this case, we have not proceeded that way. We had an understanding that we would go ahead with the—

Mr. Riely: We have been able to supply the Commission in advance, which testimony I understood the Commission has had an opportunity to read.

Chairman Catterall: You regard that as a conclusive presumption of law?

If you insist, you can read it in.

Mr. Epps: May I talk about the order just a minute?

Mr. Riely: Yes.

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Mr. Epps: I don't think it will make any difference. And one thing about the presence of the witnesses: we should like to have, if we can, certainly after the luncheon break, and even tomorrow, either, Messrs. Tipton and Maynard. We don't want to work any hardship on anyone.

Chairman Catteral: Tipton and Maynard are the second and third witnesses?

Mr. Epps: Could we have them out of order later?

Mr. Riely: I have to get my first witness on and off because he has other commitments.

Mr. Epps: Mr. Davison?

Mr. Riely: Yes.

Mr. Epps: Can we defer Messrs. Tipton and Davison, perhaps, until after Maynard?

Mr. Riely: I think so.

Mr. Epps: Maynard and Tipton we would like to put them down at the bottom of the pile because we have—

Mr. Riely: I have not agreed to put them at the bottom of the pile, but I will put them after lunch.

Mr. Epps: If we are ready after lunch, it will be fine. If we are not, we will state what we need to do and leave it to the Commission.

Can we defer to after lunch?

page 1493 } Chairman Catterall: We will take two hours for lunch so you can save time by getting that done.

Mr. Epps: There will be a great benefit.

Now, we have one more point before we start. There are seven witnesses:

Mr. Butler.
Mr. Foutz.
Mr. Crovo.
Mr. Lemon.
Mr. Tate.
Mr. Wilkerson.
Mr. Zinsli.

The last-named gentlemen have approximately the same questions asked them and we would suggest that we would like in their cross examination to have these witnesses segregated.

Chairman Catterall: We never segregate witnesses.

Mr. Epps: I know it is unusual.

Chairman Catterall: You can never make an expert change his testimony, no matter how long you cross examine him.

Mr. Epps: I don't think they are expert witnesses—they are company witnesses.

Chairman Catterall: In the 69 years, we have

page 1494 } never segregated them.

Mr. Riely: I have never been in a case before the Commission in the 20 years that I have been here.

Chairman Catterall: It is no automobile accident case; there is no jury present.

Mr. Epps: We certainly think it is appropriate.

Chairman Catterall: Let one witness testify for all; let the first witness say the agreement.

Mr. Riely: I call Professor Davison, please.

Whereupon, CHARLES M. DAVISON, JR., being first duly sworn was examined and testified upon his oath as follows:

Charles M. Davison, Jr.

DIRECT EXAMINATION

By Mr. Riely:

Q. Please state your name and address.

A. Charles M. Davison, Jr., University of Virginia Law School, Charlottesville, Virginia.

Q. What has been your formal educational training?

A. My secondary education was at St. Christopher's School and the public school system here in Richmond. I hold BA and BL Degrees from the University of Virginia.

Q. What position do you hold at the present time?

A. I am Professor of Law at the University
page 1495 } of Virginia at Charlottesville.

Q. Are you a member of the Bar?

A. I am a member of the Bar by examination in Virginia, West Virginia and the District of Columbia.

Q. Please state what your professional experience has been, particularly in the fields of taxation, valuation and railroads.

A. In 1937, after graduating from the Law School at Charlottesville, I came back to Richmond and began my tax practice with Roy Cabell who for many years enjoyed a pleasant tax practice after returning here from Washington, where he had served as Commissioner of Internal Revenue under President Taft and where he installed the federal income tax in 1913.

In 1938, at Mr. Cabell's suggestion, I accepted a position as an attorney in the Treasury Deparment of the United States government in Washington for the purpose of broadening my tax experience.

In 1941, I accepted a position with the law firm of Steptoe & Johnson in Clarksburg, West Virginia as one of two associates of the firm specializing in tax matters, federal, state and local.

From 1942 to 1947 I was associated with the
page 1496 } law firm of Covington & Burling in Washington, where my assignments were primarily in the tax field.

During this period, I had an interesting and valuable experience representing the Finance and Accounting Conference of the Air Transport Association in the early years of that industry, which were also the war years. For a considerable period, we were concerned particularly with the question of state and local taxation of airline property, a difficult subject.

Charles M. Davison, Jr.

Q. Did you then join the Southern Railway?

A. Yes; in 1947 I was appointed General Tax Attorney for Southern Railway System in Washington, D. C., and in 1950 I became General Solicitor with responsibility for tax matters for the System.

In 1953, I was elected Comptroller and Chief Accounting Officer for Southern Railway Company and affiliated lines, in Washington, D. C.

For the years 1953, 1954 and 1955 I certified the accounts for Southern Railway Company and some 40 of its affiliated companies, including five Class I railroads.

In 1956, I was elected Vice President Finance and Taxation for these companies and continued in that position until

page 1497 } I was elected Professor of Law at the University of Virginia in Charlottesville in 1963.

One of my major assignments with Southern, was developing the value of all of the property of Southern in 1895 as the starting point for the excess profits credit for Southern for the war years. We were also concerned from time to time with approaches to valuation for state property taxes in the 14 states served by Southern Railway System lines.

Q. What were your executive assignments with the Southern?

A. As Comptroller and later as Vice President Finance and Taxation, I was responsible, on the administrative side, for all tax matters for the railroad.

During this period, our taxes tended to exceed our earnings and be about twice our dividend distributions. As Vice President Finance and Taxation, I was a member of the executive committee of the boards of directors of each of the companies other than the parent company, Southern.

I also served as a member of the board of directors of certain industry-owned companies such as Railway Express, Incorporated, Trailertrain, Incorporated, Fruit Growers Express and Norfolk Portsmouth Belt Railway.

It was my responsibility to handle the raising, through the

page 1498 } issuance of some $50 million or more of securities annually, of necessary funds for capital improvements and acquisitions.

I negotiated the arrangement through which the City of Cincinatti sold some $30 million of its general obligation bonds to finance improvements to the track of the railroad owned by the city and leased to and operated by the C.N.O & T.P., a subsidiary of Southern. This is the railroad that runs

from Cincinatti, Ohio, to *Chatanooga*, Tennessee, and represents the railroad most nearly parallel to the R.F.&P. for north-south traffic.

During this period, Southern acquired a substantial minority interest in the C.N.O. & T.P. from the B & O Railroad for $15 million cash. This represented a substantial valuation problem and was of particular significance because the B & O was, in substantial part for economic reason, releasing its ownership interest in a highly valuable connecting line. Southern was glad enough to be obliging, and happy to be in the financial position, to increase its control relationship in C.N.O. & T.P. substantially.

In 1959, Southern acquired all of the stock of the Interstate Railroad here in Virginia through an exchange of Southern stock valued at some $15 million.

page 1499 } In 1960, Southern acquired all of the stock of Republic Carloading, a freight forwarder, for some $11 million in cash.

In 1963, Southern disposed of Republic to Yale Express, a trucking company, and at a slightly higher figure.

In 1963 also, the company acquired substantially all of the stock of the Central of Georgia Railroad and affiliated companies, some 2,500 miles of track, for approximately $30 million cash.

Also in 1963, Southern acquired the property of the Georgia-Florida Railroad for $7-1/2 million cash.

I mention these acquisitions and the one sale to illustrate that railroads are sold occasionally and that this factor in determining overall value is available.

Q. Have you ever had public responsibilities?

A. By appointment from the City Council of Alexandria, Virginia, where I lived, I twice participated in the work of Fiscal Survey Commissions seeking additional revenue sources for the City.

By the same appointment, I participated in an important fiscal survey for the four communities of Northern Virginia for the same purposes.

page 1500 } By appointment from the Northern Virginia Regional Planning and Economic Development Commission, I participated in a study of a proposal originating with the Virginia Airport Facilities Study Commission that state authority acquire and operate the Washington National Airport and the proposed supplementary Washington Airport, now known as Dulles.

Charles M. Davison, Jr.

Q. What have been your fields at the University of Virginia?

A. At the University of Virginia my courses include

Corporate Finance

Law and Accounting

State and Local Taxes, sometimes referred to as Financing the Urban Crisis

Federal Income Taxes

Estate and Gift Taxes

In each of these courses we are constantly concerned with questions of evaluation of property.

Q. Are you acquainted with Professor A. J. G. Priest who has appeared as a witness in this proceeding?

A. Yes.

For five years A. J. and I were colleagues on the Law Faculty at the University of Virginia. Our pleasant and genial association continues in his present status as Scholar in Residence. He has been kind enough to ask me to review his comprehensive text, "Principles of Public
page 1501 } Utility Regulation: Theory and Application." We are good friends.

Q. Have you had occasion to read his testimony in this case?

A. Yes.

Q. Does your association with Southern Railway Company or your association with Mr. Priest in any way limit your ability to testify in this case?

A. Each of us is the product of our experiences and associations. My work with Southern certainly gives me a solid basis for opinion. My friendship and intimate association with A. J. leaves me with great respect for his opinion, and no reluctance to agree and disagree in particular instances. My obligation to this Commission and to my position as Professor of Law satisfies me that I can testify objectively.

Q. In your opinion, what is the proper approach to valuation of the properties in the so-called track accounts of the railroads for local property tax purposes?

A. Under the Constitution of Virginia, the statutes, the decisions of the Supreme Court of Appeals and the established procedures of this Commission, the value of railroad property is divided between franchise value and remaining value.

Under general theories of property taxation
page 1502 } this is not surprising. In most situations we seek to take the same property values only

once. Under the Virginia system, the franchise value is taxed by the State in the form of a gross receipt tax. The Virginia Gross Receipt Tax on railroads is a property tax and produces very substantial revenue for the state. This part of the value of the railroad property is reserved for taxation by the state and is not taxed a second time by the local governments. It is my understanding that the purpose of this proceeding is to determine the value of the property in the railroad track accounts, exclusive of the franchise value which is reserved for taxation by the state.

As I outlined earlier, I have been directly concerned with the concept of value of railroad properties over a good many years now. While it is an elusive concept, there are certain fundamentals that have received general acceptance. For me, the most fundamental concept is that the value of property is demonstrated by a sale of the property in an arms-length transaction. While railroads as entities are not bought and sold every day, it is a mistake to suggest that they are not sold from time to time and that we cannot find useful information on value, mostly franchise value, from such sales as do occur.

Q. What if no sales figures are available?

page 1503 } A. In the absence of sales of the identical or similar property, we usually turn first to earnings. To some extent the concept is the same; property is worth what it would bring either through sale or through earnings. Prospective purchasers are concerned with earnings, usually prospective earnings.

Prior earnings are sometimes useful in estimating prospective earnings.

Railroad earnings, the basis of price and therefore highly useful in fixing value, they vary greatly among properties. This variation describes the franchise value. Thus the overall value of one railroad is greater than the value of another because of differences in earning potential. The franchise of a railroad which enjoys substantial earnings is worth more, has a higher value, than the franchise of a railroad with little or no earnings. These values differ without any particular relation to the length of the track or the size of the investment in the track accounts.

A relatively short railroad, such as the R.F.&P., is much more valuable than a rather lengthy railroad, such as the Norfolk or Southern. Such a low-earning railroad, or even a railroad operating at a loss, may nevertheless have substantial franchise value. This has been demonstrated from

time to time through actual sales. The price
page 1504 } paid reflects the prospect that through a
change in conditions, such as affiliation with another railroad or the development of the railroad's territory, improvement in earnings may be anticipated in the future.

Q. Does value mean the same thing for all purposes?

A. No. Value means different things in different circumstances and for different purposes. Thus, value for insurance purposes might be very different from values for loan purposes.

Similarly, for regulatory purposes, the value of a utility, including a railroad, for rate-making purposes might be quite different from its value for property tax purposes.

In the usual course, no adjustment would be made to either of these values to reflect an actual sale of the property, whether sale was at a value higher than rate base or property valuation or lower than either. Rate base might even survive bankruptcy and reorganization. Neither value should be, or customarily is, increased when some optimist pays a high price for reasons satisfactory to him.

Turning now to the valuation of the track accounts of the railroads, exclusive of franchise value, we find franchise value is intimately related to and based upon earnings. It
would seem to follow that value, including fran-
page 1505 } chise value, must be determined on some other
basis—that is to say, excluding consideration of earnings. This is consistent with the practice of this Commission for at least the past 40 years. As I understand it, as early as 1926 this Commission fixed a value per mile for various classes of track based in part on weight of rail and applied this valuation uniformly to the railroad properties located in the state.

Q. Have you prepared an exhibit that illustrates these classes?

A. Yes, I have.

Mr. Riely: If it please the Commission, Exhibit 1-CMD, which is in the folder right behind—

Chairman Catterall: Will be received.

(The document identified as Exhibit 1-CMD was received in evidence.)

By Mr. Riely:

Q. Do you have a copy, Mr. Davison?

What does Exhibit 1-CMD show?

A. This exhibit, when compared to exhibit LBY-1, shows that there was a distinct correlation between weight of rail and assessment per mile of track in the 1926 assessment.

Q. Does this mean that earnings were taken into account in the 1926 assessment?

page 1506 } A. No. By applying uniform values of this sort the Commission has eliminated any approach based on earnings. Thus, any two miles of track of the same weight have approximately the same value even if one is used for high-density, high-earning traffic and the other for low-density, low-earning traffic. This is a rough method of eliminating franchise value which, as we have seen, is based on earnings.

It is true that the railroad cannot earn without property and equally true that the property would not enjoy earnings without the franchise. But if we had the franchise we could build the property, and if we eliminate the franchise the property will have re-use value only. I use the word "reuse" because the word "salvage" has a connotation of residual scrap, usually connected with use for a different purpose.

Thus, it seems to me that if we are to value the property as it is, after eliminating the franchise value, we may look with greatest certainty to the value of the property that could be used again. I hasten to say that this is not an inconsiderable figure. Re-use is particularly significant in the track accounts. Most significant, of course, is the rail and related OTM which has a ready market. With modern methods of treatment and mechanized installation, the ties have considerable re-use value. Relay rail

page 1507 } and second and third use ties are installed every day in the railroad industry.

Q. Have you considered reproduction costs?

A. Yes. I mentioned before that if we had the franchise we can build the railroad. This is not an unusual phenomenon in the railroad industry today. The extension of track to serve a new industry, the upgrading of existing track to serve new industry, or under new ownership with new affiliations, is a frequent occurrence.

In the situation of wholly new track we would have the value of the property at its cost, reduced as obsolescence and physical wear and tear inevitably take their toll. The concept of wholly new track is unrealistic, of course. While the railroads build a new track from time to time, the overwhelming bulk of investment in track accounts represents

main line track which has been in service for a great many years. Thus, replacement costs may be of some use in determining the value of the property in the track accounts if the assets are new or are relatively new. Most regulatory agencies, however, are reluctant to give it much weight.

Replacement cost is virtually worthless in the case of the railroads because it is inconceivable that the railroad property would be replaced in kind. If we approach the value of the track accounts, exclusive of franchise value, page 1508 } on the basis of reproduction cost, we will have a difficult, if not impossible, problem of determining which properties would actually be replaced and which are obsolete.

In the case of the Norfolk and Western property, after the merger with the Virginian, we know very well that very significant properties are now redundant and that they will not br replaced in kind. Quite simply and quite understandably, the merged railroad operates its tonnage service over the Virginian tracks where they present the most economical operation and over the Norfolk and Western Properties where they present the most economical operating.

This concept is not confined to an obvious redundancy such as the Norfolk and Western-Virginian situation. On all railroads at any given time there are always important elements of investment in the track accounts which have not been retired from the accounts although the facilities have been made obsolete through a change in traffic patterns or improvement in the art.

We do not have this problem if we approach valuation from a re-use standpoint. As indicated, there are important elements of re-use value in the track accounts and all of them can be readily identified.

Q. How about original cost?

page 1509 } A. This leads me to the question of using book figures in making valuations. We know that when corporations are bought and sold through an exchange of securities or for cash, careful consideration is given to balance sheet figures. I hasten to agree that primary consideration is given to earnings and prospective earnings as reflected in the income accounts, with all of their limitations. But just as surely, careful consideration is given to balance sheet figures. We know that balance sheet figures reflect recorded historical costs, again for want of a better figure, and in the interest of certainty. By using historical costs we avoid the difficulty of periodic valuation which can

never be more than an estimate. Thus, if we are interested in what the property, including the track accounts, will bring, we know that every day corporations are bought and sold on the basis of balance sheet figures, an important element of which is the recorded cost of the property.

The Commission is familiar with the retirement, betterment and replacement accounting system prescribed for the railroads by the Interstate Commerce Commission. It is my understanding that the record contains a restatement, prepared by Mr. Tipton, of the book investment of the Norfolk and Western in the track account which reflects the actual cost of the facilities now in service.

page 1510 } We know, however, that railroad properties are not in new condition and in using the cost new of the property in the track account, we must make adjustments to reflect the present condition of the property.

It is fair to say that the railroad industry is not now in a period of rapid expansion of physical properties and might propertly be described as a mature industry, certainly a very old and well established industry. In any such situation it is fair to say that at any given time after full development and maturity is reached, the investment in physical properties is, on the average, and as a rough approximation, 50 percent consumed through the process of obsolescence and physical wear and tear.

Q. What, in your opinion, is the best method of valuing track property?

A. In my opinion, the best approach to valuation of the track account, exclusive of franchise value, is the prices at which the removable property would sell. As indicated, there is a ready and *continous* market for relay rail and relay ties. Any given railroad is constantly lifting track and related facilities and using the physical property in another location on its own property.

page 1511 } For the reasons indicated above, I believe that the original cost of the track account is of relatively little use in determining market value. It is a useful check on any conclusion reached, but must first be adjusted for condition percent. The simple fact is that expenditures for a hole dug through a mountain, or expenditures for a cut to improve grade, which represent a very substantial part in the total investment in the track accounts, is of no value except as a part of an operating railroad.

Q. What do you think of the Commission's approach of a standard valuation per mile?

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A. I mentioned before the Commission's pragmatic approach of assigning a standard valuation per mile as furnishing a procedure to eliminate values based on earnings—franchise values.

Similarly, a standard valuation per mile of track can be said to eliminate any of the non-reusable values and, therefore, to be based on that portion of the investment in the track accounts that has a sales price. For example, the standard mileage approach applies whether the track lies on relatively flat territory or in more mountainous regions involving expensive tunnels or cuts which, as I have said, would have no value except for use by an operating railroad. The Commission's approach quite properly eliminates the values which form the basis of franchise value, page 1512 } or earning value, on an operating railroad. These elements of the track account represent no value once the franchise value is eliminated.

I have indicated that in my view the value of the earning capacity of the railroad is absorbed in franchise value. I say this because the price that will be paid for a railroad property varies with the opportunity to earn, the franchise value. In this respect, the Virginia approach to a property tax on franchise value is quite good. While net earnings do not necessarily follow gross receipts because of differences in cost of operation, nevertheless gross receipts surely are a useful though rough measure of franchise value. Franchise value varies with the opportunity to earn, which, in a given case, is unrelated to the property account. I am not saying that the property does not contribute to the enterprise and to the earnings. I am saying that the franchise or earning value can be substantial with relatively small investment in property.

For example, when Southern Railway purchased Republic Carloading, we acquired what was essentially a service industry with valuable franchise rights. A forwarder may or may not have a fleet of trucks, but in general its investments in property is not substantial. Southern's valuation of Republic was based on proven, demonstrated, page 1513 } capacity to earn, and just as importantly on Southern's estimate of prospective earnings—directly by Republic, along with Republic's contributions to Southern's earnings as the two companies were operated in affiliation.

When we were selling Republic to Yale Express, the trucker, Yale, was also interested in the same factors. It so hap-

pened that Republic was the only forwarder in the United States that had operating rights, franchise rights, in each of the 48 states in the continental United States. While these rights were valuable to Southern, they were even more valuable, although not fully exploited, to Yale, which had a better opportunity to expand its service pattern through its affiliation with Republic than did Southern.

This notion of franchise value is familiar in other situations such as the substantial sums that are frequently paid for the right to operate a taxi cab or a fleet of taxi cabs in a given community, the right to sell alcoholic beverages, the right to operate radio and television stations. The trucking business and the airline business are familiar situations where very substantial prices are paid for the monopoly or exclusive privilege to perform a service subject to public control and in the public interest.

Q. Is franchise value a consideration in a
page 1514 } railroad acquisition?

A. Yes. It might be useful to consider the basis of valuation used in certain railroad acquisitions in which I have participated. It is interesting to note that the price in these transactions was a function of the situation in which each of the properties found itself.

For example, when Southern was acquiring from the B & O a substantial additional interest in its already controlled subsidiary, C.N.O. & T.P., the price of $15 million had little, if any, reference to values in the property account. C.N.O. & T.P. was, and is, operating profitably and paying substantial dividends. Southern was in a position to borrow money at a lower cost than the dividend income produced by the additional investment, so the investment could be expected to pay for itself.

When Southern acquired the Interstate Railroad, the stock of that railroad was closely held and the owners were interested in diversification beyond a railroad limited to serving the coal industry in which they, the selling stockholders, were already heavily committed. Various railroads, including Southern, had been interested in the Interstate for some time as a valued connection. Southern's haul on the coal delivered to it by the Interstate was considerably
page 1515 } longer than the haul of the coal over the Interstate. We fixed our offer on a competitive basis and were the successful bidders at a price satisfactory to the sellers. The basic element of the price was the valuable franchise of the Interstate as a source of coal traffic.

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In the acquisition involving Southern's purchase of Republic Carloading, as I mentioned before, it is interesting to note that the value fixed was agreed to not only by the shareholders of Republic, three individuals, and Southern, but was also agreed to by Yale, which within a period of three years, purchased the company from Southern. As indicated, this price was not related to any substantial property account.

Q. What then, in the light of your experience, is the most important and useful factor in valuing railroad track property under the Virginia system of taxation?

A. The most important and useful factor is the value of the property for re-use within the Norfolk and Western system or the railroad industry. A ready market is available and transactions occur with great frequency. This approach, which eliminates earnings factors, ties in nicely with the Commission's established practice of a standard value per mile and is consistent with the Constitutional mandate of value other than franchise value.

page 1516 } Q. You say that you have reviewed the testimony introduced in this proceeding by Mr. A. J. G. Priest. Would you outline your principle areas of agreement and disagreement with Mr. Priest's testimony?

A. My principle area of agreement would lie with his thought that cost is not particularly useful in this inquiry. My reasons are not the same as A. J.'s and I prefer, of course, to rely on my own approach. I do not, however, take great exception to his analysis of the limitations of cost. My principle area of disagreement is A. J.'s testimony that franchise value is difficult to measure and is of relatively small proportion.

The Virginia Gross Receipts Tax which annually produces substantial revenue for the state is itself a measure of the franchise value. I have indicated that gross receipts are a rough measure of ability to earn as a measure of value. Surely a tax which for 1968 amounted to $2,300,000 indicates an underlying value of very substantial proportions. Quite simply, it means that from the Norfolk and Western properties, on the basis of 36.8 percent assessment ratio, and a 3.4 percent tax rate, the state has reserved for itself an equivalent of some $157,927,778 of taxable property value. In my view, the published ratio of 36.8 percent

page 1517 } is much too high. The more realistic ratio of 25 percent will produce the figure of $280 million of taxable property values.

Furthermore, A. J.'s comments about the minimal allowances for franchise value in computing rate base for utilities are, in my view, inappropriate in determining value for property tax purposes. We are not concerned with rate base but with property taxes. We do have sales all through the utility sector and these sales reflect franchise value, the exclusive right to perform the service. We certainly have sales of railroad properties which reflect the value of the opportunity to earn, or franchise value. An outstanding example would be the Southern's purchase of the Georgia and Florida railroad for 7-1/2 million dollars cash. Earnings were not only dismal but were non-existent and had been for years. The physical properties were in such poor shape that Southern could not operate its equipment over the Georgia-Florida track without substantial repair and rebuilding. Yet Southern paid 7-1/2 million dollars cash primarily for the franchise rights involved.

Q. Do you agree with Mr. Priest's quotation in his testimony in this proceeding from his article in Volume 51 of the Iowa Law Review that "The utilities need not solicit customers. The public is clamoring for service. The
page 1518 } utility needs only connect."?

A. No. I am not as familiar as Mr. Priest is with the electric utilities, but I can say with the greatest certainty that railroads do need to solicit customers and regularly spend substantial sums for this purpose. The best demonstration that the railroads need to solicit business is the fact that they are not able to earn what any regulatory agency would call a fair rate of return. In transportation, other than in times of dire national emergency, competition is the name of the game. This results in substantial part from an excess supply of transportation which again in part results from public policy aimed in the direction of transportation facilites adequate for national emergency and, therefore, in excess of peace time requirements. Thus, the franchise of a railroad that enjoys substantial traffic is worth considerably more than the franchise of a railroad which has to scramble for business.

Q. Do you agree with Mr. Priest's statement that a railroad which has dismantled its trackage would not possess significant franchise value?

A. No. A railroad without track can readily build such track as it needs for the exploitation of its franchise to perform the public service on an exclusive basis.

For example, I would be happy to arrange

page 1519 } financing for the rebuilding of the Norfolk and Western track for use under its valuable franchise in the event its track was dismantled, destroyed or became obsolete. There are a number of improvements in the art on the drawing board, and one under construction in France, which would make the investment in the track accounts of a railroad largely obsolete. I would anticipate no difficulty arranging financing for the new operating facilities.

Q. Do you agree with Mr. Priest's statement that it is difficult to prove franchise or going concern value for a railroad?

A. No. As I have indicated elsewhere in my testimony, railroads are bought and sold on the basis of earnings and without any particular reference to the level of investment in the property account. Without the franchise there would be no earnings nor would there be any prospect of earnings and, as I have indicated, the property would be worth only its value for re-use. In my view the gross receipts franchise tax is itself a measure of the value of the franchise.

Q. Do you agree with Mr. Priest's statement that railroads are seldom sold?

A. No. As I have indicated, there are sufficient sales to represent very real assistance in the overall

page 1520 } appraisal process. Particularly for purposes of this proceeding the basis of valuation used in these actual sales demonstrates the prices based on earning power without any particular reference to investments in the property accounts.

Q. Do you agree with Mr. Priest's statement that tangible property is more important to the railroad than franchise value?

A. No. As I have indicated, and as actual sales in the railroad industry will demonstrate, the right to perform the public service on a monopoly basis has a very great value not necessarily related to the investment in physical property. I repeat, if we have the franchise we can build the railroad.

While the railroad industry as a whole does not earn a satisfactory return on the investment in physical property, some railroads do. The difference represents the franchise value, the territory served, the opportunity to earn. If a pragmatic standard value per mile of railroad is to be continued for valuing railroad properties in Virginia for property tax purposes, we must recognize that earnings are not related importantly to the investment in the track accounts.

It is true that if we enjoy good earnings, we will have the money to maintain and improve the railroad track, but there is a limit to the necessary investment. At the page 1521 } other end of the spectrum, a minimum standard of maintenance may be sufficiently costly to minimize or eliminate earnings.

Fortunately, in this proceeding, we are not so much concerned with overall value as we are with fair market value of the track structure and appurtenances, eliminating franchise value.

Q. Professor Davison, have you read the testimony of J. Rhodes Foster introduced in this proceeding?

A. Yes.

Q. Please state your major areas of agreement and disagreement with Mr. Foster's testimony.

A. I agree with Mr. Foster that value is intimately related to earnings and that in determining rate base for the purpose of fixing prices for utility service, we cannot proceed on the basis of earnings since the price fixed will determine the earnings. Thus, franchise value is inappropriate in calculating rate base. Furthermore, in a situation where an increase in price will produce an adequate rate of return on investment, we are primarily concerned with the level of investment required for the service.

In contrast with Mr. Foster, I believe that in fixing the total value of an entity for property tax purposes, we are certainly entitled to consider all elements of page 1522 } value including earning power or franchise value. Thus, overall value for property tax purposes might in a given case, exceed rate base. In this proceeding we are required to eliminate franchise value and thus all reference to earnings.

Elimination of this factor from this proceeding of course does not mean that this important element of value is not taxed; rather, as we have seen, it is reserved for taxation in substantial amount at the state level.

Q. Do you agree with Mr. Foster's statement that the value of the franchise of a railroad depends upon its ability to realize profits in excess of a fair return of its investment of intangible assets?

A. No. Mr. Foster's statement which you have paraphrased is part of a longer statement, the thrust of which seems to be that railroads do not have franchise value. I believe that I have indicated before in my testimony in this proceeding, that the facts are to the contrary. Railroads

do indeed have a very substantial franchise value, not necessarily related to prior earnings. Value of a railroad franchise is a function of prospective earnings, either as a separate operation or as a contributing factor in the overall earnings picture of a railroad system.

page 1523 } Mr. Foster makes comparisons with unregulated industries. In my view the comparison breaks down because unregulated industry may enjoy either a very handsome profit or a low profit—less than the fair rate of return on historical investments. Unregulated industry may also enjoy no earnings, in which event, in the course of time, it would probably go out of business. In contrast, the regulated public service industries are not allowed to realize profits in excess of a fair return, tend to be assisted in a variety of ways to earn a reasonable rate of return and are not allowed the privilege of terminating the service, even though in bankruptcy.

Q. Do you agree with Mr. Foster's statement that without the tangible property assembled as an operating entity the franchise value of the railroad would have little or no value?

A. No. As I have stated before if we had the franchise we could *built* the railroad. Tangible property for the operation of a railroad is readily available. Railroad franchises are not.

When available, railroad franchises, command a considerable price. The right to extend service to a new industry, or in a new territory, or the right to incorporate a connecting line into an affiliated system command a considerable price

page 1524 } although substantial expenditures for tangible property will be necessary before the service can be performed.

I have mentioned one outstanding example of this in Southern's acquisition of the Georgia-Florida. The C.N.O. & T.P. revision of its track is another. Without a $30 million expenditure on the track, largely for improvements in grade and clearance, the substantial earnings enjoyed in the past and contemplated for the future for that railroad would not have been available. Nevertheless, while the necessary expenditure was substantial, the value of the franchise was much more substantial.

Again, to demonstrate the elusive nature of the concept of value, Southern, already owner of over 80 percent of the stock of the operating railroad, a leased line, would have been willing to offer the owner of the property, the City of Cincinatti, a very substantial sum for the railroad al-

though the lease does not expire until the year 2026 and this, with or without the additional investment in the track accounts. At the same time, Southern could have commanded a very large price for its interest in the leased line, again with or without the additional investment in the track accounts.

Q. Have you had an opportunity to read the direct testimony of Mr. Lee B. Younger in this proceeding?

A. Yes.

page 1525 } Q. What comment, if any, do you have on his statement that a valuation in this case was made on the basis of an overall operating condition of 80 percent?

A. It seems to me that Mr. Younger is commenting as an engineer on the operating condition of the railroad. In contrast, this proceeding is concerned with the fair market value of the physical properties in the track account, exclusive of franchise value. Mr. Younger is seeking an appropriate adjustment to the cost of the properties now in service. I have indicated before my opinion as to the limitation of cost as an approach to valuation. Surely, if we are to use cost, it is clear that we must make some adjustment for the fact that the properties are not new. I believe it is fair to say that the railroad industry, including the Norfolk and Western, is not in any period of expansion. Rather, it may be described as a mature, certainly a very old, industry. In such a situation as I have indicated, the proper adjustment is approximately 50 percent. While the operating condition of the property from an engineering standpoint may be quite good, the consumption of the values invested in physical property is at least 50 percent at any point after maturity and one life cycle. For example, we might maintain

page 1526 } an obsolete facility in perfect operating condition and yet its value would be minimal. There are many such situations in the track accounts of the railroads.

Mr. Younger makes reference to the operating property which has been substantially charged off on the books and yet is still in service. Just as important, particularly in the track accounts, are the properties which have not been charged off on the books or physically removed, though obsolete in the operation because of a change in traffic pattern or an improvement in the art. This might be the track which is used infrequently and the extensive tunnel bores and cuts related to such track. It would also include track and re-

lated investment made obsolete by developments such as centralized traffic control.

An example of a property charged off but still in service might be a bridge. Mr. Younger takes credit for including only 80 percent of residual value of such a bridge still in service. In many instances even this figure is too high. Many bridges, high-cost items could be eliminated through improved techniques which make it possible to provide easy passage for surface water and small streams through corrugated piping over which is introduced a fill making for a better road bed and substantially decreased maintenance cost.

Mr. Riely: I have no further questions of Professor Davison.

page 1527 } CROSS EXAMINATION

By Mr. Shannon:

Q. Professor Davison, you are, I believe, a reporter for the Supreme Court of Appeals of Virginia, are you not?

A. I might say I am the reporter.

Q. Yes, sir; the reporter.

As such, is it not part of your duties to make editorial corrections and make suggestions as to style, snytax?

A. Yes.

Q. As a matter of fact, you see all of the Opinions before they are published, do you not?

A. Not all of them, but I do see most of them. Some of the Justices don't take advantage of the availability of my services.

Q. Now, you are aware, are you not, that this case will undoubtedly be appealed to the Supreme Court of Virginia?

A. No.

Q. You think the Norfolk and Western will abide by the decision of this Honorable Commission?

A. I expect that the Commission will hand down a decision which will be fair under all the circumstances. I don't anticipate an appeal.

Q. Well, suppose an appeal is taken. You, no
page 1528 } doubt, will have a part in the preparation and headnoting of the Opinion, would you not?

A. I will certainly write the headnote, but it will be a very simple matter to see that I do not see the Opinion before it is handed down. I will undertake to do so.

Q. You will know the outcome of the case before it is announced to counsel, will you not?

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A. No, sir. If you want to know how I arrange that, I just make sure that the Justice to whom it is assigned doesn't send me the draft. I won't get it until after it is handed to counsel, namely next day. I will see it in the paper.

Q. You don't feel—is your advice ever sought and given as to substantive revisions of Opinions, Professor Davison?

A. Yes, it is, but is a very simple matter to arrange for it not to be sought in the proceeding.

Q. You don't find yourself here in a position of potential conflict of interest because of your being the reporter of the Supreme Court of Appeals, do you?

A. No, sir.

Q. Professor Davison, do you hold yourself out as an expert in railroad valuation?

A. Yes.

page 1529 } Q. Have you every *particpated* in a railroad valuation proceeding?

A. Yes.

Q. When?

A. I mentioned in my testimony that I had to value the Southern Railroad as of 1895 in a proceeding before the Federal Internal Revenue Service.

Q. Is that valuation made in accordance with the ICC valuation requirements?

A. The Service, the Internal Revenue Service made quite a bit of use of that. We didn't agree with it.

Q. I don't quite understand your answer, sir.

A. Well, we didn't think the ICC valuation was high enough. It was very substantially below the book valuation, and we tried to support the book figures.

Q. Now, where was this made, and when?

A. We went all up and down the eastern seaboard. We had to go to libraries to get ancient information. We went to the Library of the City of New York, Harvard College Library; of course, right in Washington we had the Library of Congress. We had some valuable railroad materials in Charlottesville. We developed the historical cost of building a railroad.

page 1530 } Q. Of the Southern Railway?

A. Southern, and its predecessor company.

Q. Mr. Davison, Professor Davison, the Southern is made up of numerous subsidiaries, is it not, the Southern System?

A. The Southern Railway Company is an operating railroad with substantial direct operations and a smaller overall operation performed by numerous subsidiaries.

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Q. Does Southern have so many subsidiaries—as Vice President of Finance, maybe you could enlighten me—I have been trying to enlighten myself on that several years—is it for tax reasons?

A. No, it is historical, and, as a matter of fact, if you followed it, they eliminated an important subsidiary last year. I was talking to the president over the weekend—and anticipate eliminating some more. It is primarily historical. There is an argument that for financial reasons you can raise more money on segments of a railroad than you can on the whole. The whole is not as great as the sum of the parts—the division mortgage approach.

There is a certain amount of lethargy involved. Other things are more important.

Q. At one time there was a federal income tax advantage to operate numerous subsidiaries?

page 1531 } A. Not enough to cause us to do it. I take it there still would be except that Southern has filed a consolidated return.

Q. Professor Davison, have you ever testified before in a railroad *ad valorem* tax proceeding?

A. No.

Q. This is your first instance?

A. Yes, sir.

Q. Professor, are you the author of any text or law review articles dealing with the subject of railroad valuation?

A. No, sir.

Q. Now, in the summary of your qualifications, on sheet five, I believe, in your prepared testimony, you state that at the University of Virginia, your courses include Corporate Finance, Law and Accounting, State and Local Taxation, Federal Income Taxes, Estate and Gift Taxes.

Do you teach any other courses at The University?

A. I taught a course called Securities Regulation.

Q. In any of the courses you teach, do you specifically deal with the assessment of railroad property for *ad valorem* taxation?

A. State and Local taxes.

page 1532 } Q. And in what respect does that deal with assessment of railroad property, sir?

A. Well, we teach the course out of a book, Cases and Materials, and we start the course with property taxes. Of course, the railroads pay more property taxes than anybody else; they have got more property. So we have some cases on it. And we go into the approach to value in railroads. In

this respect they are not too different from other large property-owning multi-state operating corporations.

Q. But you don't really go into any detail. You deal with them in a general sort of way, in a similar manner that you would any other public utility property?

A. Well, I go into right much detail on valuation because it is a very interesting point and there is a lot of confusion about it: it is elusive.

We spend considerable time on valuation and on valuation of railroad property as an example of the problem.

We also looked at the—not so much valuation because it isn't that hard to value an airline, an airplane—but how to distribute the values that should be taxed which is one of the things that is involved in this proceeding, as I see it.

page 1533 } Q. Now, Professor Davison, is Virginia's system of taxing railroad property unique?

A. As far as I know, it is.

Q. Do you know of any other state that has a similar statutory requirement?

A. No, I do not.

Q. Are you admitted to practice before the Interstate Commerce Commission?

A. No.

Q. Then you have never actively engaged in the practice before that agency?

A. No

Q. As a general tax attorney for the Southern Railway, I take it you were engaged, you were not engaged in any regulatory practice?

A. Well, in taxes, we tend to think of Internal Revenue Service and various state commissions as regulatory agencies but it is true they don't prescribe our prices.

Q. Not in the economic sense; we are talking about regulations here?

A. No.

Q. What were your principle duties as general tax attorney with the Southern?

page 1534 } A. When I went to work for Southern, the big problem was federal income tax. Until about 1940, the big problem for the railroads was state and local taxes, largely property taxes. But by 1947 we were faced with the tremendous federal income tax, 85 percent rate, with the statute changing every time Congress met, and with high volume of business which produced substantial taxable income.

Nevertheless we continued to have property taxes to be handled as we went along.

We also had other state and local taxes. The sales tax was being adopted in many of our states and we had quite a team working on taxes, all taxes.

Q. Then do I take it that it was your responsibility to keep Southern Railway's tax assessments and tax payment as low as possible, in accordance with the law?

A. Well, our assignment was to pay the proper tax, yes.

Chairman Catterall: Proper tax or the lowest tax?

The Witness: Well, the way I teach it, it is—

Chairman Catterall: When you were working for the railroad.

Mr. Riely tries to get the lowest possible tax.

The Witness: I would think that the lowest proper tax—certainly, you wouldn't want to pay the highest proper tax.

page 1535 } Mr. Riely: I agree not with Your Honor but the witness—the lowest proper tax.

Judge Dillon: Judge Catterall says the lowest possible tax.

Mr. Riely: That is why I said I did not agree with him.

Chairman Catterall: I am not asking what he was testifying now but when a railroad hired a man that didn't try to get the lowest possible tax—

The Witness: In those days, with the interest rate on tax deficiency at six percent, there was no economy in underpaying a tax. The situation may—I am curious as to whether the situation may be different today.

Go ahead.

By Mr. Shannon:

Q. Do you know of any state that uses sales value of railroads as the basis for property tax?

A. I would think that they all do.

As I read valuation cases, we have learned our lesson now and we always say we consider everything, and sales is an important element.

page 1536 } Q. Now, are you basing your qualifications to testify in this proceeding on your experience as a Professor of Law at The University? Are you predicating your qualification on your experience as a former tax attorney and Vice President of Finance and Taxation for the Southern Railway System?

A. All of them.

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Q. Are you retired from the Southern Railway?
A. No, sir.
Q. Do you hold any position with the Southern Railway?
A. I am tax counsel of Southern Railway, one of many.
Q. Are you a stockholder of the Southern Railway?
A. Yes, sir.
Q. So it is certainly to your advantage to see that the railroads pay no more than the proper tax as a stockholder?
A. That's correct.
Q. Now, referring to sheet three of your testimony, you state with respect to your assignment with Southern, involving the Southern's property in 1895, forward, that: "We were also concerned from time to time with approaches to valuation for state property taxes in the 14 states served by Southern Railway System lines."
Specifically, what do you mean by "approach to valuation"?
A. I regarded the testimony that I was going to give as directed to the point of an approach to valua-
page 1537 } tion under the Virginia system, and of course you have to have the approach before you can arrive at any determination. So we were constantly, on a day-to-day basis, concerned with the valuation of our properties in 14 states, in the course of which we considered the various approaches.
As I have indicated, we didn't find another one like Virginia's; Virginia statute is different.
Q. On sheet number four of your testimony, you are speaking about the C.N.O. & T.P. Railroad. You estimate during that period Southern acquired a substantial interest in the C.N.O. & T.P. from the B & O Railroad for $15 million cash. What years are you referring to, Professor?
A. It is going to be about 1953.
Q. About 1953.
Now, further down on the same sheet you state that, "Southern acquired a substantial minority interest and paid B & O $15 million cash."
You mean Southern acquired B & O's minority interest because, at the time the C.N.O. & T. P. was a controlled subsidiary of the Southern, was it not?
A. It was a complicated relationship. There was actually a holding company between Southern and C.N.O. & T.P. which held some, in which Southern held some
page 1538 } stock, and Southern's subsidiary, AGS, held some stock. Each of the companies held some

stock directly. Adding up these interests, Southern was in control but B & O had a substantial interest in the intermediate holding company.

We bought out their interest in the intermediate holding company.

Q. Would you say that Southern's overall interest in the C. N.O. & T. P. was approximately 70 percent?

A. After the acquisition?

Q. No, prior to acquisition?

A. No, after the acquisition.

Q. After the acquisition?

A. From B & O. We then picked up additional stock, from the public.

Q. Southern had the controlling interest in C.N.O. & T.P. prior to the acquisition of B & O?

A. In the order of 56 percent.

Q. You say that you were able to get this because of B&O's —you say—let me quote you so I will quote it correctly:

"This represented a substantial valuation problem and was of particular significance because the B & O was, in substantial part for economic reasons, releasing its
page 1539 } ownership interest in a highly valuable connecting line."

What were the economic reasons that you referred to?

A. As I understand it, they were recapitalizing about $400 million RFC loan. The restrictions under that loan prevented them from paying dividends and increasing salaries; and they had done everything they could, and $15 million was just the key that would turn the lock and make the whole thing go.

Q. It was kind of a distress sale as far as B & O was concerned?

A. If I had been B & O, I would have regarded it as distress on one side but joy on the other. I could now increase salaries.

Q. We would go on a little longer and operate a little longer?

A. It wasn't that kind of distress. They were not in danger of going out of business.

Q. Now, continuing on sheet four, you state that:

"In 1963 also, the company acquired substantially all of the stock of the Central of Georgia Railroad and affiliated companies, some 2500 miles of track, for approximately $30 million cash."

Did you participate in that proceeding, Pro-
page 1540 } fessor Davison?

A. Yes, sir.

Q. To what extent?

A. Well, I had to raise the money and I helped fix the price.

Q. Wasn't that after Central of Georgia had, attempt had been made to acquire the stock of Central of Georgia? I think attempt was made by Frisco, was it not?

A. More than attempt. The Frisco started buying up the Central of Georgia when Central of Georgia came out of reorganization. They started out with a market operation at about $3 a share, and finally paid as high as $90 a share which is an indication of valuation.

They didn't go into Interstate Commerce Commission until they had 49 percent. There they were told that they were already in control and that this was illegal. Ultimately they were prosecuted and ordered to sell, although there was a finding that it was very much in the public interest for them to control. Now they had to sell.

The prime buyers would have been the Coastline and Seaboard, the Southern last. Coastline and Seaboard were tied up in a merger. Southern had a chance to buy something that it wouldn't ordinarily have a chance to buy page 1541 } and they were able to buy it at the Frisco's cost, which is a circumstantial figure unrelated to property tax; to a certain extent they had to sell; certainly we didn't have to buy. They didn't have to sell at that price. It was just bargained out that this was a price that all the parties could support.

Chairman Catterall: Do you all mind if I interrupt? I think we are getting a long ways away from the value of the cuts, fills, bridges, tunnels and tracks of the railroad.

I assume that this cross examination—

Mr. Shannon: I will continue; I will defer.

By Mr. Shannon:

Q. What is your understanding, Professor Davison, of franchise value?

Chairman Catterall: He has made that perfectly clear. Don't have him repeat what he said on that.

The Witness: I will rest on what I have said.

By Mr. Shannon:

Q. All right.

Then I will ask you this:

Charles M. Davison, Jr.

Is it not a fact that in Virginia the franchise value is not assessed in dollars?

A. Well, now, the Supreme Court of the United States has told us about that thing and that is a property tax or it is nothing. And I say, yes, it is assessed in dollars. You may have to go back upstream from the two percent of gross—it is not too hard to get up there; I did it myself.

page 1542

Chairman Catterall: That is a legal question.

Mr. Shannon: Yes, sir; he is a Professor of Law.

Chairman Catterall: He is a Professor, I know.

By Mr. Shannon:

Q. Do you have any work papers, Professor Davison, underlying your exhibit CMD Number One?

A. No, I don't have any work papers except the Form A.

Q. Did you examine each one of the Form A's?

A. No, sir; someone did that for me.

Q. Who prepared that exhibit for you?

A. It was prepared in the offices of the Norfolk and West-figures.

Chairman Catterall: That is a good way to speed the cause.

By Mr. Shannon:

Q. I am going to ask you one question as to this report. Would you refer to your page one of your exhibit, please, sir.

A. Yes, sir.

Q. Did you determine the amount in column C by multiplying the figures in column A by the figures in column B?

page 1543

A. That is the theory of the exhibit.

Q. I refer you to the very bottom number. 50 times 7.82, that doesn't equal 8.91, does it?

A. No, sir.

Q. That is a mistake, isn't it?

A. I think so.

Q. Would you accept my arithmetic?

A. Yes.

Q. You are taking a chance.

A. I will take your arithmetic. It won't change the result.

Q. 50 times 7.82 will provide 891.00?

What does it do to the 97.59?

A. Changes it to 97.88.

Q. But, as you said, you relied on what somebody else gave you there?

A. Yes, sir. I am sorry for the error.

Mr. Shannon: I don't believe I have any further questions of the witness.

Chairman Catterall: Mr. Epps, do you have anything to add?

page 1544 } By Mr. Epps:

Q. Professor Davison, you are aware, are you not, that the Southern Railroad is by stipulation a party in this litigation, or would be bound by it?

A. Yes, sir.

Q. Now, you state that railroads are sold from time to time and you use it as a factor, and in this regard I take it you agree with Mr. Koncel who says he couldn't find any element of valuation in impartial sales. Do you?

A. Did you say I agree with him or it would seem to disagree?

Q. I meant to say you disagreed.

A. Yes.

Q. You testify on page five "that this factor in determining overall value is available"—at least that is how I interpret that.

A. That is correct.

Q. What is your authority for stating, on page six, that the value of a railroad property divided between franchise value and remaining value?

A. The Constitution of Virginia.

Q. Where is it in the Constitution of Virginia in that language?

page 1545 } A. I would have to paraphrase it; I haven't got it before me; but it seems to me the whole theory of the thing is that the localities are entitled to tax the property of the railroads excluding franchise value.

Q. But there is no language in any statute, Constitution, or case in Virginia, is there, which says that you determine property valuation by subtracting from some figure, the value of the franchise?

A. I say subtraction? It said, exclude.

Q. Doesn't say subtract. It says exclude.

Now, in a rate case where franchise value is excluded, you don't exclude it by subtracting it, do you?

Charles M. Davison, Jr.

A. You could exclude it by subtracting it if you had it in there; then you would subtract it to exclude. But if you exclude it before you get it in there you won't have to subtract.

Q. Exactly. The method is not to get a grand total and subtract it but just to disregard it, isn't it?

A. I don't know where it is. People can do it any way they want to.

Q. Do you know of any case where it has been done other than as I have described it, just exclude it, put it over on the side?

page 1546 } A. I don't know of a similar situation in property taxes and I would suppose—I am not an authority on public utility rate base—but I would think a normal approach there, you wouldn't put something in there and take it out.

Q. Just leave it out?

A. Just leave it out.

Q. We are agreed on that.

On page eight, you say, "Railroad earnings, the basis of price and therefore highly useful in fixing value, vary greatly among properties. This variation describes the franchise value."

Do you mean by that that the franchise value is the variation in earnings?

A. No, it is the earnings.

Q. The franchise value is the earnings?

A. Franchise value is measured by the earnings and the earnings create and describe the franchise value.

That isn't the variation. If you read the two sentences together, "demonstrates," might be a better word than "describes;" the fact that one property will bring a higher price than another because it earns more shows that it is the earnings that are the primary consideration in price and value.

page 1547 } Chairman Catterall: In that sentence, do you mean net earnings?

The Witness: Not necessarily.

Chairman Catterall: Since the witness has agreed that we don't include the franchise value, we don't put it in and take it out; this witness has agreed. Doesn't that take care of this franchise value?

Mr. Epps: All right, sir. I will pass on to the next point.

The Witness: Could I finish the answer to the question?

Charles M. Davison, Jr.

Chairman Catterall: Excuse me; I thought you had finished.

The Witness: I did have a very interesting situation where we were negotiating for the sale of the Railway Express and the buyer, we kept telling him we didn't have any earnings. He was very impressed by $400 million of gross and his theory was that anybody could make money out of $400 million gross and this factor is certainly an important consideration in a given situation.

And past earnings, as I have tried to say here, can be completely disregarded. We didn't buy the Georgia and Florida on the basis of earnings or gross, but

page 1548 } our hope, desire, expectation through the opportunity to parallel the merging Coastline and Seaboard.

Chairman Catterall: Let's go to the next point, Mr. Epps.

By Mr. Epps:

Q. On page 10, the first two sentences, you say:

"Turning now to the valuation of the track accounts of the railroads, exclusive of franchise value, we find franchise value is intimately related to and based upon earnings. It would seem to follow that value, excluding franchise value, must be determined on some other basis, that is to say, excluding consideration of earnings."

I submit to you that that is a non-sequitur. Would you agree?

A. No, I don't agree it is a non-sequitur.

I might say further in here that earnings are absorbed in franchise value. That is the thought I am following there.

Q. Yet you say that in establishing property value you take into consideration all elements. Didn't you say that?

A. Overall.

Q. Overall.

A. In overall value, enterprise value, entity

page 1549 } value, you take all of them.

Q. Isn't this true?

A. If you exclude the elements, you exclude them.

Q. Isn't this true, that you must take into account in determining property values the earnings of those properties?

A. I think I have just finished saying—

Chairman Catterall: We are going around in circles.

Might I suggest that even though we have a lawyer on the stand, it might be better to put the legal argument in a Brief instead of arguing it with the witness.

Charles M. Davison, Jr.

Mr. Epps: I thought this was an appraisal question, Judge. I am not trying to argue the law.

Chairman Catterall: It is a question of the legal methods of appraising. It is purely a legal question; the appraisal of the *Florda-East* Coast Railroad doesn't throw any light on it. So much of this testimony is so very interesting that we get into it even though it is a little irrelevant.

Mr. Epps: I agree with it.

By Mr. Epps:

Q. Before I pass this point, and I want to do so rapidly, we are agreed that you can have a railroad sustaining a loss in a given year and still pay a substantial franchise tax?

A. Yes.

page 1550 } Q. And now, it is also true that the franchise tax in Virginia is being reduced, isn't it?

A. I don't know about that.

Q. You are familiar with the reduction in franchise tax in Virginia?

A. No.

Q. If it is being reduced, does that mean that the value of the franchise is going down each year?

The Commission sometimes suggests, Mr. Davison, when a witness is puzzled about his answer, that he simply say, I don't know, and then we can go on to the next question.

A. Another way of doing is to think a few minutes and you may have an answer.

Chairman Catterall: May I suggest that that answer is totally irrelevant. It is a nice question and a nice answer but has nothing to do with this case. Don't make the witness think any longer.

Mr. Epps: This was in the direct testimony; I think we ought to be entitled to cross examine.

Chairman Catterall: The fact that the direct testimony brings up irrelevant matters doesn't make it proper to cross examine on them.

Mr. Epps: Then I think the direct should be

page 1551 } stricken.

Chairman Catterall: We give proper and due weight to all the testimony and never strike anything in a case of this kind.

Mr. Epps: Yes, I have heard that. Thank you, sir.

Charles M. Davison, Jr.

By Mr. Epps:

Q. Now, if you base your testimony of the value of the property of Norfolk and Western on earnings, then you would agree, would you not, that the testimony of Mr. Caywood and Mr. Maynard have no relevance?

A. That is an iffy question. I don't know that much about their testimony and I don't base it on earnings so I can't answer that question.

Q. Now, you say on page 11 that if the franchise is eliminated from value, the property has a re-use value only, but wouldn't another railroad buy the property in place for use in bearing locomotives?

A. That would be a re-use. I don't know what you mean by "bearing locomotives."

Q. You have a track with line and surface. That is all in there. And locomotives will run over it. Doesn't this have an element of value?

A. Not without a right to operate over it.

page 1552 } Chairman Catterall: You understand in Virginia you don't have to get permission to operate a railroad the way you do to operate an electric company or a gas company or a water company. The law of Virginia permits anybody who can raise the money to parallel the tracks of any railroad except the R.F.&P.

The reason I bring that up is because you used the word "monopoly" so often.

Mr. Epps: Thank you, Judge. I will pass over that question.

By Mr. Epps:

Q. You agree, don't you, that an appraiser seeks the highest and best use of property?

A. Available use.

Q. Right. And isn't the highest and best use of the track properties of the Norfolk and Western to carry locomotives which will bear railroad cars behind them?

A. Pursuant to its franchise.

Q. Which, as the Judge has said, you don't need for the purposes of running locomotives over it.

A. Well, the Judge got by with the State of Virginia. I am not that familiar with how you come out under the federal rules and regulations paralleling the Southern. I would be very much surprised.

Q. Now, actually two railroads can merge

page 1553 } and produce a higher resulting valuation than the sum of the two component parts, can't they?

A. Theoretically possible.

Q. Didn't it happen in the Norfolk and Western and Virginian merger?

A. Value for what purpose? I would think it would lower the property value because they wouldn't need all the property.

Q. Let's talk about the earnings and securities values about which you have testified.

A. It is a very difficult comparison to make. You might find, and you typically do find in mergers occurring in distress situations where, if they had operated separately, they would have gone on down, but the results of the merged company might be less than the sum of the two before, in a given economic climate. It is a comparison to make.

Q. It went through in the Norfolk and Western and Virginian merger that there was distress?

A. Distress?

Q. There was no distress in that merger?

A. Well, one of the factors, as I understand it, is that the Virginian was going to run out of coal. They could tell when they were going to run out of coal and that is a very distressing thing for a coal-hauling railroad.

page 1554 } Q. Yet, you say in such case they can merge and have a greater value?

A. I will give you this: they usually merge in order to have a greater value.

Q. Factually, that is why they don't?

A. That's right.

Q. The merger hasn't but one franchise, but before they had two, isn't that right?

A. Well, now, no, it is not right. They still have them both. That is what happens in a merger; they are still both there; they have got all of the franchises that they had before.

Q. Would you name me the franchises the Norfolk and Western has in Virginia?

A. No, I can't do it; I am sorry.

Q. Do you know what they paid for any of them?

A. No, and it would be a very difficult calculation. But I can give you some prices that they could sell them for.

Q. No sir; didn't ask you that.

On page 12, you say that "overwhelming bulk of investment in the track account represents main line track which has been in service for a great many years."

Charles M. Davison, Jr.

In this regard, I take it you disagree with
page 1555 } the company's witness, Mr. Maynard, who
states that at least 40 percent of the track properties of the Norfolk and Western-Virginian are not in main line tracks?

A. I don't have his statement before me.

Q. You have read it, I take it?

A. I am not at all sure that I have. If you want to read it to me again—what did he say—miles of track or dollars?

Q. He said, at least 40 percent of the track properties. He is talking about miles of track, I take it.

A. I was talking about the investment.

Q. You make your distinction—the money is in the main line—the investment is, regardless of the percentage of mileage, is that it?

I will accept your explanation if that is it.

A. That would be the explanation that I would make.

Q. Now, on page 14, you state, that Mr. Tipton has given a restatement of the book investment of the Norfolk and Western Railroad and track accounts which reflects actual cost of the facilities now in service.

Actually, don't you know that that is not what Mr. Tipton did at all?

A. No, but I don't know that that is not what
page 1556 } he was told to do at all. As I read what Mr.
Younger asked him to do, and said he asked him to do, that is what he said he asked him to do. I have understood that he came pretty close to it, did a better job than I could do.

Q. Well, he approached it differently from you and from me, too.

Now, on pages 14 and 15 of your testimony, it reads in part like this:

"It is fair to say that the railroad industry is not now in a period of rapid expansion of physical properties and might properly be described as a mature industry."

That is the end of your quote, but I want to ask you: Isn't it a matter of fact that in the pending merger of the C&O—B&O into the Norfolk and Western, the Norfolk and Western is on the verge of its greatest period of expansion since it was formed?

A. No. As a company, it will be a larger company but the physical properties will contract.

Q. So that that is not the kind of expansion you are speaking of?

A. I am talking about physical expansion, expansion improvement in increase in the property accounts which I thought this proceeding was about.

page 1557 } Q. Now, on page 15 of your testimony, you say that a tunnel, in spite of its tremendous cost, has no value?

A. Except as a part of an operating railroad.

Q. Let's take a tunnel of an operating railroad and let's say that it becomes tortiously blocked by somebody else—you can't run the railroad.

Mr. Riely: Excuse me; would you repeat the adverb?

Mr. Epps: Which?

The Witness: Tortious.

Mr. Riely: Tortious.

Mr. Epps: Negligently. By negligence or tort of some third party.

Mr. Riely: Excuse me.

By Mr. Epps:

Q. Would it still be your opinion that the tunnel has no value if you are still representing the railroad?

A. If we built another one, that wouldn't have another value. We did try to use these tunnels to store gas. We have done a great many things to try to develop a value in some of these very expensive bores but in Virginia they won't hold the gas. We haven't found anything yet to do with an old hole.

Chairman Catterall: Any tunnel? You say, tunnels or cut has no value except as part of an operating

page 1558 } railroad. Didn't you mean to say, as an operatable railroad?

The Witness: If you want to conceive of a situation where the railroad wasn't operating at all, either because of some temporary interruption of service or some economic collapse, I said there would still be a value there, that's correct.

By Mr. Epps:

Q. Let us take the case where the system has been built and everything is ready to go but no tracks have run on it, no trains have run on the tracks, and it is ready to go; that is an operatable railroad, but it has never—

A. I never heard of such a thing.

Q. But I ask you to assume that. Then we are talking about—

A. It is very hard to assume. I don't see how it could possibly be.

Chairman Catterall: Union Pacific was built before the trains ran over it.

Mr. Epps: Thank you. You got that before I did.

The Witness: Every new track is built before you run over it.

Chairman Catterall: That's right.

Judge Dillion: Couldn't conceive otherwise.

Chairman Catterall: Let's recess for 10 minutes.

page 1559 } (Short recess.)

Chairman Catterall: During the recess, counsel on both sides agreed not to make any expert change his opinion on the witness stand.

Mr. Epps: I have only two points. I was almost finished when we broke for the recess.

By Mr. Epps:

Q. Professor Davison, you are aware, are you not, that although you capitalized the franchise tax that that approach to value has more than once been rejected by this Commission?

A. I don't think I capitalized it.

Chairman Catterall: We weren't going to argue any legal questions with the witness, either.

Mr. Epps: Can I find out whether the expert knows about those cases?

Chairman Catterall: It doesn't make any difference whether he does or not.

Mr. Epps: I think it does, considering the experts.

Chairman Catterall: I don't want you to take an appeal but—

Go ahead, ask.

By Mr. Epps:

page 1560 } Q. On your direct testimony, did I understand you to say that Norfolk and Western was the largest taxpayer in the state?

A. No, I didn't say that. They at one time were but I

didn't say that in this testimony and I don't believe they are now.

Q. I wanted to call your attention to the fact that they are not.

A. They do pay very substantial taxes as do the other railroads.

Q. Yes, sir.

I don't want to dog this point, but I thought that what you did was captialize the tax. You didn't capitalize the franchise tax?

Chairman Catterall: He testified it was a great big tax and it must mean a very fine franchise.

Mr. Epps: He divided it by a percentage return and came up with a value, as I read his testimony.

Chairman Catterall: Suppose he did, Mr. Epps; it doesn't make any difference.

Mr. Epps: Well, if he didn't, I am very confused. I would like to be enlightened.

The Witness: My problem is I would like to be enlightened, too. I don't really know what the word "capitalized" means. I have studied that at great length and find
page 1561 } a great deal of company in not understanding.

Chairman Catterall: If the franchise is two dollars, you multiply by a certain sum and you get certain value. If it is one dollar you multiply it by—

The Witness: If that is capitalizing, that is what I did.

Mr. Epps: That is what you did.

Chairman Catterall: You may stand down and be excused.

The Witness: Thank you, sir.

(Witness steps aside.)

Mr. Shannon: May I interject at this point that Mr. Stuart Carter, one of the counsel for the cities and towns, called and said that he had been grounded up in the southwestern part of the state somewhere and he is driving down and he won't get here until around noon or a little after, so he asked me to express his regrets for his failure to be here.

Judge Dillon: If you have time to spare, go by air.

Chairman Catterall: Who was the next expert?

Mr. Riely: You wanted to put Mr. Tipton off till after lunch. Mr. Brinner's testimony is here. It consits of four and a half pages and here are the copies that you have. It doesn't have the jurat on it but I have got it. I believe we agreed that we could put this in the record.

page 1562 } Chairman Catterall: That will be copied into the record. He has no exhibits?

Mr. Riely: He has no exhibits. This will support Tipton's figures; he says that they are right.

Chairman Catterall: What is the question?

Mr. Riely: He wants to copy it in the record after Tipton.

Chairman Catterall: I am afraid the record has already been put together and paged, so we will put it in—

Mr. Riely: Tipton is coming back.

Chairman Catterall:—after he comes back?

Mr. Riely: Yes.

Chairman Catterall: Sure.

Mr. Pascoe: It makes more sense to read it that way.

Mr. Riely: You want to put Mr. Maynard off until after lunch, so we will call Mr. Butler.

Mr. Butler has been previously sworn.

Whereupon, EUGENE L. BUTLER having been previously sworn, was examined and testified upon his oath as follows:

page 1563 } DIRECT EXAMINATION

By Mr. Riely:

Q. State your name, please, sir.

A. My name is Eugene L. Butler.

Q. Are you the same Eugene L. Butler who testified earlier in this case?

A. I am.

Q. Mr. Butler, what are the duties of your position as Assistant Director State and Local Taxes for Norfolk and Western?

A. My duties include the supervision and preparation of Norfolk and Westerns' annual property tax returns for each of the states in which it operates. More specifically, in the preparation of Norfolk and Western's Virginia tax return, I work closely with the staff of the State Corporation Commission in ascertaining the fair market value of the various classes of property.

Q. Does this include land valuation?

A. Yes.

Q. Have you ever accompanied State Corporation Commission representatives on land appraisal inspection trips over Norfolk and Western property?

A. Yes. Since 1957, I have been on such inspection trips on numerous occasions.

page 1564 } Mr. Epps: I don't understand what this is rebutting. This is supposed to be rebuttal testimony.

Chairman Catterall: We have run these cases and let people come in out of order whenever they feel like it and if they have two witnesses on the same thing—

Mr. Epps: We take it for what it is worth and we can argue it is not rebuttal. I don't know what it has to with assessment of land in this case.

Chairman Catterall: It doesn't matter whether it is rebuttal or not. He is going to say something. Let's find out what he has to say. It will become apparent in a minute.

By Mr. Riely:

Q. Based on this experience and your association with State Corporation Commission personnel, would you state your opinion of the practice of the Commission in determining the value of public service corporation land in Virginia?

A. To the best of my knowledge, it has always been the practice of the Commission to determine such land values by making direct comparisons with surrounding locally-appraised land having similar physical characteristics.

Q. Is it your understanding and impression that the State Corporation Commission appraises, always appraised, land on the basis of its present condition?

page 1565 } A. Yes.

Q. And would that present condition include any grading that has been done?

A. Yes. Of course, there are parcels of land where cuts, fills, and embankments have reduced the value. In such cases, the Commission makes adjustments from the locally-appraised comparable property before application to the public service corporation property.

Q. Could you give us a specific example where grading has enhanced the land value of Norfolk and Western's property?

A. Norfolk and Western's classification yard at Norfolk is a good example. This undeveloped tract of land was developed from a low, wet and marshy condition to a high, dry and usable tract of land. The appraised value of this property was developed by applying local values of improved property in the surrounding area.

Q. Do you know when the most recent appraisal was made to this property?

A. Yes. The most recent appraisal was made in December, 1968.

Q. Did you accompany Commission personnel on that particular appraisal?

A. Yes, I did.

page 1566 } Q. Does grading enhance appraised land value only where filling is involved?

A. No. Another example of increased land values resulting from grading is the Norfolk and Western's Roanoke classification yard which was cut from a high sloping hillside to a large level tract on grade with Shenandoah Avenue in Roanoke. The appraised value of this land was based on the superior value of improved industrial land. A portion of the hillside was not used for the classification yard, and, since it was not graded, it has a low value based on the value of hillside property.

Q. Do cuts and fills enhance land value only in the case of yards?

A. No. For example, Norfolk and Western has right-of-way in Nansemond County that runs through a low-lying area. The adjoining property is appraised at $5 per acre. Norfolk and Western land that has been cleared and graded is appraised at $20 per acre. The appraisal for Norfolk and Western land was based on the value of cleared land owned by an industry in the area.

Q. Have you prepared an exhibit illustrating the effect of cuts and fills on appraised values of railroad property as compared with locally appraised adjoining land?

A. Yes.

page 1567 } Mr. Riely: If it please the Court, that is Exhibit 3-ELB: It consists of five sheets. It is in your book.

Chairman Catterall: It will be received.

(The document marked Exhibit 3-ELB for identification was received in evidence.)

By Mr. Reily:

Q. Let us go to that Exhibit for a moment, please, Mr. Butler.

A. Yes, sir.

Eugene L. Butler

Q. Do all of these five sheets show actual examples or are they merely designed to exemplify what goes on?

A. All five sheets do not show actual examples. They are merely to exemplify certain situations, with the exception of one exhibit.

Q. Which one is that?

A. That is the third exhibit, the low, wet and marshy illustration.

Q. Where is that located?

A. That is the Nansemond County situation.

Q. That you previously mentioned?

A. Yes.

page 1568 } Q. The others do not purport to represent actual?

A. Not actual.

Q. Do they exemplify conditions that exist in general?

A. Yes, they exemplify principles used by the Commission.

Q. All right, sir.

Are cuts and fills the only elements of investment included in grading?

A. No. For example, clearing and grubbing represents a substantial element of grading.

Q. Do clearing and grubbing enhance the value of Norfolk and Western's land?

A. Yes.

Q. Is such enhanced value included in appraised land values as assessed by the State Corporation Commission?

A. Yes. The Nansemond County right-of-way to which I referred is a good example.

Q. Have any Commission representatives ever inquired, as part of an inspection for reappraisal or otherwise, as to whether railroad land has been graded, filled, and so forth?

A. No.

Q. Have any Commission representatives ever inquired as to the condition of such land prior to any grading which may have been done?

A. No.

page 1569 } Q. Mr. Butler, in your opinion, has it been the consistent policy of the State Corporation Commission to treat grading as a composite part of land value?

A. Yes.

Mr. Riely: No further questions of Mr. Butler.

Eugene L. Butler

Mr. Shannon: I will endeavor to be very brief, Your Honor.

CROSS EXAMINATION

By Mr. Shannon:
Q. Mr. Butler, what is your testimony in rebuttal of?
A. To the statement made by Mr. Younger concerning the grading.

Mr. Riely: Speak lounder.
The Witness: It is in rebuttal to Mr. Younger's testimony.

By Mr. Shannon:
Q. Specifically what part of Mr. Younger's testimony are you rebutting?
A. Mr. Younger was referring to grading, I think in the yard areas. Most grading, I think he said, was on the right-of-way of operating strips.
Q. I am not real certain what was the point that he made that you are now rebutting here.

page 1570 } Mr. Riely: If it please the Commission, I suggest that this is not a proper type of—
Mr. Shannon: No, it is not. I think the witness, the rebutting witness certainly knows what he is rebutting.
Mr. Riely: The testimony appears on a page of the record that I cannot read, because, I think, page 1250 and after that, where Mr. Younger was discussing grading, that is why this—
Mr. Shannon: Mr. Butler, I have just a few questions here I want to ask you.

By Mr. Shannon:
Q. Doesn't the ICC evaluate land, or value land on a zoning basis?
A. Yes, it does.
Q. Could you explain just for the record briefly what this zoning amounts to and what it is?
A. It is my understanding that the zoning, each zone represents where a value starts and where there is a break in value.
Q. In other words, you have numerous values in a particular zone and that is shown, on a zoning map, is that right, or chart?
A. That's right.

page 1571 } Sometimes a zone may extend over two or three maps?

A. That's correct.

Q. The land studies then, as far as the railroads are concerned, are worked out jointly with representatives of the Commission?

A. Yes.

Q. And you accompany these representatives on these land studies?

A. Yes.

Q. Now, when arriving at an average appraised value per acre for each zone, did not the Commission's representatives give consideration to the narrow strip of right-of-way which resulted in a lower appraised value of the right-of-way, when compared, say, with local-appraised property?

A. Yes, they considered with—

Q. They took into account in reducing the value of the railroad land?

A. Yes.

Q. Is it not also true, Mr. Butler, that each zone may show a wide variation in value within the zone, the land within the zone reflects various values?

A. It could, yes.

Q. Doesn't it, in fact?

page 1572 } A. Yes.

Q. Now, is it not also true that the appraised value of a zone is an overall average in most cases of all the values in the zone?

A. Not in all cases.

Q. In most cases?

A. I don't know.

Q. Now, Mr. Butler, I believe you testified that your exhibits don't reflect actual situations, save one, the three sheets that you show on your exhbit 3-ELB.

Mr. Riely: Five sheets.

Mr. Shannon: Five sheets actually. I stand corrected.

By Mr. Shannon:

Q. Is that correct?

A. That's correct.

Q. This one, where you show the wet and marshy land, is that the same land to which you refer on page four of your testimony when you say, for example, Norfolk and Western has a right-of-way in Nansemond County?

A. Yes.

Q. It runs through low-lying area. Is that not land in fact through the Dismal Swamp?

A. Yes, it is.

page 1573 } Q. Now, have Commission appraisers ever asked the dollar value of grading fills, cuts, and so forth, for any zone in making an appraisal of railroad land?

A. No, have not.

Q. Now, Mr. Butler, on your appraisal inspections, could you have furnished the Commission appraisers with the physical conditions of the land prior to grading, and the cost of grading at that point if they had so requested?

A. It would have been difficult to furnish some of the information.

Q. You never did, in fact?

A. I never did.

Q. Now, where a railroad runs through an area with timber, is it not true that the appraised value of a right-of-way —that is the railroad right-of-way, is ordinarily less than that of adjacent property?

A. I don't know.

Q. You don't know that timber land carries a higher appraisal say, then cleared land?

A. No, I don't.

Q. You don't know that? You have never noticed that from these appraisal maps that you studied with the Commission's representatives?

page 1574 } A. We merely compare the figures that they have. We don't—I don't know what they are.

Q. Have you ever inquired of the Commission's representatives during your tours with them on these inspections, if the Commission appraises that land separately, or appraises land and grading together? Have you ever inquired of the Commission's representatives as to that?

A. Yes.

Q. And what did they tell you?

A. They appriased the land as they see it.

Q. They do not include grading?

A. They appraise it as they see the land.

Q. But did they tell you that they appraise them separately?

A. No.

Q. Haven't you talked to Mr. Chapin about that on a number of times, a number of occasions?

A. When we made the Norfolk appraisal, we asked how he handled grading. When we made the Norfolk appraisal, he was asked how he handled the grading.

Q. Did he say that he appraised land separately from grading?

A. He said, "I appraise the land as I see it."

page 1575 } Q. When you say "The Norfolk" you are talking specifically about a particular situation? You are talking about that yard in Norfolk?

A. Yes; the classification yard is the one I am referring to.

Q. Now, leaving aside your terminals for a moment and considering N&W's line of railroad and its right-of-way in Virginia from the east coast to the West Virginia border, can you cite any instance, Mr. Butler, where any excavations, cuts and fills, have resulted in the value of the land being increased above the value of comparable land?

A. Cuts and fills increased above comparable land?

Q. That is, where the land, the right-of-way, have cuts and fills in it and, as a result of those cuts and fills being in the line of railroad, the land has been assessed at a higher value than comparable adjacent land?

A. As I mentioned, in the Roanoke classification—

Q. I said, leaving aside those.

A. I don't recall right at the moment.

Mr. Shannon: I have no further questions.

Thank you, Mr. Butler.

By Mr. Epps:

Q. Mr. Butler, as Assistant Director of State

page 1576 } and Local Taxes of the Norfolk and Western, it is a part of your responsibility to file the necessary forms for the taxation on the track account, is it not?

A. Yes, sir.

Q. And it is, therefore, a portion of your duties to know what should be included in those accounts, is it not?

A. Yes, sir.

Q. You know, do you not, that the statute requires that cuts be included, do you not?

A. If it isn't in the land value.

Q. Are you familiar with Section 58-532 which has to do with valuation of the tracks?

A. I have read it.

Q. That uses, that says that there shall be a value, includ-

ing cuts. It doesn't say, including cuts not already taxed, does it? It says, including cuts.

A. Including cuts.

Q. So you would accept that amendment to your testimony? The statute says you must include cuts.

A. The statute reads—

Q. The statute reads that way, we agree.

Fills?

A. Yes.

page 1577 } Q. Excavations?

A. Yes.

Q. All of those go into the grade account, don't they?

A. Account three, grading, yes.

Q. Now, if your testimony is that in your opinion the assessors of land have attempted to include those items in the land value, your remedy wouldn't be in this proceeding but would be in a proceeding to correct your real estate assessment, wouldn't it?

Mr. Riely: If it please the Commission, I think that is a question of law. I object to it.

Mr. Epps: He is a Director of State and Local Taxes.

Chairman Catterall: It is sort of a borderline case. The witness is testifying as to what Mr. Younger has done. It seems to be different from what Mr. Younger has specified. Perhaps it is closer to a question of fact than a question of law.

Mr. Riely: He is asking him what legal proceeding, remedy should be sought. That is the vice of the question, I submit to Your Honor.

Chairman Catterall: The point is that everything about this track or roadbed or whatever it is called, has to be assessed locally. Then there is a ribbon of rail

page 1578 } which has to be assessed and spread out on a mileage pro rate and if Mr. Epps wants to know whether the land underneath it is locally, goes under the local assessment or whether it has been thrown into the ribbon of track assessments by mistake—let's use the word roadbed—the roadbed is in the—

Mr. Riely: I am not objecting to his asking that question of Mr. Butler. What I am objecting to is his asking Mr. Butler technically what sort of a proceeding, a remedy, would be—

Chairman Catterall: Ask him the question without mentioning—

Mr. Riely: That is the question that was asked. It seems to me that is an improper question.

Chairman Catterall: I agree with that.

By Mr. Epps:

Q. Now, Mr. Butler, in your position as Assistant Director of State and Local Taxes, you would be responsible for applications of preparation and consideration of applications for relief from erroneous assessments, wouldn't you?

A. No.

Q. That is a portion of your duties, working on this?

A. It would be handled by the Director of Property Tax.

Chairman Catterall: He said, no.

page 1579 } Mr. Riely: He said, no, if the Commission please, in answering Mr. Epps' question. I would suggest that Mr. Epps might not follow that line much further.

Mr. Epps: You might let me ask the question before you object to it, Mr. Riely. You seem to—

Mr. Riely: I am asking you not to ask the question you asked after said, no. I ask it be stricken.

Mr. Epps: I will ask the reporter to read it.

Chairman Catterall: No, let's not waste time on this.

Start all over again, Mr. Epps.

By Mr. Epps:

Q. You worked on the present application, didn't you? Didn't you help in the preparation of this present application which we are hearing?

A. I helped prepare certain parts of it.

Q. Of course you did. You would help in the preparation of an application for a change in a real estate assessment, wouldn't you? Isn't that part of your duties?

A. Yes, sir.

Q. Now, I understand your testimony to say that it is your opinion that cuts, grades, excavations, are included in the real estate assessment, is that correct?

A. They have been considered in the real estate values.

Q. Now, if that is in error, and not pursuant

page 1580 } to the statute which you and I have referred to, your remedy wouldn't be here today in this proceeding, would it?

A. I don't know.

Chairman Catterall: That's the end of that.
Judge Dillon: That is really the end.
Chairman Catterall: That's really the end.
You may stand aside, sir.
Do you have another question?
Mr. Epps: I have just one more.
No, sir; I do not have any more.

REDIRECT EXAMINATION

By Mr. Riely:
Q. Mr. Butler—

Chairman Catterall: You have another question?
Mr. Riely: Sorry.

By Mr. Riely:
Q. In answer to one of Mr. Shannon's questions, you said that you did not know of any place where a cut or fill on line had increased the value of a Norfolk and Western Real estate over the surrounding real estate, is that correct?
A. That's correct.

Mr. Epps: He already said he didn't know.
page 1581 } I was not allowed to pursue it. I think counsel should not pursue it.
Chairman Catterall: He is refreshing his memory.
Mr. Riely: I am not refreshing his memory a bit. But I am going to ask him now:

By Mr. Riely:
Q. You do not know that there are no such cases?
A. Right.

Mr. Riely: That's all I have from Mr. Butler.
Chairman Catterall: Now you may stand aside.

(Witness stands aside.)

Mr. Riely: If it please the Commission, I should like to point out for the benefit of counsel that the application in this case is broad enough to include an application for reassessment of the real estate values, too. It includes all of the physical property locally taxed.
Chairman Catterall: That is a legal question that I am

not prepared to agree with because this tax was a reassessment of the right-of-way, whatever you wanted to call it, the road bed. It did not involve anything outside of it.

Mr. Riely: I hesitate to contradict Your Honor.

Chairman Catterall: I am just saying for the record.

Mr. Riely: The application in this case includes all of the locally-assessed taxes, locally-levied taxes, in-
page 1582 } cluding real estate and everything else.

And, as I explained to you when—Your Honor may forget—back when this case first began, that is requisite because of the way the tax is spread back and forth among the various counties. So the application—

Chairman Catterall: I don't understand that the application—

Mr. Riely: We will read it sometime.

Mr. Foutz, please.

Whereupon, ROY E. FOUTZ, JR., having been previously duly sworn, was examined and testified upon his oath as follows:

DIRECT EXAMINATION

By Mr. Riely:

Q. State your name and address, please.

A. Roy E. Foutz, Jr., Roanoke, Virginia.

Q. What is your position, Mr. Foutz?

A. I am currently Assistant to Manager Insurance for the Norfolk and Western.

Q. What were your previous positions with the Norfolk and Western?

A. Following graduation from Virginia Poly-
page 1583 } technic Institute with a Bachelor of Science in Business Administration in 1954 and a half year of graduate school in 1956, I joined the Norfolk and Western as an employee in the Engineering Department where I was involved in engineering surveys and valuation work.

In 1962, I was transferred to the Office of Tax Commissioner in the Accounting Department where my duties included work in *ad valorem* taxation and insurance.

In 1964, I was transferred to the Taxation and Real Estate Department as a tax agent and continued my work in *ad valorem* taxes. I was transferred to my present position in 1968.

Roy E. Foutz, Jr.

Q. Were you directly involved in the appraisal of Norfolk and Western's land in Virginia by the State Corporation Commission personnel?

A. I was.

Q. Have you read the testimony on rebuttal of Mr. Butler in this case?

A. Yes, I have.

Q. Does your experience as to the practices of the Commission in including the value of grading in land assessments been the same as Mr. Butler's?

A. Yes. It has been my experience that Commission personnel examine the following factors in appraising the railroad's property:

page 1584

(1) Land values of adjacent property;

(2) Size and shape of right-of-way on fill, in cut, or on grade with;

(3) Access to property;

(4) Street frontage.

The improved industrial land to which Mr. Butler referred as a basis of comparison for the Norfolk and Western yard in Roanoke included American Viscose property and Virginia Bridge Company property, both large industrial sites in the Roanoke area.

Q. In your opinion, has it been the consistent policy of the State Corporation Commission to treat grading as a composite part of land value?

A. Yes.

Mr. Riely: I have no further questions of Mr. Foutz.

Mr. Shannon: Just several questions, Your Honor.

CROSS EXAMINATION

By Mr. Shannon:

Q. Mr. Foutz, did you write your testimony?

A. Yes, sir.

Q. I don't ask that facetiously, I simply ask you because I see your testimony is almost verbatim with the testimony of almost three or four other witnesses. Did you all collaborate together on it?

page 1585

A. No.

Q. You wrote yours separately?

A. Yes.

Roy E. Foutz, Jr.

Q. Now, my question is, on sheet three, you in reply to question: "In your opinion, has it been the consistent policy of the State Corporation Commission to treat grading as a composite part of land value?"—what do you mean by that?

A. Well, an example would by your West Roanoke Yard.

Q. Leaving out the yards—go ahead. I didn't mean to interrupt. I'm sorry. Go ahead.

A. Graded down the outside of the bank to grade with Shenandoah Avenue. The value of the land was increased because of this grading.

Q. Now, can you recall any instance, leaving aside your yards in Roanoke and Norfolk, where any railroad right-of-way has been increased in value because of cuts, excavations or fills that have been put in that right-of-way?

A. I don't know of any.

Q. You don't know of any?

A. No.

Mr. Shannon: That's all I have.

page 1586 } By Mr. Epps:

Q. Mr. Foutz, who is it that establishes this policy of the State Corporation Commission that you talk about on page three?

A. I suppose it comes out of Mr. Younger's office, I would guess.

Q. Is that what you mean, Mr. Younger's office?

A. Yes.

Q. You are not familiar with what should be taxed as part of the track property and what should be taxed as part of the real property, are you, under the Virginia law?

A. I have read the statute.

Q. You have read the statute?

A. Yes.

Q. You heard my inquiries of Mr. Butler, did you?

A. Yes.

Q. You would be able to answer the question that he couldn't answer?

Mr. Riely: I have forgotten what the question was, Mr. Epps.

Mr. Epps: You may have, but I am sure the witness hasn't.

Mr. Riely: object to that. If we don't know

page 1587 } what the question is, if Your Honor please, I ask that the question be asked again.

If necessary, I would like to vouch the record.
Mr. Epps: I was just trying to speed it up, Mr. Riely.
Mr. Riely: am in no hurry. I am here all summer.
Chairman Catterall: Can you ask if he disagrees with the testimony?

By Mr. Epps:
Q. Do you agree or disagree with the testimony of Mr. Butler?
A. I agree with his testimony.

Mr. Epps: That's all.
Chairman Catterall: You may stand aside and be excused.

(Witness stands aside.)

Mr. Riely: Mr. Crovo, please.

Whereupon, FRANK A. CROVO, JR., having been previously duly sworn, was examined and testified upon his oath as follows:

DIRECT EXAMINATION

By Mr. Riely:
Q. Mr. Crovo, state your name and address, please.
A. Frank A. Crovo, Jr., Richmond, Virginia.
page 1588 } Q. That is C-R-O-V-O?
A. Right.
Q. What is your position?
A. My present position is Assistant Comptroller of the Richmond, Fredericksburg and Potomac Railroad Company.
Q. How long have you been employed by the R.F.&P.?
A. Since September, 1957.
Q. Do your duties as Assistant Comptroller include responsibility in the property tax field?
A. Yes, I am charged with responsibility of representing the Comptroller before the assessing officers of the State Corporation Commission.
Q. In that regard, have you ever accompanied the assessors on field trips in connection with the reassessment of R.F.&P. property?
A. Yes. I have accompanied the Commission personnel on these reassessment trips since 1963.

Frank A. Crovo, Jr.

Q. Based on this experience, is it your judgment that the Commission appraisers, in arriving at the fair market value of you railroad's property, compare such propety to adjoining locally-assessed lands?

page 1589 } A. Yes. Consideration is given to topography as it relates to surrounding land. I am sure that the field notes and land maps of the Commission appraisers would support this statement. I have examined these notes and maps and seen such notations as: "on grade," "deep cut," "high fill," "low," and so forth.

Q. Has it been your experience that where an area has been filled, the land is appraised at a value comparable to adjoining land?

A. Yes. The R.F.&P.'s Potomac Yard in Alexandria, Virginia, is a good example. A portion of this yard was reclaimed from the backwaters of the Potomac River. Over the years through the process of filling and grading, this land has become useful for railroad purposes. Today, this land is comparable to adjoining land where no filling or grading has been necessary.

Q. If the grading of the Potomac Yard area had not been taken into consideration by the Commission appraisers in arriving at the fair value of the land, how would this area be appraised?

A. It would have to be appraised in its original state—that is, as a swamp.

Q. Is it your opinion that the value of grading has been consistently considered and taken into account by Commission personnel in arriving at the full value of

page 1590 } the R.F.&P.'s land for assessment purposes?

A. Yes.

Mr. Riely: I have no further questions of Mr. Crovo.

Mr. Shannon: Just several questions.

CROSS EXAMINATION

By Mr. Shannon:

Q. Mr. Crovo, I take it you wrote your testimony, too?

A. Yes, sir.

Q. Mr. Crovo, is it not true that in some cases along the R.F.&P., the land values have been reduced due to heavy fills?

A. Yes.

Q. Is it not a fact that in Alexandria, in a zone where the R.F.&P. crosses the Southern, the average appraised value of adjacent land was about $22,000 an acre but, due to a heavy fill, this was reduced by approximately two-thirds to $8,100 an acre for the entire zone?

A. I assume your figures are correct, yes.

Q. Is that correct, assuming my figures are correct here?

A. Right.

Q. Is it not a fact, Mr. Crovo, that in the City of Richmond, where the R.F.&P. has a deep cut under Monument Avenue, that is Monument and Grove Avenues, the value has been substantially reduced?

page 1591 } A. Yes.

Q. That it was raised, in fact, from $52,000—some odd an acre for land on grade to $100 an acre for land in the deep cut?

A. I couldn't support your figures, but it was reduced.

Mr. Shannon: That's all I have.

By Mr. Epps:

Q. Mr Crovo ,when did you form the opinion which you expressed on page three of your testimony?

A. That the grading is considered in the land values?

Q. Yes.

A. I couldn't say exactly. I have been under this impression since I have been with this company, these people.

Q. That is since 1963?

A. Yes, sir.

Q. And, if it was your opinion in 1963 that your corporation was being, as I understand you to say doubly assessed, did you report this to anyone?

Mr. Riely: If it please the Commission, I don't believe the witness said it was being doubly assessed.

Mr. Epps: I will go back.

By Mr. Epps:

Q. Are you familiar with the statute in this—

A. I have read it, yes.

page 1592 } Q. You know the statute requires the inclusion of cuts, fills and excavations for the track properties, don't you?

A. Yes, sir.

Q. And you knew that in 1963?

A. I wasn't as familiar as I am now.
Q. But that was part of your duties in 1963, wasn't it?
A. Yes, sir.
Q. Now, knowing those two, did you complain to anyone in 1963 when you formed this opinion that grading was being included in the land?
A. No.
Q. Don't you think you should have?

Chairman Catterall: That is an unfair question.
Mr. Riely: If it please the Commission, I don't believe the don't think that is a proper question to ask the witness.
Chairman Catterall: Very improper.
Mr. Epps: That's all.
Chairman Catterall: Stand aside, sir, and you may be excused.

(Witness excused.)

page 1593 } Whereupon, JOHN F. LEMON, being first duly sworn, was examined and testified upon his oath as follows:

DIRECT EXAMINATION

By Mr. Riely:
Q. Mr. Lemon, please state your name and address.
A. John F. Lemon, Richmond, Virginia.
Q. Where are you employed and what is your position?
A. I hold the position of General Accountant in the Tax Department of the Chesapeake and Ohio Railway. From October 1, 1960 to December 31, 1963, I held the position of tax investigator and was responsible for the administration of property taxes so far as C & O's properties in Virginia were concerned.
Q. During this time, did you ever accompany personnel of the State Corporation Commission on inspection trips for the purpose of reappraising C & O's land?
A. Yes, on numerous occasions.
Q. What were the general procedures employed by Commission personnel in making appraisals of your company's land?
A. The consistent procedure was to compare railroad-owned land with adjoining land.

In each instance, if our land was comparable to the unit value of the locally-appraised adjoining land, such value would be used in setting a value for the railroad land.

page 1594 } Q. Were adjustments from such adjoining land values made in cases where the railroad land was comparable?

A. Yes, consideration was given to access, size, shape and topography of railroad land as compared to adjoining land and an increase or reduction in value was made depending on whether the railroad land was superior or inferior.

Q. Did any Commission representatives ever inquire, as part of an inspection for reappraisal or otherwise, as to whether railroad land had been graded, filled, and so forth?

A. No.

Q. Did any Commission representatives ever inquire as to the condition of such land prior to any grading which might have been done?

A. No.

Q. Mr. Lemon, in your opinion, has it been a consistent policy of the State Corporation Commission to treat grading as a composite part of land value?

A. Yes.

Mr. Riely: I have no further questions of Mr. Lemon.

I point out that the text shows an error at the—

Mr. Shannon: I guess when he wrote that he put—

Mr. Riely: He didn't type it, Mr. Shannon.

page 1595 } CROSS EXAMINATION

By Mr. Shannon:

Q. Did you write your testimony?

A. I did not type it, no.

Q. I assumed that would be your answer.

Did you write it out in long hand and give it to Mr. Riely or did he submit a list of questions to you?

A. I had a typed one sent to Mr. Riely for him to have typed.

Q. Mr. Lemon, what is your definition of an appraisal?

A. An appraisal is to determine the value of land, whether it has been increased or decreased.

Q. It is an opinion, is it not?

A. An appraisal is an opinion?

Q. Yes.

John F. Lemon

A. Well, it would be a fact concerning comparable land, if you are talking about railroad land.

Q. Isn't judgment involved in it?

A. Yes.

Q. Is it not a fact that an appraisal is only as good as the integrity and experience of the person making the appraisal?

A. I would say, yes.

Q. Now, Mr. Lemon, does the C & O have a

page 1596 } line going through Charlottesville?

A. Yes.

Q. Isn't there a deep cut in there through the area adjacent to Rugby Road, through the area that goes through Rugby Road?

A. They have a cut through there but I can't recall exactly where it is.

Q. Is it not a fact, sir, that the railroad property has been assessed at a very low figure through there as a result of that cut, as compared with the adjacent property on Rugby Road?

A. It would be less now. I couldn't say whether it was low, very low, or not, without checking the records.

Q. You have never checked that?

A. I have checked it but it has been some time, so I would have to review it.

Q. You do know it is less?

A. I do know it is less.

Mr. Shannon: That' all I have.

By Mr. Epps:

Q. How long ago did you form your opinion which you wrote out on page three of your testimony?

A. On page three?

page 1597 } From the time that I became Tax Investigator.

Q. Which was how many years ago?

A. October 1st, 1960.

Q. Now, is it a part of your duty to understand and know the language of the taxing statutes and the statutes summing—

A. No, it was not, is not.

Q. Is it now?

A. As General Tax Accountant, it is not.

Q. You are not familiar with what the statute says with regard to where the cuts and fills and excavations should be?

Joseph C. Tate

A. We were following, as had been precedent, the job that, the man that I followed—this was a precedent we followed.
Q. You did it the way he did it before?
A. Yes.

Mr. Epps: I have no further questions.
Chairman Catterall: You may stand aside, sir, and be excused.

(Witness stands aside.)

Mr. Riely: Mr. Tate, please.

Whereupon, JOSEPH C. TATE, being first duly sworn, was examined and testified upon his oath as follows:

page 1598 } DIRECT EXAMINATION

By Mr. Riely:
Q. Please state your name and address, Mr. Tate.
A. Joseph C. Tate, Richmond, Virginia.
Q. Where are you employed and what is your position?
A. I hold the position of Tax Investigator in the Tax Department of the Chesapeake and Ohio Railway.
Q. What are your duties in that position?
A. I am responsible for administration of property taxes so far as C & O's Virginia properties are concerned.
Q. How long have you held this position?
A. Since January 1, 1964.
Q. During this time, have you ever accompanied personnel of the State Corporation Commission on inspection trips for the purpose of reappraising C & O's land?
A. Yes, on numerous occasions.
Q. What were the general procedures employed by the Commission personnel in making appraisals of your company's land?
A. The consistent procedure has been to compare railroad-owned land with adjoining land. In each instance, if our land was comparable to the unit value of the locally-appraised adjoining land, such value would be used in setting a value for the railroad land.
page 1599 } Q. Were adjustments from such adjoining land values made in cases where the railroad land was not comparable?

A. Yes. Consideration was given to access, size, shape and topography of railroad land as compared to adjoining land, and an increase or reduction in value was made depending on whether the railroad land was superior or inferior.

Q. Have any Commission representatives ever inquired, as part of an inspection for reappraisal or otherwise, as to whether railroad land has been graded, filled and so forth?

A. No.

Q. Have any Commission representatives ever inquired as to the condition of such land prior to any grading which may have been done?

A. No.

Q. Mr. Tate, in your opinion, has it been a consistent policy of the State Corporation Commission to treat grading as a composite part of land value?

A. Yes.

Mr. Riely: I have no further questions of Mr. Tate.

Chairman Catterall: There is a certain similarity between all these witnesses.

Mr. Shannon: I was just going to ask. I don't see what this—

page 1600 } Chairman Catterall: No use in cross examining the same evidence again and again.

Mr. Epps: I don't see any sense in putting on the same direct.

Mr. Riely: I want to make sure the record shows the same thing.

Mr. Epps: Does it take two C & O witnesses to say the same thing?

Mr. Riely: It takes two C & O because they—

Judge Hooker: Counsel and Commission ought to be familiar with the C & O Railroad.

Mr. Shannon: I am. I didn't know if it took two witnesses. When I came up, I could do it with one.

Mr. Riely: I am not, I am sorry to say, as good as Mr. Shannon.

Chairman Catterall: Can this witness go?

Mr. Shannon: I will ask him a couple of questions.

Chairman Catterall: Don't ask him when he made up his mind. That suggests that he was coached.

Mr. Shannon: I am not going to ask that, Your Honor.

Joseph C. Tate

By Mr. Shannon:

Q. Mr. Tate, you have been in this hearing room when I just asked Mr. Lemon a question about Rugby Road?

A. Yes, sir.

page 1601 } Q. Can you shed any light on that? Wasn't there substantial reduction in the value of the railroad land as compared to the adjacent land values along Rugby Road?

A. There was a reduction but I don't know whether it was substantial or not.

Q. You don't know?

A. No.

Q. You never made any attempt to find out before you came over?

A. No, sir.

Q. You say that these values are predicated on adjacent land. Don't you mean they make a comparison or determination of comparable land?

A. Of adjacent—

Q. Comparable adjoining. It might not be necessarily adjacent.

A. Yes, sir; I would say adjacent.

Q. Did they do that in the case of Rugby Road?

A. I am not sure.

Q. Well, didn't you just say that it was reduced?

A. It was reduced, yes, I think, I am sure it was reduced.

page 1602 } Mr. Shannon: I have no further questions of this witness.

By Mr. Epps:

Q. I take it you followed Mr. Lemon in the position he had before?

A. I did.

Q. Did you just continue doing the same thing he was doing or did you read the statute?

A. I have read the statute but I continued doing the same policy.

Q. When did you read the statute?

A. I couldn't say.

Q. Some time ago?

A. Yes.

Q. You are familiar with the fact that property accounts for property tax include excavation, cuts, and fills, aren't you?

Joseph C. Tate

A. Yes.

Q. And yet, it is your opinion that you have seen these items also included in the real estate assessment, is that your testimony?

Mr. Riely: I don't think he said, also, if the Commission please. I object to that question.

page 1603 } Chairman Catterall: The word "also" is stricken as improper—trying to trip the witness up.

Mr. Epps: Thank you, sir. I appreciate the compliment.

Judge Dillon: A privilege of cross examination.

Mr. Epps: That is what I thought, Judge.

By Mr. Epps:

Q. Knowing about the statutory language, you have also been of the opinion that these items are included in real estate assessment, is that your testimony?

A. No, not all of it, no, sir.

Q. Grading includes cuts, fills, excavations, doesn't it?

A. Yes, sir.

Q. The property accounts for taxation which we have been testifying about here includes those three items, specifically, by statute, don't they?

A. I believe so, yes, sir.

Q. And yet it is your opinion that they have also been included since the whole includes the sum of its parts in the real estate tax.

Mr. Riely: Again I object to the use of the word "also".

page 1604 } Chairman Catterall: The question—

Mr. Epps: There is nothing wrong with it there. I laid the foundation. I have got to express it in the English language.

Chairman Catterall: He says he knows that they are part of the track roadbed account. He knows that the statute makes them part of that account.

Mr. Epps: Yes, sir.

Chairman Catterall: His testimony is that they were included in a land account?

Mr. Epps: Yes.

Chairman Catterall: When you put the word "also" in, you are talking or trying to make the witness say he thought it was double taxation.

Mr. Riely: That is not the witness' testimony.

Chairman Catterall: That is not what the witness said.
Mr. Epps: All right.

By Mr. Epps:
Q. Is it your testimony that knowing these items were in the statute, that they had been included in the land assessment.

Chairman Catterall: That is exactly what all of these witnesses have testified to.
page 1605 } The Witness: I don't know.

By Mr. Epps:
Q. You don't know.
A. I couldn't say that.

Mr. Epps: I think you don't know, too.
Thank you, sir; that's all.
Chairman Catterall: You may stand aside and be excused.

(Witness excused.)

Chairman Catterall: We will recess for two hours, until 2:30, so that counsel can get together and shorten the testimony.
Mr. Riely: Ours is brief.
Chairman Catterall: Cross examination.
Mr. Riely: Let them get together.

(Whereupon, at 12:30 o'clock p.m., the luncheon recess was taken.)

page 1606 } AFTERNOON SESSION

(The hearing was resumed at 2:30 o'clock p.m.)

Chairman Catterall: Judge Dillon will be a little late. If anything new comes up, I will call it to his attention.
Mr. Carter: Planes don't fly in the mountains any more and the railroads don't have any passenger trains, either.
I thought I was going to have to ride the Pocohontas Arrow sometime in the next 48 hours to get down here.
Mr. Riely: Mr. Wilkerson.

J. I. Wilkerson

Whereupon, J. I. WILKERSON, being first duly sworn, was examined and testified upon his oath as follows:

DIRECT EXAMINATION

By Mr. Riely:

Q. Mr. Wilkerson, state your name and address, please.

A. J. I. Wilkerson, Richmond, Virginia.

Q. Please state the name of your employer and your position.

A. My employer is the Seaboard Coastline Railroad. I am the Tax Commissioner of that company.

page 1607 } Q. Does the handling of *ad valorem* tax matters in the State of Virginia for the Seaboard come under the jurisdiction of your position?

A. Yes.

Q. Have you ever accompanied State Corporation Commission personnel on appraisal inspection trips of Seaboard property?

A. Yes.

Q. As a result of such contacts with Commission personnel, have you formed an opinion as to the practice of Commission appraisers with regard to the treatment of grading and land values?

A. Yes. I have found that the consistent practice of the Commission is to consider the value of grading in arriving at the full value of Seaboard Coastline's operating land for tax assessment purposes. Consideration is regularly given to topography as it relates to surrounding locally-appraised land. I have found that railroad land values have been both increased and decreased because of the topography of our land as compared with that of adjacent property.

Mr. Riely: I don't know that you need to tell Commissioner Dillon here.

Chairman Catterall: He is familiar with this line of testimony.

page 1608 } Mr. Riely: That's all I have.

Chairman Catterall: He is also familiar with the cross examination.

Mr. Shannon: I should like to ask Mr. Wilkerson one or two questions.

Raymond W. Zinsli

CROSS EXAMINATION

By Mr. Shannon:
Q. Where do you find, Mr. Wilkerson, an instance or can you cite an instance, where the Seaboard Coastline property has been increased over comparable property because of topography?

Chairman Catterall: On the right-of-way, you are talking about?
Mr. Shannon: On the right-of-way, yes, sir.
The Witness: I don't recall of any specific instance where railroad property has been increased over locally-assessed or other adjacent properties.
I have found instances where property that has been improved through grading has been raised from what it was prior to the work being done on it.

By Mr. Shannon:
Q. Is that on the line of railroad?
A. Yes.
Q. Well, as I say, there have been a number
page 1609 } of instances where we have levelled land and filled it in to make a right-of-way or a roadbed, where the value per square foot or unit value used would have been increased because of improvements we put on it.
Q. Have you ever been asked by any of the Commission's assessors to furnish you with costs as to grading, cuts, fills, or excavations?
A. No.

Mr. Shannon: That's all I have.
Chairman Catterall: You may stand aside and be excused.

(Witness stands aside.)

Mr. Riely: Mr. Zinsli, please.

Whereupon, RAYMOND W. ZINSLI, being first duly sworn, was examined and testified upon his oath as follows:

DIRECT EXAMINATION

By Mr. Riely:
Q. Please state your name and address.

Raymond W. Zinsli

A. Raymond W. Zinsli, Stone Mountain, Georgia.

Q. What is your position?

page 1610 } A. I am employed as a tax agent by the Southern Railway System.

Q. When did you join Southern?

A. I entered the service of the Southern as assistant tax agent in 1950 and was assigned to duties with the tax agent in charge of Virginia tax matters.

In 1953, I was promoted to tax agent and since that time my duties have included Virginia tax returns and other aspects of Virginia taxes.

Q. Have you ever accompanied Virginia State Corporation Commission personnel on appraisal inspections of Southern's lands and buildings in Virginia?

A. Yes, on many occasions.

Q. Have you formed any opinion as to the practice of the Commission in appraising such property?

A. Yes. The Commission has consistently applied locally-appraised values of surrounding land as a basis or guideline figure for establishing unit values of Southern's lands.

Q. Did such local values include the value of grading?

A. The local values take into consideration all conditions affecting use of the land, including grading.

Q. What factors did the Commission's appraisal take into consideration?

page 1611 } A. Analysis of a parcel of land including general elevations, access and street frontage, draining and flood problems, cuts and fills, and the size and shape of the parcel. The relationship of these elements to comparable locally-appraised parcels served as a basis for the determination of unit values for Southern property.

Q. Are there any areas in Virginia in which grading has significantly increased the land value of Southern property?

A. Yes. In Alexandria, in particular, Southern has areas substantially improved by filling, and, as filling has progressed, assessed values have increased because of such fillings.

Gradings also enter into the valuation of some of our land in Richmond. However, this increased value has been largely mitigated by adverse zoning.

Mr. Riely: I have no further questions of Mr. Zinsli.

Russell D. Tipton

CROSS EXAMINATION

By Mr. Shannon:

Q. Mr. Zinsli, you referred to this land in Alexandria—

A. Yes, sir.

Q. —the Southern has substantially improved by filling. Is the property mentioned in Alexandria, is that leased out?

A. It is used by the City as a land fill project.

Q. Is the City filling in that land?

page 1612 } A. Yes, sir.

Q. Is the Southern Railway paying the City to fill it?

A. No, sir.

Q. You are getting it filled in free?

A. I believe Southern pays a lease rental on that property. I believe the City pays a lease rental to Southern on that property.

Q. Is it also a fact that once property is leased out under the ICC Uniform System of Accounts, it must be transferred to the status of a non-carrier property, isn't that correct?

Mr. Shannon: That's all I have, Your Honor.

Chairman Catterall: Stand aside. You are excused.

(Witness stands aside.)

Mr. Riely: Mr. Tipton, please.

He has been on the stand.

Whereupon, RUSSELL D. TIPTON, having been previously duly sworn, was examined and testified upon his oath as follows:

DIRECT EXAMINATION

By Mr. Riely:

Q. Mr. Tipton, will you briefly tell us what the purpose of your rebuttal testimony is?

page 1613 } A. Yes. My rebuttal testimony will be directed to two subjects:

First, I would like to clarify any possible confusion as to what the study previously introduced as Exhibit 2-RDT was directed to show.

Second, Witness Garrett in his testimony, called attention

to the procedure used in the preparation of that exhibit which he believed produced a less accurate result than an alternative procedure which he suggested.

Chairman Catterall: Exhibit 3-RDT will be received.

Mr. Riely: It has not been offered yet, Your Honor.

Chairman Catterall: I thought the Witness was talking about it.

(The document referred to was marked Exhibit 3-RDT, and received in evidence.)

By Mr. Riely:

Q. For purposes of clarification, will you explain again the purpose of the study introduced as Exhibit 2-RDT, particularly the part of it headed "Schedule 2—Norfolk and Western Railway Company—Original Cost—State of Virginia"?

A. This schedule is a computation made pursuant to the request of Mr. Younger that Norfolk and Western

page 1614 } supply him with the cost of the track property actually now in place in Virginia. In order to do this, it was necessary to prepare a restatment of the amount shown on the books or in the annual reports to the State Corporation Commission because of the fact that the track accounts of railroads are not subject to ratable depreciation under ICC accounting but are depreciated under retirement-replacement method.

This means that the book balances do not necessarily represent the cost of the items now in place. To determine the investment in the assets presently in the track, a separate computation is required and Schedule 2 of Exhibit 2-RDT was directed towards that purpose.

Q. A calculation was prepared then showing the investment or cost in the track accounts as it would have been for the property now in place in the track structure if railroads had followed the more usual ratable method of depreciation?

A. That is correct. The results shown on Schedule 2 of Exhibit 2-RDT represented the cost of the property in the track structure recomputed as if these assets had been depreciated like the assets of a non-railroad company. Depreciation was then accrued on these accounts to determine the depreciated cost of the assets now in place in the track structure.

Q. Did this calculation seek to show the re-

page 1615 } production cost of these assets?

Russell D. Tipton

A. No. According to my understanding, Mr. Younger did not request the reproduction cost of the assets and I was not instructed to make a determination of the reproduction cost. Instead, my instructions were to review a calculation of the actual cost of the assets in place in the track structure in Virginia, and that is what I did.

Q. To determine reproduction cost, then, a completely separate calculation would have been required, is that correct?

A. Yes, the determination of reproduction cost would have been a totally different undertaking and I was not instructed and did not attempt to make such a calculation.

Q. Has a revision now been made of the computation of the actual cost of the track property in Virginia?

A. Yes.

Q. And is that revised statement shown in Exhibit 3-RDT?

A. Yes.

Mr. Riely: That, I believe, has been admitted into evidence, I believe, Your Honor.

By Mr. Riely:

Q. Why was this revised calculation made?

A. Mr. Boyd E. Garrett, a witness for the State Corporation Commission, called attention in his testi-
page 1616 } mony to the fact that in making the original calculation of the cost of track property shown in Exhibit 2-RDT, in seeking to restate the cost of assets to uniform 1910-1914 dollars before trending to values for the appropriate years of acquisition of the assets in place, net additions were trended back to the accounts for years following the 1916 engineering report base year rather than trending back additions and retirements separately.

Q. Do your papers show this change in greater detail?

A. Yes. The work papers show the method of determining the figures which appear in Exhibit 3-RDT. The calculation begins with the amount shown for the track account assets in the basic engineering report for the Norfolk and Western. To this basic figure, which represents the cost of the property in place in 1916, must be added additions made subsequent to that time and requirements after 1916 must be recognized.

Under ICC procedure for making computations like this, it is customary to trend the additions subsequent to 1916 back according to indices prepared by the ICC. This procedure produces an amount representing the total assets in

the track structure price at 1910-1914 dollars. These uniform dollar figures are trended, as shown, based on ICC index figures, up to the appropriate date. This is the basic procedure followed in calculating the cost of assets

page 1617 } now in the track as shown in Exhibit 3-RDT.

Q. How does Exhibit 3-RDT differ from previous calculations which, I believe, followed the same general procedures.

A. They have been changed pursuant to the suggestion made by Mr. Garrett in his testimony that additions and retirements subsequent to 1916 should be trended back separately rather than being netted before the trending index is applied as is done in the old exhibit. Thus, as the work papers show, additions after 1916 have been trended back to 1910-1914 dollars separately. Then, for retirements, a division has been made between retirements of assets which were present in 1916 when the engineering report was made and retirements of assets acquired later.

The former, since they are recorded in 1910-1914 prices, in any event do not need to be trended back to 1910-1914 prices but have been deducted separately from the engineering report. Assets retired which were not engineering report assets have been trended back to 1910-1914 prices, according to their year of acquisition and then deducted.

Q. This change then has been made in conformity to the suggestion of Mr. Garrett?

A. That is correct. It follows Mr. Garrett's suggestion.

Q. What is the total amount of the actual cost

page 1618 } of the assets in place in the track structure in the State of Virginia as now amended pursuant to Mr. Garrett's suggestion?

A. Before depreciation the original cost of these assets computed with Mr. Garrett's suggested change amounts to $149,243,440. This compares with an original cost previously computed without the refinement proposed by Mr. Garrett of $187,985,461.

Q. In other words, the original cost as computed based on the corrected procedure suggested by Mr. Garrett, is some $38,742,021 less than the original cost which was originally calculated?

A. That is correct.

Q. What is the total depreciated cost of the assets actually in place in the track structure after this correction?

A. The total depreciated cost of the assets now in place is $73,331.063. This compares with the previously-calculated

depreciated cost of $92,702,077 and thus reflects a reduction of $19,371,014.

Q. And the depreciation has been calculated as previously discussed in your testimony?

A. That is correct.

Q. Have you reviewed the revised calculations on which the determination of the actual cost of the as-

page 1619 } sets in place in the track accounts is based?

A. Yes. My accounting firm has reviewed the procedures and mathematical computations used in trending the engineering report plus additions less retirements and in my opinion, subject to the accuracy of the records of Norfolk and Western, Exhibit 3-RDT shows the cost of the track account assets of the Norfolk and Western in Virginia computed in accordance with the procedures suggested by Mr. Garrett.

Mr. Riely: I have no further questions of Mr. Tipton.

CROSS EXAMINATION

By Mr. Epps:

Q. On page four of your testimony, you indicate that your testimony in chief was not accurate, don't you?

A. I am sorry, sir; what is the reference?

Q. Page four.

A. What is the question?

i'm sorry; I don't understand that my testimony in chief—

Q. You have testified here before?

A. Yes.

Q. You are now changing that testimony?

A. No, sir.

Q. You testified in your testimony here today, as I understand it, that you are changing your

page 1620 } figures to adopt Mr. Garrett's suggestion, isn't that correct?

A. This calculation is made to comply with the suggestion of Mr. Garrett, yes.

Q. So to that extent you are amending your previous testimony, is that not correct?

A. I wouldn't state it that way. I believe my original testimony stands. This is additional testimony to give effect to the suggestion made by Mr. Garrett.

Q. You come up with a different figure?

A. Yes, sir.

Q. Which is the correct figure?

A. In my opinion, the previous presentation is the more reasonable result.

Q. Then why did you come in with this testimony?

A. This is rebuttal testimony to bring attention to the comment made by Mr. Garrett that his suggested method would produce a more accurate result in the calculation.

Q. You don't agree with that answer?

A. I don't agree with that.

Chairrman Catterall: That ought to be the end of this.

Mr. Epps: I would think that maybe we ought to strike this evidence.

page 1621 } Mr. Riely: I should say not.

Chairman Catterall: It may not rebut previous testimony but he says he doesn't want to—

Mr. Riely: He came in to rebut Mr. Garrett's testimony whose implication was, if we used his way, the figure would be a lot higher. This testimony is to show the—

Mr. Epps: I don't think that Mr. Garrett said that he said it was inaccurate. He said Mr. Garrett was inaccurate.

Mr. Riely: If the Commission prefers to choose Mr. Garrett rather than Mr. Tipton who has had that opportunity, and should take advantage of what the figures are, but Mr. Tipton says that in his opinion, his original method is more accurate than Mr. Garrett's.

Chairman Catterall: I see. Certainly the testimony that he gives here appears to say that $73 million is the right figure and 92 is the wrong figure. There is no other possible conclusion.

Mr. Riely: He just said he didn't give that testimony. He said that $73 million is the gospel according to Garrett.

Chairman Catterall: I know. But here he comes—

Mr. Riely: He doesn't think that is right.

Chairman Catterall: He has reduced it from

page 1622 } $92 million to $73 million. In accordance with Mr. Garrett's views which counsel in asking these questions always said, Mr. Garrett's corrected views, certainly suggested that they were offered as correct views.

Mr. Riely: Mr. Garrett offered them as corrected views, but Mr. Tipton says he doesn't agree with them.

Chairman Catterall: I think you don't need to cross examine this witness any more.

Mr. Epps: I would like to ask him this suggestion, then.

By Mr. Epps:

Q. You say you adopted Mr. Garrett's suggestion, but I ask you, it is true, is it not, you only adopted a part of his suggestion because Mr. Garrett said this should be expressed in 1967 dollars, didn't he?

A. As I recall Mr. Garrett's testimony, when he was referring to my exhibit, he commented on the fact that my exhibit too, in his opinion, should have been computed in this manner.

Q. Didn't he further say that to determine the cost figures they should have been expressed in 1967 dollars? That was his testimony?

A. I don't recall that Mr. Garrett said that.

page 1623 } Q. Well, if he did say that, then you have adopted only a portion of his suggestion, isn't that correct?

A. If he said that, yes.

Q. So you adopted only that portion which would show a reduction in the overall dollar figure, didn't you?

A. This calculation is directed at arriving at original cost, not at reproduction cost.

Q. I don't want to accept that as being responsive.

Chairman Catterall: The question contained the word "reduction". Maybe you understood him to say reproduction.

Mr. Epps: I said, "reduction," not reproduction.

The Witness: Could you state the question again?

(The reporter read the question referred to.)

The Witness: I believe I adopted Mr. Garrett's suggestion, his comments, on Exhibit 2-RDT.

By Mr. Epps:

Q. Now, when you take this average life cycle, you don't take that in dollars, you take it in years, don't you?

A. Average life cycle?

Q. Yes, sir.

A. In years, yes, sir.

Q. You subtracted from the latest year and get a mid point. That is what you did, isn't it?

page 1624 } A. That is correct.

Q. You are not averaging dollars when you do that? You are averaging years, isn't that correct?

Russell D. Tipton

A. It is the mid point in the life cycle of the year, yes, sir.

Q. If you had averaged dollars during that period, you would have reached a higher figure, wouldn't you?

A. Not necessarily so.

Q. Let's assume this: wouldn't it have been more accurate to have taken the indices for each year during the life cycle and averaged these indices and come up with a present valuation, so that you would have some '67 dollars and '66 dollars as well as '51 and '52 dollars?

A. The method followed should produce a result very similar to the method you are suggesting.

Q. But the method that I suggest would undoubtedly have been more accurate since the end result is dollars, isn't that correct?

A. When you say "more accurate," working with additions over a life cycle, it would depend entirely on the rate of additions in each year of the life cycle.

If, for example, there were more than 50 percent of the assets, replaced in the first half of the cycle, and less than 50 percent replaced in the second half of the cycle, the result would come up with a lower number than what this method does.

page 1625

Q. Yes, but that is equally true in the case of accepting years, over the life cycle, as well as dollars, then?

A. We are mixing two things, units and dollars.

Q. Let me put it this way: the purport of my question is this:

You point out to a possible inaccuracy of these averages over the life cycle?

A. Yes, sir.

Q. But that same possible inaccuracy comes from theory of adopting the center year of a life cycle? You assume in such adoption that you have got as many afterwards as you have got before?

A. Yes, statistical average.

Q. So your assumption would be the same as my assumption, isn't that correct?

A. I believe so.

Q. So that if you actually use dollars, you would be more accurate because we are making the same assumption as to life cycles, aren't we?

A. I wouldn't say.

Q. Why didn't you use indices instead of going back to '51 and '39 and '49, and so forth?

page 1626

A. Well, it is an accepted statistical premise to use the average life in making a computation.

Q. Even if you accept that, you still would come up better if you used dollars expressed in 1955 or '52 or '39, as the case may be?

A. That would depend upon the degree of change in the indices in each one of the individual years, both before and after the midpoint. You could come up with exactly the same argument.

Chairman Catterall: Are you saying that a pure average is more significant than a weighted average? Is that what you are getting at?

The Witness: As I understand Mr. Epps, he is talking about averaging the dollars.

Chairman Catterall: He is talking about a weighted average, if I understand him.

Are you talking about a weighted average?

Mr. Epps: No.

What he has done, his testimony is that in the case where you have, say, a 30-year life cycle, you go back 15 years from 1966 and say you get the year 1951; and he is using 1951 dollars for the present value of the property in that particular account. I am suggesting to him rather than take 1951 dollars as the present value, he should have taken his life cycle and averaged the indices over the life cycle, the 30 years which I have suggested, each year, and would have come up with a closer to the 1967 dollar figure than if he expressed his testimony in 1951 dollars, as in the case which—

page 1627

Mr. Riely: I wonder if Mr. Tipton could say whether he agrees with your position.

Mr. Epps: I am trying to get him to say whether he does or not.

The Witness: First I would like to dispel the notion of present value which Mr. Epps is using. This is directed to that.

By Mr. Epps:

Q. I am talking about the original cost in present dollars.

Chairman Catterall: That is a contradiction in terms.

By Mr. Epps:

Q. Go ahead, sir.

A. Using the actual index for each year of additions versus the average of the midpoint in theory would present the same results.

page 1628 } I did a little informal calculating of my own one night and I came up with about the same result using the method you suggested.

Q. Did you work it out and test it against the midpoint theory?

A. Yes, sir.

Q. Actually, it works out to some $20 million more, doesn't it?

A. I said, I merely made a test on one small portion of the analysis. I did not make a test.

Q. Didn't I understand you to say you made an overall test?

A. No, sir.

Q. It did come out greater, though, didn't it?

A. No, sir; I don't recall. I recall that it was very close.

Q. Now, assuming that we would like to do the arithmetic for the calculation which I have just shown you, we could use the indices shown in your Exhibit 17 and make an arithmetical calculation, couldn't we, on an average?

A. What is Exhibit 17?

Q. That is your—have you got your testimony in chief there?

Mr. Riely: Those are the original work papers.

page 1629 } Can you find Exhibit 17?

Mr. Epps: It is prepared by Mr. Tipton.

Mr. Riely: Let us let Mr. Tipton have a look at it.

Mr. Epps: I would like him to.

The Witness: Would you read the question, sir?

(The reporter read the question referred to.)

The Witness: Yes.

Mr. Epps: No further cross examination.

Mr. Shannon: No questions.

Mr. Riely: Excuse me, sir.

Chairman Catterall: Do you have another question?

Mr. Riely: Yes, sir.

REDIRECT EXAMINATION

By Mr. Riely:

Q. If you used the averaging of indices, your result would

be affected by the various different variations in investments by years, would it not?

A. Yes, sir; it would.

Q. Now, if you used the 1967 prices, as Mr. Epps suggested, what would you come up with? 1967 price indices—what would you have come up with?

A. If we used the 1967 index, we would have a higher result.

page 1630 } Q. What would it be? I don't mean in dollars. Would it be original cost?

A. It would not be original cost.

Q. What would it be?

A. It would be reproduction cost.

Mr. Riely: Thank you. I have no further questions.

RECROSS EXAMINATION

By Mr. Epps:

Q. Mr. Tipton, if you used the 1967 figures, and '66 and '65, over the period you would come up with the same approach which you have in your original Exhibit 17, wouldn't you?

A. Yes, sir.

Mr. Epps: That's all.

Chairman Catterall: Now you may stand down.

(Witness stands down.)

(The testimony of Howard J. Brinner on Direct Examination in Rebuttal is reproduced as though Mr. Brinner were present in person and examined by Mr. Riely.)

TESTIMONY OF HOWARD J. BRINNER ON DIRECT EXAMINATION IN REBUTTAL

DIRECT EXAMINATION

By Mr. Riely:

Q. State your name and address, please.

page 1631 } A. My name is Howard J. Brinner. My address is Roanoke, Virginia.

Q. What is your current position?

Howard J. Brinner

A. I am Comptroller of the Norfolk and Western Railway Company.

Q. Will you briefly state your educational background, *experience* and professional associations.

A. I attended the University of Illinois from 1932 until 1934 when I moved to Washington, D. C. to work for a public accounting firm. While in Washington, I also attended Southeastern University where I received a Bachelor's degree in 1936 and a Master's degree in 1940. Except for wartime service, I was engaged in public accounting work in Washington until 1951 when I was employed by the Accounting Department of the Norfolk and *Westerns* as Assistant to Comptroller. I became Assistant Comptroller in May, 1957, Deputy Comptroller in April, 1962, and was appointed Comptroller in July of 1966.

I am a Certified Public Accountant and a member of the American Institute of Certified Public Accountants, the Virginia Society of Certified Public Accountants, the Accounting Division of the Association of American Railroads and the National Association of Accountants.

Q. What is the purpose of your rebuttal testimony?

page 1632 } A. The purpose of my testimony is to confirm the data which is the basis of the information introduced by Mr. Tipton in his Exhibit 3-RDT which was used in the determination of the actual cost of the assets presently in the track structure of Norfolk and Western in Virginia as shown in that exhibit.

Q. What information was used in making the calculations which are the basis of Exhibit 3-RDT?

A. The basic valuation records of the Norfolk and Western, including the records of the Virginian Railway which was acquired by the Norfolk and Western through merger in 1959.

Q. Are these records maintained under your supervision?

A. Yes. It is my responsibility to maintain accurate accounting and valuation records for the Company, including those used in preparing that exhibit.

Q. Are you familiar with the records used in preparing Exhibit 3-RDT and can you describe them?

A. Yes. The starting point of the exhibit is the basic Engineering Report prepared by the Interstate Commerce Commission which reflects the value of property in the track structure as of 1916 (based on 1910-1914 prices). In addition, the exhibit uses additions to the tract structure and retirements from the track structure subsequent to the En-

gineering Report as recorded in the basic valuation records of the Company.

page 1633 } Q. Have you reviewed the accuracy of the figures used in that computation?

A. Yes. I have reviewed the figures which were relied on in computing the cost of Norfolk and Western track account assets in place, and they accurately reflect the additions and retirements from the track structure made subsequent to 1916. The values in the Engineering Report which shows the property in the track structure as of 1916 were, of course, established by the Interstate Commerce Commission.

Q. In summary, then, have all the basic figures used in preparing Exhibit 3-RDT including the related work papers been reviewed by you to insure that proper figures were used as a starting point in the calculation of the actual cost of Norfolk and Western account assets?

A. That is correct.

Q. Mr. Brinner, there is evidence in this record (Exhibit LBY-H) that Norfolk and Western recovered $68,373 in salvageable material when it retired a 5.7 mile segment of its Blacksburg Branch. Has that figure been reduced by the cost of recovering the material in the abandoned portion of the branch line?

A. No.

Q. Do you know the actual cost of recovering that material?

page 1634 } A. Yes. Our records show that a total of $21,905.92 was charged to expense as the cost of recovering the material in the abandoned portion of the Blacksburg Branch.

page 1635 } Mr. Riely: Mr. Maynard.

Whereupon, ARVIE L. MAYNARD, being first duly sworn, was examined and testified upon his oath as follows:

DIRECT EXAMINATION

By Mr. Riely:

Q. Mr. Maynard, please state your name and address.

A. Arvie L. Maynard, Huntington, West Virginia.

Q. Please state your experience in the railroad industry.

A. My first railroad position was an an apprentice machinist on the B & O in 1943. I became a signal helper on the B & O in 1944.

Arvie L. Maynard

I served in the United States Army during the period 1944-1947 and left active service as a First Lieutenant in the Corps of Engineers.

During the period 1947-1948, I served as Assistant Signalman and Signalman on the Baltimore and Ohio.

I received the degree of civil engineer from the University of Cincinnati in 1953.

From 1953 to 1955 I was Assistant on Corps with the Baltimore and Ohio. During that time I made track, roadway and property surveys. I made situation
page 1636 } surveys and testified to their accuracy in court cases and public utility hearings. I also designed track layouts and prepared estimates.

During the period 1955-1960 I was Assistant Division Engineer with the Baltimore and Ohio, and I assisted in directing division track and structures maintenance.

During the period 1960-1961, I served as maintenance engineer and was in charge of construction forces completing installation of a new classification rail yard at Cumberland, Maryland. I worked with a system committee consisting of representatives from several departments analyzing operations and making cost reduction recommendations.

From 1961 to 1965 I was a division engineer with the Baltimore and Ohio on the Pittsburgh Division. I was in charge of division track and structures maintenance and construction and I administered the budget allotted to the division for engineering maintenance. I supervised engineering corps in preparation of plans and estimates and directed their field itinerary.

From 1965 to 1966 I was Engineer, Roadway and Track, with the Baltimore and Ohio. I supervised planning and preparation of systemwide yearly track work maintenance programs. I directed rail welding plant operations and system rail laying gangs. I directed general track supervisors and general forement working systemwide with
page 1637 } local production units. I drafted standards, procedures and policy concerning track work and coordinated delivery of track work material.

During the period 1966 to 1968 I was Engineer, Bridges and Buildings, Construction and Maintenance for the Chesapeake and Ohio-Baltimore and Ohio Railroads. I was in charge of systemwide maintenance of railroad bridges and other structures and construction when done by company forces. I supervised preparation of yearly maintenance program and budget requests and administered subsequent im-

plementation. I directed activities of system bridge and tunnel gangs. I established policies on work methods and procedures, force organization and materials used by division structures forces.

In April, 1968, I left the C&O-B&O and joined DeLeuw, Cather & Company as a civil engineer. During my employment by DeLeuw, Cather I worked on a track work study for the Washington, D. C., rail rapid transit system and provided daily direction and supervision of DeLeuw, Cather's valuation appraisal of roadway items of the Norfolk and Western's lines in the State of Virginia, including collection of basic data from company records, on-site inspection of all trackage in Virginia and preparation of charts and tables presenting the results of the study.

page 1638 } In February of this year, I returned to the C&O-B&O as Special Engineer and am currently employed in that position. My duties have included compilation and consolidation of instructions and standard procedures for combined C&O-B&O Maintenance of Way personnel. I have also been working on a study of the company's rail needs for purposes of budget planning.

Q. Mr. Maynard, then may I assume that you are familiar in detail with the testimony of Mr. Caywood as presented in this case?

A. Yes, I am.

Q. And are you also familiar with the testimony of other witnesses in this case, particularly Mr. E. Q. Johnson, Mr. Kenneth Dunn, Mr. Harold Howland and Mr. Lee Younger?

A. Yes, sir. I have read the direct testimony of these witnesses and was present when these gentlemen were cross-examined.

Q. Mr. Maynard, do you find any point with which you would disagree with Mr. Caywood's testimony or with the methods of valuation adopted by DeLeuw, Cather in response to the Norfolk and Western's request to that organization?

A. No. As a matter of fact, I participated fully in the design of this study and was in constant communication with Mr. Caywood on this project.

page 1639 } Q. During the course of DeLeuw, Cather's valuation appraisal, how much time did you spend on the Norfolk and Western property and how much of its track structure in the State of Virginia did you examine?

A. I was involved full time on this project for a period of six months. About one-half of this time was spent examining

the Norfolk and Western track structure in Virginia. I personally covered Norfolk and Western property at Norfolk Terminal, portions of the line between Crewe and Roanoke, and virtually all lines South and West of Roanoke, and I supervised the personnel handling the remaining mileage.

Q. There is one thing I would like to clear up at the beginning, Mr. Maynard. Opposing counsel in this case have on more than one occasion implied that DeLeuw, Cather did not determine on "in place" value of Norfolk and Western track structures and appurtenances. Do you feel this is a fair characterization of your valuation?

A. No, sir. We made every attempt to value this property on the same basis that a knowledgeable buyer would make a decision as to what he would pay for it. For example, we knew that a price of $2.00 per tie f.o.b. in cars on the Norfolk and Western was the top price to be expected from a broker in used ties. If ties are in cars, they are not "in place." Therefore, we reduced this $2.00 figure

page 1640 } by 81 cents, the calculated cost of removing a tie from single track. This left a value of $1.19 and this is the value of that particular tie in place. A buyer, in deciding how much to pay for a given tie, would certainly have to follow the same procedure—calculate the value of the tie removed from the track and reduce that figure by the cost of removal.

Q. Mr. Maynard, in addition to your original field work for DeLeuw, Cather on this project, you also accompanied Mr. Dunn and Mr. Howland on their brief tour in Virginia, did you not?

A. Yes.

Q. Then you observed their sampling methods and heard them testify to those methods earlier in the proceeding?

A. Yes.

Q. I believe Mr. Howland testified on cross-examination (Transcript page 889) that there could be a substantial difference in the accuracy of determining condition percent between the methods used by Mr. Dunn and Mr. Howland and the methods used by DeLeuw, Cather. Do you agee with that opinion?

A. I certainly do.

Q. Then you believe that DeLeuw, Cather's methodology would produce more accurate results or less accurate results?

A. More accurate results, definitely.

Q. Since you accompanied Mr. Dunn and Mr.

page 1641 } Howland, I would like to solicit your opinion

as to the extent to which these gentlemen examined the spur branch lines, side tracks and yard tracks of the Norfolk and Western. Do you think a fair sampling was made of this type of trackage?

A. No. In the eight days in which we were on the road, we stayed on main line track almost the whole time. We did make brief examinations of some yard tracks in Roanoke, but as a general rule, the secondary lines of the company were viewed, if at all, from the switch at the main line and while passing by in a hyrail car at speeds up to 40 and 50 miles an hour.

Q. What effect would this procedure have on Mr. Dunn and Mr. Howland's findings, in your opinion?

A. It could not help but distort the overall condition percent determined by these gentlemen—particularly as to Rail and Other Track Material. The lines on which they actually travelled and those which they inspected firsthand are the very best lines of the Norfolk and Western. They are heavily travelled and naturally are well maintained relative to the trackage on the lines which were not examined. Side and yard track comprise almost 40 percent of the total Norfolk and Western trackage in Virginia.

Q. Would any such distortion produce a higher or lower condition percent than is warranted by the overall condition of Norfolk and Western's lines?

page 1642

A. The distortion would produce a higher condition percent than is warranted.

Q. Mr. Howland rated tunnels at a condition of 80%. In your opinion, was the method used by Mr. Howland for inspecting tunnels satisfactory?

A. I would say it was not at all satisfactory. In the first place, they didn't stop at a single tunnel. It is very difficult to determine anything about the condition of a tunnel, or of a house or car or anything else for that matter, while moving at 25 miles an hour. Even if you could make a valid inspection while on the move, you can't value what you can't see, and the headlights of a hyrail car provided no illumination of the ceiling or arch of the tunnel and a minimum illumination of the tunnel walls. In addition, because of this "moving" inspection, by the time our eyes became accustomed to the darkness of the tunnel, we were practically out of it.

Q. Mr. Maynard, you observed Mr. Howland and Mr. Dunn's examination of rail. How would you compare the methods used by these gentlemen with the methods you used in the DeLeuw, Cather study?

Arvie L. Maynard

A. Their failure to take physical measurements of any kind is a definite and significant omission in
page 1643 } their method and makes their findings unreliable. In cases of extremely worn curve rail, mere visual observation may be sufficient to indicate that rail is very near the end of its useful life.

Q. Now, Mr. Maynard, I hand you two objects that are tied together by a rubber band and ask you if you can identify them?

Mr. Shannon: Your Honor, I am going to object to this. I think this is the same object, if I am not mistaken—at least it looks like it—that Mr. Riely endeavored to put into the record at the initial phase of this hearing.

Chairman Catterall: I believe he kept it because we didn't have anywhere to store it.

Mr. Riely: I don't believe that was the reason. I didn't have a witness to identify it. Now I have a witness.

Mr. Shannon: You had Mr. Caywood. I don't know whether he was competent to identify it. This is the same piece of metal.

Mr. Riely: This evidence is very relevant to a discussion of what Mr. Howland and Mr. Dunn did, if Your Honors please.

Chairman Catterall: Let's hear and decide after we hear it what to do with it.

Mr. Carter: What do you have?

page 1644 } By Mr. Riely:

Q. What is it, Mr. Maynard? Tell us what it is.

A. Two pieces of metal here. The larger piece, the higher piece of metal, is a template, the same size as the 131-pound rail in cross-section. The second piece of metal in front of the template is a piece of curve-worn rail and, as I said in my testimony, curve-worn rail can be observed as nearing a totally unusable condition.

Q. Where did that come from, that section?

A. This section of rail was taken from the main track at milepost—eastbound main track at milepost 361.6 on the Hendrin Mountain on the New River Division. It is a piece of 132-pound RE rail. It was rolled in 1953.

Mr. Riely: Now, if it please the Court—

Chairman Catterall: How did you get it out of the railroad?

The Witness: Sir, I, of course, didn't get it out of the railroad. The Norfolk and Western removed this rail from track because it was worn beyond structurally sound limits.

Chairman Catterall: That was rail that had been rejected at all?

The Witness: It is rail, when they removed it from the main track at the end of its useful life, they

page 1645 } took a slice out of it to show the wear.

Chairman Catterall: That is a rail that is no longer usable?

The Witness: Yes.

Chairman Catterall: Couldn't even use it for a side branch line?

The Witness: With heavy loaded cars, that rail is worn to the limits. It wouldn't be structurally sound at any appreciable load.

Chairman Catterall: For any railroad purpose?

The Witness: I wouldn't use it, no, sir.

Chairman Catterall: It would have scrap value only?

The Witness: Yes, sir.

Chairman Catterall: Go ahead.

By Mr. Riely:

Q. All right, sir. That rail is from curved track, is that correct?

A. Yes.

Q. How about tangent rail?

A. However, most rail in tangent track will normally fail due to fatigue with little headwear.

Metal fatigue, of course, is largely a function of tonnage carried on the rail. It becomes very important

page 1646 } then to consider tonnage which has moved over tangent rail in order to determine its present condition percent. The slight headwear which tangent rail undergoes relates to the traffic moved over the rail.

Q. So, variations in wear on tangent track are very small but very significant?

A. Yes. Rail in tangent track which is worn as little as 1/8th inch indicates to an experienced engineer that a substantial portion of the useful life of that rail has expired, and it is impossible to measure variations as small as 1/8th inch without using a rail contour machine or, at the very least, making some type of physical measurement of headwear and relating such measurement to known standards.

Q. Mr. Maynard, I want to read to you an excerpt from

the transcript of Mr. Shannon's cross-examination of Mr. Dunn appearing at Transcript page 800:

"Any rail on a tangent that has only one eighth inch headwear is going to be around for a good many years and get many, many more years of service."

Do you agree with that statement?

A. I do not agree with that statement.

I would like to have introduced as an exhibit a section of 131-pound rail which was taken out of the
page 1647 } eastbound main track of the Norfolk Division on August 24, 1968.

Mr. Shannon: Is that the rail just introduced?

Mr. Riely: No, sir. You see what I have got in my hand, coming around to let you have a look at it.

Mr. Shannon: Do you want to look at it, Mr. Epps?

Mr. Epps: I don't want to hold it.

By Mr. Riely:

Q. Now, this was tangent rail?

A. Yes, sir.

Q. How much headwear loss is there on that rail?

A. One-eighth inch.

Q. Why was it removed from the track?

A. It broke under train—it is a service failure.

Chairman Catterall: That is a fatigure failure?

The Witness: Yes, sir. As I said, rail and tangent track normally fails from fatigue, not from extreme wear like we saw on this prior rail, on rail from curve. It was removed from track due to a compound fissure.

This was a service failure; the rail broke in the track. Although this rail has only one eighth inch headwear, I am sure that Mr. Dunn would have to agree that this rail would not provide "many, many more years of service."

Mr. Riely: Now, if it please the Commission,
page 1648 } I would like to introduce that as Exhibit 2-ALM.

Chairman Catterall: You can introduce it if you will carry it away when the case is over.

Mr. Riely: May I bring it back for the argument?

Chairman Catterall: You may bring it back for the argument.

Mr. Epps: Before the Court allows it, I would like to examine this witness further so as to find out whether it has any relevance to this point.

Chairman Catterall: That is proper. We will decide it again at the end of cross examination, whether to withdraw it.

By Mr. Riely:

Q. Now, have you a copy of the report that was made as to this rail break?

A. Yes, sir; I have.

Q. Is that a copy of the exhibit that is marked 3-ALM here?

A. Yes, sir.

Mr. Epps: I should like to ask the Court to reserve.

Chairman Catterall: The report of failure of main track?

page 1649 } Mr. Epps: Same ground, until the end of the cross examination.

Chairman Catterall: We will consider that, the relevance of it, along with the relevance of that particular piece of rail.

By Mr. Riely:

Q. All right. Then, Mr. Maynard, other than failure to take meaningful physical measurement, are there any other factors which make the Dunn and Howland valuations unreliable?

A. Yes, sir.

Q. What are they?

A. By relating our findings to studies of the American Railway Engineering Association on tonnage and life of rail, I feel that the DeLeuw-Cather study brought an objectivity and control to its method which was totally lacking in the inspection valuation of Mr. Dunn and Mr. Howland.

Let me add that I have a great deal of respect for the experience and professional competence of Mr. Dunn. On looking on his testimony as a whole, I think he did as good a job as could be expected in the time available to him. He simply didn't have enough time to do the job thoroughly and produce a reliable result.

The DeLeuw-Cather study, on the other hand, was

page 1650 } thorough, involved controlled measurement procedures by personnel with specialized experience, and produced an accurate and reliable result.

Q. Do the studies of Mr. Dunn and Mr. Howland necessarily contradict the DeLeuw, Cather study?

Arvie L. Maynard

A. No. As a matter of fact, they support our findings in many significant areas. Mr. Dunn's condition percents for various elements of the track structure are very similar to DeLeuw, Cather's. The only exception is rail, and I think the discrepancy there can be easily explained.

We found the overall condition percent of Norfolk and Western's rail to be approximately 35 percent. Mr. Dunn determined the overall condition percent to be 52 percent, or a difference of approximately 20 percentage points.

On cross examination, Mr. Dunn testified that there is always a certain percent condition remaining in a rail which would provide a factor of safety and he estimated that percentage to be 20 percent. He testified that when he set numerical condition percents on rail, he used a value of 20 percent on rail when it was in its poorest condition. DeLeuw, Cather started at this point with approximately a zero condition percent rating. In other words, we rated rails which were about ready for removal from track as scrap at slightly higher than zero percent. It is really just a

page 1651 matter of semantics. I think we agree in principle.

As for elements other than Rail and Other Track Material, Mr. Dunn's condition ratings are very close to ours.

Q. What about Mr. Howland's study? Does that support DeLeuw, Cather's findings in any way?

A. Howland's ratings on tunnels is too high, and I have already commented on the shortcomings of his method of evaluating tunnels. The real discrepancy is in Rail and Other Track Material, the life and condition of which is related to rail. Mr. Howland rates rail at 75 percent, but he testified that he rated rail at 41 percent on a dollar basis when the rail was in a zero condition percent physically. Of course, Mr. Dunn and DeLeuw, Cather were determining condition percent on a physical basis. So if you subtract 41 percent from 75 percent, the resulting 34 percent condition is almost exactly the same condition percent determined by DeLeuw, Cather and Mr. Dunn, for that matter, if you make the one adjustment to which I previously referred.

Q. Then what you are saying is that the DeLeuw, Cather study, the Dunn study and the Howland study, when adjusted for differences in approach, produce a similar results?

A. That is correct. When converted to a measurement of present condition percent stated as a percentage of new, their figures for track laying and surfacing

page 1652 } would also come into line if these adjustments were made in the ratings for the property accounts.

Q. Where does that leave Mr. Younger's figures?

A. Well, I think he is way off base. His inspection method was inadequate, and since his results contradict the findings of Messrs. Howland and Dunn as well as DeLeuw, Cather's, they are unreliable. For example, Mr. Howland in his survey found an average age of life of rail in place on various lines of the Norfolk and Western ranging from 14 to 27 years (T. 859). Mr. Younger contends that the condition percent. Projecting a total useful life of rail, use of these figures would produce lives ranging from 70 to 135 years. I think any knowledgeable railroad man in the United States would agree that this is absurd result. Even Mr. Howland says that the average life of rail nationwide is only 50 years (T. 913). Because the Norfolk and Western carries such heavy tonnage relative to other roads, the life of its rail would be considerably less. As for Mr. Younger's ratings for elements other than rail, with the exception perhaps of ties, his ratings consistently exceed the DeLeuw, Cather ratings, the Dunn rating and the Howland rating.

It is not surprising, I suppose, that Mr. Younger's results differ so greatly from those of DeLeuw, Cather, page 1653 } Dunn and Howland. His "operating condition" approach doesn't make much sense. He seems to be saying that since trains are running on the Norfolk and Western tracks that the property must be almost as good as new. This is as illogical as saying that because an automobile is still running it must still be almost as good as new. The condition of property can and does vary from 100 percent to zero. Even Mr. Dunn recognizes that property can still be operable at a condition of 20 percent.

Q. Mr. Maynard, will you please go to Exhibit 3-ALM. This is the Report of Rail Failure in Main Track of that rail that is Exhibit 2-ALM?

A. Yes, sir.

Q. Where was that rail located?

A. It was located on the Norfolk Division, as indicated in the upper right-hand corner of the form, on the Norfolk District, Section Number 3, at milepost 52 plus 2500 feet. The nearest station was Wakefield, Virginia.

Q. When was the rail rolled?

A. The rail was rolled in the second month of 1938.

Q. Which rail was it? Eastbound, westbound, north or south?

A. It was taken out of the eastbound track, the north rail.

page 1654 } Q. When was it discovered?

A. It was found at 1:45 a.m. on August 24, 1968.

Q. Who discovered it?

A. The signalman.

Q. When was the rail removed?

A. On August 24, 1968.

Q. What was put in place of it?

A. 131 RE control cooled, open hearth, United States Steel Company rail, which was rolled in 1945.

Q. What was the defect that was found in the rail?

A. A compound fissure.

Q. What does that mean?

A. You can relate it to a compound break as doctors use the term. It is broken two ways; starts out as a horizontal break from a horizontal split head, then breaks downward laterally through the rail.

Q. The rail was broken in two?

A. Yes, sir.

Mr. Riely: Thank you; I have no further questions.

Chairman Catterall: Where is the 35 percent?

The Witness: By the 35 percent, pertains to the size of the fissure before the final break, Your Honor.

If you will notice here, if you can see it from

page 1655 } that distance, there is a shinier spot and that represents approximately 35 percent of the area.

CROSS EXAMINATION

By Mr. Shannon:

Q. When you served in the United States Army Corps of Engineers between 1944 and 1947, you were not a graduate civil engineer, were you?

A. No, sir.

Q. What were your duties with the Corps of Engineers?

A. Well, my final duty was as a company commander of an engineering dump truck company.

Q. Dump truck company?

A. Yes, sir.

Arvie L. Maynard

Q. You didn't do anything about railroading while you were in the Corps of Engineers?

A. No, sir.

Q. I note you testified you received a degree in Engineering from the University of Cincinnati in 1953. Did you attend the University of Cincinnati while working for the B & O Railroad?

A. Yes, sir; I was a cooperative student. I went to school part-time and worked part-time.

Q. Did you go at night?

page 1656 } A. No, sir; I was a full-time day student. The University of Cincinnati has a cooperative program. It is a five-year course while most schools are four years. We go 11 months a year instead of nine months that other schools go to, so we have the same amount of classroom time. However, we also spend work sessions, obtaining actual experience along engineering lines.

Q. It just takes a year longer to take the course?

A. A year longer and more classroom time per year.

Q. What type of civil engineering degree did you get from the school? Did you just get BS or BS in CE?

A. No; at the University of Cincinnati during wartime they sometimes will have an accelerated course without having work experience and they do award BS of Engineering or Bachelor of Science for this reduced course, but anyone that goes through the cooperative program gets a degree known as Civil Engineer.

Q. It is not a BS in CE, just a degree of CE?

A. In a sense it indicates more actual experience along with the academic experience and they differentiate degrees in that way.

Q. Now, are you a licensed, certified professional civil engineer?

A. Yes, sir; in the State of Ohio.

Q. State of Ohio?

page 1657 } Is that the only state you are licensed in?

A. Yes, sir.

Q. Now, you state on sheet two of your testimony that you served as Assistant on Corps with the B & O. Tell me what Assistant on Corps is. That is a new one.

A. That was just the B & O. In B & O they have what they call an engineering corps; all the people working on that corps carry the title, Assistants on Corps, although there are different steps throughout the Corps. It is really the training ground of young engineers. You start out mak-

ing simple surveys, working with other engineers. As you step through the various steps, you obtain experience the railroad hopes you will obtain before putting you out in more responsible positions.

Q. It is a training program?

A. In a sense it is training as a young attorney would work with an experienced attorney, yes, sir; that type. Not a training program as such differentiated from training programs that B & O-C & O has where they hire engineers or other graduates for two years and send them out to observe. We did perform work.

Q. Now, while you were Assistant on Corps, you have heard the statement you made that, "I made situation surveys and testified as to their accuracy in court

page 1658 } cases and public utility hearings."

In what courts did you testify?

A. I testified in Illinois before the Public Service Commission in Illinois.

I have testified in Ohio before the Utility Commissions of Ohio.

Q. In what courts did you testify?

A. Well, the Illinois case was, I assume, a court similar to this, comparable in Virginia where I testified before a Commission.

Q. Examiner?

A. Or Examiner, right.

Q. What was the nature of your testimony?

A. In that particular case, the railroads were trying to get relief from a statutory stop in Pana, Illinois. I made a situation survey showing sight distances and various features in the vicinity of the rail crossing and attorneys for the railroad used that exhibit to show the court the on-ground situation.

Chairman Catterall: S-i-g-h-t?

The Witness: I assume that's right.

By Mr. Shannon:

Q. Have you ever testified in an *ad valorem* tax case before, Mr. Maynard?

page 1659 } A. No, sir.

Q. Have you ever participated in or had anything to do with valuation of railroad property before this case?

A. Not for *ad valorem* taxes, no, sir.

Q. For any purposes?

A. For maintenance purposes, as far as condition of properties, I would value for my own purposes, but not for purposes in proceedings such as this, no, sir.

Q. I take it from the outline of your qualifications that at no time during your employment with the B & O or the C & O-B & O, were you in charge of maintenance of track structures for the B&O or the C&O-B&O on a system basis, is that correct?

A. No, that is not correct.

Q. What is correct then?

A. I have been on system-wide jobs since 1964, other than the time I was with DeLeuw, Cather when I was engineering every roadway and track on the B&O, one of the responsibilities of that position was to determine the maintenance needs for track, for the entire system. Of course, I worked under the chief engineer. He, of course, is the responsible party. He has staff. I was his staff for track. He had other staff for signals, others for bridges and

page 1660 } so forth.

Q. Were you staff assistant to the chief engineer, is that it in effect?

A. I was on his staff but my title was Engineer of Roadway and Track. It is one position just like there is Engineer of Signals, there is Engineer of Bridges. My position was Engineer of Roadway and Track.

Q. On sheet three of your testimony, you stated you drafted standards, procedures and policy concerning track work and coordinated delivery of track work material.

Specifically, what standards, procedures and policies did you draft in connection with track work?

A. I drafted procedures for welded rail, both the laying, the adjusting, the maintenance of it, for one. There were numerous. I would have to go a bit back. I established procedures for handling distribution of cross ties from specially adapted cars we had constructed.

I worked on procedures for bridge building inspection, a routine part of my job. There were numerous.

Q. You submitted those to your superior, did you?

A. Yes, for approval.

Q. Your superior was actually one who had charge of implementing those procedures or rejecting them?

A. The chief engineer is responsible for all

page 1661 } engineering aspects, yes.

Arvie L. Maynard

Q. Who was the chief engineer that you worked for then?

A. The chief engineer was J. T. Colinson.

Q. Of the Baltimore and Ohio?

A. Yes, sir.

Q. Further down, you state you supervised preparation of yearly maintenance program and budget requests and administered subsequent implementation.

Am I correct in assuming, Mr. Maynard, that you supervised preparation of the yearly maintenance expenses for bridges and other track structures only?

A. When I was with the B&O, I was Engineer of Roadway and Track and worked on the track budget.

When I was with the C&O, prior to my present position, I was Engineer of Bridges and Buildings, Construction and Maintenance. One of the functions of my job was working with local bridge and building people on the divisions to determine maintenance needs for bridges and buildings, all structures on the entire system and then attempt to get what we felt we needed from management.

But as far as the actual getting the money, the chief engineer went to management. I did not.

Q. That would answer my next question.

page 1662 } My next question is: who was your immediate superior while serving as Engineer for Buildings, Bridges, Construction and Maintenance for B&O-C&O?

A. My answer, to Mr. F. R. Rice, Assistant Chief Engifyer System.

Q. That is Mr. Frank Rice, is it?

A. Yes, sir.

Q. Does he report to Mr. R. C. Tench?

A. Yes, sir.

Q. Mr. Rice and Mr. Tench, they have more or less veto over your recommendations or suggestions as to these items?

A. Yes, sir.

Q. Now, I understand from your testimony that in April, 1968, you left the C&O-B&O and joined DeLeuw, Cather and Company as a civil engineer. Why did you leave the C&O-B&O?

A. I left primarily because I felt that the opportunity for B&O people wasn't as good as I would like for it to have been, working with the C&O.

Q. In the Engineering Department, that was so?

A. A situation common in all merger situations, espec-

ially when you are the stepchild. I would rather be with a mergor than the mergee.

Q. If you had said you were coming back to
page 1663 } Virginia, I would have fully understood.

Now, where was DeLeuw, Cather and Company? You stated that you worked on a track work study for the Washington, D. C. Rail Rapid Transit System. How long did you work on this study, Mr. Maynard?

A. Primarily, as far as the length of time, from approximately a month and a half. I didn't compile the study. I reviewed it. There were other engineers who had worked on it and it was put in more or less final form. I was given the job of reviewing it, to pick it apart if I could, at least find anything that I could see that may have been overlooked.

Q. What did it involve?

A. It involved the standards that the DeLeuw, Cather Company recommendation be adopted in the building of the track portion of the rapid transit system in Washington, D. C.

Q. Now, I understand that you have returned to the C&O-B&O and are now employed as special engineer. Mr. Maynard, what is a special engineer?

A. Well, it is one postion again on the C&O-B&O, in this particular case I worked for Mr. J. W. Brent, Assistant Chief Engineer, Maintenance.

Q. You report to Mr. Brent?

A. Yes, sir; and kind of between Mr. Brent
page 1664 } and Mr. Tench. Either one of them will give
me these special projects that a special engineer does. I believe in my earlier testimony I said what I have been working on but it could be any assignment by the chief engineer or by Mr. Brent.

Q. Why did you leave DeLeuw, Cather and return to the mergee?

A. I missed railroading, to be honest about it. I have been with the railroads some 25 years. I found I liked to do the work. I was happy with the work. I am going back and hoping, I hope that I can still continue to advance, but I will take my chances.

Q. Did you join DeLeuw, Cather for the express purpose of working on the appraisal of the Norfolk and Western lines in the State of Virginia?

A. No, sir; I gave up 25 years of continuous service when I left the railroad and I have not got it back.

Q. Mr. Maynard, do you consider that your engineering

experience in railroad valuation, in maintenance matters, is comparable to that of either Mr. Kenneth Dunn or Mr. H. H. Howland?

A. My own personal opinion, I think it is superior for the type of survey we did than that of Mr. Howland.

Q. I am talking about your overall ex-
page 1665 } perience in evaluation matters.

A. Repeat the original question.

Q. Do you consider that your engineering experience in railroad valuation and maintenance matters is comparable to that of, either that of Mr. Kenneth Dunn or Mr. H. H. Howland?

A. For the type of survey that I made, I consider it is superior to Mr. Howland and perhaps equal to Mr. Dunn's.

Q. In fact Mr. Howland was engineer in charge of the ICC original valuation of the Norfolk and Western line from Bluefield, Virginia to Cincinnati, Ohio, wasn't he?

A. For his testimony, he was involved in the original valuation.

Q. You had no reason to disbelieve that?

A. No, sir.

Q. Also, is it not a fact that for eight years Mr. Dunn was engineer, maintenance of way, for the entire New York Central Railroad, wasn't he?

A. He was engineer, maintenance of way, at the time. That is in his testimony. I will accept that if that is what he said.

Q. In your tours of service with B&O, C&O-B&O, you never had an assignment comparable to that Mr. Dunn has held with the New York Central, have you?

A. No, sir; I haven't. Interestingly enough,
page 1666 } our years have parallelled very closely up to
the time we were both special engineers. However, I have had more signal experience than Mr. Dunn, dating back to when I was signalman and prior to going into the Army.

As far as having the responsibility of Mr. Dunn, I haven't reached that level, no, sir.

Q. Mr. Dunn's responsibility would be very comparable to that of Mr. Tench, wouldn't it?

A. No, sir. It would be more comparable, perhaps, to Mr. Brent.

Q. Who is Assistant Chief Engineer?

A. Yes, sir.

Q. Of C&O-B—O?

A. Chief Engineer, Maintenance.

Arvie L. Maynard

Q. Now, Mr. Maynard, you state that you are familiar with Mr. Caywood's testimony. Did you write any of it?

A. I didn't write his testimony, no, sir. I worked with Mr. Caywood fully in developing the appraisal but as far as his testimony, I didn't write a page of his testimony.

Q. Did you assist him in any way with writing it?

A. No, sir. I was with, back with the C&O Railroad, C&O-B&O, at the time his testimony was prepared.

Q. Let's see. You rejoined C&O-B&O in Feb-
page 1667 } ruary, I believe, didn't you?

A. Yes, sir.

Q. Now, I believe you indicated that you were involved full time on DeLeuw, Cather's valuation appraisal of the Norfolk and Western track properties in Virginia, is that correct?

A. During the period of time I was on that particular project it was my full time assignment with DeLeuw, Cather; yes, sir.

Q. You were with DeLeuw, Cather ten months and spent six months on the Norfolk and Western project?

A. Yes, sir.

Q. Now, aside from the portions of the Norfolk and Western line that you reviewed with Messrs. Dunn and Howland on this inspection trip, what portions of the Norfolk and Western line of railroad in Virginia have you inspected personally, discounting what you saw when you were with them?

A. Part of my testimony, I walked most of Norfolk's yards.

Q. Yes.

A. I travelled the entire Winston-Salem District from Roanoke down to the state line, Virginia State line. I travelled the entire Pocohantas Division. I was the only one who worked on the Pocohantas Division.

Q. Where is the Pocohantas Division?

page 1668 } A. That is the western-most division with headquarters at Bluefield. That includes generally the coal-producing areas up in the mountains.

Q. The mountains?

A. Yes, sir.

I covered the Radford Division west of Roanoke, including the *Saltsville* Branch, the Abingdon, the North Carolina extension, all branches off of the Radford District, west of Roanoke; also travelled part way over the line from Roanoke toward Crewe. I travelled part of the line from Roanoke.

Arvie L. Maynard

Q. What part of the line did you travel from Norfolk to Crewe?

A. We travelled to—I have to think of the name of the town—is it Bedford, Pennsylvania?—also.

Q. But I believe that is between Roanoke and Lynchburg?

A. It is east of Roanoke, at any rate, yes. I travelled east of Roanoke to Bedford on the rail.

Q. How did you travel, on hyrail?

A. Yes, sir.

Q. Now, what portions of the line did you travel over between, say, Lynchburg and Norfolk, aside from this trip? Everything I am asking you is predicated on, you went on the trip with Messrs. Dunn and Howland.

page 1669 } A. Just the Norfolk Terminal.

Q. How about the Old Virginia rails between Jarratt and Norfolk? Did you go over that?

A. Not prior to my tour with Mr. Howland.

Q. Did you personally inspect the Shenandoah Division?

A. Just a portion of it.

Q. What portion of it did you inspect?

A. A little bit about Roanoke itself.

Q. You know that goes all the way up, I believe, to Hagerstown and probably has several hundred miles in Virginia doesn't it?

A. Almost 200 miles in Virginia. I did not cover the upper part of it at all. Just took a few miles out of Roanoke to the first station. I can't recall the name of that particular station.

Q. Have you personally inspected the Norfolk and Western line between Crewe and Norfolk?

A. Not prior to my tour with Mr. Howland and Mr. Dunn.

Q. Have you personally inspected the Norfolk and Western between Brookneal and Jarratt, and Jarratt east of Norfolk?

A. No, sir; not other than from the yard limits at Norfolk. I personally covered on into Sewell's Point.

Q. Have you personally inspected the Norfolk

page 1670 } and Western Knitting Mill Branch?

A. No, sir.

Q. Do you know where it is?

A. Yes; it is Lynchburg, if I recall, right? There are so many branch names. I could tell you for certain.

Q. Did you take notes on your trip, on your inspection that you made for DeLeuw, Cather?

A. Yes, sir.

Q. Do you have those available?
A. I don't have them; no, sir.
Q. You don't have them with you? You couldn't make them available to me now?
A. I assume they could be made available. I am back with the C&O Railroad.
Q. They claim their property? DeLeuw, Cather took their property now?
A. I didn't say that. I don't personally have them.

Mr. Riely: We can get them if you would like to have them.
Mr. Shannon: It may not be necessary. If I want them, I will renew the request.

By Mr. Shannon:

page 1671 } Q. Have you personally inspected the City Point Branch of Norfolk and Western?

A. Yes, I walked over that in—no, sir; no, I didn't.
Q. Have you personally inspected the Catawba Branch?
A. No, sir.
Q. Now, have you personally inspected the remaining portion of the unabandoned segment of the Blacksburg Branch?
A. I saw a portion of it, yes, sir.
Q. A portion of the portion?
A. Just a portion of the portion, right.
Q. What about the Kingston Branch?
A. No, sir.
Q. What about Potts Valley Line?
A. No, sir.
Q. How about the Norfolk and Western western branch?
A. Yes, sir; all of it.
Q. Little Tom's Creek?
A. Yes, sir; all of it. By the way, it is out of service.
Q. Well, how long was that Little Tom's Creek Branch? How long was it?
A. I would have to look at the notes. It is very short.
Q. If I said point sixty-five hundreds of a mile—

page 1672 } A. From our testimony it would be—I don't recall the exact length of it at all.

Q. If that was from the records of this Commission, would you accept that?
A. Yes.

Arvie L. Maynard

Mr. Riely: Did you really mean point six five hundreds or point six five miles?

Mr. Shannon: Point six five miles.

Mr. Riely: It would be an exceedingly short line.

Mr. Shannon: I understand.

By Mr. Shannon:

Q. Big Tom's Creek Branch?

A. I covered that, yes, sir.

Q. Now, Mr. Maynard, on page five of your testimony, you referred to the in-place value of the Norfolk and Western track structure and appurtenances. Does your determination of the value, in-place value that you assigned to Norfolk and Western track, track appurtenances in Virginia assume that Norfolk and Western will continue as a viable, operating railroad?

A. Our instructions as given to me by Mr. Caywood was that we were to disregard any franchise or going-concern value; it was defined as something that included good will, so forth, and we were instructed to assign just a bare-bones value. That is the basis I used in making the appraisal,

page 1673 } a value without a going-concern or franchise value.

Q. You didn't assign a value to it as a line of railroad track?

A. I assigned a value to it as, we take a piece of property there with no going-concern value.

Q. Now, Mr. Maynard, one final question and I am going to turn you over to Mr. Epps. We have collaborated a little bit and I don't want to be repetitious over here.

You say, we made every attempt to value this property on the same basis that a knowledgeable buyer would make a decision as to what he would pay for it.

Did you have in mind at that time selling it to a junk dealer or did you have in mind what a willing buyer would pay for an operating railroad?

A. I had in mind what a willing buyer would pay for it as a bare bones.

Q. Scrap?

A. Not necessarily scrap, no, sir. Some of it we valued as relay rail which could be reused elsewhere. Some of it we valued as rerolled rail which could be taken back to a rolling mill and rerolled into different shapes. Some of it we valued as not suitable for re-use if it were taken up from its exisitng position.

page 1674 } No, we didn't value it as scrap.

Q. Mr. Maynard, I am sure you prepared estimates and statements that go into returns to questionnaires in connection with railroad abandonments, whether seeking to abandon lines—you have to file an application and return the questionnaire to the Interstate Commerce Commission. Are you familiar with those?

A. I have never worked in that phase of railroading.

Q. You have never worked in that phase?

A. No.

Mr. Shannon: I have no further questions.

Chairman Catterall: You spent full-time for six months on this assignment, did you?

The Witness: Yes, sir.

Chairman Catterall: Your testimony as to the time you spent going over the rail would hardly account for more than one month. What did you spend the rest of the time doing?

The Witness: I spent approximately three months travelling the property, making notes of things I observed and appraisals I made. I started right after Memorial Day. I was on the property through the early part of August and then I worked back in the office in Washington, of DeLeuw, Cather, from August, latter part of August page 1675 } through September and October and part of November, compiling this data, plus working with the other engineers that were on the property, making visual inspections. We worked together relating this data and compiling it into the tables that were presented in this case.

Chairman Catterall: There were other people making inspections beside yourself?

The Witness: Yes, sir. We had a man, formerly signal engineer with the Southern Railroad, made the signal appraisal. We had a man formerly in charge of structures on the R.F.&P., made the appraisals on bridges and tunnels.

My appraisals were concentrated on track. Then there were three other people helping me appraise track, all of them with track background.

Chairman Catterall: Have you any questions of this witness?

Mr. Epps: Yes, sir.

Chairman Catterall: Do you have any questions or shall we go on?

Mr. Epps: I think we can finish before 4:00 o'clock.
Mr. Riely: Leave me time for two.
Mr. Epps: Did you make notes of your inspections—
Chairman Catterall: Suppose we start tomorrow morning at 9:30?
page 1676 } Mr. Riely: We have one more witness, unless you have rebuttal. It won't be very long.
Chairman Catterall: You would rather start at 10:00 o'clock?
One more witness.

(Discussion off record.)

Chairman Catterall: The Commission will recess until 10:00 o'clock tomorrow morning.

(Whereupon, the hearing was recessed until 10:00 a.m. Thursday, July 10, 1969.)

page 1677 }

* * * * *

Richmond, Virginia

Thursday, July 10, 1969

The above-entitled matter came on for hearing, pursuant to recess, at 10:00 o'clock, a.m.

BEFORE

Judge Ralph T. Catterall, Chairman
Judge H. Lester Hooker
Judge Jesse W. Dillon

* * * * *

page 1678 } Chairman Catterall: You may proceed.
Mr. Riely: Mr. Maynard was on the stand, I believe, gentlemen.

Whereupon, A. L. MAYNARD resumed the stand and testified further as follows:

A. L. Maynard

CROSS EXAMINATION RESUMED

By Mr. Epps:

Q. Mr. Maynard, what were your instructions when you were told to go on this trip with Mr. O'Brien and Mr. Howland and Mr. Dunn?

A. Just generally to observe their trip as an observe, see what they saw and where they went. Very general instructions. No specific instructions.

Q. Did you ever watch a professional football game?

Mr. Riely: I object to that question as irrelevant.

Chairman Catterall: We don't know whether it is irrelevant until we hear the answer.

Judge Hooker: It may be very relevant to what we are interested in.

The Witness: I have seen one professional football game.

page 1679 } By Mr. Epps:

Q. Did you see it on television?

A. I watched it on television.

Q. Do you know what we mean when we say, Sam Huff keys on Jim Taylor? Do you know what that means?

A. No, sir, I am not that much of a football fan, to know all the football slang.

Q. Were you told to key—

Judge Dillon: Taylor knows.

Mr. Epps: Jim Taylor knows what that means.

By Mr. Epps:

Q. Were you told to key on Mr. Dunn or to watch Mr. Dunn and record what he did?

A. No, sir. As a matter of fact, when they told me to take this trip, I don't think they knew Mr. Dunn was even going to be on it. I met Mr. Dunn for the first time and didn't even know who he was until that morning when we went on the trip.

Q. Well now, these notes that you have given us, these were made while you were actually in the hyrail car or walking or inspecting, weren't they?

A. Yes, sir.

Q. Right on the spot?

A. Yes, sir. Those are the notes I took on the page 1680 } dates we were on the road.

Q. In here, you have certain references to D and to Dunn—I take it both of those mean Mr. Dunn?

A. Usually. I had abbreviations in there. As I recall, I used D for Dunn and I may have used, I think I used K for Howland because for some reason I had Knowland in my mind.

Q. K for Howland?

A. Yes.

Q. Is that what K means?

A. I would have to look at the note. I have my original notes. I would have to look at it to recall.

Q. Yes, sir; let's take a look.

I compliment you. I can read everything on you note. I can't tell you I know what it means, but I can read it.

Would you look at page 12-A under the time, 10:05, and tell me what DO and KO mean there.

A. 12:05?

Q. 10:05.

A. 10:05, we began the Dry Fork Branch and, yes, these small numbers are the mileposts as we went by them. For instance, 10:05 to 10:15, we went by four miles in that ten minutes; and at mile 44 I just made this note to myself. I noticed there was battered rail, and then the next note was DO, which means Dunn observed, and KO means that Howland, instead of Knowland, noticed a 1912 date above the portal over the tunnel as we passed through it.

page 1681

And then, the next note there, 41, mile 41, I note of my own, I just made some general notes as we went along, too, to compare with some of my prior notes, but the survey wasn't made on these—ties installed to keep safe. I wanted to check back to see if those ties were in when my first survey—this was several months after—I covered some of these lines.

Q. May I have that back, please, sir? I will let you see any of these you want to.

In your direct testimony you made a statement that you couldn't inspect tunnels or you couldn't get any proper evaluation of the tunnels because of speed and because of the effect of light on your eyes going from the outside into the tunnel. Then by the time you had adjusted, you would be at the end of the tunnel, almost.

Do you remember that?

A. Yes.

Q. Does this apply to all of the tunnels or just some of the tunnels?

A. It applies to most of the tunnels. There were a few long tunnels on the Norfolk and Western, one

page 1682 } about 3000 feet long that your eyes become somewhat accustomed to the darkness. However, you still didn't have enough illumination from the headlights of the automobile which nornally focused down to see the arch. But as far as accustoming your eyes, that applies to most of the tunnels.

Q. You have specific notations as to the condition of some tunnels in your notes, do you not?

A. Are you referring to the tour I made with Mr. Dunn and Howland or to—

Q. As shown by these notes, these are the notes we looked over.

A. If you would call my attention to any particular note I would interpret it for you.

Q. I will be glad to, sir.

If you will look on page four, at the time 11:55, you checked on the tunnel at that point, didn't you?

A. That note refers to what I thought Mr. Dunn was doing at the time. At 11:55, I had to look back where we were at that particular time. I see on that day we crossed the Blacksburg Branch at the highway crossing.

Q. What do your notes say at 11:55?

A. I am trying to orient just where I was that particular day. It says, noted tunnel partly lined. That

page 1683 } note meant that Mr. Dunn noted that the tunnel was a partly lined tunnel.

Q. Right.

Did it have a partly lined tunnel, I suppose, because of seepage that had developed, gone back and lined it, is that the reason?

A. In the case of a rock bore tunnel, often times the tunnel begins to fail and particularly the rocks fall down from the top of the tunnel and you lose the arch effect. Then there may be some solid rocks from the other side of the tunnel. It is a standard practice to just land the portion that has failed.

Q. This is an important factor to determine the condition of the tunnel?

A. Not the condition of the entire tunnel, no. The lining also has a condition. Noting that the tunnel is partly lined or fully lined, it is a description of the tunnel but it is not a condition of the tunnel.

Q. I see. But it is a factor in the condition?

A. The fact it is lined or not lined. I won't say it is a factor in the condition of the tunnel itself. A condition of that particular tunnel, partly lined or partly unlined tunnel.

Q. Thank you, sir.

Now, on page six, some time between 9:00 and 9:25, you also wrote down, noted wet condition tunnel. Is
page 1684 } that correct?

A. Between 9:00 and 9:25? Yes. I am referring to what I think Mr. Dunn or Howland—I don't have my D or K—but they noted that. I may have made a comment, for that matter, but they note that the tunnel was we.

Q. If the tunnel is wet, that means it is seeping, is that right?

A. It could either be seeping or be on grade and water could be coming in one portal, flowing through the tunnel and going out the other portal.

Q. That is a factor that determines the tunnel condition. I take it.

A. If it is seepage through the walls, it could reflect tunnel condition, yes, sir. If it is wet because of drainage going through the tunnel, no, sir, because all tunnels are constructed with side ditches to allow for passage of drainage.

Q. I take it it is something like a symptom that the physician would know?

A. It is definitely a symptom if you see seepage coming through the walls of a tunnel, yes, sir.

Q. Thank you.

Now, if you will keep that same—what sheet did I give you? Six?
page 1685 } At between 9:53 and 10:16, I think maybe we will give you credit for Daylight Savings Time for a minute—I think you mean 9:53 and 10:16, but it doesn't matter—you see another reference to a tunnel?

A. I see a reference outside of a tunnel.

Q. Would you read what it says?

A. Are your referring to "muddy off tunnels?"

Q. "Muddy off tunnels", right. Is that correct?

A. Yes. That is a note of my own, that particular one. It is nothing they observed. I noted there was muddy ballast off a highway bridge and then we went from that high bridge to a tunnel; I noticed the mud continued on to the tunnel. That was my own.

Q. Mud from the highway bridge went through the tunnel?

A. Went to the tunnel.

Q. To the tunnel?

A. Yes, sir.

Q. May I have that one back just so I don't get your notes mixed up.

Now, would you look at page 12-A of your notes? Between the hours of 10:05 and 10:15, I think you have already seen that and told me that DO and KO mean Dunn observed and Howland observed. It says, they observed a 1912 tunnel, isn't that correct?

page 1686 }

A. Yes, sir.

Q. Thank you, sir.

They observed—what the note means is they observed a 1912 date on the tunnel?

A. On the tunnel portal.

Q. Now, on page 13-A of your notes, at milepost 448 and at 449—first at milepost 448, there is a reference there. Are you and I together?

A. That is my note.

Q. The tunnel is wet.

A. Yes.

Q. That is also the type of symptom that you talked about? Correct?

A. Yes, yes.

Q. It also says, doesn't it, brick-lined masonry portal, is that correct?

A. Yes, sir.

Q. Then at milepost 449 another reference to a tunnel, isn't there, tunnel brick and partly rock, is that correct?

A. Yes, sir.

Q. On page 14 down to March 30, under 8:35, milepost 20—are you with me?

page 1687 }

A. Yes, sir.

Q. That reads, as I believe, RAIT the tunnel dry, is that correct?

A. Yes.

Q. The fact that a tunnel is wet is a symptom of condition. I suppose the fact that a tunnel is dry is a symptom of condition, is that correct?

A. It would indicate that there was no water seeping through the tunnel, perhaps no surface drainage going through the tunnel.

Q. May I have that one back.

Now, you say you are not keying on Mr. Dunn but just as an example of what I am trying to illustrate, on page 9, at

11:38—I'm sorry, at 1:38, not 11:38—there is a notation there, isn't there, "Dunn made notation F in his notes."

A. Yes, sir.

Q. Do you know what "F" means in Mr. Dunn's notes?

A. I didn't at that time. After listening to his testimony and cross examination and direct examination, I do now. It meant, "fair."

Q. I think you said "poor" didn't you?

A. No, I said "fair."

Q. Excuse me. Opposite that, don't you say, "ties poor?"

A. Yes.

page 1688 } Q. Same line?

A. Yes. I made the note the ties were poor.

Q. Does that make an illustrated point where you disagreed with Mr. Dunn, perhaps?

A. I must have at that particular spot since he later, I found out his "F" meant fair.

Judge Hooker: Fair means fair condition?

The Witness: I am only going by Mr. Dunn's testimony. At that time I didn't know what his testimony was. It could have meant "failed" for all I knew, but later in this Court he testified his rating system was good, fair, poor, if I recall right. He testified to that.

By Mr. Epps:

Q. Now, you had several references to Sperry cars or Sperry tests, is that correct?

For example, if you would look on page 10 of your testimony at between hours 9:15 and 9:35, would you tell us what the January Sperry test, 253, Sperry rail, means?

A. I have got to find it here.

9:15 to 9:35, you said?

Q. Yes, sir; on the right-hand side.

A. We were on the—yes, I certainly will.

page 1689 } See, the January Sperry test was 1969. We made our survey in 1968 and the roadmaster made the comment that he had 253 Sperry rail on that line in 1969. I couldn't at that time believe it because I recalled we looked up the Sperry test in 1968 and it had 60. Then I dug into it a little bit. This is a note to myself. I found out they started putting C & O unit coal trains down that line. It was breaking the line up with fatigue and they had this tremendous number of Sperry rail increase, but it had

nothing to do with my original survey. My original survey was 1968.

Q. This indicated that it had a Sperry rail test in January, found 253 rails should be removed, is that correct?

A. Yes, on that roadmaster's territory, the Durham District.

Q. Durham District?

A. That included going back to North Carolina. That was entirely the roadmaster's testimony, not just what was in Virginia. But there was tremendous increase in the Virginia Sperry rail.

Q. Now, on 9:38 on that same page, you have a notationm do you not, "Dunn asked, where are your worst ties?".

A. At 9:38—are you sure that is at 9:38?

Q. Well, that is the way I read it. You have 9:35 curve. Do you see that?

page 1690 } A. Yes, 9:35 curve.

Q. 9:38, L-10.

A. That is milepost L-10.

Q. You go down to the third item there, D.

A. Oh, yes. Dunn asked—he asked the roadmaster, I recall that. He asked the roadmaster, where were your worst ties. The roadmaster's answer as I recall, is: there are several places.

Q. So Mr. Dunn was not looking just for the good; he was looking for the bad, too?

A. I believe he was there. He wanted to see the worst ties on that line.

Q. Now, at the same time, at L-13 milepost, the right-hand side, you have an indication—I can't read the copy, you help me—Dunn asked if—

A. Dunn asked if it was slow ordered. That was one of these spots that the roadmaster said he had very poor ties and Mr. Dunn did get out and for two rail lengths count the totally failed ties. I walked behind him, getting my thoughts, and Mr. Howland was behind me getting his thoughts. That is what that notation meant there, that Mr. Dunn counted 20 failed ties out of the 46 ties and he only counted the failed ones, totally failed. Mr. Howland counted 25. I had counted 23.

page 1691 } And then Dunn, after seeing that half the ties had failed, he asked the roadmaster, "Is this slow-ordered?"

I assumed he was wondering if it was safe for traffic. The roadmaster's answer was, "No, the track just has a 35-mile-

an-hour permanent speed on it," and he felt it was safe because of the permanent speed.

Q. Thank you.

Tell us what track that was?

A. That was the Durham District.

Q. Thank you. Page 11-A at 4:55, hour 4:55, you have a parentheses that reads, if I read your writing correctly, this is location of scrap rail profile used in exhibit. Will you tell us which exhibit that is?

A. If I may see Mr. Caywood's testimony, I would have to relate the milepost. That is on the Winston-Salem District and Mr. Caywood's testimony, there is an exhibit showing some sample rail contours indicating, yes—Mr. Caywood's exhibit 10. I will have to find the time again. What time was it we were looking at?

Oh, yes, at curve, at mile 17.

Well, I was on the Winston Salem District myself. That is one of the lines I inspected. I took rail contours at mile 17.

page 1692 } That particular rail you show in this exhibit as being scrap rail and, as I recall, I would have to look at my field notes, but I think I graded that rail one percent after seeing its condition, and that was just as interesting to me, I noticed that we had gone by it, the rail had been changed out from the time we had made our inspection, and we made this tour with Mr. Dunn and Howland.

Q. In other words, when you went there with Mr. Dunn and Howland, the same rail was not there?

A. Right; that had been changed out. Just something to confirm if I was right when I said it only had one percent condition.

Q. You were familiar with this because this was part of your bailiwick in the beginning?

A. Yes, sir; that was one of the lines I checked.

Q. Now, on page 14 at time 8:15, if I read your note correctly, it says: Dunn asked if Branch were about like this.

A. Dunn asked if Branch was about like this on up. He directed that question to the, not the roadmaster, Mr. Kendrick —no, he directed it to the supervisor. The supervisor answered, it was.

He said, let's just back out of the main, then.

Q. Didn't want to go to the end of it?

page 1693 } A. That was the LaVisa Branch. We went about half way of that Branch—that is in Virginia.

Q. Thank you, sir.

Now, on page 16-A at 10:59, there is a reference to something Mr. Dunn did. I am not sure I can read it; that is one place I couldn't quite read your writing. Would you tell us what it said?

A. 10:59? Oh, yes. I made a note of a remark Dunn, Mr. Dunn, made in the car. He remarked that sometime prior to our survey, he walked from Windsor to Myrtle in October and I got October and November. I just made a note of a comment he made.

Q. This is an inspection he had made of part of the Norfolk and Western system when you were not present?

A. From the remark in the car, I gathered that his firm had some kind of a contract with the Navy and he was out on the Norfolk and Western at that time.

Q. So that he had other knowledge than what he saw there at that point?

A. Yes. I don't know what he was looking for at that time, but he did make the comment he walked from Windsor to Myrtle, yes, sir.

Q. Now, on page 17, at times 2:47 and 3:03, there are two references to Sperry. Would you read those for me?

A. The one at 2:47, at 66.9 is the milepost, page 1694 } and says, "Slow order for Sperry rail was installed." Three miles installed. Bars all defects. Mostly small transverse defects; few engine burned fractures. Those were comments Mr. Kendrick told us the type of Sperry rail they were installing in that storage track.

Q. At 3:03, milepost 70.

A. Milepost 70, defective Sperry rail. Mile 72, end of Sperry rail. Those are notes I made myself.

Q. Would that mean that the Sperry rail would cause you to remove from milepost 70 through milepost 72—it doesn't mean that, does it?

A. No, sir; that is a section of track on the Old Virginian that is not used any more. It is located between a couple of switches, as I recall, and they have taken their Sperry rail out of the main track. This is a track they used, as I understand it, to store cars occasionally when they had a surplus of hopper cars. So they have taken this Sperry rail out of the main track and put angle bars on all these failures and they have installed it in the storage track.

Q. This is relay track that you saw there?

A. It is relaid, Sperry rail relaid into this storage track, yes, sir.

Q. Thank you, sir.

page 1695 } Now, would you take all of these notes, please, and you have certain symbols on there. You have, as I read it, you have used asterisks at certain places and you have used arrows at certain places. Would you check and see if my—

A. Yes, sir.

Q. Is that correct?

A. Yes, sir.

Q. What do the asterisks mean?

A. I will try and recall that.

If I recall right, now, I am not sure, but I summarized these and I think as I summarized them I did some check marks, but I can't recall exactly what the asterisks and arrows mean.

Q. You don't know what the arrows mean, either?

A. No, I can't recall, but they refer somehow to my summary sheets.

Q. Would you look at the arrows separately and see if they have references, perhaps, to branch lines or sidings?

A. One of the first arrows is, we passed a switch to the Blacksburg Branch.

Q. That would be a branch line indication, wouldn't it?

A. Yes, sir.

The second arrow, we passed Radford.

Q. Arsenal?

page 1696 } A. Arsenal, I believe—is that spelled wrong—but I think that is what it was.

Q. That would be a siding, would it?

A. No, I think as I recall, that someone pointed out to me that was an arsenal back there that had something to do with this Radford Branch, but I just made a few notes as we went along.

The third arrow is milepost 320, corrugated rail on curve. Stopped on tangent instead of curve.

The next arrow was by Potts Valley shifter on spur.

Q. That would be a branch line or spur track, right?

A. Yes, sir; there is a Potts Valley Branch.

Q. That would be a branch line or spur track, right?

A. Yes, sir; there is a Potts Valley Branch.

The next arrow is crossed Blacksburg Branch at the highway.

Q. That has reference to a branch line?

A. Yes, sir.

And the next arrow was, passed Radford Branch and crossed New River.

Q. That had to do with a branch line?

A. Apparently that is some of my notations when I summarized them because the next one is, passed Cloverdale Branch.

page 1697 } I think you have refreshed my memory somewhat. I think what those arrows meant, were places we had gone by, branches where we very easily could have stopped and inspected them but did not. I think that is where later on I marked down the branches that we didn't look at.

Q. You were stopping at all the arrows that you have gone by?

A. I have run out of arrows here.

Here are some more. These arrows refer to that Sperry rail we talked about earlier.

Q. Not always branches?

A. I believe most of those that I have mentioned earlier were branch lines that we went by without stopping.

Q. When did you prepare your summary?

A. Oh, I did it somewhat, immediately after I got done with those notes, just so that I could perhaps read them a little better. I don't know if I dated it or not, but I did it at the end of our trip.

Q. I don't know whether it is significant or not, but there is a "26" up there. I don't know what that means.

A. I couldn't recall either. I noticed that. I can't recall what it is.

Q. This was contemporaneous, and this was

page 1698 } done later, using this as your work paper?

A. Yes, sir.

Q. Right.

Now, when you worked originally on the Durham Branch, I think that was one of them you said you worked on?

A. No, I didn't. Winston-Salem.

Q. Excuse me, Winston-Salem, right.

Did the Corporation Commission have somebody there keying on you and writing down what you were doing?

A. No, sir; they did not. Is my understanding of your word "keying" right?

Q. Let's use the word "spying" then. Was there anybody spying on you and writing what you were doing?

A. We made our own, independent survey. Just had the DeLeuw, Cather people with me, and the roadmaster that drove the hyrail car. There was a trainmaster on that particular line.

Q. Just to return, and I am done with these notes, I think—I would like to have them admitted—just to return for a minute for the purpose of your going on the trip, wasn't the purpose of going on the trip to see what Howland and Dunn were going to do and what they were going to see?

A. Yes, sir.

page 1699 } Q. And what they might say?

A. Not what they might say. I was not given any instructions. I used my own initiative in making those notes. No, they didn't, Norfolk and Western did not ask me to spy on them. They did ask me to accompany them and see what procedure they used in their inspection.

Q. So that your purpose in going along was to see what Dunn and Howland did?

A. Where they went and just keep an itinerary, like summarized. What I summarized there is the itinerary. It doesn't have all the other notes I made myself. The summary gives the times that we started and the *placed* that we stopped.

For instance, it tells how many minutes we may have been stopped, and so forth.

Mr. Epps: I would like to move that this be admitted as an exhibit. I have given up on the numbers.

Chairman Catterall: Does anybody object to putting them in?

Mr. Riely: I would like to have the summary, too. I haven't seen it.

Mr. Epps: Sure, put them both in. I do not have the original of the summary.

The Witness: I have the original of the sum-

page 1700 } mary, I believe.

Chairman Catterall: Put it together as Exhibit 23.

The Witness: I did not have a copy.

Mr. Riely: May we have copies made of them?

Chairman Catterall: Before you clip it, Mr. Bailiff.

Mr. Epps: Copies were made of this yesterday.

Mr. Riely: No copies were made sufficient to include me.

Mr. Shannon: The copies I have here cannot be read, Xerox copies.

Mr. Epps: That is the reason we worked with the original; we couldn't read the copies. The summary copies can be read.

Mr. Riely: Here is the original of the summary.

The Witness: That is the original of the summary and that is the original notes as I took them on the trip.

Mr. Riely: May I take them home and Xerox them?

Chairman Catterall: You want to take them downstairs?

Mr. Riely: If we could, yes.

Chairman Catterall: Have them copied on a typewriter.

Mr. Riely: They are right long.

Chairman Catterall: We can do it either way. The exhibit will be available for your use at any time.

page 1701 } Mr. Riely: Thank you.

Chairman Catterall: It will be Exhibit Number 23.

(The papers referred to were marked collectively for identification Exhibit No. 23 and received in evidence.)

By Mr. Epps:

Q. Now, Mr. Maynard, I am back where I was yesterday when I was getting—

Chairman Catterall: Nine minutes as certainly—

Mr. Epps: I didn't have the notes when I said the nine minutes, I'm sorry.

By Mr. Epps:

Q. You heard Mr. Dunn testify that he was employed to obtain a condition percent of the railroad with relationship to new, isn't that correct?

A. Yes, sir; I believe that is what he said.

Q. What is your definition of that, condition percent with relation to new?

A. My definition is that a product or material will have a useful condition as that particular product, and when it is new, it is in 100 percent condition, and through wear and tear or usage, it will reach a condition that no

page 1702 } longer is useful as that product. Then it has zero percent condition.

Q. This is in turn obtained by observation, is it?

A. Not necessarily.

In our particular survey we used measurements to determine a percent condition of rail.

Now, in perhaps the case of a radio or something like that, an electronics man might test tubes—I don't know. It is not necessarily observation, no, sir. It could be, depending on what the product is.

A. L. Maynard

Q. There is a distinction between observed depreciation, let's say, and accumulated depreciation based on a life cycle, isn't there?

A. I don't know that I can get into those definitions. I don't know. You would to describe each one, define each one to me.

Q. All right. We won't get into that. I don't want to ask you something you are not familiar with. I am not smart enough to tell you so I want to pass on.

But I do want to point out the difference, and I think you have done it another way. The difference between what Mr. Dunn was doing and what DeLeuw, Cather was doing, you folks relied on studies of life cycles, didn't you?

page 1703 } A. I don't believe you understand particularly what we did, Mr. Epps.

Q. I think I did.

A. I will tell you what we did.

For ties, we didn't use life cycles in any manner, shape or form.

Q. Let's talk about rails?

A. We went out and looked at individual ties and we, from our experience, all of us were track-experienced people that looked at track—we had signal people look at signals and bridge people look at bridges, or one bridge person made the entire survey, but we didn't study life cycles of ties. We looked at those individual ties and graded them from zero to 100 percent based on how they appeared in the track.

Q. In the case of rails, did you use life cycles in the study of the findings of the American Railway Engineers Association? You said so and so did—Mr. Caywood.

A. You used the term, life cycle. We used not life cycles; we used from AREA studies that have been made relating to headwear of rail to tonnage over the rail. It wasn't a case of years. It was a case of tonnage related to headwear.

Q. Correct. But that wasn't observed depreciation? That is a study of other railroads based on a whole lot of railroads, isn't it?

page 1704 } A. That particular study was a composite of several railroads, including the Norfolk and Western, yes, sir.

Q. Right.

You don't know, do you, what Mr. Dunn's observation was of side tracks, yard tracks, and spur lines at Sewell's Point?

A. No, sir.

A. L. Maynard

Q. You don't know what he had seen and walked on at Lammett's Point, do you?

A. No, sir.

Q. You don't know what other experience he had had with the Norfolk and Western system?

A. No, sir.

Q. You were not with Mr. Howland when he participated in the original engineering evaluation of the Norfolk and Western Railway, were you?

A. Hardly. I wasn't born.

Q. That was the next question.

Now, on page eight of your testimony, you were asked what would be the result of a word you called distortion in the testimony. You indicated that the distortion produced a higher condition percent than is warranted.

As a matter of fact, you don't know what the
page 1705 } effect was on the testimony of Mr. Howland,
do you?

A. Mr. Howland—I will have to read the question and answer to refresh myself about getting in line here.

Q. Page eight.

A. The question, the original question leading up to that, asked me was:

"Since you accompanied Mr. Dunn and Mr. Howland, I would like to solicit your opinion as to the extent to which these gentlemen examined the spur lines, side tracks, and yard tracks of the Norfolk and Western. Do you think a fair sampling was made of this type of trackage?"

My answer was:

"In the eight days in which we were on the road, we stayed on main line track almost the whole time."

I think in the summary notes you have somewhere it adds up to around a thousand miles of main track that we covered with the hyrail car. We did make brief examinations of some yard tracks in Roanoke but as a general rule, the secondary lines of the Company were viewed, if at all, from the switch of the main line and while passing by in hyrail car at speeds up to 45 and 50 miles per hour.

Q. What effect did this procedure have on Mr. Dunn and
Mr. Howland's findings, in your opinion?

page 1706 } A. In my opinion, I did feel that it would dis-

tort. I recall now, I felt that their seeing only the main line tracks would distort the result because, from my experience having covered the branch lines in our survey, the branch lines were in worse condition than the main lines.

Q. Then you were asked:

"Would any such distortion produce a higher or lower condition percent than is warranted by the overall condition of Norfolk and Western's lines?"

And your answer was:

"The distortion would produce a higher condition percent than is warranted."

Now, my question to you is:

You don't know what effect it had on either Howland's or Dunn's testimony, do you?

A. They asked me what my opinion was, Mr. Epps, and having seen these branch lines and having accompanied them when they were looking at main lines, my opinion was that if they were averaging out main line conditions without taking into consideration these branches we didn't go up to, they come up with a higher percent.

Q. So, on page eight, your answer should read: if they did not take these into account, in my opinion
page 1707 } the distortion would produce a higher condition percent than is warranted.

A. I will have to read what the question was again.

Q. The first question on page eight, sir.

A. I have to get the prior questions that led up to that.

Q. All right, sir.

A. It goes right back to that original question. They asked me in direct examination here—"I would like to solicit your opinion as to the extent to which these gentlemen examined the spur branch lines, side tracks and yard tracks of the Norfolk and Western."

Well, my opinion stands that to that degree that I didn't think Mr. Howland had ever seen the branch lines out in the western part of Pennsylvania, it was my opinion he may have—

Mr. Riely: Virginia.

The Witness: Some time, but I don't know—

A. L. Maynard

Mr. Epps: Let him testify.
Mr. Riely: Thank you for your instruction.

By Mr. Epps:
Q. Now, have you ever had as part of your duties the inspection of tunnels by a lower echelon line officer?
A. On the B & O, the tunnel engineer reported to me—or, rather, on the C & O when I was Engineer of Bridges in the building, construction and maintenance of
page 1708 } tunnels, the engineer reported to me.
Q. As a matter of fact, the method used by Mr. Dunn to inspect the tunnels is that used by lower echelon line officers charged with the responsibility of inspecting and maintaining tunnels, isn't it?
A. Certainly is not.
Q. You don't agree with that?
A. I definitely do not agree.
Q. You say you couldn't see the tunnels but you don't know whether Mr. Dunn or Mr. Howland could see them or not, do you?
A. I can't presuppose what someone else's eyes see, you are right.
Q. We know that.
Don't you know that Mr. Dunn made notes of every tunnel, as to the type of lining, seepage, wet ties and ballast and other indicators of tunnel condition?
A. I didn't see Mr. Dunn's notes other than as they were looked at in the courtroom here on the timetables.
Q. You say some of them?
A. I saw him take the notes, but—
Q. You saw him write "F" down once?
A. Yes, but as to every tunnel, I can't say that.
Q. You can't say that he did?
page 1709 } A. I can't say that he did not, right.
Q. Now, is it not a fact that a properly qualified engineer can tell by visual inspection the difference between a track worn an eighth of an inch as contrasted to a track worn a quarter of an inch?
A. Looking down on the top of it, no.
Q. But by visual inspection he can?
A. No, sir.
Q. You don't agree with that?
A. He can't, by looking down on top of it. He has to measure somewhat. It would be hard for a person, any engineer, to say what that wear is without measuring it.

A. L. Maynard

Q. He could tell the difference between an eighth and a quarter?

A. I don't know that he could.

Q. Don't you think you could?

A. I don't say that I could without measuring it, no, sir.

Q. Now, this testimony disclosed that Norfolk and Western had made continual use of the Sperry car to determine defective rail, didn't it?

A. My testimony didn't. I believe Mr. Cay-
page 1710 } wood's testimony, did, as I recall.

Q. The whole DeLeuw, Cather testimony and exhibits show this, doesn't it?

A. I believe so, yes, sir.

Q. *You* notes indicate some additional Sperry, continuing Sperry car use?

A. Yes, sir. My field notes do.

Q. All right.

Isn't it true that when you and Mr. Howland and Mr. Dunn went out on the line there was really only one spot where there had been defective rails and that they were being removed at that time? Isn't that correct?

A. I don't know where all the defective rails were. I can't answer that question one way or the other.

Q. Now, it is true, is it not, that no amount of measurement will discover a fissure in a rail?

A. No amount of physical measurement. Electronic type measurements—I am not an electronics engineer—but somehow they put a current through the rail and they can find fissures. That is what Sperry does.

Q. Right.

A. But no visual observation and no physical measurement.

Q. Right.

page 1711 } You find this about the Sperry car?

A. Yes, sir. Unless it breaks like this one did.

Q. Now, the fact that it has one-eighth inch measurement wear hasn't anything to do with the breaking? It broke because of the fissure, didn't it?

A. It broke because of fatigue. Fissure is the result of a fatigue. A fatigue is tied to the amount of wear.

Q. Let's see if I can get it straight. It broke of fatigue which caused the fissure which, I guess, was already inherent, to grow, and then it broke, is that right?

A. The fissure may not necessarily have been already in-

herent. Many things will cause a fissure. One of the causes is overstressing the rail because these heavy cars we haul nowadays, there is a plastic flow in the metal, the metal bed may have been perfectly sound originally, but that plastic flow starts these little cracks and they, through repeated cycles of loading, develop into the fissures.

Q. Now, you agree, don't you, that the measurement of the headwear hasn't got anything to do with the defective portion of the rail?

A. I will agree to this, that the measurement of the headwear does not indicate that there is a fissure in that particular rail.

page 1712 } Q. Correct.

A. Measurement of headwear indicates how much tonnage had gone over that rail.

Q. Now, if you find a fissure or transverse defect by a Sperry car, the rail is removed immediately, isn't it?

A. Normally.

Q. Should be?

A. Sometimes it will be angle-barred if rail is not available to protect that particular spot, and when later removed, try to get them out as soon as you can.

Q. Corrective action is taken immediately?

A. Yes, sir; should be.

Q. If it is big enough, if this fissure or the transverse defect is big enough to cause a break, then something is wrong with the Sperry car inspection, isn't there?

A. No, sir; the whole intent of the Sperry car is to try to catch these fissures before they break. But we do have fissures which can develop very rapidly under heavy loading and this is an example of one that developed and broke.

Q. Right.

A. But the fact that there was a one-eighth inch headwear in this rail really has no relevance to the gneral statement made by Mr. Dunn about rails with one-eighth headwear, has it?

page 1713 } A. I think it does because he made the statement, and I will have to repeat it verbatim, if I can find it, I think it was quoted to me that his statement was: any rail on a tangent track that has only one-eighth inch headwear is going to be around for a good many years and get many, many more years of service.

That, I say, is not true because this particular rail is one of the any rails. It has one-eighth inch headwear and it broke under traffic, actually under a train; if you will note

the batter—luckily, the train didn't derail when it went over this track but it broke under a train. It is a piece of scrap rail right now, so that particular rail with only one-eighth inch of headwear did not and will not get many, many more years of service.

Q. That is certainly true. But that is completely non-typical or atypical.

A. No, sir; no, it is not non-typical. On the Shenandoah Division, for instance, we took many contours and I don't know if you are familiar with what I mean by contours, but we have a machine and it is in Mr. Caywood's testimony, where we can actually trace the head of the wear and these are some of them. We took many contours of rail up there that

page 1714 } the Sperry car had found numerous defects in that it had only one-sixteenth inch wear but the tonnage was light over that particular line and studies indicate that on lighter tonnage lines the total tonnage life of the rail is not as great as it is on heavy tonnage lines.

Q. How many rails on tangent with one-eighth inch headwear had such a defect?

A. I don't know.

Q. You don't know a percentage?

A. No, I wouldn't know.

In track, I would hope not too many because as the Sperry car goes out we try to get them out.

Q. So this is a very unusual circumstance?

A. Oh, no, sir. That is not an unusual circumstance. That is a very normal circumstance. It indicates to me that Norfolk and Western is going to have to put some additional rail out on that particular line pretty soon because the first indication that you are getting these fatigues are one or two failures. Usually you detect them with the Sperry car, that number of failures. It increases and it indicates that the rail is fatiguing. For maintenance purposes, you don't wreck trains and you have to get that type of rail out of the track.

Q. Now, control cooled rail eliminated practically the danger of fissures, hasn't it?

page 1715 } A. No, sir. Control cooled rail first reduced them until we got to these heavy cars. The early fissures were mostly caused by internal defects like you mentioned earlier, mill defects or, they call them, shadow cracks.

Q. But when we get—

A. A lot of fissures from Shelly rail, which are called de-

tail fractures—in fissures today, this is a lot of fissures developing and the curve has started to go back up on the fissure rails. For many years, when they first started to detect them, it took a sharp drop.

Q. This particular one was, this particular rail was replaced with a control cooled rail, wasn't it?

A. If I recall, it was.

Yes, sir, in this particular rail, it was a control cooled rail, also.

Q. Tell us what a piece of rail is that has a zero condition?

A. In my definition a piece of rail that is in zero percent condition is no longer useful as rail.

Q. Could cause a derailment, perhaps?

A. Because its useful life as rail has expired. It will be zero percent condition for my definition.

page 1716 } Q. Would it cause a derailment in your definition, use of it?

A. I would hope that zero percent condition rail would be out of track.

Q. Long since removed?

A. Not necessarily long since removed. I would call that zero percent condition rail (holding exhibit.)

Q. There used to be an old saying that if you could hide a pencil under the head of a rail—

A. I don't particularly accept it. It is just one of these old roadmaster type things, that the rail is still safe. Well, apparently it is safe beyond that point because you can't hide a pencil under this particular rail, but I would certainly call that a zero percent condition rail. It is no longer suitable as rail.

Q. If zero percent under your definition condition rail was in the road, would it cause a derailment?

A. I don't think you can have a zero percent condition rail in the road at that time. There is a moment of time that as soon as you take it out, you take it out when it might be one percent or a tenth of a percent, but you don't have a zero percent condition rail in the track.

page 1717 } Q. The fact it is in there and bearing traffic, it means it has some percentage greater than zero?

A. It might be minute, but it has some percentage greater than zero.

Q. In your DeLeuw, Cather study, you made no allowance whatsoever for line and surface, did you?

A. We made two appraisals in our survey. One, a percent

condition, variable materials. We made no percent appraisal of line and surface as such.

The other condition or appraisal we made was a bare bones value and we gave no value to line and surface in that bare bones appraisal.

Q. As a matter of fact, line and surface has a substantial relationship to the value of track properties, does it not?

A. Depending on your usage being put of the track.

Q. Assuming you are going to use the track?

A. Assuming you are going to use the track.

Q. Or can use the track?

A. It is not a value you can sell; it is kind of a deferred type thing. You don't have to spend it if you already have it.

Mr. Epps: That's all, sir.

REDIRECT EXAMINATION

By Mr. Riely:

page 1718 } Q. In answer to one question by Mr. Epps, you said that Mr. Howland didn't see the Sperry tracks in western—what state?

The Witness: Bedford, Pennsylvania—I lived in Bedford. And when I think of Bedford, I think of Pittsburgh.

Q. Now, when you saw this tunnel with the date on it, 1912 was the date inside the tunnel?

A. No, sir; it was on the outside portal.

Q. This was in the sunlight?

A. Yes, whether sun or haze, but on the outside portal.

Q. It was on the outside.

Now, Mr. Epps asked you yesterday whether you had examined the Knitting Mill Branch.

Mr. Epps: I didn't examine him yesterday.

Mr. Riely: Excuse me—Mr. Shannon asked you yesterday whether you had examined the Knitting Mill Branch. What was your answer to that question?

A. At first I started to say I had. I saw so many branches I thought a second and said, no, I didn't observe that particular branch.

Q. Did anybody examine it for DeLeuw, Cather?

A. L. Maynard

A. Yes, sir; we examined every foot of main track on the Norfolk and Western in Virginia. There were four of us. Mr. Floyd Smith made the survey on the Knitting Mill Branch.

page 1719 } Q. What was his background and experience?

A. He has a railroad background of, he has progressed on the railroad through position of an assistant division engineer and he left the railroad and went with DeLeuw, Cather.

However, he was one of the persons working on the track portion of the DeLeuw, Cather's work for the rapid transit system in Washington, D.C.

Q. How about the City Point Branch which I believe Mr. Shannon also asked you about?

A. As I recall, I said I didn't observe it and I didn't. I didn't see it, for that matter, on our trip with Mr. Dunn and Mr. Howland because we didn't go up to Petersburg. I have never seen the Petersburg line.

Q. Who made it for DeLeuw?

Mr. Epps: If he wasn't there and didn't see it, how can he testify?

Mr. Riely: He is testifying as to this examination that was made by DeLeuw, Cather in which he was in charge under Mr. Caywood and these were people that reported to him. I suggest to the Commission it is perfectly appropriate.

Mr. Carter: He can't describe what he said, of course.

page 1720 } Mr. Epps: As to rebuttal?

Mr. Riely: I am rebutting what? The implication given in Mr. Shannon's questions that nobody looked at these branches.

The Witness: The City Point Branch was, both Mr. J. F. Dunsett and Mr. F. R. Smith, were on the appraisal of the City Point Branch.

Q. If I asked you the same thing about every branch in the Norfolk and Western, could you tell me who examined it?

A. Yes, sir.

Q. As a matter of fact, how about the Little Tom's Creek Branch? Have you got any pictures of that?

A. I examined that one myself. Yes, sir; I did take many pictures when I made my examination to refresh my memory because, seeing so many branches, those pictures became very useful to me later.

Mr. Carter: I don't think he can testify. He can't testify as to whether or not they examined those branches unless he was with them. He can't testify what they said.

Mr. Riely: He just testified he examined the branch we are talking about, Little Tom's Branch.

Mr. Carter: I am talking about the other branches, Mr. Smith and others.

Were you with them when they examined?

page 1721 } Mr. Riely: May it please the Commission, I again repeat, he, under Mr. Caywood, is in charge of making these investigations. These gentlemen reported to him. He was supervising them. He is entitled to, his testimony is obviously based on their reports because he could not physically examine every mile of line himself and he is entitled to testify as to their reports.

Mr. Carter: It is all hearsay.

Chairman Catterall: Of course you have to consider hearsay in a case as voluminous as this.

By Mr. Riely:

Q. Have you got pictures of the Little Tom's Creek?

Mr. Shannon: I am going to object to that. I asked Mr. Maynard if he has inspected, personally inspected the Little Tom's Creek Branch. He said he did. I don't see what these pictures are designed to rebut.

Mr. Riely: Show what he saw.

Mr. Shannon: I am going to object to any further evidence being given.

Chairman Catterall: If he inspected it and nobody contradicted him and we do not have to have his fingerprints to show he was there—

Mr. Riely: Just to show—Mr. Shannon's im-

page 1722 } plication was that he did—

Mr. Shannon: I phrased my question: have you, personally—

Chairman Catterall: I think you are right about that. Let's not get into any more pictures. We know he was there; we take his word for it; he has told us what he saw. And I think we are just being repetitious.

By Mr. Riely:

Q. Are your records such that you could tell us the condition as reported in your survey at any milepost on the Norfolk and Western?

A. I could readily find them on the miles that I personally inspected. I think I could find them in notes of other people because their notes are pretty neat on the miles they inspected.

Q. Every mile was so inspected by your team?

A. Yes, sir.

Q. Now, just to make it perfectly clear, we have referred to Sperry rail today. What is Sperry rail? What do you mean by that?

A. Sperry rail is a sort of a slang term to refer to any rail that Sperry rail service has detected as having a fault or flaw. We refer to that as a Sperry rail.

page 1723 } Mr. Riely: I have no further questions.

Chairman Catterall: I guess this witness may be excused?

Mr. Riely: May two exhibits be admitted in evidence?

Chairman Catterall: Exhibit 23.

Mr. Riely: Exhibits 1 and 2-ALM. I put them in for what they are worth.

Mr. Shannon: He started with these pieces. I objected to this in the first place.

Judge Dillon: I will take it home for my workshop.

Chairman Catterall: That would make a very good doorstop.

Mr. Carter: Not much life left in it.

Mr. Riely: I don't think you will put it in the case jacket but I would like it admitted in evidence.

Chairman Catterall: It will be admitted into evidence.

Mr. Riely: Thank you.

(The exhibits referred to, marked 1 and 2-ALM, were received in evidence.)

Mr. Riely: Mr. Maynard may be excused?

Chairman Catterall: He can be excused.

(Witness steps aside.)

page 1724 } Mr. Riely: Exhibit 1-ALM, which is the little one, and Exhibit 2-ALM, which is the big one.

Judge Hooker: In evidence.

Mr. Riely: I will call Dr. Zeis, please.

Mr. Shannon: Before Dr. Zeis comes around, I would like to request one thing of the Commission here. Yesterday, I

asked the witness for the R.F.&P., and I asked, I believe, the witness for C & O, maybe one or two others, specific questions about reduction in land value as a consequence of cuts. Specifically I asked about the cut on the R.F.&P., both under Monument Avenue, Patterson and Grove. I asked about Rugby Road. I would like to request that this Commission permit reference to the official records of the Commission pertaining to the valuation of the land and to the reduction that was made in consequence of the grading of the cut. They will be available to Mr. Riely, too.

Chairman Catterall: As I understand, the records are opened to inspection by either side, copying or quoting, anything you please.

Mr. Shannon: My purpose is, I asked a specific question and quoted the amount and he accepted it. I would like to have that confirmed from the record.

Mr. Riely: Put your witness on, Mr. Shan-
page 1724-A } non; you have got them.

Chairman Catterall: All of the records of the Commission are available.

Mr. Shannon: Simply to refer to the—

Mr. Riely: Dr. Zeis has not been sworn.

Whereupon, PAUL M. ZEIS, being first duly sworn, was examined and testified upon his oath as follows:

DIRECT EXAMINATION

By Mr. Riely:

Q. Would you state your name and address, please.

A. My name is Paul M. Zeis. My address is Roanoke, Virginia.

Q. What is your current employment?

A. I am currently Director of Research for Norfolk and Western Railway.

Q. Can you breifly outline your present duties, Dr. Zeis?

A. In my present position, it is part of my assigned duties to make a constant evaluation of the various sections of the transportation industry in this country and the major individual companies within each mode of transportation.

More specifically, in connection with the vari-
page 1725 } ous merger proceedings in which the Norfolk and Western has been involved I have had occasion to evaluate railroads such as the Erie, Delaware and Hudson, and the Boston and Maine as well as a number of

smaller companies in the Northeast and in other sections of the country.

Q. Before coming to the Norfolk and Western, have you had similar experience?

A. Prior to joining the Norfolk and Western, I have had many years of experience in academic service, in government service and in the railroad industry. Nearly all of this experience involved some phase of the transportation industry and much of it affected problems such as are being considered in this proceeding.

Q. Please describe your academic background.

A. I hold a Doctorate from Princeton University in Government and Economics. Subsequent to leaving Princeton I taught at the University of Nebraska and at the University of Akron over a six-year period. During most of this time I offered a course in Government and Business which was concentrated on the questions of public finance and the regulation of public utilities.

Q. Describe your activities after leaving teaching.

page 1726 } A. In 1942 I left the teaching profession for a position as Budget Examiner with the United States Budget Bureau. During most of the war period I was initially responsible for the budgets and operations of the Office of Defense Transportation and the War Shipping Administration. In 1944 I was requested by the Chairman of the Civil Aeronautics Board to make a study for that agency of the post-war air service pattern to Europe. After completing this assignment, I transferred to the Department of Commerce as a Transportation Economist and later served as the Chief of the Transportation Division for the Department of Commerce. In that capacity I served as advisor on transportation problems to the Secretary of Commerce, and I was the author of his report to the president entitled "Issues Involved in a Unified and a Coordinated Federal Program for Transportation." In 1952 I left government service to take a position with the Akron, Canton & Youngstown Railroad. With that road I served in a number of executive positions, including Vice President of Research and Vice President of Finance, and I served on its Board of Directors. I was responsible for all tax reports, both federal and state, and my duties included frequent appearances before the state officials concerned with valuation and tax problems.

Q. Will you tell us about the professional organizations of which you are a member and about your publications?

Paul M. Zeis

page 1727 } A. I am a member of the American Economic Association and the Transportation and Public Utilities Subdivision of that organization. I am also a member of the Transportation Research Forum and have participated frequently in its proceedings. I am a former Vice President of the Railway Systems and Management Association, and I am presently on its governing board. I am a member of the Research Committee of the Transportation Association of America. I am the author of one book and numerous government studies and monographs dealing with all forms of transportation. I have represented the United States Government overseas at inland waterway conferences and most recently my paper on competitive rate making in the United States was awarded a major prize at the Pan American Railway Congress in Buenos Aires last year.

Q. What have you done to prepare for your testimony in this case?

A. I have reviewed the testimony submitted by Dr. J. Rhoads Foster as well as the transcript of his answers on cross-examination. I have likewise reviewed the testimony of other witnesses who appeared in this proceeding.

Q. What is the nature of your testimony of rebuttal?

page 1728 } A. I wish to offer evidence in rebuttal which will demonstrate that the proposed increase in valuation of the Norfolk and Western track property is excessive and that the valuation of the portions of the property at issue in this proceeding should be reduced rather than increased.

Q. Do you depart from the principles of valuation outlined by Dr. Foster in his testimony and cross-examination?

A. In approaching the question of valuation, I agree with much of the testimony submitted by Dr. Foster, although I should point out that Dr. Foster was discussing general principles of valuation and admitted that he had made no study of the economic worth of the Norfolk and Western or for that matter of the other railroads operating in Virginia. As the cross examination brought out, Dr. Foster had made a detailed valuation of the Pennsylvania Railroad in connection with a valuation proceeding in Ohio some years ago. With the general approach which he followed in that proceeding and with the general conclusions which he reached, there is no serious dispute. In fact, after taking into account the peculiarities of the taxation system applicable to railroads in Virginia, there is no reason why the general

principles advanced by Dr. Foster cannot be applied to the situation of the Norfolk and Western in Virginia and my rebuttal testimony will do that.

Q. Have you made a study of the situation of the railroad industry presently as compared with 1926, when page 1729 } the last general valuation of track property was established, and since 1902, when the present constitutional provisions applicable to the railroad industry in Virginia were adopted?

A. Yes. I have made such observations, and I believe it is significant in the light of these observations that the franchise tax system dates from 1902 while the assessments of track property which is locally taxed essentially were determined by the 1926 assessment prior to the great increase currently proposed and being contested in this proceeding. In 1902 the railroads had a virtual monopoly in the movement of both goods and people and the burden of local and state taxes could be shifted to the customers of the railroads. To a very considerable extent this was still the situation in 1926 although competition in the movement of people and merchandise was showing signs of developing. In 1969 railroads are confronted with strenuous competition for the movement of every ton of merchandise and have virtually been eliminated from the market in the movement of people. In short, although still subjected to constitutional and regulatory provisions applicable to public utilities with monopoly markets, the railroads are actually subject to as much or more competition as confronts any other type of business organization operating in Virginia.

Q. To what conclusion do these observations page 1730 } lead you?

A. Under the circumstances, it is completely irrelevant to contend that because pieces of railroad track property cost more today than they did in 1926 that they are worth more. Looking at the railroad industry as a whole, it is clear that under the type of valuation envisaged by Dr. Foster or for that matter by an competent security analyst, the railroads are worth less today than they were in 1926. Net railroad operating income of all line haul railroads of the United States in 1926 was $1,229,000,000 and net income was $883,000,000.

And by that, I am referring to the Pennsylvania and New York situation where they wrote off an awful lot of property in connection with the consolidation.

Paul M. Zeis

Ordinary income exclusive of extraordinary items involved in mergers was $554 million in 1967 and $593 million in 1968. The accompanying graph indicates the extent of the decline in net income shown by these figures.

Q. That is a graph that is marked Exhibit 1-PMZ?

A. That's correct.

Mr. Riely: I ask the Commission that this be admitted in evidence.

Chairman Catterall: All of these will be admitted and will be identified as the witness identified them.

Mr. Riely: Thank you.

page 1731 } (Exhibits 1-PMZ to and including Exhibit 7-PMZ were received in evidence.)

By Mr. Riely:

Q. Now, what conclusion does this lead you to?

A. This exhibit shows that in terms of return on total investment or in terms of income available for stockholders, the railroads are clearly less valuable than they were 40 years ago.

Q. Is the same decline in net income present on the Norfolk and Western system itself?

A. Yes. The present Norfolk and Western system, of course, bears little resemblance to the Norfolk and Western Railway as it existed back in 1926 or 1927, but a comparison of the operating results of the present Norfolk and Western with the operating results of the individual railroads which subsequently became part of the Norfolk and Western shows that the present system or that part of it located in Virginia has no greater value than did the individual components back in 1927. In 1927 the net income of the Nickel Plate, Pittsburgh and West Virginia, Wabash, Virginian and Norfolk and Western totalled $50,586,000. Comparable net income for Norfolk and Western after adjustment for special federal income tax credits was $38,055,000 in
page 1732 } 1967 and $39,790,000 in 1968. Thus, on a net income basis, current results are clearly less favorable than those of 40 years ago. Details of the adjusted net income for the years since 1960 are shown in the attached exhibit.

Q. That is Exhibit 2-PMZ?

A. 2-PMZ.

Q. Have you made a study of the franchise tax as it has a bearing upon the valuation of property in this proceeding?

Paul M. Zeis

A. Yes. The franchise tax stems from a provision of the 1902 Constitution, which was originally imposed at a time when the railroads did have a monopoly in the movement of merchandise and people. The monopoly has long since disappeared, but the franchise tax continues as a burden upon Virginia railroads, including the Norfolk and Western. No similar tax applies to the trucking business or for that matter on manufacturing and commercial establishments which own their own trucks. On a national basis, goods moved by truck represent the quivalent of $3 of freight revenue for every $1 of freight revenue obtained by the railroad industry, and there is no reason to doubt that a similar relationship prevails with respect to the movement of goods within and through the State of Virginia. My purpose here, however, is not to discuss the fairness of the franchise tax, but rather its impact on the valuation of prop-
page 1733 } erty which is involved in this proceeding.

Q. How do you view the franchise tax as affecting valuation of property involved here?

A. Witnesses in this proceeding have had considerable difficulty in trying to describe the value of the franchise and the nature of the franchise tax. In general, I concur with Dr. Foster that the entire property must be looked at as a unit and that the franchise to operate and the tangible property together should be valued on a basis which reflects present and prospective earning power of the property as a whole. Some portion of this total value can then be allocated to the State of Virginia using the various allocation factors commonly employed. It is also clear that the franchise is an essential ingredient of the company because if the right to operate were discontinued, the tangible assets would have to be disposed of for whatever they would bring on a salvage basis. Thus, even if the company is not making earnings above the average to justify real value for the franchise, as implied by Dr. Foster, once the business is in operation and a lot of capital has been sunk in it, preventing the cessation of operations does have value since the capital once sunk in the railroad business cannot be effectively transferred elsewhere. This, of course, is only partly true with respect to locomotives and cars since presum-
page 1734 } ably some railroads would continue operating in other parts of the country and would provide a market, even if a depressed one, for locomotives and freight cars. Most of the remaining assets, however, would have to be disposed of on a salvage basis.

Paul M. Zeis

Q. As an economic matter then, do you view the franchise tax as a part of the property tax system in Virginia?

A. As noted earlier, the franchise tax in Virginia results from the provisions of the Constitution of 1902. It was imposed to insure that no elements of value in a going railroad system would escape a fair share of taxes. Since at that time the railroads has an effective monopoly in the field of transportation, the burden of the tax was normally passed on directly or indirectly to the users of railroad service.

Under today's highly competitive conditions in the transport field and in view of the fact that the franchise tax does not apply to the major form of competitive transportation —motor trucks—it is clear that the burden of the tax now falls directly upon the railroads just as is true of property taxes on land, rolling stock and track structures.

The franchise tax under today's conditions is clearly not an excise tax and it is also not an income tax since it falls upon the carriers whether they have any in-
page 1735 } come or not. In fact, the tax is clearly what the State Corporation Commission and the courts have held it to be, namely, a form of property taxation. As a property tax, its impact must be considered in connection with the imposition of other property taxes in order that the total of the property taxes levied does not impose an inequitable burden on the railroads as compared with other taxpayers.

Q. How can the value of the franchise which serves as the basis for the franchise tax be determined?

A. As I noted earlier, other witnesses in this proceeding have had difficulty in measuring the value of the franchise. The tax is a tax on gross receipts or rather that portion of receipts allocated to Virginia on a track mile basis. While not levied directly on any piece of tangible property, its burden falls on all of the tangible properties linked together as a going concern. The value of the property on which the burden falls is, accordingly, equivalent to the value of sufficient pieces of tangible property which at current assessed values and current tax rates would produce an amount of tax revenue equivalent to that produced by the franchise tax. This relationship necessarily follows from the role of the franchise tax as a property tax in the taxation scheme in the State and the lack of any indication that
page 1736 } the franchise is singled out for a heavier tax burden than other items of property.

Q. Have you determined a value for the franchise of the Norfolk and Western in Virginia?

Paul M. Zeis

A. The franchise tax paid by the Norfolk and Western was $2,211,629 in 1967 and $2,025,010 in 1968. Using the 1968 yield for the franchise tax, the average property tax rates in effect and the applicable relationship between assessed value and full value leads to a conclusion that the full value of the property necessary to equal the yield of the franchise tax must be $157,927,728. This is the procedure used and the figure arrived at by Mr. Koncel in his testimony, and I concur with that method and the amount which it determines. Accordingly, in arriving at a valuation of tangible Norfolk and Western property in Virginia for property tax purposes, it is necessary to subtract this sum from the total value of all tangible property units of the Norfolk and Western in Virginia.

Q. Does the value of rolling stock taxed in Virginia also need to be deducted from the total value of the railroad in Virginia in order to calculate the value of the track property?

A. Yes. The second phase of the property tax system applicable to Virginia railroads is the tax on rolling stock, which imposes a tax on that part of the total

page 1737 } property of a railroad in Virginia. The fact remains that the tax on rolling stock constitutes a property tax upon the railroads in Virginia. Accordingly, to determine the reasonableness of the valuations assigned to track structures, it is necessary to consider the impact of the rolling stock tax as if it were local property locally taxed just as has previously been done in the case of the franchise tax. In 1968 the rolling stock tax on the Norfolk and Western produced a yield of $2,017,396. This yield was based upon an assessed value of $80,695,848, which at the present 40 percent equilization ratio, represented a full value for the rolling stock of $201,739,620.

Q. Based on your calculations then, what is the extent of the property taxed by those two taxes, the franchise tax and the tax on rolling stock?

A. If one assumes that there is some degree of equity in the taxation of property in Virginia both on a state and on a local level, it is clear that the combined effect of the franchise tax and the property tax on rolling stock is equivalent to the taxation on a local level of property with a full value of almost $360,000,000.

Q. What other property needs to be deducted from the total value of Norfolk and Western property in Virginia to determine the value of its track structures?

page 1738 } A. The value of locally taxed real estate and locally taxed track structures represent the residual values which remain after the State has taken its share of the property taxes imposed against all of the property values of the enterprise. Thus, from the total value of all Norfolk and Western property in Virginia, the above determined values for rolling stock and franchise plus the value of locally taxed property other than track should be deducted to arrive at the maximum value of locally taxed track structure.

Chairman Catterall: The Commission will recess for ten minutes.

(Short recess.)

Chairman Catterall: You may resume.

Whereupon, PAUL M. ZEIS resumed the stand and testified further as follows:

DIRECT EXAMINATION RESUMED

By Mr. Riely:

Q. Have you determined the amount of property other than track structures which were assessed for property taxes at a local level in 1968?

A. The 1968 Norfolk and Western assessments for property taxes at a local level included an assess-
page 1739 } ment of personal property of $6,150,695 with a full value of $18,161,322. The assessment for land and improvements was $21,727,383 and its full value was $64,155,027. The total of these items at full value is $82,316.349.

Q. What then is the total value of property exclusive of track taxed in Virginia?

A. Combined with the elements of property which are assessed and taxed at the State level, the total full value of the Norfolk and Western operating property in Virginia subject to property taxation is $441,983,697, exclusive of the property which is included in the various track accounts. This figure is the amount which must be deducted from the properly determined total value of the Norfolk and Western property in Virginia in order to determine the value remaining which is applicable to the track structure.

Q. Have you made a study of the value of the Norfolk and Western using Dr. Foster's conception of value?

Paul M. Zeis

A. Yes.

Q. Can you briefly outline that conception?

A. Dr. Foster's conception of value is that the value of a railroad is essentially determined by present and prospective earnings with present earnings and those of the near past used as the basic consideration for predicting what future earnings are likely to be. It is Dr. Foster's contention, with which I agree, that in competitive enterprises like railroads, earnings determine value rather than the reverse as is still true in the case of monopolistic public utilities whose rates are limited by regulation rather than by competition.

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Q. How did Dr. Foster apply this concept in the Ohio study which was referred to in his cross examination?

A. In the Ohio study made by Dr. Foster, he describes his procedure in evaluating 12 representative railroads, including the Norfolk and Western, as a prelude to his valuation of the Pennsylvania Railroad. The general result of Dr. Foster's examination of the 12 roads, including the Norfolk and Western, was that the return on equity averaged 11.5%. After balancing the claims of equity holders and the claims of the holders of fixed debt according to the relationship existing among the 12 railroads, Dr. Foster applied this relationship to the Pennsylvania. Because of the doubtful quality of Pennsylvania earnings, Dr. Foster raised the return on equity to 12.5 percent and arrived at an earnings price factor of about 10. In other words, a property which produced net railway operating income of about $100 million would be expected to be worth approximately $1 billion.

Q. Have you analyzed the results of the Norfolk and Western using the same procedures followed by Dr. Foster?

page 1741

A. Yes. I have analyzed results of the Norfolk and Western over the past five years using the same basic procedures followed by Dr. Foster in determining the relationship between equity and fixed capital and using the same rate of return on equity for investment grade railroads which he employed, namely, 11.5 percent. The only significant variation in Dr. Foster's procedure was in connection with the proper rate on debt capital where it has been necessary to take into account the sharp rise in interest rates which has occurred since 1965. The Norfolk and Western is currently paying up to 8 percent on equipment financing. Actually, it is over 8 percent now.

Triple A utility bonds are currently being marketed at

Paul M. Zeis

7-3/4 percent, and as of now the prime rate offered by New York banks to select customers *if* 8-1/2 percent with the condition that deposit balances be maintained. The effect of those is to raise the effective rate of interest to about 10 percent. Despite these evidences of 8 percent money or higher, in the interest of conservatism I have applied a 7 percent rate to that portion of the Norfolk and Western capital represented by fixed obligations.

Q. What is the result of your calculation
page 1742 } based upon Dr. Foster's methods?

A. Based on the averages of the last five years, the composite rate on fixed and equity capital is about 9.4 percent or slightly below the 10 percent composite rate which Dr. Foster arrived at for the Pennsylvania two years ago. The reasons for the reductions are the greater proportion of fixed debt as compared with equity capital and the use of 11.5 percent for equity capital rather than the 12.5 percent which Dr. Foster considered appropriate for the Pennsylvania.

Exhibit 3-PMZ shows the detail of this calculation.

Q. What does this calculation show with respect to the fair market value of the Norfolk and Western system?

A. It shows that a fair value for the Norfolk and Western system can be arrived at by capitalizing its net railway operating income on a 9.4 percent basis.

Q. Have you made that calculation?

A. Net railway operating income as reported to the Interstate Commerce Commission was $105,770,000 in 1964, $117,939,000 in 1965, $128,518,000 in 1966, $104,770,000 in 1967 and $106,883,000 in 1968. The trend is clearly downward since 1966 despite boom conditions in economy, but the average for the past five years is $112,776,276. Capitalizing this income on a 9.4 percent basis in accordance
page 1743 } Dr. Foster's procedure produces a total value for the Norfolk and Western system of $1,195,-428,526.

Q. Is there an adjustment which needs to be made to this calculation?

A. Yes. As I indicated previously in Exhibit 2-PMZ and as Mr. Koncel pointed out in his testimony, the operating results should be adjusted to reflect certain federal tax benefits included in the net railway operating income figures above. If proper adjustment is made for these factors, the net railway operating income would have been $80,691,000 in 1964, $88,532,000 in 1965, $90,378,000 in 1966, $70,219,000 in

1967, and $72,533,000 in 1968. Again, the trend has been downward since 1966 and the five-year average is $80,471,000. Capitalized on a 9.4 percent basis, this would produce a total value for the Norfolk and Western system of $852,992,600.

Q. Both of those valuation figures are shown on Exhibit 3-PMZ?

A. Yes.

Q. Does this value represent the total value for the Norfolk and Western system in all states based on the methods and procedures outlined by Dr. Foster as proper in the valuation of railroads?

A. Yes. That is correct.

page 1744 } Q. What further needs to be done in computing the total property value in Virginia?

A. The final problem in measuring property values in Virginia is the allocation to Virginia of the appropriate percentage of the total value of the enterprise. On a track mileage basis that allocation is 19.72 percent. On other allocation bases, the percentage attributable to Virginia is somewhat higher, and using a combination of these factors, Mr. Koncel in his testimony arrived at an average allocation factor of 28.29 percent. This figure seems reasonable to me, particularly in view of the fact that during the past two years freight car mileage in Virginia was 28.55 percent, and 29.33 percent, respectively, of total freight car mileage and normally there is a good correlation between freight car mileage, gross revenues and railroad operating income. In any event, not more than 30 percent of the value of the Norfolk and Western system can reasonably be assigned to Virginia.

Q. With an allocating percentage of 30 percent, what would be the total property value of the Norfolk and Western in Virginia?

A. Assigning 30 percent of the property value of the Norfolk and Western to Virginia based on the capitalized earnings value as reported to the Interstate Com-

page 1745 } merce Commission without adjustment for the tax factors mentioned above produces a value for all property in Virginia of $358,628,558. This represents the maximum figure for the value of all property. If proper adjustment is made, as it should be, for federal income tax accounting factors, 30 percent of the capitalized value would produce a total value for Norfolk and Western property in the state of Virginia of $255,897,780.

Q. What do these total value figures for all Norfolk and

Western property in Virginia show about the track assessment?

A. Regardless of which of the earnings figures, adjusted or unadjusted, for the above-mentioned federal income tax factors is used, the result makes clear that the property values already taxed in Virginia by state or local units exclusive of the track structure exceed the true values which are subject to taxation. The values taxed by the franchise tax and the property tax on rolling stock plus the locally taxed property amounted, as shown above, to over $440,000,000, far in excess of the total fair value of Norfolk and Western property within the State.

Q. Will you summarize your conclusions about the valuation of Norfolk and Western property in the State of Virginia?

A. On the basis of the foregoing analysis, page 1746 } which has carefully followed the principles of valuation approved by Dr. Foster and which has also employed his procedures in determining the capitalization of earnings, it is apparent that prior to the reassessment of the track structures all of the property values in Virginia were more than fully assessed and indeed the railroad has been overtaxed. Indeed, on the basis of sound principles of valuation no tax at all should be imposed on the track structure and Dr. Foster's testimony indicates that there are situations in which he would agree that this was the equitable result. The fair value of all of the property in Virginia of the Norfolk and Western is $255,897,780 computed according to the principles of Dr. Foster, but the fair value of the rolling stock taxed in Virginia ($201,739,620) and the personal property and land and improvements taxed by local assessments, local people, $82,316,349 together total $284,055,969 which exceeds the total value of all the Norfolk and Western property in Virginia even disregarding both the franchise and the tax imposed on it.

Only by completely eliminating the franchise tax and by using figures for net railway operating income unadjusted for temporary federal tax benefits is it possible to produce any element of value for the track accounts. Using the high unadjusted income figure, the value of all prop- page 1747 } erties in Virginia still would not exceed $358,628,558. Then if one subtracts from this value the property values represented by rolling stock, personal property and land and improvements and ignores the franchise completely as representing anything of value, the

resulting property values applicable to the track accounts would be $74,572,589. This figure obviously represents a gross overstatement of track structure value. It should be compared, however, with the $91,644,710 which represented the full value of the track structure according to the 1967 assessment and graphically shows that the $141,851,035 full value of the track properties proposed by the assessment now being contested is radically overstated.

Q. Does Exhibit 4-PMZ show the results of the computation of elements of value for Norfolk and Western in Virginia?

A. Yes. The results of the above computation of the elements of value of the Norfolk and Western in Virginia, which are based on principles outlined by Dr. Foster in his testimony and cross examination, are summarized in Exhibit 4-PMZ.

This exhibit computes the possible value of track accounts using the above outlined principles and readily shows that only under Part 4, which represents the most radical approach to valuation consonant with the prin-
page 1748 } ciples of Dr. Foster, is there any value available to be assigned to the track accounts. Even that value is substantially less than the value on which the previous assessment of the track property of Norfolk and Western in Virginia was made and, of course, is far less than the amount of value proposed for the track accounts by the increased assessment which is being contested.

Q. Turning to another problem, Dr. Zeis, would you comment on the merits of using an 80 percent factor applied against original cost figures to determine the value for the railroad's track structure for *ad valorem* purposes?

A. This theory of taxation of assets at book value or a percentage thereof may well be appropriate in the case of general public utilities which have a rapid growth rate and with a monopolistic price structure where rates are limited by regulatory authority and not by competitive forces. The theory is most definitely not appropriate in the case of railroads which have long since ceased to be growth industries and which in fact have their rates determined by competition rather than by regulatory agencies. In the case of enterprises subjected to intense competition, book values of assets have no relationship whatsoever to the real value of the company in terms of fair market value. Moreover, in the case of declining industries such as the rail-
page 1749 } roads, an assumption that assets are worth

80 percent of their original cost simply is not true.

Q. Then in your opinion only in rare cases would there be any correlation between the book value of a company's assets and its value in the market place as indicated by the values represented for its debt capital and its stock?

A. Yes, that's right. Careful analysis company by company of firms listed on the New York Stock Exchange would bear this out. In the case of growing prosperous companies the normal pattern is for the market value of stocks and bonds to far exceed the book value of its assets. If one confines the picture to stock alone, the book value of the stock is almost always far below the value of the stock as measured by its price on the Exchange. That is for growing companies that have rapidly rising earnings.

Conversely, in the case of depressed industries with declining markets, such as the railroads, the book value of the shares is usually far above the actual work as measured by market price.

Q. Would the terms of actual sales and abandonments of railroads during the past 20 years support your theory?

A. Yes. Some railroads, like the Rutland I mentioned here —the New York, Ontario and Western is another—have gone out of business and have become worthless page 1750 } although their books still show assets worth millions of dollars.

Other railroads, like the New Haven, have gone into receivership under conditions where what was finally realized was only a small fraction of the book value of the assets as carried in the company's books of account.

Still other railroads have been sold to larger carriers, and, in most cases, these sales were figures which represented only a fraction of the book value of the assets.

In fact, the railroad by which I was formerly employed was sold to the Norfolk and Western for a figure representing less than two-thirds of its book value and during the past few years, to my knowledge, Norfolk and Western has acquired by purchase or long-term lease three other railroads: namely, Pittsburgh and West Virginia, the Erie-Lackawanna, and the Delaware and Hudson, at prices which represented only a fraction of the values indicated in their books of account.

In short, where monopoly and a monopoly price structure are not involved, the book value of assets is not a useful yardstick for determining value. The depreciated book value

of the railroad industry of the United States is about $28 billion but its net railway operating income has been less than $700 million in each of the last two years, and I regret to say, has little prospect of growth in the
page 1751 } future. Under these circumstances, a realistic value for the industry would probably be in the neighborhood of one-third of its depreciated book value.

Q. Let us turn to Exhibit 5-PMZ. Would you please explain that exhibit?

A. Well, this exhibit shows the growth pattern for the railroads, the telephone companies, the electric utilities, and the natural gas companies in comparison with the general growth of the gross national product over the past 30 years.

Q. What is the source of this material?

A. All this material is taken from information developed by the Department of Commerce and published in its biennial publication "Business Statistics" supplemented by the monthly publication, "Survey of Current Business."

Q. What does this exhibit demonstrate?

A. The exhibit demonstrates what is a matter of common knowledge; namely, that the railroads have grown much more slowly than the general public utilities; namely, telephone, gas and electric companies. It also demonstrates that the railroads have grown more slowly than has the country as a whole as measured by the growth in Gross National Product. Finally, the exhibit clearly demonstrates that as a matter of fact railroad growth came to an end in
page 1752 } 1953 and the railroads have been declining both absolutely and relatively since that time.

Q. Now, let us turn to Exhibit 6-PMZ. Please explain that exhibit.

A. In this exhibit, I have sharpened the comparisons between the railroads and the various public utilities by showing what has happened since 1953, using that year as a base year.

The exhibit also shows how the railroads fared as contrasted with the telephone companies, the electric and natural gas companies in terms of the relationship to Gross National Product. Companies which grow faster than the rise in Gross National Product are growth industries, while companies which grow more slowly than does the Gross National Product are declining industries. As the exhibit demonstrates, the railroad industry has a 57 percent decline in the last 15 years while the telephone companies show a 37 percent growth, the electric utilities a 15 percent growth,

and the natural gas companies a 62 percent growth, all as compared with the average growth for the country as a whole.

Q. Excuse me, Dr. Zeis. The first page of that exhibit is a graph, and the second page contains supporting figures. Is that correct? That is exhibit 6?

A. That's right; the first page is the material graphically presented.

page 1753 }

The second page are the detailed figures which were then graphed in the first page.

Q. Now let us turn to Exhibit 7-PMZ. Does that exhibit show the relationship between the growth pattern of the Norfolk and Western and other types of utilities?

A. Yes, it does. It clearly demonstrates that there is no comparability between the growth pattern of the Norfolk and Western, as indicated by its investment in the track accounts, and the growth pattern of the various telephone companies, gas companies, and electric power companies serving Virginia, as indicated by their plant investments. I should explain that the Norfolk and Western figures used in this exhibit are those of the Norfolk and Western system as it existed before the 1964 merger. Thus, the distortions resulting from the 1964 merger and lease agreements are eliminated. The exhibit shows that there has been practically no growth in Norfolk and Western investment in the track accounts while the comparable investments in the plant capacity for the public utilities have increased 401 percent. And that is shown in the figures on the second page of that exhibit, after 401 percent.

Q. Does the same disparity in growth exist when the unrecovered cost—that is, cost less depreciation—

page 1754 }

is considered?

A. Yes. Even after depreciation, the public utility accounts reflect a growth rate of approximately 375 percent since 1951.

Q. What pattern exists in the depreciation reserves of the public utilities because of this high rate of growth?

A. Because of this growth rate, their reserve ratio for the most recent year shown is 21.7 percent or, stated differently, the condition percent of their assets is approximately 78 percent.

Q. What conclusions do you draw from this exhibit?

A. The contrast between the growth pattern of the Norfolk and Western and the growth pattern of the public utilities is so striking as to make it clear that techniques of

regulation and valuation which may be appropriate for the public utilities are not appropriate for the railroads, including the Norfolk and Western. Without any real growth in revenues or traffic, there has been no need to make increased investments for additional capacity, and the assets already in place have certainly not become more valuable. Moreover, without new investments of any magnitude, there is no offsetting factor to compensate for the deterioration of assets already in place. In contrast, the pub-
page 1755 } lic utilities have had so rapid a growth rate, and their new investments have been so large as to compensate for most of the depreciation on assets already in place. As a result, the percent condition of the public utilities has remained fairly close to 80 percent. This is obviously not the situation which prevails with respect to the Norfolk and Western and other railroads whose low rate of growth results in a much higher depreciation factor and thus a much lower condition percent.

Q. Despite their declining fortunes since 1953, and in particular since 1958, the railroads have continued to make capital expenditures, have they not?

A. Yes, they have. Most of these investments, however, have been for equipment and not for roadway and structures.

Q. How do you account for this?

A. Equipment seemed to offer a much better chance for return on investment, and, possibly more important, it was still possible to borrow money on equipment, while the improvements on roadways and structures had to come out of depreciation allowances and meager earnings.

As a result, during the past six years, the railroad industry has devoted only 23 percent of its investment to roadways and structures, and if indirect investments, such as the Trailer Train Company are considered, less
page 1756 } than $1 out of $5 invested by the railroads has gone for the improvement of roadway and structures. The level of expenditures in recent years for roadway and structures has been lower on an average than the level which prevailed in the years immediately following World War II despite the great increases in prices which have taken place.

Q. In short, far from adding new assets at an expanding rate as have telephone, power and gas companies, the railroads have been making limited expenditures at a declining rate.

A. That is correct.

Paul M. Zeis

Q. And what has been happening to the reserves for depreciation on the road accounts?

A. Under these circumstances, of course, depreciation as a percentage of original cost has been rising, or stated another way, the condition percent of the roadway assets has been declining.

Q. The track accounts are not subject to ratable depreciation for ICC purposes, are they?

A. No, but in theory, if one assumes that rails, ties and other track material have a normal life cycle and are replaced on a normal basis, the average depreciation would be about 50 percent with half of the ties and track being relatively new and the other half approaching the

page 1757 } end of their life cycles. There is testimony in this proceeding to the effect that 50 percent depreciation is appropriate.

Q. Would you consider a 20 percent depreciation allowance—and thus an 80 percent condition rating—unreasonable for the Norfolk and Western track property in Virginia?

A. Yes. I believe the facts shown in the preceding exhibits make it clear that, while such a condition may be appropriate for rapidly expanding utilities, it is completely unreasonable for Norfolk and Western.

Mr. Riely: I have no further questions of Dr. Zeis.

CROSS EXAMINATION

By Mr. Epps:

Q. Dr. Zeis, in your testimony, you say that the relationship between present-day cost and value, in track accounts, is irrelevant. In other words, the fact that it cost more than it did in 1926 does not add value? This, I think, is a summary of your testimony?

A. Yes.

Q. In this regard, I take it you would disagree with Professor Davison who says if he had the franchise and no tracks he would have no difficulty building the tracks today and financing it?

A. I heard his testimony. With that particu-

page 1758 } lar portion, I would have some—

Q. You would disagree?

A. That's right.

Q. You would also disagree, I take it, with that portion of his testimony which ascribes value to the franchise separate,

based on earnings, separate and apart from the earning capacity is in the franchise and not in the property, or the track account. And you say it takes both?

A. Yes, you have to consider the two together. That is what Dr. Foster did. I think that's right.

Q. Right.

Now, in speaking of the, you speak in your charts, in many of them, and in your testimony about the averages of all the railroads in the country. Isn't that correct? Pages six, seven, eight, for example.

A. That's right.

Q. It is true, is it not, that Norfolk and Western is well above the average?

A. Well, since—well above the average as of today or as of 1926, or can you make your question a little more precise?

Q. It is right now well above the average?

page 1759 } A. Norfolk and Western is still making money and about a third of the railroads of the country are not making anything at all.

Q. So, I take it, your answer is, yes?

A. Yes, I would say that.

Q. Take 1966—well above the average?

A. We like to think so.

Q. Yes, sir.

As a matter of fact, in Dr. Foster's study of the Pennsylvania Railroad case in Ohio Norfolk and Western led the pack, didn't it?

A. They were close to the top.

However, if I may, our coverage of fixed charges has gone down 80 percent in the last 10 years so, when you consider the Norfolk and Western as a grade A, operable railroad, I think you should take into account that the trend of earnings, the trend of coverage, the investment character of the railroad, is declining, as reflected by the fact that New York bond houses have cut the ratings on our bonds.

Q. Would you look on page nine of your testimony where you have your income figures, I think, for the railroad, and then look at your annual reports and see why it is I can't make them jibe. Do you have your reports to stockholders?

page 1760 } A. I brought the 1968 report to stockholders.

Q. I have the '67 here, too, sir.

A. At least I think I brought the '68 one. Bear with me. I am still looking.

Q. Would you care to look at these two? I think they are the same one.

Paul M. Zeis

A. I found the '68.

Q. Now, on page—

A. You can have it back.

Q. You have got '68? I will refer to '67 which is an exhibit in your—on page 20, is that your income statement?

A. Consolidated income statement.

Q. Yes, sir.

A. Which covers Norfolk and Western and also covers our interest in the so-called Dereco companies, just acquired in 1968.

Q. If I as a stockholder were to read that, could I find this figure, $39,790,000 for 1968,which you mentioned?

A. No, sir; but the appropriate figure from which you should start is on page 22, rather than page 20, which is the income statement of Norfolk and Western Railroad itself.

Q. Then bring me down to the $39 million. It seems to me we have come out—I can't get lower than $74 million so I am confused by your testimony.

page 1761 } A. All right. We are talking about my Exhibit 2-PMZ, right?

Q. Right.

A. This is for 1968.

Q. Right.

A. Pre-tax net income which we had in 1968 was $84,301,000. That is prior to the payment of income taxes.

Q. Where would I find that in this income statement?

A. I don't think you would find it, frankly. I don't think we report it to our stockholders, our net income before payment of income taxes. We reported the post-payment, but I have made the correction in my testimony. I have applied the 52.8 percent income tax rate which is applicable to all the business, the business of the corporation, of the country, including ours, and have reduced the pre-tax net tax by that amount of money, what that tax rate would provide.

Q. So your $39,790,000 doesn't appear in your annual report anywhere, is that correct?

A. I don't believe it does.

Q. And your annual report shows your net income after taxes of $74 million, isn't that correct—page 22?

A. Correct.

Q. And earnings based on that per common

page 1762 } share, based on that figure, is that correct?

A. That is correct.

Q. Now, what do you mean in your testimony when you say, adjustment for special federal income tax credit?

Paul M. Zeis

A. Well, the most important one, most important single one, is the income tax credit, the investment tax credit, which has currently been in the news. As I think, the members of the Court are aware of the fact that this is in process of being repealed at the present time.

This particular provision permits you, in effect, to reduce your income tax by one-half if you continued to buy new equipment and charge part of the cost of that against your income taxes.

Q. Does that mean that you, therefore, are discounting that in your figure?

A. I am assuming that for the future we are not going to have that benefit.

Q. You assume it is going to be repealed?

A. That's correct.

Q. Tell me if your figures which, I take it, must be some *pro forma* figures that we can't find, your figures do what with accelerated depreciation?

A. I am assuming that over the course of
page 1762-A } time that will average itself out.

In other words, we have had the benefit, in the last few years, of major tax benefits. In other words, we haven't been able to reduce our federal income taxes by using the double-declining depreciation on the purchase of new assets.

With double-declining depreciation, you soon get down to the break-even point, to where your depreciation catches up with you and you start paying more.

Q. That's right. But you have had the use of this money all of that time?

A. Oh, yes. And we have reported that as helping us to make these nice, so-called lovely earnings reports to the stockholders.

Q. Correct, because you have had the use of that money?

A. That's right.

Q. You are assuming in *pro forma* figures you will not be able to do that in the future?

A. Yes.

Q. What are you basing that on? There is no legislation on that?

A. No legislation on that.

Q. That is just an assumption?

A. No, that is just a fact, that if your invest-
page 1763 } ments in equipment taper off, your curve of depreciation that you can take advantage of is

going to taper off very quickly. In fact, that has already happened in Norfolk and Western.

Judge Dillon: That wouldn't be true in a rising electric company?

The Witness: That is where a company is making new and greater investments all the time; they can offset that for many years to come.

In fact, you can say, hell, he will never get to the normal tax rate. But when you are talking about an industry that has practically run out of money to buy new equipment, you are talking about a situation where we are rapidly going to get down to where we no longer have these depreciation benefits to reduce on a temporary basis our income taxes.

Q. Doctor, Professor Davison would have no trouble in the world raising your millions of dollars. He was in here yesterday—give him a franchise and he will raise all the money you want.

A. Yes, I heard him.

Q. This, what you describe in the future, hasn't happened yet?

A. No, but I gather we are talking about setting a rate on tax structures that will be applicable in the

page 1764 } future years.

Q. We are not setting any rates here, Doctor. We are not setting any tax structures. We are talking about existing assessments.

A. All right; we are talking about something that will cost, if approved, will cost the railroad money in future years.

Q. Right.

Is a part of your testimony, as the difference between 1926 and 1966-67, based on the fact that you are paying more income tax?

A. The tax structure is different in 1966 or '67 than it was in '26, that's true. Different for us and different—

Q. Different for all corporations?

A. That's right.

Q. And all taxpayers?

A. Right.

Q. Even you and me?

A. That's right.

Q. Now, on page 11 of your testimony, sir, when you state that: "It is also clear that the franchise is an essential

ingredient of the company because if the right to operate were discontinued, the tangible assets would have to be disposed of for whatever they would bring on a salvage basis." you are talking about a salvage basis without a franchise, is that right?

page 1765 } A. Yes, if we can't operate, we have to sell the track.

Q. Did you consider that you might sell it to another railroad?

A. Which has a franchise?

Q. Let's assume you are going to sell it to—you heard Mr. Catterall say, yes, in Virginia you don't need a franchise. Let's assume you are going to sell it to another railroad that doesn't have the franchise?

A. I don't have the Commission's learning in the law but I was certainly operating under the impression that without a franchise, without paying the franchise taxes, you can't operate.

Q. Then you are saying that you did not consider the sale to another railroad?

A. I am just saying if they wouldn't let us operate we would have to sell the track and everything else on a salvage basis.

Q. So your answer is, you didn't consider sale to another railroad for operation?

A. In actual fact, the track would probably be sold to some other railroad for use.

Q. How about for sale to the government to operate as a railroad, or the state of Virginia?

A. If things keep the way they are going,

page 1766 } that may be what is going to happen.

Q. They would find a place to operate a railroad?

A. Right.

Chairman Catterall: They would have to pay the present and reproduction cost if they condemned it.

Mr. Epps: Yes, sir; we found that out.

By Mr. Epps:

Q. You talk about equity and inequity in the tax burden. What would you say as to the custom in Virginia over the past years of taxing railroad properties for local tax purposes at 40 percent of assessed value with the tax rate set by the locality with relationship to equity and inequity?

A. You ask me to comment whether 40 percent is a fair—

Q. No, sir; I am asking you to comment as to whether the system produces and can produce certain inequities?

A. Any property tax system can produce some inequities.

Q. That one does and has, hasn't it?

A. I didn't agree with that. I don't know whether that one does.

Q. You don't know. That's fair enough. We will pass that one.

On page 14 you attempt to capitalize the value of the franchise based on a capitalization of the tax, isn't that right?

page 1767 } A. That's right.

Q. And you know, don't you, that this Commission has more than once refused to follow such a principle of evaluation?

A. This is 1969. I don't know what the Commission has done in the past, but I do know that the courts have held franchise tax is a property tax and, to my mind, this is the best way of arriving at what the value of what is being taxed is.

Q. You are not familiar with the holding of this Commission in the Railway Express case?

A. I have seen the Railway Express case. I have seen the court's decision in the Railway Express case.

Q. Did you know that the Seaboard some years ago, tried the same approach to this capitalization and were unable to get it accepted?

A. I am not familiar with what happened in the Seaboard case but I point out again this is 1969.

Q. Now, you attempt, as I understand your testimony, to subtract from a valuation of the entire railway system, allocated to Virginia, based on capitalized earnings, first the capitalized value of the franchise, isn't that right?

A. My procedure is farily simple. First I tried to determine what the whole property was worth.

Q. Right.

page 1768 } A. Including, using Dr. Foster's procedures.

Q. Right.

A. Then I took the various taxes which are levied against that property.

Q. Right.

A. And of course I took first the taxes levied by the state because the state is the sovereign and the municipalities and

so forth are creatures of the state. So I took the franchise tax and rolling stock tax first.

Then I took the other tax, the tax on local property, and I arrived at it by a process of subtraction.

Q. By subtraction—if you had been trying to attach real estate tax—instead of a tax on real estate property, you would have subtracted out the tax and said the real estate tax is unfair.

A. This happens to be a proceeding on track structures.

Q. Yes. That is why you took that out last? You could use the same argument to attack real estate tax.

A. It is quite true, you could start at any one of them.

Q. And end up where you wanted?

A. But the point is the total tax that we are paying is too great and we currently are involved in one phase of that tax.

page 1769 } Q. It doesn't have any thrust on this particular tax—it is just the way you direct your arrangement, which one you subtract first?

A. This is the proceeding with respect to the tax on tax structure.

Q. Yes, sir; I know that is the way your testimony is designed; we agree with that.

Now, on page 16 of your testimony, you say you want to deduct the value of locally-set real estate. Will you tell me what real estate owned by the Norfolk and Western railroad system is locally assessed?

A. There is a correction in my statement which you possibly didn't catch. The value of locally taxed real estate. I made a correction on page 16.

Q. You didn't tell us about that?

Mr. Riely: That is the way he read it. I heard it.

Mr. Epps: Mr. Riely didn't ask you that question, though. He said on page 16: have you determined the amount of property other than track structures which were assessed for property taxes at a local level in 1968.

Mr. Riely: Dr. Zeis is more intelligent than I am.

Mr. Epps: I would be the first to admit that,

page 1770 } Mr. Riely.

The Witness: I thank both of you.

By Mr. Epps:

Q. So, your testimony is not that it was locally assessed but it was locally taxed?

A. The testimony is correct, to use the word "taxed."
Q. Wherever it is "locally assessed" you meant to say "taxed"?
A. Right.
Q. Your lawyers should have written "taxed."

Chairman Catterall: You seem to be going into this thing—
Mr. Epps: I have about five more questions.
Chairman Catterall: Do you all want to go on?
Mr. Epps: We will come back.
Chairman Catterall: Let's recess until 2:00 o'clock. Maybe you will decide it.
Mr. Riely: Off the record.

(Discussion off the record.)

(Whereupon, at 12:30 o'clock p.m., the luncheon recess was taken.)

page 1771 } AFTERNOON SESSION

Chairman Catterall: You may proceed.
You have five more questions, Mr. Epps?

Whereupon, PAUL M. ZEIS having been previously sworn, resumed the stand and testified as follows:

CROSS EXAMINATION RESUMED

By Mr. Epps:
Q. Doctor, you are aware, are you not, that the franchise tax in Virginia has gone down every year?
A. It is my understanding that it has, yes.
Q. If you use the projected figures to capitalize the franchise or did you use the 2 percent?
A. I used the actual payments which were made in the last years for which—
Q. You used dollar figures?
A. That's correct.
Q. So that if you did it at the end of this year it would go down another one-tenth of one percent?
A. The percentage would go down. The amount would depend on the gross receipts.
Q. Now, you indicate that the railroads have
page 1772 } been investing their money primarily in rolling

stock to the neglect of the track accounts. Isn't this dangerous from a safety point of view?

A. If carried too far, yes.

Q. You indicate it has been carried pretty far?

A. Yes, I have.

Q. Now, if you would look on page 13 for a moment, please, sir, starting from the middle of your answer, the value of the property on which the burden falls is, accordingly, equivalent to the value of sufficient pieces of tangible property which at current assessed values and current tax rates would produce an amount of tax revenue equivalent to that produced by the franchise tax. This relationship necessarily follows from the role of the franchise tax as a property tax and the taxation scheme in the state and the lack of any indication that the franchise is singled out for a heavier tax burden than other items of property.

That is the assumption upon which you based your figures, isn't it?

A. That's right.

Q. So that if the franchise tax were singled out for a heavier tax burden than other items of property, the rest of it wouldn't follow, would it?

page 1773 } A. The rest of it would have to be adjusted.

Q. We have already seen that the franchise tax is being adjusted downward, haven't we?

A. The rate of franchise tax is going down.

Q. Just one more point, your figures on the income of the Norfolk and Western, and your charts and statistics are based solely on Norfolk and Western showing that the income trend in the past, say four years, has been upward rather than down?

A. No.

Q. No?

A. No.

There was a slight rise in '68 as compared with '67, but the trend from '66 on is down and it is now—that is still true in terms of the preliminary figures for the first five months of 1969.

Q. Let's look at your exhibit—which exhibit would that be?

A. Exhibit 2-PMZ.

Q. I am not talking about—these *pro forma* figures here? I was talking about—

A. There is nothing *pro forma* about the pre-net. The pre-tax net income, those are actual figures.

Paul M. Zeis

page 1773-A } Q. The income reported to your stockholders has been upwards for the past three years, then?

A. No, sir; I don't think that even that is true.

Q. '68 was more than '67?

A. '68 was a slight improvement over '67, that's right.

Q. And '66 was a real good year in the railroad industry, wasn't it?

A. '66 was the best year we had had for several years.

Q. Right.

A. I would not characterize any year since 1957 as a real good year in the railroad industry.

Q. I will skip that. But two out of the last three years have, relatively speaking, been good years and you have an increase in '68 over '67 and you had what we might say is a relatively good year in '66, is that correct?

A. We had a fair year in '66, a lousy year in '67, and slightly better year in '68.

Chairman Catterall: I think that question has been answered four times, that one question.

Mr. Epps: I have no further questions.

Mr. Shannon: I just have one or two.

Chairman Catterall: Two?

Mr. Shannon: All right, sir. Now you put me in the dilemma to know which one to ask first.

page 1773-B } Mr. Riely: Put them all together.

By Mr. Shannon:

Q. Dr. Zeis, when did you join Norfolk and Western?

A. October 16, 1964.

Q. Now, referring to sheet two of your testimony, you say that you have had occasion to evaluate railroads such as the Erie, Delaware and Hudson, the Boston and Maine. In what sense of the term do you mean, evaluate?

A. Determine what they were worth.

Q. Did you use the ICC method or did you use the methods that you have described here today?

A. I used every method we could think of but primarily we used the method we discussed here because, in the final analysis, value is determined by earnings or potential earnings.

Q. Dr. Zeis, on sheet five of your testimony, you agree that Dr. Foster made no study concerning the economic worth of the Norfolk and Western or any other railroad operating in

Virginia, and further on sheet six you state that you find no serious dispute with Dr. Foster's approach in Ohio.

Then on page ten, you state that the entire property must be looked at as a unit after which you conclude that some portion of the total of Norfolk and Western's property can then be allocated to the State of Virginia, using the various allocation factors commonly employed.

page 1773-C

Have I correctly paraphrased what you have said?

A. I believe so.

Q. Then, Dr. Zeis, aren't you advocating that the State Corporation Commission of Virginia follow the unit method in assessing Norfolk and Western property in Virginia?

A. Well, frankly, I think it is a superior method to the method which has been employed in Virginia.

Mr. Shannon: Thank you very much; that's all I have. I tried to endeavor to—

Chairman Catterall: That was three, but I always allow 50 percent.

Mr. Shannon: I tried to take Mr. Riely's suggestion and put about six into one.

Mr. Riely: I will be very brief, if Your Honor please.

REDIRECT EXAMINATION

By Mr. Riely:

Q. On page eight of your testimony and page nine, you talked about earnings in 1927 compared with earnings in '67 and '68, and in answer to the question of Mr. Epps, you stated that there was a considerable difference in the tax structure in that 40-year period.

page 1774

In your opinion, does that difference in the tax structure invalidate your comparisons?

A. Not at all because all business was operating according to tax structure that was in existence in 1926 or back in 1927, just as all business is operating according to the tax structure today.

The fact is that virtually every other type of enterprise has shown growth in net income before taxes, growth of income after taxes, and the railroads have not.

Q. On page nine, you speak of comparable net income after adjustment for special federal income tax credits.

Mr. Epps questioned you about them. Why did you make adjustments?

Paul M. Zeis

A. Well, because we are looking towards the future here. This is an attempt to evaluate the road in terms of what its prospective earnings will be which is exactly the same thing that Dr. Foster did in his approach in Ohio, so naturally you knock out any temporary tax advantages which do not appear as if they are going to continue so far as this particular property is concerned.

Q. One further question:

On page 567 of the Transcript, Commissioner Catterall asked Dr. Foster; haven't the railroad freight page 1775 } rates gone up four percent every year? And Dr. Foster answered: railroad freight rates have gone up with considerable frequency, sometimes more than four percent.

Have railroad rates gone up more than four percent a year?

A. No, they haven't.

Now, there have been a number of rate increases requested from the ICC on a federal basis and from—

Mr. Epps: Is this redirect, sir?

Chairman Catterall: They are all matters of public record so anybody can put them in a brief. I don't see any sense in going over them.

Mr. Riely: I think it is redirect. It is a question of economic significance that we were getting. I don't think you can put that in a brief.

Chairman Catterall: Go right ahead.

The Witness: Despite the various rate increases on a general level which have been requested and which have been granted in part, in actual fact, the level of freight rates, the effective level of freight rates, has gone down.

The ICC index of freight rates was 1.21 in 1958 and by 1967 had dropped to 1.05, or a decrease of about 13 percent in the last ten years.

page 1776 } So, what happened, the regulatory authorities granted a rate increase and within the next year or two, as a result of the forces of competition, the railroads had to cut their rates or lose the business.

Mr. Riely: I have no further questions of Dr. Zeis.

Chairman Catterall: You may stand aside, sir. Thank you for coming.

Mr. Riely: That completes our case, if Your Honor please.

Chairman Catterall: Do you want to file a Brief?

Mr. Riely: Yes, sir; I would like to suggest, rather, a

time that you may think inordinately long, but you are going away and I am going away—I have got a three-week case to try within the next month.

Chairman Catterall: Then my going away has nothing to do with it.

Mr. Pascoe: It proves that going away is the proper thing to do.

Mr. Riely: I hope to file it by the time that you would read it. I would like to suggest to the 15th of September, if that is not too much.

Chairman Catterall: That is perfectly all right. The 15th of September will be all right for your Brief.

page 1777 } You want to file your Brief on the same day?

Mr. Epps: No, sir; we would like to reply to it.

Chairman Catterall: You can write most of it. We can see if there is anything new. Ten days more?

Mr. Epps: I think Mr. Riely is getting—this is not quite the 15th.

Mr. Riely: Thirty days.

Mr. Epps: I think 30 days.

Chairman Catterall: You won't use it unless you have to?

Mr. Riely: May we set a date for oral argument.

Chairman Catterall: Briefs and oral arguments?

Mr. Riely: Yes, sir.

Judge Dillon: All you are going to do is read your Brief. We had one read up here the other day.

Mr. Riely: I recognize that.

Chairman Catterall: Mr. Riely's Brief will be filed on or before September 15 and the answering Brief will be filed on or before the 15th of October and as much before as possible.

You can start writing the Brief tomorrow.

Mr. Epps: I am not able to write Briefs. I will have to talk to my lawyer.

Chairman Catterall: He can start.

page 1778 } Then I suppose Mr. Riely would like to have another five days to answer any possible new thing that came up.

Mr. Riely: Five days would give me two working days in a weekend. Could we make it a week?

Chairman Catterall: One week after.

Mr. Epps: Fair enough.

Chairman Catterall: After you receive Mr. Epps'.

Paul M. Zeis

Mr. Riely: So long as Mr. Epps' Brief does not come when I am out of town.

Mr. Epps: I will not accept that condition.

Chairman Catterall: Now you want to set a date to argue it on?

Mr. Riely: Yes, sir.

Chairman Catterall: Twenty minutes to a side?

Mr. Riely: No, sir.

Chairman Catterall: Let's get out the black book, then.

Let's pick a date in October.

Judge Hooker: Some Friday.

Chairman Catterall: These are odds and ends of things that have been put on.

Mr. Riely: How about the 31st of October?

Mr. Epps: All Hallows Eve.

page 1779 } Mr. Riely: That's a good day, I think.

Chairman Catterall: October 31, a Friday.

Mr. Riely: Yes, sir.

(Whereupon, at 2:15 o'clock p.m. the hearing in the above entitled matter was concluded.)

page 1780 } STATE CORPORATION COMMISSION AT RICHMOND NOVEMBER 21, 1969

APPLICATION OF

CASE NO. 18629

NORFOLK AND WESTERN RAILWAY COMPANY

For review and correction of the assessment for taxation of its property subject to local taxation for the year 1968 and for the right to recover from local authorities excess taxes paid.

Investigation of the matters and things involved in this proceeding having been made, a hearing and oral argument having been held, briefs having been filed by the parties, and the Commission, on the date hereof, having rendered its opinion that the assessment for local taxation of Applicant's property was correct, which opinion is hereby made a part hereof:

IT IS ORDERED, That the application for review and correction of the assessment be denied for the reasons stated in the opinion this day filed;

IT IS FURTHER ORDERED, That the record in the proceeding be passed to the file of ended cases.

IT IS FURTHER ORDERED, That an attested copy of this order, together with a copy of the opinion, be sent to John W. Riely, H. Merrill Pasco, Guy K. Tower, David R. Goode, Counsel for the Applicant; A. C. Epps, Stuart B. Carter, J. Edward Betts, Hullihen W. Moore, Counsel for Defendants; Preston C. Shannon, Commerce Counsel to the Commission; and to the Commission's Director of Public Utilities Taxation.

page 1781 } COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

Application of

NORFOLK AND WESTERN RAILWAY COMPANY

Case No. 18629

For refund of local property taxes

November 21, 1969

Opinion, Catterall, Chairman

STATEMENT OF THE CASE

The Norfolk and Western Railway Company seeks to recover from 42 counties, 17 cities, 66 towns and 211 districts over $1,200,000 that it has paid in taxes on its tracks. This is a test case that will govern fifteen other cases brought by fifteen other railroads and will involve additional counties, cities, towns and districts. The arguments on behalf of Norfolk and Western apply equally to all other railroad property as well as to the track property, and would, if accepted, support claims for the refunding of additional millions of dollars. And finally, if some of the railway's arguments should prevail they would apply to other public service companies.

The 1968 reassessment of railroad track property was made at the request of local tax officials who suggested that, as a result of changed conditions, further study should be undertaken to ascertain present value. The Commission directed the railroads to compile and furnish figures showing what it had cost to construct the trackage still in use in Virginia. On the Norfolk and Western, Southern, Clinchfield and the Pennsylvania (now Penn Central) furnished the

requested information, and in doing so each of them omitted the cost of grading. N&W furnished figures showing $177,800,335 as the original cost of its present
page 1782 } roadbed in Virginia. At the hearing it furnished corrected original cost of $187,985,461.
In 1967 N&W reported the value of its rail and track property at $91,644,710. In making the 1968 assessment the Commission took the railroad's figure of $177,800,335, reduced it 20% for depreciation, and related the resulting figure of $142,240,268 to the $91,644,710 reported by N&W. This comparison produced a factor of 1.55. The Commission applied this factor to the reported 1967 valuation per mile for the various track classifications to arrive at the 1968 valuation per mile. The statutory equilization rate was applied to the full value and the much lower assessed value was certified to the localities.

Prior to 1968, N&W reported its signal and interlocker property to the Commission at 50% of cost, but failed to include the value of highway grade crossing protective devices. In making the 1968 assessment the Commission required N&W to report all signal and interlocker equipment in Virginia, including highway grade crossing protective devices. The Commission concluded that this class of property was properly in 80% instead of 50% condition and assessed it accordingly.

The Norfolk and Western and the fifteen other railroads filed their petitions for refunds on November 13, 1968. The Commission, in nine days of hearings, took over 1700 pages of testimony from 29 witnesses and received 130 exhibits. Counsel were given three months in which to prepare and file briefs. The case was argued orally on November 14, 1969.

Applicant asserts: "At issue is the proper valuation of all the property of N&W subject to local taxation," and argues that the physical property of railroads should be assessed for local taxation at its salvage value, to be ascertained by expert testimony including that of junk dealers. This particular case involves specifically only the assessment of the roadbed; but if it should be decided that sal-
page 1783 } vage value is the proper value for the roadbed the same reasoning would apply to all other railroad property.

CONSTITUTIONAL BACKGROUND AND APPLICABLE LAW

This controversy concerns the proper method of assessing

for local taxation the roadbed of a railroad. Sec. 176 of the 1902 Constitution provided:

"The State Corporation Commission shall annually ascertain and assess, in the manner provided by law, the value of the roadbed . . . of each railway corporation . . ."

The framers of the Constitution were well aware of the difficulty of ascertaining the value of this kind of property. They did not attempt to lay down a rule-of-thumb for ascertaining the "market value" of property for which no market exists, and recognized that the Commission would have to exercise a certain amount of discretion. At page 2636 of the Debates Mr. Meredith explained the committee's proposal:

"Mr. Meredith: Because, Mr. Chairman, it is absolutely impossible to get at what you call the market values of some classes of property. You cannot get at the market value of the railroads, and we do not propose to do it in this report. We offer the scheme of railroad taxation contained in this report really as a compromise measure, for what we thought was a better scheme of taxation. But in order to satisfy the railroads and not to get too much taxes out of them immediately we adopted this compromise. It is impossible to give the market value of a railroad property and, in the same way, it is impossible to give the market value of franchises.

"Mr. Hamilton: Will the gentleman allow me to ask him how he expects to get at the value of the thing he taxes, if he is not going to take valuation as the basis?

"Mr. Meredith: I have said it is impossible to get at the actual market value. It has no actual market value."

And at page 2640 he said:

"Mr. Meredith: The gentleman will still continue to ignore the fact that it is absolutely impossible to determine the actual market values; that you cannot get at the value of a franchise as you do at the value of a horse.

page 1784 } "Mr. R. Walton Moore: That fact was practically and substantially admitted by the representatives of the railroads when they appeared before the committee."

At page 2676 Mr. Meredith said:

"Mr. Chairman, how are we to get at the actual market value of the roadbed of a railroad? That is a thing that you cannot actually and accurately ascertain; it is a matter of calculation and of estimate."

Sec. 176 forbids including in the value of the physical property any element of franchise value. The physical property must be assessed at its "bare bones" value. Counsel for the taxpayer argues that the proper way to exclude any element of the franchise value is to ascertain the total value of the railroad as a going concern, and then deduct the dollar value of the franchise from the total value. But franchise value of a public service company is not a value that can be assessed in dollars. It is classified by the Supreme Court of Virginia and the Supreme Court of the United States as a tax on intangible personal property. Although Sec. 177 of the Virginia Constitution calls it a privilege tax, the courts hold it to be a property tax. Otherwise it might conflict in some situations with the Commerce Clause of the Federal Constitution. (Compare *Railway Express Agency* v. *Commonwealth,* 194 Va. 757, reversed, 347 U. S. 359, with *Railway Express Agency* v. *Commonwealth,* 199 Va. 589, affirmed, 358 U. S. 434.) The franchise *tax* is assessed by the State Corporation Commission but the *value* of the franchise is not. The tax on the franchise is not a percentage of the value of the franchise: it is a percentage of the company's gross receipts.

That the local tax on physical property and the state franchise tax on intangible property are entirely separate under Sections 176 and 177 of the Constitution appears from the Debates of the Constitutional Convention. Mr. C. V. Meredith, Chairman of the Committe on Taxation, at pages 2662-2664 of the Debates described the evolu-
page 1785 } tion of Virginia's method of taxing railroad property:

"Your committee, after long consideration, and after very earnest study of this subject, and after going to considerable expense in bringing an expert here from Harrisburg, Pa., for the purpose of giving them assistance, came to a conclusion as to what they thought was *the best way to tax railroad property. They came to the conclusion that the proper system of taxing railroad property is according to the Connecticut plan;* that is to say, to take the value of the franchise to be worth the market value of the capital stock plus the market value of the bonds, not above par. That, we thought, was the proper way to fix the value of the franchise. We had in our plan some details as to how that should be worked out. We divided it so as to let the State tax two-thirds of such aggregate amount, and the counties and cities tax one-third of it, according to the mileage rate in each particular county or city. We adopted that plan because the

present value of the railroad properties of this State is just above one-third of what would be the value of the franchises of these same roads if assessed under the Connecticut plan; and therefore the cities and counties of the State would not lose anything by taxing one-third of that aggregate amount. The value of one-third of the franchises, on the Connecticut plan, would give them about the same amount of property to tax as they have now under the present plan, when they tax the real estate and the tangible personal property. *This matter was fully discussed before the committee. We then determined that, as it was a very important matter,* and bore somewhat greviously upon the railroads, because it would increase their taxes to about $400,000 a year, and that *we would ask the railroads to come and discuss this matter before us;* and they did so. Some of you gentlemen are aware that *we had a meeting in the courtroom of the Supreme Court,* where several of the railroad presidents came and discussed our plan. *They said:* The State has been taxing us as provided in the statute. We are not denying that it is a proper thing to increase our taxes, but we do say that your proposed method of taxing us is such a large increase from what you are now taxing us, that we earnestly urge you will not impose it upon us. They said: You must recall the fact that most of these railroads have failed once, twice, or three times, and that at each reorganization there has been carried over a large amount of stock held by the owners of the property previous to such failure and reorganization. That has been carried on two or three times, and has accumulated the stock according to the number of receiverships and reorganizations, until now there is carried by the roads in this State such a large amount of stock that, if you were to attempt to fix the value of the franchises by the value of the stock, it would be far in excess of the real value, because the accumulation of stock, by reason of these failures

page 1786 } and reorganization and the issuing of preferred and common stock, has been so greatly increased. They made that plea, and *they suggested this as a simple plan.* They said: We will say this to you, if you determine to put anything into the Constitution, this, we submit, would be a fair basis of taxation. You will get a larger revenue from it, and, at the same time, it will not be such an increase to bear too harshly upon us. *They then suggested that we should continue the present method of taxation upon the roadbed, the other real estate and the tangible personal property, and that, in order to get an increased revenue, that we might add a seven mill tax upon the gross earnings as a franchise tax. Your* committee con-

sidered the matter, and some of us still thought that we ought to adopt the Connecticut plan; but after due consideration we came to the conclusion that, as they would, perhaps, bear pretty harshly upon the railroads, and as we were looking forward to more control over the rates through the corporation commission, it would, perhaps, be wiser not to be too hard in the beginning, but to be fair and take a reasonable step, so as to get what would be fair compensation at present, considering the conditions surrounding those companies. Therefore we said we *will agree to tax you under this system as suggested by you; to tax your real estate and tangible personal property,* and other real estate and tangible personal property, as other real estate and tangible personal property is taxed; *and in addition, we will lay upon you a franchise tax of* 1 *percent* of your gross earnings instead of 7 mills. That is the scheme proposed here, to continue for ten years. Then the question came up as to whether it should be forever or whether the length of time for which it was to continue should be fixed. It was desired by the roads that we would fix it for ten years. They said, if this is a fair compensation to you, as we have got to meet this burden, we ask that you give us a reasonable time in which to meet it, so that if you hereafter desire to change it and adopt the Connecticut plan, we will have the chance to get the benefit of increased prosperity. In addition to that, it will keep us out of politics, more or less, as we will not have to be constantly watching the question of taxation before the Legislature if we know that for ten years we will not have any change.

"*But understand that this does not affect and does not limit the right of the State Corporation Commission to increase the value of this real estate and personal property.* Nor does it bind the hands of the Legislature as to increasing the rate of taxation upon real estate and personal property of these railroads. It is fair for you to consider that under the present system of taxation the method of fixing the value of roadbeds is very uncertain. It is almost impossible to see how the Board of Public Works can ascertain that one road is worth $10,000 a mile and another $15,000 a mile. T*hey claim that while they have not been imposing a franchise tax upon the railroad in ascertaining the value of their property, yet that subject has entered into the ascertainment of value. But we do not think so. We feel very confident that when the State Corporation Com-*
page 1787 } *mission comes to assess the values of these roadbeds, it will find that there has not been a dollar assessed by reason of the value of the franchise.*

It will find that the value of $10,000 a mile, or whatever it may be, which has been laid on such property, exists today just as it did twenty years ago, although the railroads have gone from deficits and bankruptcy up to handsome net earnings.

"Considering all these matters, taking into consideration what we would get, and at the same time, the change of circumstances that might come to these roads, we agreed to this method of finding out the value of the real estate and tangible personal property. We recognize that there would be a reasonable method of ascertaining the value of such properties, and recommend that this method of ascertaining such valuation should remain in force for ten years. The value of the property, and the rate of taxation is not affected by this section at all. This provision simply provides for ascertaining the value. If you should pass an ordinance tomorrow saying that the rate of taxation on real estate and personal property should go down to three mills, instead of being four mills, they would get the benefit of that reduction. If you should say tomorrow that the rate should be five mills, they would feel the increased burden. I want it to be understood that we have done nothing in this section except to say that this method of ascertaining the value of this railroad, as a unit, for State taxation, and the method of subdividing for local taxation. I need not say it would be extremely inconvenient and cumbersome to put all of the long statute here referred to into the Constitution. The act has been in force since 1882 or 1883, and it has worked well." (Emphasis added.)

The railroads themselves proposed that the state should *continue* to tax the roadbed and other real and tangible personal property as it had always done; and that, to produce additional revenue, it *add* a seven mill tax on gross earnings. The Convention adopted the railroads' proposal of continuing the tax on real estate and tangible personal property as before and, in *addition,* levying a franchise tax on gross receipts. Now, 67 years later, the railroads contend for the first time that the law does not permit this Commission to continue assessing their property as before but requires the Commission to assess it on a scrap value basis. The railroads want us to assess their property at what it would be worth if they had no franchise to operate a railroad. We cannot go on that assumption because

page 1788 } the whole structure of railroad taxes rests on the assumption that the railroad does have a franchise. If it had no franchise it would have no earnings,

would be liable for no tax measured by gross earnings, would not be a public service corporation, and its local property would be assessed locally and not by the State Corporation Commission. They are asking us to tear down the structure that has stood for more than half a century. It is hardly necessary to add that every statute on public service company taxation passed by the General Assembly since 1903 takes it for granted that no franchise value has been or is being included in the assessments for local taxation made by the State Corporation Commission.

The railroads' other argument (that the way to *exclude* the franchise value is to start by *including* it *in* total value and then *subtracting* it *from* total value) was made by the Receivers of the Seaboard Air Line Railway Company at a time when Seaboard had little gross income and no net income. The Commission demolished that argument in an order dated September 8, 1937, page 420 of its 1937 Annual Report, at page 422:

"There is another important feature of the Virginia law to be considered in connection with the use of the system method of valuing railroad properties. By this method, of course, is determined the value of the entire railroad system, including its physical properties, its franchises and other intangible values. Indeed, in the case of *Great Northern Railway Co.* v. *Weeks,* 297 U. S. 135, so strongly relied on by the Seaboard, the North Dakota statutes there under review expressly included the franchise in the valuation to be determined. It follows that Virginia's portion of the system value of the Seaboard shown in its Exhibit No. 17, namely, $1,193,350, includes the value of the franchise. But by its Constitution and statutes, Virginia taxes a railroad franchise separately, the tax being measured by gross receipts in the State. Therefore, in order to arrive at the remainder of the Seaboard's properties which are taxed separate and apart from the franchise, it would appear that the value of the franchise should be deducted from the total value of $1,193,350, which includes the franchise. No Virginia statute prescribes any method of determining the value of this franchise. The Seaboard in the past, in some of its protests, has urged that the value of its franchise should be
page 1789 } deducted from Virginia's portion of the system value, and has suggested that the value of the franchise be taken as a sum equal to the franchise tax capitalized at the average prevailing tax rate in the State. The adoption of this suggestion would produce the following startling result:

1. Franchise tax for 1937	$ 23,135.14
2. Capitalized at the average prevailing rate estimated to be $2.00 per $100	1,156,750.00
3. Virginia's portion of system value as shown by Exhibit No. 17	1,193,350.00
4. Item 3 minus Item 2	36,600.00

A suggestion that the physical properties in Virginia of a great trunk line railroad, which properties are conceded by the Seaboard in Exhibit No. 14 to have a cost of reproduction value, less depreciation, plus additions and betterments, of $18,674,004.00, have a value for tax purposes of $36,600.00, is too absurd to merit further comment or consideration."

If we followed the method advocated by the applicant, we would be subtracting one unascertainable figure from another unascertainable figure, ending up with a lump sum to be allocated by some unknowable method among the roadbed, the other tangible property, the raw land and the rolling stock. We appraise the "bare bones" directly, without including anything for franchise value. Since we have not included it we have no occasion to subtract it.

In the Constitution of 1902 the taxes on railroads were levied by the Constitution itself. Those self-executing provisions of the Constitution, by virtue of Sec. 181, ceased to be binding on the General Assembly after January 1, 1913, with the result that the present taxes on railroads are imposed by statute.

In the present case we are dealing specifically and only with the assessment of the value of the roadbed for local taxation. The 1919 Code of Virginia required railroads to report for taxation all of their property under various heads, of which the first was:

"First: Roadway and track or canal bed."

That classification was made more detailed in Acts of 1926, page 650:—

page 1790 } "First: Right-of-way, terminal and yard lands, and roadbed and trackage or canal bed, bridges, trestles and tunnels and all signals (track and crossing), and interlockers, buildings, structures and other improvements thereon, except only such improvements as are provided for in classes below mentioned. In making report of and assessment of the property included in the first class,

there shall be found for each railroad, for its main line or lines, and for each branch line, for single, and where existing, double, triple, and quadruple track and for side track the average value per mile in this State of its track, track appurtenances and track structures, including cuts, fills, track surfacing, excavation, ballast, bridges, trestles and tunnels, but not including right of way lands, or buildings or structures thereon, other than track structures, or improvements required to be reported in other classes; and in any county, corporation or school district, the assessment of all property of such railroad included in the calculation of such average, as above provided, shall be the number of miles of its single, double, triple, quadruple, or side track therein, as the case may be, multiplied by the assessed average value thereof per mile."

The section just quoted was divided into two sections in the present Code:

§58-524 describes the roadbed, etc. as:

"(1) Right-of-way, terminal and yard lands, and roadbed and trackage or canal bed, bridges, trestles and tunnels and all signals (track and crossing), and interlockers, buildings, structures and other improvements thereon, except only such improvements as are provided for in classes below mentioned;"

§58-532 deals with the mileage prorate:

"In making report of and assessment of the property included in the class described in paragraph (1) of §58-524, there shall be found for each railroad, for its main line or lines and for each branch line, or single and, where existing, double, triple and quadruple track and for side track, the average value per mile in this State of its track, track appurtenances and track structures, including cuts, fills, track surfacing, excavation, ballast, bridges, trestles and tunnels, but not including right-of-lands or buildings or structures thereon other than track structures, or improvements required to be reported in other classes, and in any county, corporation or school district, the assessment of all property of such railroad included in the calculation of such average, as above provided, shall be the number of miles of its single, double, triple, quadruple or side track therein, as the case may be, multiplied by the assessed average value thereof per mile."

page 1791 } All property of the railroad must be taxed under one heading or another. The property making up the "roadway and track" or the "roadbed and trackage" is taxed differently from all the other property. The other physical property is reported for taxation in the taxing district it lies in, but the roadbed is taxed like a ribbon whose value is prorated on a mileage basis among the taxing districts it runs through. Nothing required to be assessed as part of the roadbed can be assessed under any other heading, and nothing required to be assessed under any other heading can be assessed as part of the roadbed. *The land on which the roadbed rests cannot be assessed as part of the roadbed.* Right-of-way lands are physically part of the roadbed and the only reason they are not taxed as part of the roadbed is that §58-532 expressly forbids them to be so taxed. Track structures are assessed as part of the roadbed, and the particular track structures referred to by witnesses and counsel in the course of these proceedings as *"grading"* are described in §58-532 as:

"... track structures, including cuts, fills, track surfacing, excavation, ballast..."

There are four possible methods of calculating the value of public service company property for taxation and rate-making:

1. Scrap value.
2. Reproduction cost.
3. The unit method.
4. Original cost.

1. We reject scrap value because that method has never been used and has never heretofore been suggested. An additional reason is that the General Assembly has included grading as an item to be taxed, and the General Assembly, like everybody else, know that cuts, fills, surfacing and excavation cannot be sold for scrap.

2. We reject reproduction cost because it can-
page 1792 } not be ascertained and because it would be unfair to the taxpayer. Reproduction cost is higher than original cost. We have appraised N&W mainline double track at $147,000 a mile. On October 9, 1969, (Finance Docket No. 25887) the Norfolk & Western estimated that the cost of reproducing 4.87 miles of previously abandoned roadbed in Campbell County would be $251,540 a mile.

3. We reject the "unit method" used by most states be-

cause our statutes forbid use of that method by requiring a different method.

4. We use original cost because it is the only method that can be used, and because it is the only method that is fair to the taxpayers and to the taxing districts.

Original cost means the cost of grading and the installed cost of existing items of property ascertained from the best evidence available. When we fix the rates of other public utilities we know what the original cost was because they keep their books in conformity with systems of accounts prescribed by the Commission, but the railroads were built before there were any regulatory commissions with the result that more than half the money appearing on their books as costs of construction did not go into the constuction of the railroad. The most famous of the railroad-building scandals was the Credit Mobilier scandal, famous because so much of the money was used to bribe members of Congress. *The Richmond Times-Dispatch of* Sunday, May 4, 1969, the 100th Anniversary of the driving of the golden spike at Promontory Point, summarized the oft-told tale as follows:

"One of the railroad builders' tactics was to generate big profits through the organization of contracting companies. Once funds were received for the building of track, a separate firm would be formed by the inside circle to contract for the construction and supplies at inflated prices. Thus the railroad officials, as directors of the project, would enter into contracts with themselves to build the road and divide the profits among themselves.

"Union Pacific insiders utilized the technique largely through the Credit Mobilier. The Central Pa-
page 1793 } cific's leaders worked through Charles Crocker & Co. and the Contract and Finance Co.

"An example of the Credit Mobilier operation can be seen in Union Pacific costs. The first 247 miles of track brought a profit to Credit Mobilier of more than $5,000,000. This seemed hardly worthwhile, so a new contract was drawn up with Oakes Ames while his brother Oliver was the Union Pacific president. The new terms resulted in a profit of nearly $30,000,000 for the next 667 miles of track.

"Oakes Ames was a congressman from Massachusetts and a member of the House Committee on Pacific Railroads. He gave or sold at heavy discount shares of Credit Mobilier to influential congressmen and senators.

"In the 13 months after November, 1867 six dividends were declared: dividends of 90% in cash, 155% in first-mortgage bonds, and 300% in stock—for a total of more than

$20,000,000. The last 125 miles of the Union Pacific construction brought a profit of more than $7,000,000 to Mobilier members.

"The Credit Mobilier ring collapsed when factions began fighting among themselves and Ames was officially censured by Congress.

"On the Central Pacific side, contracts through the Contract and Finance Co. resulted in estimated profits of about 500% to 600% on an investment of about a million dollars over a six-year period.

"Just how much did the railroad cost and how much of that came from the Big Four? The 1869 Central Pacific annual report lists construction costs of $56.8 million to date. A federal commission later estimated the Central Pacific could have been built for $23 million."

An article by Allen W. Moger, Professor of History at Washington and Lee, "Railroad Practices and Policies in Virginia after the Civil War," 59 Va. Mag. of History, 423 describes what went on in Virginia. Writing of what is now called the James River Division of the C&O, he said (p. 430):

"In the meantime the Richmond and Alleghany was organized as a highly speculative enterprise about 1880 to follow the old route of the James River and Kanawha Canal from Richmond by way of Lynchburg to Clifton Forge. Its chief backers were non-Virginians, among them George W. Bartholomew of Connecticut, Cyrus H. McCor-
page 1794 } mick, and James G. Blaine. Its apparent cost was $56,300 per mile, but Imboden estimates that, since its bed was largely prepared along the route of the old canal which it purchased, its actual cost in money was probably less than $20,000."

In the leading case of *Smyth* v. *Ames,* 169 U. S. 466, 42 L. ed. 819, Smyth was the Attorney General of Nebraska and Ames was the Oliver Ames referred to in the *Times-Dispatch* article quoted from above. Counsel for the appellants, William J. Bryan, asserted, 42 L. ed., at 826:

"The evidence shows that the railroads of Nebraska can be reproduced complete for about $20,000 per mile."

He asserted that the stocks and bonds issued by the Union Pacific added up to $103,786 per mile. The court accepted as probably correct a report of the Nebraska Board of Transportation "that the railroads in this state could not be dup-

licated for a less sum than $30,000 per mile, taking into consideration their equipments and depot and terminal facilities."

The court held that the Nebraska rates deprived the railroads of their property without due process of law because the rates established would not yield sufficient revenue to pay operating expenses. By way of dictum the court said (p. 544):

"If a railroad corporation has bonded its property for an amount that exceeds its fair value, or it its capitalization is largely fictitious, it may not impose upon the public the burden of such increased rates as may be required for the purpose of realizing profits upon such excessive valuation or fictitious capitalization; and the apparent value of the property and franchises used by the corporation, as represented by its stocks, bonds, and obligations, is not alone to be considered when determining the rates that may be reasonably charged."

Symth v. *Ames* has been cited as holding that public service company rates must be fixed so as to yield an annual percentage of reproduction cost, although that is not what the court held. It said (pp. 546, 547) that in fixing rates a great many things must be considered, including: "the original cost of construction . . . the present as compared with
page 1795 } the original cost of construction . . ." Since those two figures would never be the same number of dollars, the lower tribunals would need to know which of the two should be given the greater weight. For the guidance of the lower tribunals the court said they:

". . . are to be given such weight as may be just and right in each case."

49 U. S. C. A., §19a, added to the Interstate Commerce Act in 1913, required the Interstate Commerce Commission to appraise the value of all the property of all the railroads. In 1913 it was not possible to ascertain the exact number of dollars that had gone into the construction of all the railroads or any of them. The Interstate Commerce Commission valued the railroads on their estimated reproduction cost because (1) there was no available evidence of original cost, (2) it was certain that reproduction cost was very much less than the original cost, and (3) the Supreme Court was then holding that rates fixed by law must produce revenues equal to some percentage of reproduction cost. Moreover, in 1913,

reproduction cost represented the closest possible approximation of the amount of money that had actually gone into the construction of the railroads. After the Interstate Commerce Commission had completed those voluminous, long-drawn out and enormously expensive studies, the State Corporation Commission naturally gave a good deal of weight to the results of those studies.

THE EPES LETTER

In a letter of September 17, 1927, Judge Epes described the methods by which the State Corporation Commission had valued the Virginia railroads as of January 1, 1927. The gist of the letter was to the effect that the railroad property was appraised for taxation at 100% and assessed for taxation at 40%; and that its 100% appraisal was not too high. Judge Epes's letter does not mention original cost, be-
page 1796 } cause the first step in appraising the railroad property was to use, with many modifications, the estimated cost of reproduction new less depreciation ascertained by the Engineering Section of the Bureau of Valuation of the Interstate Commerce Commission.

In paragraph (4) of his letter he said:

"(4) The value of a railroad property, or in general any specific part thereof, cannot be measured by any known yardstick;..."

In paragraph (6) of his letter he said:

"(6) This Commission does not accept reproduction new cost, or reproduction new cost less depreciation as value, or as the measure of value, either for ascertaining rate bases or making assessments for taxation."

The Interstate Commerce Commission estimates were computed on the value of the 1914 dollar. To give effect to the decline in the value of the dollar between 1914 and 1927, Judge Epes added 30%, saying:

"(9) This figure, 30%, is much less than the percentage of appreciation in cost of labor and materials which is claimed by the railroads before the Interstate Commerce Commission;..."

The 1927 appraisal is the bedrock on which all subsequent appraisals have been built. On reading the letter, it is hard to believe that the railroads were not satisfied that the ap-

praisal was fair, just and reasonable. They did not appeal to the Supreme Court of Appeals.

Paragraph (10) of Judge Epes's letter points the way that the Commission has followed:—

"... this Commission has added the cost of additions and betterments charged to capital outlay, since valuation date, as reported by the railroads to this Commission, less 20% to cover any depreciation which may have occurred therein, which depreciation allowance is far larger than the railroads would be willing to admit in a valuation for rate making purposes; in fact the carriers insist that there has been no depreciation, because of the maintenance and repairs applied by them."

page 1797 } THE 1968 REAPPRAISAL OF RAILROAD TRACK PROPERTY

For forty-two years the average assessed value per mile of N & W's single main line track has remained uncontested at $23,000 and the average assessed value of its main line double track at $40,000 until 1934 when it was reduced to $38,000. No increase was made in assessment between 1926 and 1968 despite the fact that the Interstate Commerce Commission's Schedule of Annual Indices (which place 1912-1914 prices at 100 points) shows that 1967 costs exceed 1926 costs by the following number of points: rail 285; ties 239; bridges, trestles and culverts 340; ballast 250 and other track materials 237 points. Between 1926 and 1967 the N & W spent $164,293,066 on ties, rails, ballast, other track material and track laying and surfacing in Virginia. Its total expenditure in Virginia for all roadway and track structures during that period was $227,772,333.

As Judge Epes said: "... this Commission has added the cost of additions and betterments charged to capital outlay." However, in accordance with betterment-replacement accounting prescribed by the I. C. C. the increase in cost of replaced like material is not classified as an addition or betterment and, therefore, is not charged to capital outlay but is charged to maintenance expense. For example: a crosstie costing $1.60 in 1928 is replaced in 1968 with a like tie costing $5.11. The entire $5.11 spent for the new tie is charged to maintenance expense. The original cost of the tie *in place now* becomes $5.11, but the railroad continues to carry the cost on its books at $1.60. The 55% increase in assessment takes into account this increased cost of property now in the roadbed that has been charged to maintenance expense instead of to capital outlay.

The effect that this method of accounting for track material has on original cost was recently explained by the Interstate Commerce Commission in its report
page 1798 } in *Ex Parte* 259, *Increased Freight Rates* 1968, 332 I. C. C. 590 (November 1968) on page 606:

"(c) Depreciation accounting is not prescribed for the 'track structure' which includes crossties, rails, track material, ballast, and labor. The use of 'betterment' accounting for rail results in the investment account balance showing a far lesser amount (probably as much as 50 percent) than the actual cost of the rail that is in the track structure today. Crossties, in the carriers' accounts, have remained static in the amount that was recorded per tie at time of the initial valuation. *This cost per tie ranges between* 30 *and* 50 *cents. If the tie account were restated today to reflect the actual cost of the ties that are in the track structure, the investment accounts would be increased over* $1 *billion.*" (Emphasis added.)

It would be physically impossible to examine the railroad's vouchers for material and labor over the past forty years in order to separate from the mass of accounts the items spent to maintain the property from the items spent to improve it. The one thing that emerges is that the Commission's valuation errs in the taxpayer's favor. It errs in the taxpayer's favor whether the proper allowance for depreciation is 20% or 50%.

Counsel for the taxpayer point out in their brief that "An oft-quoted letter written by Commissioner Epes (Ex. 3) reveals that in 1926 the Commission, starting with estimates of reproduction cost, making adjustments for *** and inflation, and *** determined the values per mile." Since the date of that assessment, the Commission's practice has been to ignore the increases in "fair cash value" brought about year after year by inflation. An adjustment for inflation would not involve the hopeless effort to ascertain reproduction cost, but would be based, as Commissioner Epes based it, on rough-and-ready price indices. We are not disposed to make adjustments for the increases in cash value caused by inflation. If the 1926 valuation were adjusted for the multiplication of dollar values brought about by inflation, the increase in the full value would be, not 55%, but 100%. The 1926 full value per mile of Norfolk & Western's mainline double
page 1799 } track was $100,000. The 1969 purchasing power of the United States dollar is 49% of its purchasing power. Therefore, the "cash" value of property worth

$100,000 per mile in 1926 is slightly more than $200,000 in 1969.

DEPRECIATION

One of the points raised by the railroad is that 20% is insufficient allowance for depreciation. N & W's engineering witnesses assert that the condition of its track properties in Virginia is 48% of new, and their accounting witness asserts that the original cost should be depreciated by 49.3%. On the other hand, the former Engineer, Maintenance of Way, for the New York Central Railroad and the former Supervising Engineer for the Interstate Commerce Commission testified, after inspection, that N & W's track property in Virginia is in 64 and 68.5percent condition respectively. The Director of the Commission's Division of Public Utilities Taxation also inspected the property in question prior to making the challenged assessment and concluded that it was in an overall operating condition of 80%. However, when consideration is given to N & W's $10,185,126 initial understatement of its trended original undepreciated cost, its use of indices which do not properly reflect the accelerating cost of replacements in recent years, and its failure to include $49,783,394 undepreciated cost of grading in its report of the cost value of N & W's roadway and track properties, the Director's estimate of present condition turns out to be well below 80% condition.

In his Schedule 2, the accounting witness for the N & W used indices compiled by the I. C. C. to calculate the increment in the cost of replacements over the 1910-1914 cost to arrive at the cost of its track property as it existed on December 31, 1966. In doing this he used the indices at the midpoint in the life cycle of the replacement materials making up the track structure at the end of 1966.

page 1800 } This reflects a straight line increase but the increase actually went up in a curve. It would be more accurate to use average indices arrived at by adding the index at the beginning of the life cycle to the index at the end and dividing the sum by two, thereby giving effect to the accelerated tail-end rate of increase. When grading value of $49,783,394 is added (with a liberal depreciation allowance of 5%) and the 1910-1914 values are trended with more accurate indices, the undepreciated cost (not including during construction) becomes $252,976,135, the depreciated overhead costs that should be included, costs such as interest cost value becomes $147,948,948,821, and the depreication rate becomes 41.5% as shown in the following table:

Account	(3) Total Invest.	(4) Avg. Life	(5) Avg. Index	(6) Trended Value	(7) Depreciation	(8) Depreciated Value
1 Egineering				2,477,150	646,935	1,830,215
3 Grading				49,783,384	2,489,170	47,294,224
5 Tunnels, etc.				10,810,937	1,725,367	9,085,570
6 Bridges, etc.				27,474,712	18,950,872	8,523,840
8 Ties	6,857,799	32	281	19,270,415	9,635,207	9,635,208
9 Rails	19,598,858	37	283	55,464,768	27,732,384	27,732,384
10 Other Track Mat'l	11,438,033	23	328	37,516,748	18,758,374	18,758,374
11 Ballast	10,742,575	53	231	24,815,348	12,407,674	12,407,674
12 Track Laying, etc.	8,051,563	35	303	24,396,236	12,198,118	12,198,118
13 Fences, etc.				966,427	483,213	483,214
	56,688,828			252,976,135	105,027,314	147,948,821

The Commission's depreciated cost value of $142,240,268 is 43.8% less than the railroad's properly computed undepreciated value of $252,976,135. In other words, if the value of grading is included in the roadbed value, as it must be, and the other lesser adjustments mentioned are made in the railroad's valuation, the reduction in the undepreciated cost allowed by the Commission to arrive at depreciated cost at the end of 1966, (whether this be termed depreciation rate or something else) is about double the 20% allowance that is challenged as being too little.

page 1801 } The proper valuation of railroad track property has been studied in many lengthy proceedings by the Interstate Commerce Commission. In those proceedings *the Class I railroads have vigorously objected to making any allowance at all for depreciation of their track structure.* The system of accounts prescribed for railroads by the I. C. C. does not permit depreciation accounting for track structures. The operating condition of a railroad's track structure cannot be accurately measured by considering only the extent of wear for each component of the structure. The well-maintained track property of the N & W has the same value for the movement of trains that it ever had; and it can well be argued, as the railroads have argued, that this leaves no room for any depreciation. Because of the failure of the railroads to report all their property as the statute requires, the rate of depreciation actually allowed in the 1968 assessment turns out to be more than 20%. In making his valuation, Mr. Younger considered that the track was in 80% condition, and he assessed it at 80% of the cost figure the railroad had furnished in response to his request. 80% of the cost figure that the railroad did report is only 56.2% of the cost figure that it should have reported. The fact that the railroad's failure to report all its property in this case has resulted in an unintended depreciation allowance of 43.8% must not be understood as a precedent in

future cases for departing from the 20% allowance established by Judge Epes in 1927.

The Interstate Commerce Commission is in a better position than any other agency to appraise railroad property and we find no instance of its allowing a depre-
page 1802 } ciation rate on roadbed higher than the 20% allowed by Judge Epes. *In Valuation Docket* 343 *Norfolk and Western Railway Co.,* 26 Valuation Reports 255, November 18, 1925, the N & W protested the valuation placed on its property as being too low. Beginning at page 275, the report shows that N & W protested depreciating tentative cost of reproduction new by 20%, maintaining that, where there is no deferred maintenance, there is no depreciation. It then insisted that its property was in 100% condition. Now it comes forward with witnesses to testify that its track property is only half as good as new. At page 282 the 1925 report shows that the N & W then contended that $20,000,000 for going concern value and $5,000,000 for good will value should be added to its tangible assets to determine the full value of its property. Now, to the contrary, their witnesses express the opinion that the franchise value has been included in the original cost assessment and must be subtracted from the Commission's valuation of the track property. One of their witnesses argues that franchise value to be deducted from N & W track property, including grading, is 50% of $99,992,051 or $49,996,026.

The Interstate Commerce Commission considered betterment accounting prescribed for railroads in *Uniform System of Accounts for Railroad Companies,* 309 I. C. C. 289, December 18, 1959. At page 291 this report shows that the major U. S. railroads collectively asserted that depreciation accounting cannot be properly employed because there is no depreciation of the track property as a whole. At page 294 the Commission said:

"Concerning the constant year-by-year cost of track maintenance, the railroads have made the following significant explanation: 'Unlike most other property which is able to perform useful service without a high degree of maintenance even while the processes of deterioration are going on, the track structure must be maintained in a good state of repair, day and night, if it is to function so that after years of service it must be in at least as good operating condition as when it was constructed. Safety is one of the
page 1803 } foremost considerations in track maintenance. While maintenance requirements vary among different railroads and among different lines or territories on the same railroad, all must meet the standard of safety.

For this reason if no other, there can be no deterioration in the railroad track structure. The day it goes out of service it must be in just as good operating condition as the day it was first put in service, except, of course, to the extent that changing conditions of use may permit a changing standard of safe operation. In fact it can be demonstrated that a track which has been in service for a number of years is actually a better track than the day on which it was installed—a phenomenon known as "seasoning" which results from settling and compaction of the grade and ballast through use. Thus maintenance expenditures are frequently greater during the first year of service on a track installation than they are in, say, the fifth year of service.' "

This statement is consistent with the position taken by the railroads throughout the years and illustrates the fallacy of applying conventional depreciation to their track property. Since, as contended by the railroads, "unlike most other property which is able to perform useful service without a high degree of maintenance even while the processes of deterioration are going on, the track must be maintained in a good state of repair day and night" and a track that has been in service a number of years is a better track than on the day it was installed, it follows that at any given stage the present value of track property must be a great deal more than half its cost. The fallacy of attempting to depreciate property which, as a whole, never wears out, at the same rate as property with a definite life span is obvious. The railroads' insistence that their track is kept in 100% condition would naturally not be made on behalf of a railroad with a substantial back-log of deferred maintenance. Norfolk and Western has no such back-log. E. Q. Johnson, Chief Engineer of the Norfolk and Western Railway testified (p. 447):

Q. Now, do you have a significant amount of deferred maintenance on the Norfolk and Western line in Virginia?
A. No, I don't think we do.

And at p. 462:

page 1804 } Q. On Norfolk and Western, have you ever been forced to neglect your normal, overall maintenance program for lack of maintenance funds?
A. I have never found the case when I really needed something that I couldn't get it.

Valuation Docket No. 235 *Virginia Railway Company et al.,* 141 Valuation Reports 595 (May 9, 1928) is another chapter in the railroads' long history of consistently protesting the making of any allowance for depreciation in arriving at a fair value of their track property. At page 631 the Commission said:

"The carriers protest any deduction of accrued depreciation of their property, contending that it is a theoretical rather than an actual element. It is said that the property is and has been well maintained and in all respects is capable of performing the service for which it was intended. Being a seasoned property, it is stated to be of greater value as of valuation date than if it had been new. Exception is not taken to our ascertainment of accrued depreciation as a basis of charges to operating expenses for replacement of worn-out physical property.

"But it is argued that purely labor items, such as track-laying and surfacing and general expenditures, including interest during construction, do not diminish in value and that good maintenance and the replacement of parts as needed, with seasoning and solidification of the roadbed, have the effect of neutralizing any current physical deterioration."

There the N & W (formerly the Virginian) objected to making any allowance at all for depreciation because of the physical nature of its track structure. But now their accounting witness states that he depreciated these assets like the assets of non-railroad property. He did this despite repeated representations by the N & W and other Class I railroads before the I. C. C. that their track property is quite different from non-railroad property.

The I. C. C. has always made some allowance for depreciation in arriving at the value of track property, page 1805 } and we agree that some allowance should be made. The question is—how much? When seeking higher rates the railroads demand zero depreciation. When seeking lower taxes they demand 50%. We find that Judge Epes' 20% is fair and reasonable in rate cases and in tax cases.

The valuation of that part of the Virginian (now N & W) in Virginia found by the I. C. C. as of June 30, 1916, (page 667 of the cited case) which was, of course, far below the cost of replacement of the track property in use on December 31, 1966, is transcribed below:

Accounts	Cost of Reproduction New	Cost of Reproduction Less Depreciation
1. Engineering	796,645	796,645
3. Grading	8,444,265	8,419,000
5. Tunnels and Subways	1,480,971	1,435,809
6. Bridges, Trestles & Culverts	3,554,315	3,129,760
8. Ties	894,444	447,447
9. Rails	1,727,274	1,519,401
10. Other track material	465,565	327,153
11. Ballast	1,313,998	1,091,981
12. Tracklaying & Surfacing	830,289	639,323
13. Right-of-way fences	72,570	49,703
	19,580,336	17,856,222

The depreciation allowance made by the I. C. C. for this group of accounts, comprising the track property, including grading, is 8.8% of the estimated cost of reproduction new. Compared to this, the Virginia Commission's intended allowance of 20% is reasonable and the unintended but actual allowance of 43.8% is much too high. The I. C. C. allowed only one third of one percent depreciation for grading because grading suffers no more than negligible depreciation.

GRADING

Applicant contends that the value of grading is included in the land valuation. The testimony of the Commission's Director of Public Utilities Taxation, the official rec-
page 1806 } ords of the Commission and the testimony of applicant's witnesses prove otherwise. §58-532 *requires* the cuts and fills to be assessed as part of the roadbed and *forbids* the land under the roadbed to be assessed as part of the roadbed. The raw land under the roadbed is appraised by comparing it with locally appraised raw land. Thus the raw land under the C & O's cuts in the Rugby Road section of Charlottesville is appraised at 3 cents a square foot and the locally-assessed neighboring land is appraised at 56 cents a square foot. The value of the cuts to the railroad is not included in, and cannot legally be included in, the land appraisal. The value of those cuts must be reported by the taxpayer and added to the roadbed assessment: the assessment of the roadbed and trackage that is prorated among the localities on a mileage basis. The raw land appraised at three cents a square foot is taxed by Charlottesville as land lying in the City of Charlottesville. The raw land under the cuts in the R F & P's belt line under Monument, Patterson and Grove Avenues in Richmond is taxed by the City of Richmond on this Commission's valuation of $100

an acre. The adjacent land is taxed by the City on its valuation of $52,272 an acre. The value of the cuts through the city cannot be taxed by the city except as part of the mileage prorate because the statute makes it part of the value to be prorated among the taxing districts through which the road runs. The assertion of the taxpayer's witnesses that the valuation of $100 an acre represents the value of the raw land *plus* the value to the railroad of the cuts under the three avenues answers itself.

Under §58-532 of the Code of Virginia it is the duty of the Commission to include in its roadbed assessments the value of cuts, fills, track surfacing and excavations but not the land itself. When this section was enacted the legislature knew that a railroad cannot sell its cuts and fills, and it knew that the land underlying the cuts and overlying the fills has little value. The value of the grading has to be page 1807 } based on original cost or reproduction cost. Many local taxing authorities have complained because we do not assess public service property at reproduction cost. Even counsel for the N & W complain in their brief that the Commission's Director of Public Utilities Taxation "did not look at reproduction costs."

Counsel for the applicant cite *Richmond F. & P. R. R.* v. *Commonwealth,* 203 Va. 294 as being significant. That case involved the assessed value of raw land, appraised at what it would sell for if it could be sold. In valuing raw land (the land alone without the structures on it) a market value in the ordinary sense of a willing seller and a willing buyer can be found by comparing the land appraised by the Commission with other similar land appraised by the local taxing authorities. In valuing the land underlying the Potomac Yards in Alexandria the Commission made an appraisal of $8,181,999 and assessed the land for local taxation at 40% of the appraisal, or $3,272,799. It is significant that the assessment was increased by 450% over the previous year's assessment, as compared with 50% in the present case. Although we do not use reproduction cost in valuing property for either tax or rate-making purposes, it is fair to consider that property values have gone up during the past forty years, that the expenses of local taxing districts have gone up during this period, and that the railroads' contributions to the expenses of the local taxing districts, even when increased by 55%, will not go as far in helping to meet those expenses as they did forty years ago.

Another significant feature of the Potomac Yards case is that it did not occur to anybody to subtract the franchise value from the physical value in the manner urged by counsel in the present case.

A third significant feature of the Potomac Yards case is that it illustrates in full detail the method of assessing raw land. In assessing raw land there is no question of depreciation, no question of original cost and no question of reproduction cost. It is assessed the same way that
page 1808 } local land is assessed by the local Commissioner of the Revenue. As the population increases, the demand for land increases while the supply of land remains unchanged; the increased demand increases the market price; the decrease in the purchasing power of the dollar increases the dollar value of the land. When this method of assessing raw land is understood, it is obvious that it cannot be said that the assessment of the raw land underlying the tracks includes the value of the cuts and fills. §58-532 is the section that requires the trackage to be assessed as a whole and prorated among the taxing districts on a mileage basis. The statute requires the assessment to include cuts, fills, surfacing and excavation, "but not including right-of-way lands." The raw land under the tracks is not included in the track assessment, and its value is not prorated on a mileage basis. Each piece of raw land, just like the raw land involved in *R. F. & P.* v. *Com., supra,* is assessed for local taxation by comparing it with the assessment of other similar local land assessed by the local Commissioner of the Revenue. As shown above, raw land under the tracks is not worth much compared to land that has not been mutilated by cuts, fills and grading.

The total assessment of public service property for 1969 amounted to $1,276,299,404. The Commission's staff does not and cannot examine each item of property each year and has to rely on the tax reports filed by the taxpayers, subject to periodic checks. The first column in the Railway Tax Report form is: "Value of the roadway and track . . . (Exclusive of land.)" It appears that none of the railroads have included in the first column the value of the cuts, fills and grading. Since §58-532 in so many words requires the value to be included, it will have to be included. Even if it be true, as railroad witnesses testified, that they thought and the staff thought that the companies had reported the value of the cuts and fills in column 1, such misunderstanding, if
page 1809 } it existed, cannot amend an Act of the General Assembly. (Const. Sec. 40.) It further appears that the railroads have not included in the track account "all signals (track and crossing), and interlockers" as required by the express words of §58-524 (1). Their failure to include some items in the past does not give them a prescriptive right to leave them out in the future. The applicant

claims that the value of the cuts and fills is included in the valuation of the raw land, a valuation that is no part of the mileage prorate and no part of the track assessment. It does not claim that the value of the crossing signals has been included, but rests its argument on the assertion that the "bare bones" value theory means the reuse value of the property. Since all public service corporations are assessed for local taxation at their "bare bones" value in the same manner, the same argument would apply to all public service company assessments and, if that argument should prevail, the budgets of all the localities would be thrown out of balance.

FAIR MARKET VALUE

Considering how much argument and difference of opinion there is over the value of a single house on a city street when the house has to be valued in a condemnation proceeding, it is not surprising that there is much argument and difference of opinion in the present controversy. The triers of fact must estimate the value as best they can.

Andrews v. *Commissioner of Internal Revenue,* 135 F. 2d 314, involved the ascertainment of the value of securities. Circuit Judge Jerome Frank, writing for the majority, said (p. 317):

" 'Value' is not a single purpose word. Men have all but driven themselves mad in an effort to definitize its meaning. The problem arises in its most perplexing form when, as here, property has not in fact been sold and an effort is made to ascertain what it would have fetched if it had been sold. The answer is obviously a guess."

page 1810 } Judge Learned Hand voted against second-guessing the Tax Court. He said (p. 319):

"In such a setting any price within certain limits—say 35 and 20—is as likely to be right as any other; the truth being that no price is better than a guess. The Tax Court has made its guess, and it is the only tribunal vested with authority to do so. We are now saying that there was no substantial evidence to support that guess, in which we are quite right; but we are sending the case back to make another guess, which in the nature of things we must know will have as little to rest upon as the first."

In *Nashville, Chattanooga & St. Louis Railway* v. *Browning,* 310 U. S. 362, 84 L. ed. 1254, the Tennessee Railroad and Public Utilities Commission found that the total value of the railroad was $23,996,604.14. From that value the Commission subtracted the value of the railroad's terminal buildings, shops and non-operating real estate. It then figured that the value of the property subject to taxation in Tennessee was the ratio of Tennessee mileage to total mileage. After valuing the property down to the last penny, it assumed that the value of each mile was the same as the value of every other mile. The Supreme Court characterized this as a "familiar and frequently sanctioned formula" and held the assessment constitutional. At page 365 it said:

"In a matter where exactness is concededly unobtainable and the feel of judgment is so important a factor, we must be on guard lest unwittingly we displace the tax officials' judgment with our own."

This Commission has treated the original cost of railroad and public utility property as the fairest measure of the "bare bones" value. That measure automatically excludes all franchise value. It values the property as of the date it was first put in service, and before it had rendered service. The price paid by the railroad was the then market value of the property. The railroad itself valued the
page 1811 } property as worth that price. The Commission's original 1927 assessment was not based on exact original cost for the reasons hereinbefore stated, but it approximated original cost. When original cost is ascertainable, original cost should be used.

This Commission asserted in 1927 that its method of assessment excludes franchise value. What Judge Epes said over forty years ago is as true now as it was then. In paragraph (3) of his letter he said:

"(3) The value of these physical properties, which the Commission has tried to ascertain as the 100% basis to which to relate its assessments, is the actual value as of January 1, 1927, of the land and other physical properties of the railroad company exclusive of any franchise value, good will, 'going concern value', cost of establishing the business, or other 'intangible' value of the company."

SIGNALS AND INTERLOCKERS

With respect to its signal and interlocker property, N & W makes the same contention that it made regarding its other

track properties: that without the franchise it has only scrap or junk value and should be assessed as such. We must reject this contention for the same reasons we reject applicant's theory that its other track properties cannot be assessed higher than their "re-use" or scrap value. The carrier also claims that highway grade crossing protective devices should not be included in the signal property reported to the Commission on the theory that the railroad derives no benefit from such property. The legislature felt otherwise, for §58-524 of the Code of Virginia expressly requires the reporting of "all signals (track and crossing)." The Commission, therefore, has no choice but to insist that the value of all highway crossing signals be reported for assessment. The record shows that N & W's 1967 net investment in signal and interlocker property is $16,775,021. During the period 1926-1967 the carrier spent $29,507,934 for additions and betterments to its signal and interlockers in Virginia

page 1812 } and spent an additional $19,000,000 in maintaining the equipment. The property is serving its intended purpose; it is being used for train control and to promote safety of operations, both on the railroad and at highway crossings. In spite of this, and after having reported this class of property to the Commission for more than 43 years at 50% of book value (less about $2,000,000 worth of highway protective equipment it didn't report) the carrier now asserts that the signals must be assessed as scrap worth $1,600,478. This contention is too extreme to merit further discussion, except to say that the 20% depreciation we allowed N & W on its signal and interlocker property is substantially more generous than the 13.9% depreciation allowed by the Interstate Commerce Commission in valuing N & W's signal and interlocker property in Virginia. See *Valuation Docket No.* 343, *Norfolk & Western Ry. Co.,* 26 Val. Rep. 255, 298 (1929). Also see *Valuation Docket No.* 235, *Virginia Ry. Co. et al.,* 141 Va. Rep. 595, 666.

CONCLUSION

The kaleidoscopic pattern of the railroad's argument, in which it complains of failure to consider reproduction cost, demands that "market value" be determined by dismantling the property and selling the pieces for scrap, insists that the unit value of the railroad in and out of Virginia be determined and that its total value be ascertained by multiplying earnings by an arbitrary factor, and then subtracting 50% for franchise value, with the remainder to be allocated somehow or other among the track structure, the land, the build-

ings and the rolling stock, make it hard to determine precisely how many dollars the applicant is seeking to recover from each of the 42 counties, 17 cities and 66 towns.

Mr. Younger's method of assessment is based on original cost less 20% and, for the purpose of attacking his assessment, the railroad argues that every other page 1813 } imaginable method of valuation but one would be better. The one possible method that it does not insist on is the method used by Judge Epes of increasing the assessment from year to year by considering the annual decline in the value of the dollar. Except for that adjustment, the Commission has followed in Judge Epes's footsteps.

The Supreme Court of the United States in *Nashville, etc.* v. *Browning* pointed out that "exactness is concededly unobtainable." The framers of the 1902 Constitution declared it to be "absolutely impossible." Our method of assessment comes as near as it is possible to come to a fair, just and reasonable method. The undervaluation resulting from the taxpayer's failure to report all its property is not an error that the taxpayer can complain of. Its application for refunds must be denied.

HOOKER and DILLON, *Commissioners,* concur.

* * * * *

A Copy—Teste:

Howard G. Turner, Clerk.

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