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Richmond, Va.

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(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

§5. Number of Copies. Twenty-five copies of each brief shall be filed with the clerk of this Court and three copies shall be mailed or delivered by counsel to each other counsel as defined in Rule 1:13 on or before the day on which the brief is filed.

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HOWARD G. TURNER, Clerk.

Dr. J. Rhoads Foster

page 604 } RECROSS EXAMINATION

By Mr. Riely:

Q. Your purpose in your Ohio valuation study was to determine the fair market value of the property of the Pennsylvania Railroad in Ohio, was it not?

A. No. My purpose was to determine the fair market value. The Pennsylvania Railroad in its entirety.

Q. I beg your pardon, but fair market value was your aim?

A. Yes, sir.

Mr. Riely: I have no further questions.

Commissioner Catterall: Now, you may stand aside. Thank you for coming down.

Do you want the witness excused?

Mr. Riely: Glad for him to be excused if he will give me back my transcript.

The Witness: I am delighted to return that.

Mr. Riely: May it please the Commission, we have two witnesses this afternoon here for cross-examination. I believe it will be brief and I think if it is acceptable to you I suggest we adjourn until two o'clock and come back.

Mr. Epps: You know more about the length of your cross-examination.

page 605 } Mr. Riely: I have told you it will be short.

Commissioner Catterall: You are going to do cross-examination?

Mr. Riely: Yes, sir. I will do the cross.

Commissioner Catterall: You know it will not be protracted?

Mr. Riely: No, it will not.

Mr. Epps: Will the Court take judicial notice of that?

Commissioner Catterall: Not only that, but we will write it down on paper.

(The witness stood aside.)

(A recess was taken at 12:15 to reconvene at two o'clock.)

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* * * * *

Richmond, Virginia
April 18, 1969

Before: Honorable Ralph T. Catterall, Commissioner
Honorable H. Lester Hooker, Commissioner

* * * * *

page 607 } PROCEEDINGS

(April 18, 1969) (Friday at two o'clock)

AFTERNOON SESSION

Mr. Shannon: I believe you finished with Dr. Foster, is that right, Mr. Riely?
Mr. Riely: Yes, sir.
Mr. Shannon: I would like to call Mr. Boyd Garrett to the stand, please.

BOYD GARRETT was called as a witness and testified on his oath as follows:

Mr. Shannon: His testimony has been entered in evidence.

DIRECT EXAMINATION

By Mr. Shannon:
Q. Would you please state for the record your name?
A. Boyd E. Garrett.
Q. Are you the same Boyd E. Garrett that prepared, verified the 12-page statement together with three exhibits in this proceeding?
A. Yes, I am.

Mr. Shannon: I tender the witness for cross-examination.

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* * * * *

TESTIMONY OF BOYD E. GARRETT
ON DIRECT EXAMINATION

Q. Please state your name, position and address.
A. My name is Boyd E. Garrett. I am Chief, Section of

Valuation and Depreciation, Bureau of Accounts, Interstate Commerce Commission, Washington, D. C.

Q. In your position as Chief, Section of Valuation and Depreciation, what are your principal duties?

A. In my present position, I have the overall responsibility for the work necessary to ascertain the value of railroad and pipeline properties and to determine equitable and reasonable depreciation rates for carrier property as required by the Interstate Commerce Act.

page 609 } Q. In your position as Chief, Section of Valuation and Depreciation with the Bureau of Accounts, do you have knowledge of why the Interstate Commerce Commission was initially required by Congress to ascertain the valuation of all railroad properties in the United States?

A. Yes. The primary purpose of requiring the Commission to make the initial valuations of the common carrier property of the Nation's rail carriers was to establish a reasonable rate base for use in maximum rate regulation. Also, such valuations would serve as a base for reasonable railway taxation by the various States and serve as a depreciation base when carriers were required to adopt depreciation accounting.

Q. Has the Interstate Commerce Commission kept itself informed as to new construction, extensions, improvements, retirements, or other changes in the condition, quantity, use, and classification of the property of all common carriers as contemplated by section 19a(f) of the Act?

A. The Commission issued various Valuation Orders which required all carriers for which a basic

page 610 } valuation was issued to maintain specific property records and submit annual reports of property changes and other data. While these reports kept the Commission informed as to the quantities and cost, its lack of resources has not permitted it to engage in the same extensive fieldwork in order to determine the actual physical condition of the property.

Q. Please explain how these reports were processed by the Commission and through what year.

A. There were applied to the capital additions and retirements reported by the carrier, normal prices at 1910-14. The additions and retirements priced at 1910-1914 prices were combined with the carrier's latest revaluation which produced an inventory as of the date of the report being processed, priced at 1910-14 normal prices.

Boyd Garrett

In determining cost of reproduction new—less depreciation—service life studies were made and guide service lives established for the major items of railroad property. These guide service lives took into consideration the normal physical and functional experience of the various types of property for the majority of the carriers, it being

page 611 } necessary to state, with respect to each piece of property, the number of service units which that property at date of revaluation has for the purpose for which it is being used. In determining that fact, an inspection of the property was made and the experience of the past, both as developed by the records of the carrier under valuation and from those of other carriers as well, was considered in the light of present knowledge and conditions. Having determined the service life as indicated above, and the date of installation or of the beginning of the use being usually known, remaining future service life was obtained by subtracting the one from the other. The service-condition percent was stated as the ratio between remaining capacity for service and total capacity for service. The annual reports of property changes of the Class I rail carriers have been processed through various years extending from 1944 to and including 1958.

Q. In the above revaluations did the Commission develop a state-by-state breakdown of the railroad properties? If so, through what year?

page 612 } A. Cost of reproduction new and cost of reproduction new—less depreciation—was developed at the state level for the various carriers as of varying dates. As previously stated, these extended from 1944 through 1958. All carriers' revaluations are not as of a common date.

Q. Do you have available for introduction in this proceeding a document prepared by the Interstate Commerce Commission's Bureau of Accounts entitled *Schedule of Annual Indices For Carriers by Railroad* 1914 *through* 1967?

A. Yes.

Q. May this please be marked as Exhibit No. (BEG-1).

Q. Please explain the purpose of these indices identified as Exhibit No. (BEG-1), and state how they were prepared.

A. These indices were issued by the Commission as information. While these indices are not necessarily applicable for estimating reproduction costs of an individual carrier, they are of value in indicating trends. In developing these

annual indices an analyses was made each year of major construction contracts, studies of carriers' re-
page 613 } turns to various Valuation Orders, joint studies made with the Industry Advisory Committees and engineering and trade publications. The index for each primary account is a composite index which was developed from the consist of the various elements in each primary account of each Class I carrier in each region. That is, the inventory as of the latest date available priced at 1910-14 prices was used to develop the composite index for each primary account for each region and the United States as a whole.

Q. Are the date developed in these indices applicable to the property of railroads operating in Virginia?

A. As previously stated, these indices indicate trends in the cost of railroad construction. They are developed by regions and Region IV which represents the Pocahontas Region would indicate the trend in the cost of Norfolk and Western railroad construction in the State of Virginia.

Q. Has the Interstate Commerce *Commision's* Bureau of Accounts also published a document entitled *Ele-*
page 614 } *ments of Value of Property Used in Common Carrier Service as of December* 31, 1963?

A. Yes.

Q. Do you have for introduction in this proceeding a copy of *Elements of Value of Property Used in Common Carrier Service as of December* 31, 1963?

A. Yes, I do.

Q. May this please be marked for identification as Exhibit No. (BEG-2)?

Q. Now Mr. Garrett, would you please explain the connection between the Schedule of Indices (Exhibit No. BEG-1) and the *Elements of Value of Property Used in Common Carrier Service as of December* 31, 1963 (Exhibit No. BEG-2)?

A. In order to answer this question it will be necessary to briefly explain the procedure followed in developing cost of reproduction new for roadway property. On page No. 6 of the elements of value we show for the Norfolk and West-
ern Railway $1,239,618,000 as of December 31,
page 615 } 1963, representing cost of reproduction new for roadway property. The last annual report of property changes for which we priced the capital additions and retirements at 1910-14 period prices was the year 1952. In order to bridge the gap between 1952 and 1963, we trended the dollar changes reported for all roadway capital addition.

The devisor used in trending these changes back to 1910-14 was the composite index for each year shown at the bottom of pages 7 and 9. For the equipment accounts the index for each primary account was used to trend the annual capital additions back to 1910-14, rather than the composite index for all equipment accounts. Briefly stated the underlying working papers prepared in connection with the development of the annual indices also provided us with the devisors for trending the capital additions back to 1910-14. In bringing the restated inventory down to 1963, a period multiplier which was applicable only to the Norfolk and Western Railway was used.

page 616 } Q. Referring to page 6 of Exhibit No. (BEG-2), please explain how the original cost—except land and rights—was developed for road accounts of the Norfolk and Western Railway.

A. The Commission in its work in connection with section 15a of the Transportation Act of 1920 had need for the original cost of all property used in common carrier service by all rail carriers subject to part I of the Interstate Commerce Act. In the absence of reliable costs of the carrier's investment in carrier property account, the Commission adopted as the best estimate of original cost the cost of reproduction new as of date of basic valuation. Subsequent to date of basic valuation the capital additions and retirements as reported annually to the Commission in response to Valuation Order No. 3 and its supplements, have been added or deducted from the estimated original cost at date of basic valuation. In the event the carrier had not submitted a report of annual property changes, recourse was had to the carrier's Form A annual report and

page 617 } the reported additions and retirements as shown on Schedule 211 were applied to the balance of original cost. The Commission by its Order of April 17, 1963, required all rail carriers subject to our accounting regulations to restate their investment in carrier property accounts to the basis of original cost as determined by the Bureau of Accounts. Today, Schedule 211N2 of the Form A, which is submitted by all Class I carriers annually, shows the original cost of all property used in common carrier service.

Q. Is a study similar to that covered by Exhibit No. (BEG-2) available for the years subsequent to 1963? Please explain why not.

A. No. The release covering the year 1963 was the last

published by the Commission. Due to the absence of a continuing need for this data by the Commission and a lack of resources, the Bureau has been forced to restrict its work in the area of railroad valuation work.

page 618 } Q. Mr. Garrett, did the Interstate Commerce Commission issue a docket covering the Norfolk and Western Railway Company's property?

A. Yes.

Q. When and in what proceeding was this valuation docket made and do you have a certified copy of it for submission in this proceeding?

A. The basic valuation of the Norfolk and Western Railway Company was decided by the Interstate Commerce Commission May 31, 1929, and is shown in 26 Val. Rep. 255. Yes, I have a certified copy of the valuation docket No. 343 for the Norfolk and Western Railway Company and request that it be marked for identification as Exhibit No. (BEG-3).

Q. Would you please explain what information is furnished by the railroads to the ICC on the Interstate Commerce Commission Form 588?

A. The annual report of property changes (B.V. Form 588R) submitted by all carriers in response to

vuge 619 } Revised Supplement No. 3, Second Revised Issue show the quantities and cost of property added and retired.

Q. Could a reasonably accurate estimate of cost of reproduction new be developed for a date subsequent to the basic valuation date of the Norfolk and Western Railway Company from information taken from the ICC's Form 588?

A. Yes, as indicated previously, these annual reports of property changes show the quantities and cost of property added and retired.

page 620 } VERIFICATION

City of Washington
ss.
District of Columbia

Boyd E. Garrett, being duly sworn, deposes and says that he has read the foregoing statement, knows the contents thereof, and that the same are true as stated.

Boyd E. Garrett

Boyd Garrett

Subscribed and sworn to before me, a Notary Public for District of Columbia, this 8th day of April, 1969.

Wm. F. Luper
Notary Public

My Commission Expires June 14, 1972.

page 621 } CROSS EXAMINATION

By Mr. Riely:

Q. Mr. Garrett, you are the chief of the valuation and depreciation section of the Bureau of Accounts of the Interstate Commerce Commission, are you not?

A. That is correct.

Q. How long have you occupied this position?

A. Approximately eight years.

Q. How long have you been employed by the Interstate Commerce Commission?

A. Off and on since 1942.

Q. Are you a Certified Public Accountant?

A. No, I am not.

Q. Engineer?

A. No.

Q. Economist?

A. No. Not a Certified Public Accountant. Accountant.

Q. You are an accountant?

A. Yes. That is my classification that the Commission assigned to me.

Q. What has been your experience other than with the Commission?

page 622 } A. I spent ten years with the Wichita Falls and Southern Railroad, a small line in the State of Texas.

Q. What duties did you have there?

A. I was employed in the general accounting office in addition to being responsible for the property records. Also disbursements and accounting.

Q. And what—have you had any other experience in business other than that, except with the Commission?

A. I spent three years with the Department of Defense in the accounting department and a year and a half with the Department of Commerce.

Q. Three years during that latter unpleasantness or when was it?

A. I beg your pardon?

Q. Three years with the Department of Defense was when?

A. During the Korean War.

Q. Korean War?

A. Yes.

Q. I gather you have testified before the Interstate Commerce Commission, is that true?

A. No.

Q. Testified before any regulatory commission?

A. No.

page 623 } Q. Have you ever testified in any proceeding involving property taxation of a carrier?

A. No.

Q. Do you appear here as an official representative of the Interstate Commerce Commission?

A. I appear here at the request of the present Commission. I assume it is—

Q. At the request of this Commission and not the Interstate Commerce Commission?

A. No.

Q. Has any member of the Interstate Commerce Commission authorized you to appear here?

A. Yes. Director of the Bureau of Accountants.

Q. But no member of the Commission?

A. Yes. The Chairman.

Q. Mrs. Brown?

A. Mrs. Brown.

Q. Are you talking officially as a representative of the Commission? Has the Commission taken official responsibility for your statements here?

A. I am not stating policy of the Commission, if that is what you are leading to.

page 624 } Q. I am just trying to find out whether you are speaking for the Interstate Commerce Commission or for yourself.

A. Based on my experience.

Q. Good.

Now, would you say that you are an expert on property taxes of rail carriers?

A. I would not.

Q. What is your familiarity with the scheme of property taxation for rail carriers adopted by the Commonwealth of Virginia?

A. I have no knowledge of any tax laws for any state.

Q. Now, on page 2 of your testimony, Mr. Garrett, and perhaps you would like a copy to refer to.

Mr. Shannon: Just a minute, Mr. Riely.

Mr. Riely: Certainly.
The Witness: Page 2?
Mr. Riely: Yes, sir.

By Mr. Riely:
Q. Just about a third of the way down the page you state, "The primary purpose of requiring the Commission" that is the Interstate Commerce Commission, is it not?
A. Yes.

page 625 ⟨ Q. "The primary purpose of requiring the Commission to make the initial valuation of common carrier property of the national rail carriers was to establish a reasonable rate base for use and maximum rate regulation." When was this valuation accomplished?
A. When was it accomplished?
Q. Yes.
A. Extended over a period of years from approximately 1914 through approximately 1933.
Q. And what was the time used for the establishment of the values?
A. I beg your pardon?
Q. What was the year or period that was used for the establishment of values? As of what date?
A. 1910 to 1914 prices were used in developing cost of reproduction new.
Q. Yes.
Now, you say that the prime purpose was to establish a reasonable rate base, is that true?
A. That is true.
Q. So at least '10-'14 prices I believe referred to as of 1916 valuation of it, is it not?

page 626 ⟨ A. 1914 valuation normally referred to 1914 valuation.
Q. Now, in 1914 reproduction cost new less depreciation was the established method of computing the rates, was it not?
A. Yes. Wait, excuse me.

Mr. Shannon: Wait.
The Witness: Just a minute. In 1914 reproduction?

By Mr. Riely:
Q. At that time reproduction cost new less depreciation was the established method of computing rates, was it not?
A. No, sir.

Boyd Garrett

Q. What was?
A. Final value determined by the Commission.
Q. And the Commission did not use the 1914 reproduction cost new less depreciation as its final value?
A. Not as final value. It was one of the elements considered in arriving at it.
Q. What other elements were considered?
A. Present value of land and rights.
Q. Anything else?
A. Working capital.
Q. Working capital?

page 627 } A. Going concern value and any other elements that might have had a determination on the value of the property.

Q. These were considered in relationship?
A. Right.
Q. Going concern value is normally associated with reproduction cost new determination rather than with original cost determination, was it not?
A. Very seldom did they determine original cost in the basic valuation for any of the major areas.
Q. In connection with reproduction cost they did take into account going concern value?
A. Not in reproduction itself. In finding final value.
Q. Finding value it did.
And how long did you say it took the Commission to determine these 1914 reproduction new figures for all of the railroads of the country?
A. Approximately 20 years.
Q. Now, next you say, again on page 2, also, "Such valuation would serve as a base for reasonable railway taxation by the various states."
So one of the purposes of these 1914 valuations were to give the state something on which to base reasonable railway taxation, is that correct?

page 628 } A. I would interpret it to mean that it would furnish a vehicle for a state to determine a fair rate basis.

Q. That was one of the stated purposes?
A. One of the stated purposes to Congress to legislate a district.
Q. Were these valuations adopted in many states?
A. Each state was served with a copy of each valuation for each carrier operating in that state.
Q. Were they adopted by the states as bases for taxation?

Boyd Garrett

A. Not to my knowledge.

Q. Now, did these valuations include franchise value as a separate item?

A. No, sir.

Q. But these were valuations made on the bases that the railroad was a going concern, were they not?

A. Right.

Q. And the railroad with a going concern has a franchise to operate its property in place, it has customers and it has contracts and running engines, isn't it?

A. Right.

Q. So all this really goes back to 1914, isn't that correct?

A. Yes.

page 629 } Q. Now, let's turn to page 8 of your testimony,

Mr. Garrett. As I understand it you bought the 1914 reproduction cost new up to 1952 railroad by railroad, is that correct.

A. We brought the Norfolk and Western up to 1952. The others are as of varying dates. The average date is approximately 1949.

Q. 1949.

Then when all, when those railroads were brought up to date, including the Norfolk and Western, to '52 it was done on a railroad-by-railroad basis, isn't that correct?

A. Carrier by carrier.

Q. But '52 as far as Norfolk and Western was concerned and '49 on the average for the other railroads was the last year for which you did it for the individual railroads, is that not correct?

A. Under the long form procedure, that is pricing each of the units of property reported in the BV588 at '10-'14 prices.

Q. And since '52 in the case of the Norfolk and Western from '32 to '63 you trended it on the basis of all railway road capital addition, is that correct?

A. By individual carrier.

page 630 } Q. By individual carrier, but what was the method by which trending was done?

A. We trended the addition using a period or using a spot divisor for the roadway property as a whole and for each equipment account. We have a divisor for each account.

Q. They were specifically applicable to the Norfolk and Western and no other railroad?

A. The divisors were specific to each region and if the Norfolk and Western, being in region four, it was applied

the Norfolk and Western, that is the divisor for carrying it back to '10-'14.

Q. Now, suppose you had a railroad in two or three different regions?

A. At the time, let's see, the Norfolk and Western, I forgot the date they took on the Wabash, but this would be part of the problem. One of the reasons we are getting away from this is because it would mean reworking, due to the Penn Central being in two and the Norfolk and Western and Wabash in two.

Q. A lot of railroads are in more than one?

A. Right.

Q. The Seaboard Coast Line?

A. No, they are in the same.

page 631 } Q. But extends in fact into the Pocahontas area?

A. Classified for our purposes as being region five.

Q. Classified as being region five even though it extends into the region four?

A. Right.

Q. So what did you call that divisor?

A. The divisor for trending back to '10-'14?

Q. How is the divisor determined?

A. It was a study of the elements within each carrier's property accounts.

Q. And it was done on a region-by-region basis throughout the United States?

A. Right.

Well, actually it is done by a carrier consolidated into that region.

Q. But the regional figure was the one you used?

A. Region.

Q. What has been done since '63?

A. Nothing.

Q. So you don't have any divisor applicable for the period to the Norfolk and Western since '63?

A. We haven't done any work ourselves. We published the indices through '67, I believe, for the region.

page 632 } Q. How did you determine those indices?

A. By making cost studies of new construction, contracts.

Q. All right. This was done on the Pocahontas region but wasn't done for Norfolk and Western individually, is that correct?

A. No, not done for the Norfolk and Western individually.

Q. All right.

On page 4 of your testimony. On page 4, let's see if I can find the place I am talking about.

Mr. Epps: It is a long page.

By Mr. Riely:

Q. In determining this fact, beginning of the third line, "An inspection of the property was made." You refer in this connection to an inspection of the Norfolk and Western's property, is that correct?

A. If we are referring to bringing the Norfolk and Western down through the year '52, yes.

Q. When was this inspection made?

A. I don't have the exact date. It would be in our files, the inspection reports.

Q. Well, the inspection was made in connection
page 633 } with the initial valuation, isn't that correct?

A. Yes.

Q. And I believe one of your exhibits is this 1929 report which is the final report on the valuation of the Norfolk and Western, isn't that correct?

A. Yes.

Q. That is Exhibit B.E.G.3.

So inspection was made in connection with that valuation of subsequent inspection made?

A. Subsequent inspection made each time they *bought* the property down to a later date under the long form procedure.

Q. Up to '52 in the case of the Norfolk and Western?

A. That was the last sum between '52 and '60.

Q. But no inspection has been made for that purpose at least by the Interstate Commerce Commission since 1952?

A. No.

Q. And these were detailed inspections?

A. Let me correct that a minute there. '52 may have been made subsequent to that date, but they were looking at '52 property inventory.

Q. I see.

And these were detailed inspections?

A. Yes, sir.

page 634 } Q. People got out—

A. Into the field.

Q. Went over the track.

And the purpose of these inspection was to determine the extent of physical deterioration or obsolescence in the property, was it not?

A. Right.

Q. Now, that means if I understand you, Mr. Garrett, depreciation was recorded by the Interstate Commerce Commission in its valuation as of 1914 was a physical depreciation rather than an accounting depreciation, is that correct?

A. In 1914 you did not have an accounting depreciation on the books of the Norfolk and Western.

Q. So then determining a physical per cent condition?

A. Physical condition of the property.

Q. And that was carried out right on down through 1952 valuation?

A. Right.

Q. So the Commission approved of depreciation determined by physical inspection for your purposes, doesn't it?

A. Plus studies made by the Commission in addition to that physical inspection.

page 635 } Q. What sort of studies?

A. Depreciation studies.

Q. You mean—well, describe those studies to us.

A. A study of the industry as a whole as to what the experience of the industry is with respect to various elements of property as to its service life.

Q. And that would be applied to the Norfolk and Western?

A. Yes, sir.

Q. To what extent would the result of the physical inspection be modified by these industry studies, can you tell me?

A. I would say it would be another way to modify the industry study by the inspection. The inspection would be by physical or by observation.

Q. Well, they would modify the industry study by the inspection and then modify the results of the inspection by the result of the industry study?

A. No, you would not make another adjustment, no.

Q. I see.

The figures used in the Norfolk and Western would then be the result of the inspection?

A. Of the inspection again.

page 636 } Q. I see.

Now, if you will turn to the B.E.G. 3, I have gotten into the habit over the last few days of calling it Beg 3, Mr. Garrett.

A. Very good.

Q. I hope you will pardon me if I refer to it that way. If you will turn to page 298. I think that you will agree with me that the Commission found that the cost of reproduction

new of the Norfolk and Western's roadway accounts other than overhead was 90 and a half million dollars and the cost of reproduction new less depreciation of overhead was about 77 and a half million dollars, is that correct?

A. Correct.

Q. Now, the condition new at that time, which is relationship of those two figures, was about 85 per cent, is that correct?

A. I would say that is approximately correct.

Q. Now, will you go backwards with me to Exhibit B.E.G.2 and turn to page 6, which is easily identifiable because it is the only one that is upside down?

A. Page 6?

Q. Yes, sir. Of Beg 2, not B.E.G.1.

page 637 } And this is the value of property as of December 31, 1963, is it not?

A. Yes.

Q. And there the cost of reproduction except files and rights of the Norfolk and Western at December 31, 1963, is stated at $1,239,618,000, is that correct?

A. Correct.

Q. And the cost of reproduction less depreciation is stated at $850,735,000, is that correct?

A. Correct.

Q. What is that condition per cent? That is about 65 per cent, isn't it?

A. Subsequent to the 1952 long form report we used the previous study that I referred to in bringing this property down to a later date. The condition per cent down to a later date. There is no physical inspection involved.

Q. No physical inspection. Why did the condition per cent change from 85 per cent at the 1914 valuation to about 65 per cent in 1963?

A. That I couldn't answer.

Q. Don't know?

A. Not without making a study of the figures that went into make this up.

page 638 } Q. You said you used the '52 study to bring these figures up to 1963, is that correct?

A. We start with that ending '52 '10-'14 prices and then the straight addition. And when retirements trended back to '10-'14 and the multiplier applicable to the Norfolk and Western is used to bring it to '63.

Q. I understand.

Now, staying right on that same page, Exhibit 6, at page 6 of the Exhibit B.E.G. 2 there is a heading "Original Cost

Except Lines and Rights." Now, Mr. Garrett, I am primarily utility minded myself and my definition of original cost means dollars actually spent to construct or acquire the property by the first person who applied it to the public service. Does this figure of original cost shown on this page 6 of Exhibit B.E.G. 2 comply with that definition?

A. Yes and no. I will have to answer it that way. I will have to qualify it. I don't know how familiar you are with the Interstate Commerce Commission.

Q. Not a bit.

A. Figures on original cost. As I indicated earlier they were unable to determine original cost in 1916 and valuation of the Norfolk and Western. In the recapture proceedings under its Transportation Act of 1920 the Commission adopted as the best estimate of original cost the

page 639 } cost of reproduction new at 1916.

Q. So that the figures shown on this page of this exhibit include cost of reproduction at 1916?

A. It includes reproduction shown in Exhibit 3 plus and minus the capital addition and retirements.

Commissioner Catterall: May I interject at this point, before 1910 original cost of railroads was about twice the actual cost because of the finagling that went on in the bill and therefore reproduction cost was the lowest cost.

The Witness: Correct, Mr. Commissioner.

By Mr. Riely:

Q. Now, as I understand it the Commission added to the 1914 valuation and capital addition at cost, is that correct?

A. Correct.

Q. And retirements were deducted, is that correct?

A. That's right.

Q. And they were deducted of original cost?

A. They were deducted at reproduction for those items of property that was included in the inventory and at original cost for those added subsequent.

Q. So there isn't any way that anybody can determine an original cost figure for the Norfolk and West-

page 640 } ern's property located in the State of Virginia following my definition, at any time?

A. Not the definition that you used.

Q. I see, sir.

Commissioner Catterall: When was the Norfolk and Western built? When did it first open for business?

Mr. Riely: I am sure it is in the valuation report, Your Honor. We could look for it if necessary.

Commissioner Catterall: I mean, it was around 1840, wasn't it?

Mr. Shannon: Your Honor, I think it was chartered in Virginia on January 15, 1896, but of course acquired a number of operating lines. They were entered together to make up the Norfolk and Western system.

Commissioner Catterall: The definition for utility purposes of original cost would require finding out how much was spent on each of the original lines back in the 1830's, 40's, and 50's.

Mr. Riely: If I understand the 1890 incorporation was a result of a bankruptcy, Your Honor.

Commissioner Catterall: You think that was as a result of a bankruptcy? Original cost would have been placed long before the bankruptcy.

page 641 } Mr. Riely: Yes, sir.

Commissioner Catterall: In fact almost every railroad in America has gone through the wringer at one time or another.

Mr. Riely: I don't think the Union Pacific has.

Commissioner Catterall: Haven't they?

The Witness: Yes, sir.

Commissioner Catterall: Oh, yes, they have all gone through the wringer once.

By Mr. Riely:

Q. You don't have a condition per cent for the Norfolk and Western for any year subsequent to 1963?

A. No, sir.

Q. Now, I note on page 10 of your testimony, Mr. Garrett, that you state that, "The release covering the year 1963 was the last published by the Commission."

A. That is correct.

Q. Due to the absence of continuing need for this data by the Commission and a lack of resources the Bureau has been forced to restrict its work in the area of railroad evaluation work. Why wasn't there any further continuing need for this report, Mr. Garrett?

A. The Commission has adopted as a rate base

page 642 } depreciated original cost in rate proceedings subsequent to about 1948, I believe it is. Five per cent rate base right after the war. There is no need for rate making purposes for reproduction for final value figure, I should say.

Q. And there just wasn't enough interest in this to justify continuing it?

A. Well, we did not have the money and had to drop it.

Q. Because people weren't using it, is that correct?

A. That is correct.

Mr. Riely: Thank you.

No further of Mr. Garrett.

Commissioner Catterall: Any others?

Mr. Epps: Yes, I would like to ask a few questions on cross-examination.

CROSS-EXAMINATION

By Mr. Epps:

Q. Mr. Garrett, we have been talking about the engineering reports and the indices. Mr. Tipton, an accountant, has testified in here about his use of these indices that you and Mr. Riely have been discussing. I should like to ask you about Mr. Tipton's use of those indices.

page 643 } In response to a question from the Commission, as I understand Mr. Tipton's testimony, to determine today's dollar value of the original cost of the railroad Mr. Tipton did the following things. He started with the investment as of June 30, 1916, from the I.C.C. basic engineering report. In the so-called road and track accounts, accounts 8, 9, 10, 11, and 12. You know them better than I. Ties, rails, other track material, ballast, track laying. And to this he has added figures derived from the net changes from the I.C.C. BV 588 from 1916 up to current date and restated in those base dollars of 1910 to '16 that you have talked about.

He then combines these two into total investment as of June 31, 1966, stated in the base dollars of 1910 to 1914.

He then determines from an industry study the average service life of each one of those five accounts, ties, rails, and other track materials, ballast, track laying and servicing. They being respectively 32 years, 37 years, 23 years, 53 years, and 35 years. He takes a point in time half way during a life cycle placed with its terminal point on December 31, 1966, and comes up with years for the various accounts of 1950, that is half way back of a 32 life cycle for ties, 1947 for rails, that is half way back, as he says, of a 37 life cycle; of 1954 for other track materials, being half way back

page 644 } on a 23-year life cycle; 1939 on ballast, half way

Boyd Garrett

back on a 53-year life cycle; and 1948 on account 12 track laying and servicing, which is half way of a 35-year life cycle. And to those base dollars which he had in that sum that you and I have just left he applies a multiplier which I take it to be the same thing you talked to Mr. Riely about as a divisor depending on which way you are going, for 1950, 1947, 1954, 1939, and 1948, accordingly and he comes up with a figure against which he applies, in general, 50 per cent depreciation factor and comes out with his figures.

Now, I would like you to comment on that procedure, if you will, sir.

A. Well, first of all I would like to say that his having added the net addition to retirements for 1916 to '63—

Q. No, sir, all the way to '67.

A. To '67?

Q. Yes, sir.

A. Well, our purpose in pricing '10 to '14 changes through '62 in the case of the Norfolk and Western was to purify our previous estimate where we had used divisors and trending dollars. He has made a split here from '16 to '67 which, under our procedure, we would never attempt to do because there is too many unknown estimates in the figure to be-
page 645 } gin with.

Q. Yes, sir.

How would you arrive at what his test was?

A. We would have started with the inventory at 1952 and taken the addition and retirement gross, not net, gross, from that date forward to '67.

Q. Not the net, but the gross?

A. Not the net, the gross because retirements are both engineering report which you don't need to divide on because they are '10 to '14 prices, and then you put a divisor on your addition subsequent to basic that were retired in that period.

Q. Had Mr. Tipton used the method which you indicate as the proper method would his result have been greater or less?

A. That would be hard to say, I am afraid.

Q. All right, sir.

A. That would be without figuring it out.

Q. We haven't asked you to figure it out.

Now, would you pass on to the use of average life cycle to determine today's dollars?

A. I know of no basis for that approach.

Q. What would you do in bringing it forward
page 646 } to '67?

A. In connection with our long form report we

also studied the tie and rail turnover as reported in the form annual report. I don't know whether you have it in this hearing or not.

Q. It is available, yes, sir.

A. Schedule 515 and 516, I believe it shows the experience of the carrier with respect to tie renewals and rail renewals. And this we would establish a life for their ties, not the industry's as a whole but for the Norfolk and Western.

Q. And what index would you use to determine the '67 dollar value of the ties in the Norfolk and Western? What factor of multiplier?

A. We apply a multiplier to the roadway property that we developed for each carrier. It isn't from the indices as published. It is a multiplier that is developed for each carrier.

Q. Could you tell me what it would be for Norfolk and Western?

A. I don't have it available.

Q. Don't have it with you. Would it be greater than the multiplier or less than the case of the ties for 1950?

A. At '67 it would be greater.

page 647 } Q. Yes, sir.

Would you say substantially greater or only a small amount greater?

A. I would say it would be substantial and this is strictly off the top of my head.

Q. I understand.

What about rail as between 1947 and 1967?

A. Rails?

Q. Yes.

A. Substantial difference.

Q. And you would use the same procedure that you have described for ties?

A. For all the same procedure applies to all.

Q. They have their own multiplier for the Norfolk and Western?

A. Yes, sir.

Q. And that would be substantially greater, as you say, for rails and would it be substantially greater for other track material?

A. Other track material would normally follow rail.

Q. Substantially greater, '54 for example, '67 versus '54?

A. Yes.

page 648 } Q. How about ballast? '39 versus '67?

A. '67 would be substantially greater.

Q. Yes.

Boyd Garrett

And what about track laying and servicing 1948 versus 1967?

A. It would be some different. It would be quite a bit higher.

Q. Now, you were asked to refer to B.E.G. 3, page 298. And Mr. Riely asked you about some figures for reproduction cost new and he said very quickly, and I am sure you heard him, "Without overheads." What are those figures with the overheads?

A. The total for roadways.

Q. Is that—

A. It is all roadway.

298?

Q. Yes, sir.

A. $101,116,755 reproduction new. Less depreciation is $86,673,243.

Q. Thank you, sir.

A. Approximately 86 or 87 per cent.

Q. A little less than 15 per cent discount for
page 649 } condition?

A. Condition.

Mr. Epps: No further cross.

Mr. Shannon: I have one, Your Honor, on redirect for the record. I am sure Mr. Riely is not going to object to this.

REDIRECT EXAMINATION

By Mr. Shannon:

Q. Mr. Garrett, you referred to the Pocahontas region. What states are embraced in the Pocahontas region?

A. Virginia, West Virginia, I believe.....

Q. What carriers comprise the Pocahontas carriers?

A. The Chesapeake and Ohio, Norfolk and Western, Richmond, Fredericksburg and Potomac. I think that is the only three at the present time.

Mr. Shannon: That is all I have, Your Honor.

Mr. Riely: I have some more.

RECROSS EXAMINATION

By Mr. Riely:

Q. Mr. Garrett, let me see if I understood your answer to Mr. Epps to that stupendous question that went on for so long.

Boyd Garrett

As I understood you to say, when Mr. Tipton
page 650 } took these net changes back by the use of your divisors to 1910 to '14 values, if he wanted to get original cost he should have brought the sum up by the use of 1966 multipliers, is that correct?

A. I said he should have carried it back—he should have worked it on a gross basis rather than net to begin with because in the net he has '10 to '14 dollars that he is applying a divisor to which would have the tendency to understate cause because it is already '10 to '14 level and he puts a divisor on it to carry it back.

Q. But these are addition for a particular year.

A. He said the statement was net. Net addition.

Q. Net addition for 1938, let's say, or 1950 he applied a divisor to trend it back to '10-'14. What is wrong with that?

A. As I understand the net was addition for that year less retirements which would have included retirements from engineering reports which would have priced it at '10 to '14.

Q. But the retirements were priced at '10 to '14 or at original cost if the retirements had been addition at some subsequent year?

A. Subsequent, right.

page 651 } Q. But you always would, and that is what the Commission calls original cost, isn't it?

A. That is what they call original cost, but having trended a '10 to '14 dollar back you have reduced that dollar.

Q. But it has been taken out, deducted before you trended it back?

A. You are carrying it back to a '10 to '14 base.

Q. But you are not carrying that dollar back. You have taken it out of the addition by subtracting the retirements.

A. He said it was a trended net addition.

Q. Net addition?

A. Net. He reduced the addition by that retirement. It is in that net.

Q. Well, then, how did you bring it forward? How would you propose to bring it forward?

A. We have a multiplier that applies only to the Norfolk and Western based on their inventory only, if you will refer to that.

Q. Yes, I understand that.

You had them to 19—

A. '52.

Q. '52.

page 652 } You wouldn't bring it up to date by the use of a 1966 multiplier, would you?

A. We worked their multiplier each year.

Q. You have it even though you haven't published it?

A. They have not published figures but we have one for each railroad.

Q. You think it appropriate to use a '66 multiplier to bring it up to date?

A. If it is properly carried back.

Q. That would give original cost?

A. That would give you reproduction.

Q. Oh, reproduction cost and not original cost?

A. Right.

Mr. Riely: Thank you. I have no further.

Commissioner Catterall: Any other questions of this witness? You may stand aside, sir.

(The witness stood aside.)

Mr. Shannon: I would like to move the admission of Mr. Garrett's testimony and exhibits.

Commissioner Catterall: They have all been received. You may be excused. Thank you very much.

page 653 } Mr. Shannon: I would like to call as our next witness Mr. Edward Johnson.

EDWARD JOHNSON was called as a witness and testified on his oath as follows:

DIRECT EXAMINATION

By Mr. Shannon:

Q. Would you please state for the record your name, sir?

A. Edward P. Johnson.

Q. Are you the same Edward P. Johnson that prepared and submitted a 27-page statement in this proceeding together with three exhibits?

A. Yes, sir.

Q. And are the exhibits and testimony true and correct to the best of your information, knowledge, and belief?

A. Yes, sir.

page 654 }

* * * * *

TESTIMONY OF EDWARD P. JOHNSON ON DIRECT EXAMINATION

Q. Please state your name and address.

A. My name is Edward P. Johnson, and I live at 406 Boyd Avenue, Takoma Park, Maryland.

Q. Where are you employed and what is your position?

A. I am employed by the Federal Government, Interstate Commerce Commission, Bureau of Accounts, as an accountant. My present position is Chief, Field Reports Review Branch.

Q. Would you please state briefly your background and experience?

page 655 } A. My background has been principally in accounting and depreciation. I received a Bachelor of Commercial Science degree from Benjamin Franklin University, Washington, D. C.

I was employed in the accounting department of the Southern Railway Company, for twenty-two years between 1942 and 1964, with the exception of military service, January, 1943 to April, 1946.

The majority of my time with the railroad was spent in the area of property investment accounting concerning the assets which comprise the physical plant and equipment of the railroad. The accounting for these assets is performed in the office of Capital Expenditures.

From September, 1942 through February, 1949, I held various junior accounting positions, including being responsible for handling a complete set of books for certain roadway accounts for Southern Railway properties and some of the properties of its subsidiaries. I also worked in

page 656 } the depreciation and valuation sections.

Between March, 1949, and December, 1953, I held the position of valuation accountant, which, as the name implies, concerns property valuation work. This was an excepted position created for the following study; Interstate Commerce Commission, Bureau of Accounts and Cost Finding Subject No. 423, proposed accounting order, which would require restatement of investment in road property and equipment to original cost basis as found by Bureau of Valuation.

Additionally, during this period I developed information to support, and helped write, Southern's "Protest" against the

Internal Revenue Service's income tax levy of $32,000,000, for tax deficiency, concerning accounting exceptions, years 1940-1946 inclusive.

From January, 1954 to April, 1958 I was Special Traveling Accountant and my principal duties were to prepare the following information for year end report-
page 657 } ing to the Southern Railway Tax Department for inclusion in Federal Income Tax Returns:

1. Depreciation—To report year end tax claim for depreciation to the Tax Department, and establish and maintain declining balance ledgers.

2. Report year end losses and gains arising from sales or casualties of road property and equipment.

3. Rates—Develop annual composite depreciation rates on equipment for both the Interstate Commerce Commission and Internal Revenue Service.

4. Settlement Accounts—Develop amount of additional rental to be paid lessors for lease of equipment.

5. National Defense Facilities—Reported I.R.S. Claims to tax department, for amortization tax deduction for both road property and equipment—for the entire Southern
page 658 } Railway System. Gross cost of the National Defense Program under my supervision was in excess of $150 million dollars.

6. Mortgaged Property—Developed and prepared statements of "Additions and Betterments Expenditures" which were certified in securing the return of monies on deposit with Trustees for mortgaged property sold by the Southern Railway System.

7. Federal bills and other bills against states and municipalities concerning railroad construction work were reviewed as to the correctness of charges and division of costs in accordance with agreements and Federal Memoranda—then forwarded for collection.

In April, 1958, I was promoted to Assistant to the Auditor of Capital Expenditures, which position I held until January 1, 1960. As Assistant to the Auditor of Capital Expenditures, I assumed all of the duties of my previous position, which was abolished upon establishment of my new position and was given additional responsibility of supervision over the entire office force of 38 people.

page 659 } From January, 1960 through June, 1964, I was Assistant Manager, Capital Expenditures. In

this position I was responsible for the flow of the work in the office and the supervision of all personnel. I initiated, directed and controlled various types of accounting, such as Financial, Corporate Property, Depreciation (Interstate Commerce Commission and Internal Revenue Service) and Electronic Data Machine Accounting. The accounting performed was primarily directed to the property accounts and the railroad plant and equipment (rolling stock). This accounting includes the complete handling for capital expenditures from the origination of the authority for the expenditure to the completion of the project as a property investment asset and eventually to its ultimate conclusion and retirement from the accounts.

In July, 1964, I entered the employ of the Interstate Commerce Commission as a Staff Accountant, Section of Accounting. In this position I handled accounting mat-
page 660 } ters incident to the prescription of new rules and interpretation of existing rules for all carriers subject to regulation by the Commission.

From July, 1965 to August, 1968, I was Chief, Depreciation Branch, Bureau of Accounts, Interstate Commerce Commission. As Chief, Depreciation Branch, I was responsible for establishment and had continuous control over depreciation rates prescribed for each common carrier subject to the Interstate Commerce Act, including railroads, water carriers, pipeline companies and others. Additionally, I was responsible for making broad technical recommendations on depreciation matters to the Director of the Bureau of Accounts, which, if approved, determined courses of action to be taken by the Commission.

Q. In your current position as Chief of Field Reports Review Branch, Interstate Commerce Commission, what are your principal duties?

page 661 } A. My main duties are twofold: First, to supervise the review, from a technical standpoint, of all field accounting audit examinations of carriers engaged in the various modes of transportation subject to the Interstate Commerce Commission's accounting regulations, including railroads, motor carriers, inland water carriers, pipeline companies and others.

Secondly, to insure, on a National scale, uniformity and continuity of the Bureau's policies concerning accounting matters and audit procedures.

Q. Are you thoroughly familiar with the Interstate Commerce Commission's Uniform System of Accounts for Railroads?

Edward Johnson

A. Yes sir. One of the prerequisites for the position I currently hold is a thorough understanding of the Commission's Uniform System of Accounts for Railraods.

Q. Have you been authorized by the Chairman of the Interstate Commerce Commission to appear here today and testify in this proceeding with respect to the

page 662 } Interstate Commerce Commission's Uniform System of Accounts?

A. Yes. I was authorized by Chairman Brown of the Interstate Commerce Commission, through the Director of the Bureau of Accounts, to testify in this proceeding.

Q. Do you have for introduction in this proceeding a copy of the Interstate Commerce Commission's Uniform System of Accounts for Railroads?

A. Yes. I have a copy of the Commission's Uniform System of Accounts for Railroads, bearing the symbol (EPJ-1) in the upper right corner, which I offer for identification as Exhibit No. (EPJ-1).

Q. Mr. Johnson, referring to Exhibit No. (EPJ-1), would you explain the Interstate Commerce Commission's accounting requirements for railroads, stating the property records which each rail carrier must keep and the reports each carrier must file with the Interstate Commerce Commission in connection with such property rec-

page 663 } ords?

A. Yes. The accounting requirements for railroads are set forth in the Code of Federal Regulations Title 49—Chapter X Subchapter C—Accounts, Reports and Records Part 1201—Railroad Companies. These regulations were promulgated under Section 20 of the Interstate Commerce Act. (49 U.S.C.) Included therein are instructions for property accounts, maintenance expense accounts, clearing accounts, depreciation accounts and income and balance sheet accounts. Railroads are required to follow these instructions and incident thereto are required to keep whatever records are necessary to properly support entries made in the accounts. Additionally, for property accounts, the Commission found it necessary to require regulations to govern the recording and reporting of all extensions and improvements or other changes in physical property of every common carrier and so issued Valuation Order No. 3 effective July 1, 1914. Contained therein are the instructions which must be followed and a list of records which the car-

page 664 } rier must keep. The main records are: Authority

for Expenditure (AFE), Roadway Completion Report and Record of Property Changes.

Q. Continuing with Exhibit No. (EPJ-1), Mr. Johnson, will you please explain the Interstate Commerce Commission's accounting requirements for each of the following property accounts: Account No. 1—engineering, Account No. 3—grading, Account No. 5—tunnels and subways, Account No. 6—bridges, trestles, culverts, Account No. 8—ties, Account No. 9—rails, Account No. 10—other track materials, Account No. 11—ballast, Account No. 12—track laying and surfacing and finally Account No. 13, fences, snowsheds and signs.

A. The accounts just referred to are rather self descriptive and are merely a part of the total property accounts established by the Commission to record the charges or costs of constructing new lines or extensions or the costs incurred

page 665 } in connection with making additions to, and/or betterments of, the road property owned by the carrier and devoted to transportation service.

The costs incurred in connection with providing ties, rail, other track material, ballast, and track laying and surfacing, designated as accounts 8, 9, 10, 11 and 12 respectively, comprise what is commonly referred to as the track accounts or track structure.

Q. What items are included in account No. 10, other track materials?

A. Generally speaking, this would include materials which when applied would be used to:

1. secure the rail to the ties
2. bolt the rails together to form a track
3. allow for the switching *or* a railroad car from one track to another.
4. permit crossing over another track

Some of the common items would be spikes, tie plates, bolts, rail joints, switches and guard rails.

Since the account includes numerous items I

page 666 } would like to offer as Exhibit No. (EPJ-2) a listing of items of other track material shown in the Uniform System of Accounts. This list is not all inclusive but is a representative guide.

Q. Does the Commission's Uniform System of Accounts for Railroads provide for depreciation for accounts 8, ties, 9,

rails, 10, other track material, 11, ballast and 12, track laying and surfacing?

A. No. there is no provision in the Uniform System of Accounts for Railroads for recording depreciation for these accounts.

Q. Under the Uniform System of Accounts for Railroads is there a reserve for depreciation set up on the carrier's books for these accounts?

A. No sir. These accounts are considered non-depreciable for accounting purposes and therefore a reserve would not be appropriate since the retirment loss is charged to operating expenses when the asset is retired from serv-
page 667 } ice.

Q. To what extent does the Interstate Commerce Commission provide for depreciation of account 1, Engineering, and account 3, Grading?

A. To the extent that the engineering cost expended applies to the construction of a depreciable asset, such as a bridge, the engineering cost would be considered depreciable. However, if the engineering cost was wholly attributable to the construction of an asset considered for accounting purposes to be non-depreciable, such as the construction of a track, such engineering cost would be considered non-depreciable.

The same general rule applies to account 3, Grading, where only the cost of the depreciable elements are provided for. Of the total cost included in this account, only a minor portion is considered depreciable for accounting purposes. This includes such items as pipe and treated timbers.

As a conservative estimate, I would say 90% of the consist of this account contains elements considered to be non-depreciable for accounting purposes.

page 668 } Q. Now would you please discuss the Interstate Commerce Commission's accounting instructions for maintenance expenses with respect to the accounting requirements for roadway and track property for the following accounts: No. 201—Superintendence, No. 202—Roadway Maintenance, No. 206—Tunnels and Subways, No. 208—Bridges, Trestles and Culverts, No. 210—Elevated Structures, No. 212—Ties, No. 214—Rails, No. 216—Other Track Materials, No. 218—Ballast, No. 220—Track Laying and Surfacing, No. 221—Fences, Snowsheds and Signs.

A. I would like to use the same approach in answering this question as was used in answering the question concerning the property accounts, i.e., state that these accounts are

part of the total maintenance accounts and that they are used to record the charges for the maintenance of the roadway physical plant, in contrast to the accounting required to be performed when there is a change in plant occasioned by the construction of an addition of roadway facilities.

page 669 } Generally speaking, maintenance, as such, is merely the preservation of an existing condition level. There is no contemplation of improving the condition through the substitution of superior parts over the existing inferior parts nor is consideration given to making an addition to the existing facility.

In other words, the cost of improving a facility would be considered addition and betterment work and not a maintenance expense project.

Q. Please explain the Interstate Commerce Commission's accounting requirements for replacing track property.

A. There are two methods used in accounting for replacements of track property. The first concerns replacement in kind and the second is applicable to betterment accounting which involves the replacement of the existing parts with superior parts.

In the first instance, where property is replaced in kind, i.e., 100 pound rail replaces 100 pound rail the property investment account is not affected. The cost of the replacement less the amount of salvage value attributable

page 670 } to the rail removed, is charged to operating expenses and the original cost of the rail removed remains in the investment account.

In the second case, where the current installation represents an improvement over the existing part replaced there is a change in the property account. The excess cost of the new part over the current cost of the old part replaced is charged to the appropriate primary property investment account. However, there is no reduction in the property investment account for the value of the property replaced. The cost of the property replaced at current prices, less an amount for salvage value, is charged to operating expenses.

Q. What are the Interstate Commerce Commission's accounting requirements when existing rail is replaced with heavier weight rail?

A. When heavier weight rail is used to replace lighter weight rail the cost of the excess in weight must be capitalized in property account 9, Rails. The following table, which is self-explanatory, may help to clarify the applica-

page 671 } tion of the "betterment" rule (Instruction 2-9)

Edward Johnson

when upgrading the track structure by replacing lighter rail with heavier rail:

page 672 }

TABLE I

EXAMPLE— 1 track mile	YR	Weight of Rail (1)	Gross Ton	Cost Per Ton	Gross Cost	Capitalized in Property Account 9	Cost of Rail Replaced at Current Prices Charged to Operating Expense Account 214 (2)
Initial Installation	1916	100#	157	$30	$4,710	$4,710	$ —0—
First Replacement	1936	120#	189	45	8,505	1,400	7,065
Second Replacement	1956	130#	204	100	20,400	1,500	18,900
			Total		$33,615	$7,650	$25,965

(1) Weight per lineal yard
(2) Salvage realized from rail replaced is credited to this account.

page 673 } Q. Is my understanding correct that only the difference between the excess in weight of heavier rails laid in replacement of lighter rails, based on current prices, is chargeable to property account No. 9—rails?

A. Yes. Your understanding is correct.

Q. To which other roadway property investment accounts does this betterment rule apply?

A. The rule applies to all roadway property investment accounts which are capable of having a physical improvement attach. The roadway property investment accounts are designated as accounts 1 through 45.

Q. Now, Mr. Johnson, under the Interstate Commerce Commission's Uniform System of Accounts for Railroads, are the costs incurred in connection with the replacement of track property, except to the extent that betterments are involved, treated as maintenance costs chargeable to operating expenses in the years incurred?

A. Yes, that is correct. Replacements of track property as such, disregarding any betterments, are
page 674 } charged to operating expenses at the time the replacement occurs.

Q. Mr. Johnson, based on your experience with the railroad and your knowledge of income tax reporting by the railroads, are these maintenance expenses deductible for Federal Income Tax purposes?

A. Yes. All maintenance expenses of this nature, in connec-

tion with replacement in kind, are deductible for Federal Income Tax purposes.

Q. In 1957 did the Interstate Commerce Commission institute an investigation concerning whether it should change its accounting rules, those then as well as now in effect, with respect to betterment and replacement of track property?

A. Yes.

Q. When was that investigation conducted?

A. Between the years 1957 and 1959.

Q. What was the styling and docket number of the Interstate Commerce Commission's investigation in that *proceedinng*?

page 675 } A. The full title was Docket No. 32153, Uniform System of Accounts for Railroad Companies, Betterment and Depreciation Accounting, Railroads.

Q. Do you have for introduction in this proceeding a true copy of the Interstate Commerce Commission's report in Finance Docket No. 32153?

A. Yes, I have a copy of the report of the Interstate Commerce Commission styled No. 32153 Uniform System of Accounts for Railroad Companies, Betterment and Depreciation Accounting Railroads, dated December 18, 1959, bearing the symbol EPJ-3 in the upper right corner. This has been certified by the Secretary of the Interstate Commerce Commission and I offer it for identification as Exhibit No. (EPJ-3)

Q. Is this report of the Interstate Commerce Commission just identified as Exhibit No. (EPJ-3), carried in the official reports of the Interstate Commerce Commission?

A. Yes. The report is published in volume number 309 I.C.C. commencing on page 289.

page 676 } Q. While the report certainly speaks for itself, would you please summarize the substance of the Interstate Commerce Commission's findings and conclusions in that report?

A. Yes. In essence, the Commission affirmed the accounting rules for betterment—replacement accounting as set forth in the Uniform System of Accounts for Railroads. It saw no necessity for requiring the railroads to go from this method to depreciation accounting, which would require the establishment of a reserve for past accrued depreciation and the changing of the property records. It was the Commission's judgment that betterment-replacement accounting, when consistently followed under our rules, is an acceptable procedure for railroads to use in recording replacement items of track

property in their corporate accounts and in preparing their corporation reports.

Q. What position did the railroads take in that proceeding with respect to changing the existing accounting rules for betterment and replacement of items of track property?

A. They were opposed to any change in the

page 677 } existing rules.

Q. Now, Mr. Johnson, would you please refer to Exhibit No. (EPJ-1) and turn to Account No. 267 of the Uniform System of Accounts for Railroads and explain what this account covers?

A. Yes. However, since this account concerns retirement losses of nondepreciable property I think it is absolutely necessary to understand what a retirement loss is before giving a full explanation of the account.

Under the I.C.C. accounting regulations the railroads are afforded two methods for recovering their investment in roadway properties, the usefulness of which is consumed in transportation service.

If the property is considered depreciable, the service value (ledger value less salvage) is recovered over the estimated life of the asset by charging the loss off through monthly depreciation expense.

If the property is considered nondepreciable for accounting purposes, the total service loss is recovered at the time of retirement by charging such loss to operating expense account 267, the one under discussion.

page 678 } An acceptable summation therefore, would be to state that this account is an operating expense account which was created to record charges representing the retirement loss or service value (ledger value less salvage) of nondepreciable roadway properties retired. When the retirement occurs there is an actual reduction in the property investment account, made by journal entry, for the ledger value of the asset.

This procedure is not to be confused with the accounting performed in connection with the cost of repairs or maintenance to nondepreciable roadway assets where there is no reduction in the investment account.

Q. Is it not a fact that before a line of railroad can be abandoned the carrier seeking abandonment must first obtain from the Interstate Commerce Commission a certificate that the present or future public convenience and necessity permits such abandonment?

A. Yes. Under the Interstate Commerce Act, Section 1-18

(49 U.S.C. 1(18)) the requirements for seeking abandonments of a line are stated, in part, as follows;

page 679 } "...and no carrier by railroad subject to this part shall abandon all or any portion of a line of railroad, or the operation thereof, unless and until there shall first have been obtained from the Commission a certificate that the present or future public convenience and necessity permit of such abandonment."

Q. When the abandonment is effected what charge is made under Account No. 267?

A. The service value (ledger value less value of salvage) of nondepreciable road property retired is charged to account 267.

Q. Does the Commission in its order authorizing the abandonment of a line of railroad require the carrier abandoning a portion of a line of railroad furnish it with two copies of the journal entry recording such transaction?

A. Yes, it generally does.

Q. Under the Interstate Commerce Commission's Uniform System of Accounts, is anything included in the primary property accounts for the going concern value of a railroad?

A. No sir.

page 680 } Q. To your knowledge in submitting their balance sheets annually to the Interstate Commerce Commission do railroads ever include on the asset side of the balance sheet any amount for going concern value of their properties?

A. The Uniform System of Accounts for Railroads does not provide for the inclusion of going concern value and therefore no such value would appear on the balance sheet presented to this Commission.

page 681 } VERIFICATION

City of Washington
ss.
District of Columbia

Edward P. Johnson, being duly sworn, deposes and says that he has read the foregoing statement, knows the contents thereof, and that the same are true as stated.

Edward P. Johnson

Edward Johnson

Subscribed and sworn to before me, a Notary Public for District of Columbia, this 9th day of April, 1969.

Wm. F. Luper
Notary Public

My Commission Expires June 14, 1972.

page 682 } Mr. Shannon: I tender the witness to Mr. Riely.

Mr. Riely: Thank you, Mr. Shannon.

CROSS-EXAMINATION

By Mr. Riely:

Q. Mr. Johnson, on page 3 of your testimony you state that you helped write several protest against Internal
page 683 } Revenue Service income tax levy of $32,000,000 for tax deficiency concerning accounting exception years 1940, '46 inclusive, is that correct?

A. Yes, sir.

Q. Do you consider yourself knowledgeable in the field of Federal income taxes as they apply to carriers?

A. Concerning the property accounts, yes, sir, and depreciation and deductions, yes, sir.

Q. Good.

Now, on page 4 you state that you developed annual composite depreciation rates on equipment for the Internal Revenue Service, isn't that correct?

A. Yes, sir.

Q. Further on page 4 you state that you developed claims for the tax department of the Southern in connection with national defense facilities in regard to their amortization, is that correct?

A. Yes, sir.

Q. Now, on page 21 you state that these maintenance expenses, and I believe you are talking there about replacements of tax properties, aren't you, on page 21?

A. Yes, sir.

Q. State that these maintenance expenses are
page 684 } deductible for Federal income tax purposes, is that correct?

A. Yes, sir.

Q. Under what section of the Revenue Code are they deductible under?

A. I can't answer that. I might say my knowledge concerning that is development of the information pertaining to the

track structure which is furnished to the tax department of Southern Railway.

Q. But you don't know what section of the Code?

A. I am not familiar with the Code number, no, sir.

Q. But you are familiar with the I.C.C. accounting techniques, are you not?

A. Yes, sir.

Q. And how does the I.C.C. treat the accounting when a railroad installs welded rail rather than joint rail?

A. The additional cost, the weld is added to the cost of the rail and the weld is capitalized.

Q. The weld is capitalized?

A. Yes, sir.

Q. But if it is the same, what happens to the joint material? Is that expensed?

A. That is replaced and charged as operating expenses.

Q. Charged to operating expenses.

page 685 } Is an accounting treatment for Internal Revenue Service purposes the same when welded rail is installed?

A. There has been a recent ruling concerning welded rail by the Internal Revenue Service and I am not certain as to that handling as to Internal Revenue purposes.

Q. Aren't you familiar with that ruling?

A. I am not that familiar with it, no, sir.

Q. Have you read it?

A. Yes, sir.

Mr. Epps: It is in Mr. Tipton's testimony and we will get it for you.

Isn't it in Mr. Tipton's?

Mr. Riely: Number one.

Mr. Epps: One isn't it.

Mr. Riely: Yes, sir.

Mr. Epps: Judge, he said he is not familiar with it.

Mr. Riely: He said he read it, Mr. Epps.

Mr. Epps: We had the same thing—wait, Mr. Riely, let me finish. This I recalled about a witness named Strouse who said he read it but didn't read all of it and then he couldn't remember any of it and we were not permitted to cross-examine Mr. Strouse on that.

page 686 } Commissioner Hooker: I think he said he glanced at it.

Mr. Epps: Ended up he first said he hadn't read all.

Commissioner Hooker: I think it was Mr. Strouse.

Edward Johnson

Mr. Epps: I think it was too, Judge, and I think sauce for the goose is sauce for the gander if he is not familiar.

The Witness: I would say that since leaving the Southern Railway Company I have naturally not kept up with income tax since my field now is regulatory.

By Mr. Riely:

Q. But you have read this?

A. I have read it.

Q. You have read it. What is the caption of it?

A. "Depreciation in General."

Q. What is the—

A. Tax treatment under retirement-replacement method of accounting for depreciation with respect to welding and rail costs is discussed.

Commissioner Catterall: Could I ask a question of counsel? I mean, of Mr. Riely. What difference does it make whether it is deductible on the Federal tax return or not?

page 687 } Mr. Riely: We want to prove, Your Honor, which I think is fairly apparent, that these track replacements are considered for Internal Revenue purposes as depreciation and are deducted under Section 167 of the Internal Revenue Code as depreciation rather than under Section 162 as ordinary and necessary business expenses.

Commissioner Catterall: Well, there is no dispute with that, is there?

Mr. Riely: Is there any dispute about that?

Mr. Shannon: Well, he proved it through his own witness. I take it from Mr. Tipton. And all he is asking this man to do—

Mr. Epps: No, sir.

Mr. Riely: No dispute on it. I will pass to something else.

Mr. Shannon: I am not agreeing to it, of course.

Commissioner Catterall: That is what the Internal Revenue Service did.

Mr. Shannon: He put it in the record through Mr. Tipton. It is there.

Mr. Riely: Judge, I don't know the difference between, "There is no dispute," and, "I am not agreeing to it."

page 688 } Mr. Epps: Mr. Riely has often filed a plea of *nolo contendere* and he should know the difference.

Mr. Riely: I judge it then I may be correct interpreting that those gentlemen admit it is true but they don't like it.

By Mr. Riely:

Q. On page 9 you state, Mr. Johnson, that Chairman Brown of the Commission authorized you to testify in this proceeding, is that true?

A. That is correct.

Q. So you are here as an official representative of the Commission?

Mr. Shannon: Your Honor, let's get one thing straight.

Commissioner Catterall: That really is confusing.

Mr. Shannon: That is confusing the record. The Interstate Commerce Commission agreed that these gentlemen as experts, that is Mr. Garrett and Mr. Johnson here, as experts in I.C.C. valuation accounting procedures can come down here and testify as to I.C.C. accounting practices and procedures. Now, they didn't agree they would come down here and testify for the Internal Revenue or any other agency of the Government that is the understanding under which these people are testifying.

page 689 } Commissioner Catterall: The I.C.C. is not intervening in this case. These are experts who are testifying as experts and not as partisans.

Mr. Shannon: At our request.

Mr. Riely: At the request of the Commission and not as official representatives of the Interstate Commerce Commission. That is all I want to bring out.

Commissioner Catterall: Naturally.

Mr. Shannon: We want that clearly understood in this record.

Mr. Riely: That is all I wanted.

Commissioner Catterall: The Interstate Commerce Commission has not intervened and has no interest. They couldn't have.

Mr. Riely: That is all I want.

Mr. Epps: May I ask a few questions?

Mr. Riely: No, excuse me. I didn't mean I was through. I beg your pardon.

Mr. Epps: Well, you didn't mean what you said.

Mr. Riely: You quibble, sir.

By Mr. Riely:

Edward Johnson

Q. Page 13, Mr. Johnson, sir, you state that the track accounts are considered to be non-depreciable, sir,
page 690 } is that correct?
A. Yes, sir, for accounting purposes.

Q. For I.C.C. accounting purposes?

A. Yes, sir.

Q. Now, that doesn't mean that the various components of the track don't wear out and are replaced, does it?

A. Does not mean that at all, no, sir.

Q. They are being continually replaced in any operating railroad?

A. That's right.

Q. But this is all charged to maintenance and is not a renewal of a capital asset, is that correct?

A. That is correct.

Q. Now, do you know a mile of railroad track on the Norfolk and Western or any other railroad that is in as good physical condition today as when it was first built?

Mr. Shannon: Objection to that, Your Honor. This man is not an engineer. He is an accountant.

Commissioner Catterall: He never saw it in 1914.

Mr. Shannon: That's right.

Commissioner Catterall: He doesn't look like he did.

Mr. Shannon: Mr. Riely wasn't here in 1914.
page 691 } Commissioner Catterall: It was built in 1840.
Mr. Riely: May I say something?

Commissioner Catterall: Surely.

Mr. Riely: Thank you.

This gentleman has testified as an expert on depreciation. He has testified that the Commission uses, observed the method of depreciation, and all I am asking from him, whether there is any track that does not in fact depreciate and change. That is all I want to get an answer to.

Mr. Shannon: He hasn't testified to that effect, Your Honor. I object to this because this man is testifying strictly as an accountant and not as an engineer and has made no inspection of the N & W. We will concede that. He has not testified as to the physical condition of it.

Commissioner Catterall: Do you want to answer the question? Can you answer it as an expert? You are here only as an expert, so if that is not within your expertise you don't have to answer it.

The Witness: Well, there was one mistake. There was one

part of his question that wasn't exactly right. He said that I said that observed depreciation.

Commissioner Catterall: Well, what did you say?

The Witness: I said we are talking about de-
page 692 } preciation for I.C.C. accounting purposes.

By Mr. Riely:

Q. I.C.C. accounting purposes only?

A. Yes, sir.

Q. And you are not in the valuation section?

A. No, sir.

Q. You are purely in the accounting section?

A. Yes, sir.

Q. Now, when a length of 132-pound rail wears out and is replaced, or when it is broken and replaced, how is that accounted for?

A. Replaced with 132-pound rail it is charged to operating expenses.

Q. And what accounts are charged to it?

A. The maintenance account for rail is 214.

Q. 214?

A. Yes, sir.

Q. How about the labor involved in such a replacement? What is that charged to?

A. 220.

Q. 220 and not charged to the same account.

And if you had an abandonment and you had recovery of salvage would the labor and the salvage material
page 693 } be charged to the same accounts or different accounts?

A. Labor cost, removal of retirement is charged to a different account, 270 and retirement loss is charged to 267.

Q. So they are charged to different accounts?

A. That's right.

Q. Now, Mr. Johnson, the fact that the figures under the accounting rules does not permit the accrual of depreciation for tax properties doesn't mean they don't wear out?

A. Of course not.

Q. They wear out in fact.

Now, on page 23 of your testimony you discuss the I. C. C.'s investigation of retirement-replacement accounting by railroads, which is Exhibit E.P.J. 3. In that report on page 291, as I read it, recognizes that adoption of ratable depreciation accounting would require an establishment of a reserve for past accrued depreciation, isn't that correct?

Edward Johnson

A. That is correct.

Q. Why would a reserve for past accrued depreciation have to be set up if such a changeover was made?

A. Well, you would have to restate the accounts in order to put the proper value on so-called non-depreciable property in restating your investment account since these

page 694 } units have been charged to operating expenses you would have to completely restate your track structure primary investment account. At that time you would have to establish a reserve to give you the true balance sheet picture of the assets involved. The cost and depreciation.

Q. Because in fact depreciation had then occurred at the time you made that changeover in the past?

A. The Commission does not recognize depreciation on so-called non-depreciable assets.

Q. I know. We are talking about a changeover now.

A. If the Commission were to make a changeover there would have to be a physical inventory taken to determine the amount of depreciation that would be applicable to the consist, yes.

Q. Because depreciation would have in fact occurred at the time of that changeover in the past?

A. All physical assets are, of depreciation—

Q. Thank you.

A. —recorded.

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

CROSS-EXAMINATION

By Mr. Epps:

page 695 } Q. Mr. Johnson, for I.C.C. accounting purposes is grading a separate account?

A. Yes, it is.

Q. What number is it?

A. Account 3.

Q. Is it separate and apart from land?

A. From line?

Q. Land.

A. Oh, yes. Yes, land is account 2 and grading is account 3.

Q. Separate account?

A. Separate primary account.

Q. Yes.

Edward Johnson

What accounts are the one that represent overheads?

A. Overheads, as such, were defined by the Commission as the 70 account, 71, 72, 73, 74, 75, 76, 77.

Q. Thank you, sir.

Now, Mr. Riely inquired of you about abandonments and retirements?

A. Yes, sir.

Q. I would like to go into the situation with regard to what happens when a section or part of a rail-
page 696 } road property track and road property is abandoned.

Let's specifically take the abandonment of the so-called Blacksburg branch of the Norfolk and Western Railroad. And in doing this I refer you to Exhibit L.B.Y. 8, sheet 2 of 3. Is that the journal entry applicable to the abandonment or retirement described here?

A. Yes, this is the retirement stated in narrative of the Blacksburg branch under Finance Docket No. 22902. These are Commission dockets.

Q. All right.

Well, would you look at that and tell me if you can answer these questions. When this retirement took place would you tell me what amounts were charged to what accounts? For example, I think Mr. Riely asked you about account 712. Was that charged to 712?

A. That is material and supply account that railroads use to keep inventory or take items into inventory.

Q. So if I understand you correctly the salvage value, for want of a better term, was left and the road properties that would be stored would be 712, is that right?

A. That's right.

Q. And if they abandon a road and take this element of salvage and put it in account 712?

page 697 } A. That's right.

Q. All right, sir.

Now, what would be charged to the road account, which is, I believe 267, is that it?

A. That is operating expense account.

Q. Operating expense?

A. For retirement.

Q. What is charged against operating expense account on the retirement?

A. The service value of non-depreciable so-called non-depreciable, property which basically is your track material.

Edward Johnson

Q. These are the various accounts that we have been talking about generally 8 through 12?

A. Yes, sir.

Q. And in this particular case for this, how many is it, 5.17 miles, is that right?

A. Approximately five, yes, sir. 37 to 890.

Q. Right.

For this 5.17 miles what was charged to the operating account of 267? Do you have that figure?

A. According to this entry account 267 got charged with $56,496.35. That would represent the retirement

page 698 } loss which is the investment. The cost less any salvage attributable thereto for non-depreciable property.

Q. So that, am I correct in believing that on the retirement the combination of 712 and 267 would be what the railroad in effect charges off by reason of that abandonment, a part to the property account and part to the operating account?

A. The retirement losses included in 267 and the salvage recovery is in the material and supply account 712, yes, sir. So the combination of the two, you take your loss for property, non-depreciable property, when it is retired and if you have any salvage that accrues to you then you either sell it or take it back into your material and supply account to be retained for reuse.

Q. So addition of the two would be the aggregate on the abandonment?

A. Before non-depreciable, plus we have in this case depreciable which is charged against the reserve.

Q. So you have another entry here because you have got some depreciable property too?

A. Based on this entry here we have depreciable and non-depreciable.

Q. What are those accounts?

page 699 } A. That is 735, accrued depreciation of road property.

Q. Yes.

And are there any other accounts, I.C.C. account items, indicated and applicable to this particular retirement or abandonment?

A. Well, from what I view here there was some parcels of land that was, would be normally in transportation purposes, while the track was in transportation operation.

However, in this journal entry it has been transferred to

what we called miscellaneous physical property or non-operating charter property.

Q. Non-operating?

A. What is apparently when it was taken out of service it has been transferred by this journal.

Commissioner Catterall: Have you got many more questions?

Mr. Epps: I don't even think I have the one more Mr. Riely usually has.

Commissioner Catterall: Any more witnesses?

Mr. Riely: No, but I have got the one more question.

Mr. Epps: I think it is time for—

page 700 } Commissioner Catterall: Let's take a recess if you are going to go any further.

Mr. Epps: Do you have redirect?

Mr. Shannon: I have no redirect.

Mr. Riely: I really have only one or two.

Commissioner Catterall: Let's finish now then. Are you through?

Mr. Epps: Yes, sir.

RECROSS EXAMINATION

By Mr. Riely:

Q. Looking still at sheet 2 of Exhibit L.B.Y. 8, I see no entry for account 270.

A. That is true.

Q. But there would be of necessity expense incurred in dismantling retired road property and recovering these materials and supplies, would there not?

A. Provided it was performed at this time it should have been included in the entry, yes, sir.

Q. If it wasn't the railroad maybe made a mistake, is that correct?

A. Well, if there are any labor costs to remove it it should have been included in account 270.

Q. Almost bound to have been labor cost on re-

page 701 } moval, isn't there?

A. Normally there would be.

Mr. Riely: I have no further.

Mr. Shannon: One question on redirect.

Edward Johnson

REDIRECT EXAMINATION

By Mr. Shannon:

Q. These journal entries have to be or ordinarily must be submitted to the Interstate Commerce Commission for their approval, is that correct?

A. Ordinarily, yes, sir.

Mr. Shannon: Thank you.

Mr. Epps: No further questions.

Mr. Riely: No further questions either.

Mr. Epps: Thank you.

Commissioner Catterall: This witness may be excused.

We thank you for coming down and giving us your information.

(The witness stood aside.)

Commissioner Catterall: We can meet again at 10 o'clock on Monday.

Mr. Riely: Yes, sir.

Commissioner Catterall: I don't think any-
page 702 } body will steal anything over the week end.

Mr. Riely: These are very important to us.

Commissioner Catterall: Leave them at your own risk.

Mr. Riely: Mr. Dunn and Mr. Howland will be on. Mr. Dunn and Mr. Howland will be our next on Monday morning.

Mr. Epps: You told me noon.

Mr. Riely: I mean in the course of the day. In the course of the day Monday.

Mr. Epps: They probably will be here earlier than that, but you told me noon.

Mr. Riely: I don't mean to back out of that.

Mr. Epps: Dunn will be here when you are ready for him.

Commissioner Catterall: Everybody will now rise.

(The hearing in the above entitled matter was concluded at 3:05.)

* * * * *

page 703 } April 21, 1969
10:00 A. M.

The Commission resumes the hearing in Case No. 18629.

Commissioner Hooker: You all take it slow and easy this morning.

Mr. Riely: Yes, Sir.

Mr. Epps: (to Reporter) We'll try not to be so rough with you as we were last time.

Are you ready, Mr. Riely?

Mr. Riely: Yes, Sir, we are ready. We would like Mr. Dunn around.

Mr. Epps: Right. We would like to call Mr. K. E. Dunn, please.

Mr. Dunn, would you come around?

DIRECT EXAMINATION

By Mr. Epps:

Q. Would you state your name and give us your address, please?

A. Kenneth E. Dunn, New York, New York.

Q. You are the Kenneth E. Dunn who has pre-
page 704 } viously testified by written, direct testimony sub-
scribed by you in this case, is that correct?

A. Yes, Sir.

Q. And for that reason you need not take another oath, Mr. Dunn.

page 705 }

* * * * *

TESTIMONY OF KENNETH E. DUNN ON DIRECT EXAMINATION

Q. State your name and address, please.

A. Kenneth E. Dunn, New York, New York.

Q. Where are you employed, and what is your position?

A. I am employed by the firm of Coverdale & Colpitts, Consulting Engineers, 140 Broadway, New York, New York as a senior staff engineer.

Q. In what type of work is Coverdale & Colpitts engaged?

A. Over a period of sixty-five years the firm has provided consulting services to industry and government at home and abroad. All forms of transportation—railroad, mass transit, highway, air, water and other forms—have been the subject of comprehensive and special studies. In addition, the firm
has made numerous studies in the industrial
page 706 } field.

K. E. Dunn

Q. Please state your educational and professional experience.

A. I received a B.S. in Civil Engineering in 1936 from the Illinois Institute of Technology at Chicago, Illinois. From 1936 to 1964 I was employed by the New York Central Railroad and held positions ranging from Transitman, Assistant Supervisor of Track, Supervisor of Track, Assistant Division Engineer, Division Engineer, Structural Engineer, Special Engineer, Assistant District Engineer to Assistant Engineer Maintenance of Way, and from 1957 to 1964 I was Engineer Maintenance of Way for the entire New York Central Railroad.

During the period 1957-1964 I was placed in responsible charge of the safe and economical maintenance of all tracks, bridges and buildings of the railroad. I supervised and administrated activities including the reorganization of labor force with introduction of new machinery and techniques resulting in large savings in operating costs. I was in direct charge of the design standards for track and turnouts. I introduced new method for dismantling, shipping and reassembly of panel track which resulted in substantial reductions in track construction costs of new classification yards. I was a member of the System Operating Rules Committee; I was the highest appeals officer for the carrier in its relations with the American Railway Supervisors' Association, preparing cases and testifying before a national labor board.

I forecasted and allocated $6 million in monthly operating expenses. Within the Maintenance of Way Department I prepared and defended from $2 million to $5 million
page 707 } in annual Capital Improvements.

I completed the Management Course of the American Management Association and was a member of the American Railway Engineering Association's committee on track design and standards.

In 1965, working for the H. L. Yoh Company, a division of Day & Zimmerman, I made a study of the reproduction value new less depreciation of the facilities of four railroads in Wilkes Barre, Pa. I also served as consultant to Mr. John Barriger, President of the Missouri-Kansas-Texas Railroad, in formulating a rehabilitation program for that railroad.

Since joining Coverdale & Colpitts in 1966, I have made studies of signal operations on the New York Transit Au-

thority; recommended the safe track speed for trains of the Port Authority Trans-Hudson Corporation operating in New Jersey over tracks that they acquired under the Aldene Plan; I have recommended an eight-year track improvement program and budget for the rehabilitation of the Hudson Tube tracks between Manhattan and Hoboken, N. J. I have participated in a liquidation study made of the New Haven Railroad on behalf of its former trustees. I have made a liquidation evaluation, except for land, of the New York, Susquehanna and Western Railroad, and have also participated in economic and valuation studies of the Union Freight Railroad, roads involved in the Dereco group and the Western Maryland.

Q. What is your connection with this proceeding wherein Norfolk and Western is applying for a tax refund?

A. On February 11, 1969, Messrs. Lee Younger and Preston Shannon, of the Virginia State Corporation
page 708 } Commission, and A. C. Epps, Counsel for the Counties, Cities and Towns in this proceeding, came to the offices of Coverdale & Colpitts, in New York, to discuss with us the possibility that we could make a study of the Norfolk and Western Railway system, to help determine if the assessment made by the Utilities Tax Division of the State Corporation Commission upon the roadway and track properties of the Norfolk and Western was reasonable. They met with Mr. William A. Gordon, Senior Partner of our firm, Mr. Ernest R. Gerlach, Parter of our firm, and me, in our offices. They explained that the case had been set down for trial commencing on March 10, 1969. We discuussed the case generally with them and pointed out the limitations imposed on any sort of study we could make of the N&W in the time allotted, and gave to these gentlemen an estimate of what such a study would cost. They thanked us and went back to their principals. They subsequently wrote us that because of the limitations of time and funds they could not hire our firm but they did get back in touch with us early in March with the request that we go out upon the roadway of the N&W to make an independent estimate of the condition percent of various property items, namely, I.C.C. property accounts number 1 (Engineering), 3 (Grading), 5 (Tunnels and subways), 6 (Bridges, trestles and culverts), 8 (Ties), 9 (Rails), 10 (Other track material), 11 (Ballast), 12 (Track laying and surfacing), 13 (Fences, snow sheds and signs), and 27 (Signals and interlockers). We undertook this em-

ployment, and I was assigned to go out and inspect the tracks.

Q. When did you go out on the tracks?

A. On March 24 we left from Roanoke and commenced our inspection of the tracks and roadway prop-

page 709 } erties.

Q. How long did your inspection continue?

A. Every day beginning March 24 and extending through March 31.

Q. In whose company did you make this inspection?

A. Mr. Lee O'Brien of the State Corporation Commission, Mr. Harold H. Howland, formerly of the Interstate Commerce Commission, Mr. A. Maynard, presently of the Baltimore and Ohio, and Mr. Jesse Kendrick, Jr., Engineer Track of the Norfolk and Western.

Q. Please describe your procedures.

A. I used the method of evaluation which I have used in the inspection of thousands of miles of track and right-of-way for many years. The inspection trip on the Norfolk and Western was made by hy-rail vehicle. Stops were made at approximately ten-mile intervals where I noted the condition percent of the rails, ties, other track material, and ballast. I also noted the weight of rail and the year rolled. In addition, I noted the line and surface of the track. For ties, rail, other track material, and ballast, I used a random rail length as a basis. For line and surface I considered several rail lengths each way from the random rail length that I had selected.

Between they hy-rail stops, I made notes of changes in track condition as they came into view, such as muddy ballast, ties damaged from derailment, poor rail on curves, track surface and line, etc. At tunnels I noted and averaged the condition of the rail, ballast, drainage, portals, and seepage. At bridges I observed the condition of the decks, steel, piers, and abutments.

page 710 } The definitions of the terms as I have used them are as stated in the Glossary-1964 of the Manual of the American Railway Engineering Association:

Track—An assembly of rails, ties and fastenings over which cars, locomotives and trains are moved.

Line—The condition of the track in regard to uniformity in direction over short distances on tangents, or uniformity in variation over short distances on curves.

Surface (Track)—The condition of the track as to vertical evenness or smoothness.

Condition Percent—The ratio between remaining capacity for service and total capacity for service in each cycle of use.

As I inspect the track I evaluate particular items as good, good to fair, fair, fair to poor, and poor. Numerically these gradations would approximate 85 percent for good, 50 percent for fair, and 20 percent for poor. Good to fair would be 67 percent, while fair to poor would be 35 percent.

After the inspection trip was completed, I reviewed my notes and assigned condition percentages for rails, ties, other track material, ballast and track line and surface for each of the portions of the Norfolk and Western tracks in Virginia as indicated on Exhibit 1. The condition percentages are not statistical averages of the number of items that I noted but are judgment values relating to the various lines of the Norfolk and Western in Virginia at which I arrived after reviewing my notes and recalling conditions as I had seen them during our inspection.

Q. What sort of schedule did you follow?

page 711 } A. We left our motel at times varying from 6:30 a.m. to 7:30 a.m. and inspected the tracks as long as daylight permitted.

Q. How many hours a day did you put in?

A. Nine to ten hours on the rails and perhaps three to four hours driving on the highway to and from the tracks.

Q. What part or portions of the N&W system in Virginia did you go over?

A. The Christiansburg District, Whitehorne District, Pulaski District, North Carolina Extension, Abingdon Branch, Fries Branch, Roanoke Terminal, Altavista District, Blue Ridge District, Burkeville-Pamplin Belt Line, Roanoke District, Hagerstown District, Durham District, Winston-Salem District, Clinch Valley District, Dry Fork Branch, Dumps Creek Branch, Buchanan Branch, Dismal Creek Branch, Levisa Branch, Norfolk District, Petersburg Belt Line, Jarratt District, and the old Virginian Main near Abilene. Yard tracks at Sewell's Point, Lambert's Point, Crewe, Portlock and the N&W and Virginian main tracks from South Norfolk to Norfolk and Sewell's Point were not inspected on this trip. Late in 1968 I had occasion to walk and inspect these tracks and facilities, and I am familiar with their condition.

Q. Prior to going out on your inspection, had you studied the testimony and exhibits therewith filed herein by Mr. J. A. Caywood?

A. Yes, I had.

Q. In what condition did you find the track and roadway properties of the N&W?

A. I found them in very uniform condition; I saw evidence of knowledge and care in the authorization of funds to maintain the property. Tunnels, bridges, tracks, and signals were well maintained.

page 712 } Q. What was the condition of the main line of the Norfolk and Western?

A. The N&W's maintenance of the main line is such that speed and tonnage capacity are quite competitive in railroad operations.

Q. Did the same condition obtain as to portions of the system that are not being used as full traffic main line?

A. Yes.

Q. In what condition did you find the branch lines and yard and side tracks?

A. Well maintained.

Q. Did you form an opinion as to the condition of the track and roadway property, expressed as a condition percent of new?

A. Yes, I did.

Q. Would you please tell us what elements go into the formulation of your judgment as to that percentage?

A. I have previously described my method of forming judgment values of ties, rails, other track material, ballast, tunnels, and bridges. As to grading, I was continuously observing the condition of cuts and fills as we traveled along the rails. I noted the numerous locations where embankment was being maintained and protected against erosion and stream cutting by use of both off-track and on-track maintenance of way equipment such as front-end loaders and clam-shell cranes. As to signals, much of the time our hy-rail vehicle was operated and governed by signal indication as well as by radio communication. Signal systems are subject to I.C.C. inspection standards. Only twice did we find a dark light at a signal and corrective action was taken immedi-

page 713 } ately.

N&W road property values, such as we are here considering, are carried on its books and reported on Form A in conformance with I.C.C. requirements as accounts (1) Engineering; (3) Grading; (5) Tunnels and subways;

(6) Bridges, trestles and culverts; (8) Ties; (9) Rails; (10) Other track material; (11) Ballast; (12) Track laying and surfacing; (13) Fences, snowsheds, and signs; and (27) Signals and interlockers.

To determine a percentage which would give an indication of the weighted average of the several foregoing accounts, I used as a basis the dollar book values of the N&W road properties in Virginia in these accounts which were furnished to me by the State Corporation Commission. If reproduction costs new had been available, then I could have multiplied the condition percent by the new costs and could have computed a weighted average from those reproduction costs new. Exhibit 2 shows the elements which go into the formulation of a weighted average. Account (1) Engineering is not depreciated; Account (12) Track laying and surfacing is an estimated condition percent which reflects the average of the condition percentages of Accounts (8), (9), (10) and (11). In the weighted average, no account is taken of the track condition with respect to line and surface.

Q. What is your opinion as to the condition percent of the N&W road property expressed as a percentage of new?

A. 64 percent.

Q. Can you assign such a percentage to Account (1) Engineering?

A. Yes.

page 714 } Q. What was it?

A. 100 percent.

Q. Can you assign such a percentage to Account (3) Grading?

A. Yes.

Q. What was it?

A. 75 percent.

Q. Did you establish one for Account (5) Tunnels and subways?

A. Yes.

Q. What was it?

A. 67 percent.

Q. Did you establish one for Account (6) Bridges, trestles and culverts?

A. Yes.

Q. What was it?

A. 75 percent.

Q. Did you establish one for Account (8) Ties?

A. Yes.

Q. What was it?

A. 47 percent.
Q. For (9) Rails?
A. Yes.
Q. What was it?
A. 52 percent.
Q. For Account (10) Other track material?
A. Yes.
Q. What was it?
A. 49 percent.
page 715 } Q. For Account (11) Ballast?
A. Yes.
Q. What was it?
A. 47 percent.
Q. For Account (12) Track laying and surfacing?
A. Yes.
Q. What was it?
A. 49 percent.
Q. And how about Account (13) Fences, snowsheds, and signs?
A. Yes.
Q. What was it?
A. 50 percent.
Q. Did you ascertain the condition of Account (27) Signals and interlockers?
A. Yes.
Q. What was it, expressed as a percentage of new?
A. 67 percent.
Q. Will you please explain what your term "line and surface" means with reference to the N&W tracks?
A. These definitions are explained on page 6.
Q. Does the condition of line and surface relate in your judgment as to the condition of the N&W tracks in Virginia?
A. Yes. U. S. railroads in 1966 spent the following amounts in the track accounts in thousands of dollars for maintaining running tracks: Ties—$61,535 (15%), Rails—$48,137 (12%), Other track material—$58,500 (14%), Ballast—$19,646 (5%), and for Track laying and surfacing—
page 716 } $227,820 (54%). The amount of money spent to maintain line and surfacing is much greater in relation to the other expenditures than is the relationship of Account (12) to Accounts (8), (9), (10) and (11) in road property investment.
Q. Do line and surface represent an element of value?
A. Yes.

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Q. In an appraisal of railroad property, would line and surface be a factor in determining the fair value of tracks?

A. Yes.

Q. Do line and surface have anything to do with, and are they related to franchise value, going-concern value, or good will?

A. I took no consideration of franchise, going-concern, or good will value in my inspection and estimates of condition percent.

Q. Did Mr. Caywood give any value to line and surface in making his appraisal?

A. No, not that I can determine in reading his testimony and examining his exhibits.

Q. Would the value assigned to line and surface be in addition to the value of the properties for salvage or scrap?

A. No. If the track is dismantled, the line and surface would be destroyed.

Q. Is your firm regularly engaged in the appraisal of railroads and railroad properties?

A. Yes.

Q. Would you tell us some appraisals that have been made by Coverdale & Colpitts?

A. Spokane, Portland and Seattle Railway; Lehigh and Hudson River Railway, Pittsburgh, McKeesport
page 717 } and Youghiogheny Railroad; Rutland Railway; Hudson and Manhattan Railroad; Chicago, Rock Island and Pacific Railroad; Chicago & Eastern Illinois Railroad; New Haven, and the New York, Susquehanna and Western Railroad.

Q. Will you please tell us some of the appraisals in which you have engaged in, yourself?

A. The New Haven, portions of the Lehigh Valley, Central Railroad of New Jersey, Delaware & Hudson, Pennsylvania, Norfolk and Western, and the entire New York, Susquehanna and Western.

Q. In arriving at a fair value, or fair market value, as an appraiser, what use does the appraiser seek for the property to be appraised?

A. The highest and best use of the property.

Q. What is the highest and best use of the Norfolk and Western track and road properties which you examined?

A. As a railroad, in-place, with proper line and surface, capable of bearing locomotives and railroad cars.

Q. If I understand you correctly, are you saying that the railroad has been graded, that ballast is in place, that

bridges, trestles, and tunnels have been constructed, that the ties have been laid and the track placed thereon in proper line and with proper surface, that there is a value for the entire property in-place, that is greater than the sum of the parts or the liquidating value of the parts thereof?

A. Yes.

Q. If the N&W would for some reason go out of business overnight, would there be a market for the tracks and roadway properties which you inspected, in-place as a railroad property?

page 718 } A. I believe that there would be.

Q. Did you make any attempt to place a value on the franchise of the N&W in Virginia?

A. No.

Q. If you assume that the track is in place and properly aligned and surfaced, does this add a percentage factor to the value of the property?

A. I did not relate the track condition of line and surface, which I estimated at 65 condition percent, to any of the I.C.C. accounts heretofore mentioned.

Q. What in your opinion would be a proper percentage to add by reason of this factor?

A. I do not place a specific percentage to add to the condition percent of the N&W tracks in Virginia. I am pointing out that the track assemblage—the form into which the material components have been built—are through usage distorted from a new condition; continuous expenditures have been made by the N&W to restore or to bring back the track assemblage into proper line and surface. Had poor line and irregular cross-level been predominant during our inspection, I would have evaluated the track accordingly.

Q. What was the condition of the N&W tracks and roadway properties when you relate them to the condition of the other railroads in the East that you have some knowledge of.

A. The uniform condition existing in the N&W tracks in Virginia is better than most other carriers achieve.

Q. What maximum speed limits did you find on

page 719 } the main line of the N&W?

A. 70 miles per hour.

Q. What percentage of condition should be maintained to operate main line trains at 70 miles per hour?

A. All deviations in the track line or surface (cross-level) such as might create undesirable sway or other motion to rolling stock must be avoided. These do not relate to a pre-

scribed condition percent. The carriers alone determine their track speeds.

Q. Did you investigate slow orders on the N&W?

A. Yes.

Q. What are "slow orders"?

A. When a portion of track is considered unsafe for the passage of trains at timetable speed for any reason, temporary restrictions are made. "Reduce speed" signs and "resume speed" signs are placed at the track location so affected. The "reduce speed" signs and "resume speed" signs are signals and govern the movement of trains.

Q. What does the existence of "slow orders" indicate?

A. Insofar as the track is concerned, if the condition percent of certain stretches of ties, rail, track line or surface is low, excessive sway or rocking might occur, contributing to a derailment; when this happens, carriers place temporary slow orders until repairs can be made.

Q. What did you learn about slow orders on the N&W?

A. There was one slow order where defective rails were being repaired. Seven others concerned normal construction and maintenance activity. There were none in effect as a result of low condition percent of the track or its components.

page 720 } Did you ascertain whether or not the N&W is continuing to lay rail in 39-foot lengths, or are they using welded rails?

A. They lay both.

Q. What is the significance of the use of the welded rails?

A. To reduce the required operating expenses chargeable to maintenance of way and structures.

Q. Does this increase the life of the rails and ties?

A. Yes.

Q. Do you have a minimum cost which you would ascribe to a mile of sidetrack?

A. I did not determine specifically any cost as might apply in Virginia. However, if 2,800 ties are used per mile, costing $3.70 each, the ties would cost $10,360. To build the track at $3.50 per foot would cost another $18,480, or a total of $28,840 exclusive of rail, fastenings and ballast.

Q. That being so, would you say that an assessment by the Utilities Tax Division of the State Corporation Commission of $9,000 for a mile of sidetrack is excessive?

A. $9,000 represents 31 percent of the foregoing $28,840. It does not appear excessive.

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Q. What percentage of depreciation would you assign to the rail of the N&W?

A. I did not make any determination of this.

Q. Would you say that a 60 percent depreciation on N&W would be excessive?

A. It seems high to me.

page 721 } Q. Would you give your reasons for your opinion as to what the depreciation on the N&W rails would be?

A. I would say that although detected rail failures such as "head-and-web" and "bolt hole" have increased due to the availability of more sophisticated testing devices, it is also true that many of these rails when changed out are cropped and butt-welded into long lengths, then returned to service with a capacity greater than for individual rails.

Q. In any of your various computations, have you added anything for franchise value?

A. No.

Q. Going-concern value?

A. No.

Q. Good will?

A. No.

Q. What was your observation of the manner in which the N&W is being maintained?

A. Very uniform, and to what I consider a high grade.

Q. Does that refer to only parts of the system or to all of the system that you saw in Virginia?

A. To all N&W tracks I saw in Virginia.

Q. What type of equipment is the N&W employing in its maintenance program?

A. Modern mechanized equipment, such as multiple-power tampers, wire liners and track raisers, tie saws, tie inserters, rail lifters, burrow cranes, and extensive automotive equipment. Also rail testing equipment, ballast cleaning equipment and rail grinding equipment.

page 722 } Q. How is the amount of money which a railroad will employ on maintenance determined?

A. Generally by a percentage of the forecasted gross revenues for the following year, by an amount expressed in terms of a previous year, or by a schedule of alternates which depend upon the monthly revenues. Concurrently with the forecasting of the anticipated revenues, the roadmasters usually have submitted through organizational channels to the system headquarters their recommendations of the amount of ties, rails, surfacing and other maintenance expenses they

consider appropriate for the following year. The same procedure applies to the bridge and building as well as signal departments. At the system hadquarters the anticipated revenues are balanced against the requests for expenditures; and allocations then are made based upon system knowledge of the property, and what special or unusual factors are planned, such as meeting a necessity to increase track speed over certain divisions to accommodate unit trains, and so forth. Finally a budget is adopted which is tailored to allocate maintenance expenditures for they system on the basis of need to maintain a safe railroad, to meet service requirements, and to avoid over-maintenance.

Q. Are maintenance expenditures ever determined as a percentage of condition of the road?

A. Not in my experience.

Q. If I understand you, you say that maintenance expenditures are made according to need, and not as a percentage of condition of the road?

A. Yes.

page 723 } Q. Have you ever heard of determining maintenance by a percentage of condition, or its relationship to a percentage of condition?

A. No.

Q. Have you ever heard that the most efficient method of maintaining a railroad is to aim for a fifty percent condition?

A. No.

Q. When you have been out on various railroads, do you ever find track conditions which might lead to a derailment?

A. Yes.

Q. Did you find any such conditions in the N&W system?

A. None whatsoever.

Q. What criteria are used in determining observed percent condition?

A. Primarily the condition of the property as it exists at the time of observation and not the age of the property.

Q. Do you know Mr. J. P. Hiltz, Jr., former president of the D&H?

A. Yes.

Q. Do you subscribe to this statement contained in I.C.C. Finance Docket No. 21510, involving the Norfolk and Western Railroad Company and New York, Chicago and St. Louis Railroad Company merger, 330 I.C.C. 780, at page 840:

"The record does support a conclusion that the average life of ties, whatever it may be, is greater than 40 years. In this connection, the testimony of D&H president Hiltz, which is summarized below, is illuminating***.

1. With the dieselization of railroads beginning in 1945, the counterbalance impacts of steam locomotives on track structure were eliminated.

2. The change from steam to diesel power also eliminated fire and water damage to ties and fouling of ballast by head-end and firebox cinders.

page 724 } 3. Improved methods of cleaning ballast adopted in the past 10 or 15 years have improved drainage and have thus eliminated moisture as a major factor in the rotting of ties.

4. Beginning in 1945, mechanized methods of performing track work have extended tie life by more precise surfacing and lining of track and by placing ballast under ties by vibration rather than by hammer blows.

5. Improvements in design of tie plates and tie pads and the use of continuous rail will prolong tie lives to a significant but indeterminable extent.

6. Reduction in the number of derailments through prohibition of cast iron wheels and waste-packed car journals has extended the average life of ties. Increased use of hot box detectors and roller bearings has had the same effect.

7. Practically all historical tie records are distorted by the need to replace untreated ties which were installed 30 or more years ago.

8. Research, development, and experimentation relating to railroad track structure did not come to an abrupt halt in 1945, at which time new ties were believed by many to have life expectancy of 40 years, but are continuing at an accerlerated pace.

From these facts, witness Hiltz drew the following logical conclusions:

'In arriving at a "normal" maintenance program for the D&H witness Jackman *** concludes that the installation of 83,000 new crossties annually would be required and arrives at such a conclusion by using an average tie life of 40 years. I submit that conditions which affect the life of crossties over the long period being considered by the witness (1935-65***) have changed drastically and that the effects of these changes are cumulative and therefore have not been realized to the utmost degree possible. I also submit that some of the changes have not been made to the fullest extent that

they can and will be. Therefore, it is my contention that past experience as it pertains to tie life is not very meaningful, and that the present experience and observation together with a professional appraisal of the future must be relied upon in reaching conclusions in this area. ***' "

A. Yes, I do.

Q. Are you familiar with the hearing before the Interstate Commerce Commission entitled "Uniform System of Accounts for Railroad Companies-Betterment and Depreciation Accounting, Railroads, being Docket 32153, reported in 309 I.C.C. 289?

page 725 } A. Yes.

Q. Do you subscribe to the following statement contained therein?

"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 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 service on a track installation than they are in, say, the fifth year of service."

A. Yes, I do.

page 726 } I hereby certify that the answers given to the foregoing questions are true and correct to the best of my knowledge and belief.

Kenneth E. Dunn.

K. E. Dunn

Subscribed and sworn to before me this 9th day of April 1969.

Jose A. Fernandes
Notary Public

My commission expires:

Jose A. Fernandes
Notary Public, State of New York
No. 41-4274250
Qualified in Queens County
Cert. filed with Queens & N. Y. Co. Clk.
Commission Expires March 30, 1970

page 727 } Mr. Epps: Mr. Dunn is hereby presented for cross examination.

CROSS EXAMINATION

By Mr. Pasco:

Q. Mr. Dunn, I understand your firm was orginally approached in this matter to see if you would be willing to undertake the job of determining whether the assessment made by the State Corporation Commission was reasonable and because of time limitations and cost limitations, you did not undertake that task. Is that correct?

A. No, Sir, the purpose of my mission was to determine the per cent condition of the Norfolk and Western's tracks, signals, grading in the State of Virginia—per cent condition.

Q. Per cent condition was the purpose of your employment in the case?

A. Yes, Sir, of certain ICC Accounts.

page 728 } Q. Now, did anyone from your firm assist you in making this inspection?

A. No, Sir.

Q. You were the only one?

A. Yes, Sir.

Q. Now, you indicate on page four of your testimony that in your discussions with Mr. Epps and Mr. Shannon about possibly undertaking the determination of whether the assessment was reasonable, that there were limitations imposed on any such study which made it impossible for you to undertake that task. Now what were those limitations that you say you discussed with them?

A. The discussion, I believe, was between Mr. Epps and the senior partner of our concern, Mr. W. A. Gordon.

Q. Yes.

A. I was not present at the entire discussion.

Q. You did not take part? You do not know what those limitations were?

A. No, Sir.

Q. In your qualifications, Mr. Dunn, you indicate you made an economic and evaluation study of the Union

page 729 } Freight Railroad, among others.

A. Yes, Sir.

Q. Where is and what is the Union Freight Railroad? I am not familiar with that.

A. The Union Freight is a two-mile railroad situated in Boston, Massachusetts.

Q. Yes. And you also stated that you did such a study for the railroads involved in the Dereco group. Is that correct?

A. On the study for the Dereco group, we made an analysis of the savings that had been presented in ICC hearings. We did not go out on the property.

Q. You didn't go out on the property? And for whom did you do the work for the Dereco group?

A. It was for a law firm representing the bondholders.

Q. Yes. Now, on page three of your testimony you say you made a liquidation evaluation of the New York Susquehanna and Western Railroad. What has happened to that railroad since then?

A. Just that the day that we concluded our liquidation study, which did not include land, the Wall Street

page 730 } Journal contained an article that Mr. Maiden, who is the principal owner of the Susquehanna, stated that he had decided that he would continue as an operating railroad on its own for the near future at any rate.

Q. Yes.

A. Therefore, we did nothing further in this case. We were employed by the Penn Central.

Q. Well, is the Susquehanna, and—New York, Susquehanna and Western still operating as a railroad?

A. Yes, Sir.

Q. You are not aware that it has been abandoned?

A. The New York, Susquehanna and Western?

Q. Yes, Sir.

A. It has not been abandoned.

Q. It has not been abandoned?

A. No, Sir.

Q. Well, now, in making this liquidation evaluation, did you place a value on the grading of this railroad?

A. I did not. The grading was included in the evaluation made by the land appraisers.

page 731 } Q. Yes. Now, did you make an evaluation of engineering in determining this liquidation evaluation?

A. The liquidation—the engineering that went into the accounts that we were placing values on, we had a zero evaluation.

Q. Yes. All right, Sir, do you consider yourself an expert in the field of signals, operation and maintenance, Mr. Dunn?

A. Yes, Sir, I do.

Q. And that arises out of the experience you had on the New York Central as chief engineer and maintenance of way, is that right?

A. Yes, Sir.

Q. Is that tue also as to bridge structures?

A. Yes, Sir. I was in charge of bridges, buildings, and track.

Q. But you have not been in active railroading since you left the New York Central in 1964, is that correct?

A. Well, I have been on many railroads making inspections since that time.

page 732 } Q. On page five, Mr. Dunn, you state there that the method that you employed in determining the condition per cent of the Norfolk and Western structure and signals is the same method that you have used in inspecting thousands of miles of railway down through the years and you describe in your testimony the method that you undertook. Is this the same kind of inspection you made as chief engineer and maintenance of way for the New York Central?

A. Yes, Sir, many, many times.

Q. You didn't do anything more particularly detailed than your inspections as chief engineer than you did on this inspection at the Norfolk and Western?

A. I spent more time obviously because it was my railroad in that sense, and I was on it more days. I was aware of changes as they might occur; but the methodology that I used here is the same as I might say is the normal method by which maintenance officers decide how much and where they will allocate their maintenance money.

Q. Then on the basis of this type of inspection that you

made of the Norfolk and Western, as described in your testimony, you made up your budget fro the New York Central maintenance when you were chief of maintenance-of-way of that railroad?

page 733 } A. Using that as a basis, yes, Sir.

Q. Now, I understand that you stopped at ten-mile intervals on this inspection trip—

A. Yes, Sir.

Q. —according to your testimony.

A. Yes, Sir.

Q. Over about fifteen hundred miles of line, I believe the record shows, and you testified that you noted three things, I believe: the condition per cent of the components, the weight of the rail, and the year it was installed, and you observed the line and surface of the track; and I understand in doing this, you selected one rail at each of these ten-mile stops. How did you make the selection of this one rail that you examined in this way at each stop?

A. As I said in the testimony, it was a random selection where the operator of the vehicle stopped near a ten-mile milepost. We got out and looked at a random rail which would be typical of rails in the area.

Q. How did you know it was typical?

A. Because I looked at them. I mean, if there is a variation in the type of rails I am traveling over, I

page 734 } am very—I am sure I am very adept at picking them out.

Q. But you just got off at each one of these steps and picked out one piece of rail that looked generally like all the rest and used that as a sample at that stop, is that right?

A. Yes, Sir.

Q. Now, did you make any measurements of these random samples that you selected?

A. No, Sir.

Q. Did you use a rail contour machine?

A. No, Sir.

Q. Did you use a gauge?

A. No, Sir.

Q. Of any kind?

A. No, Sir.

Q. And you didn't measure the rail layout in inches or components of inches?

A. I did not measure it with a device.

Q. You observed it?

A. By observation, yes, Sir.

Q. And you used no equipment then on determining the condition of these rails? It was entirely by observation?

A. Yes, Sir.

page 735 } Q. Now, Mr. Dunn, wouldn't the rail-wear effect the condition per cent of the rail that you have been investigating?

A. Rail-wear, yes, Sir.

Q. But you determine that solely by a visual inspection, is that right?

A. Yes, Sir.

Q. How about the loss of rail contour? Would that have an effect on the condition per cent?

A. On curve-wear and rail definitely.

Q. Yes. And you observed that only where these stops that you had made were on curves, then I take it?

A. Oh, no, I observed very intently all of the curves around which we traveled. Going in the rail auto, it is very easy to detect whether there is an appreciable amount of railwear or very little railwear.

Q. Yes. You covered all of this inspection in eight days, I believe. Is that right? That is the number of days shown here I believe.

A. All right.

page 736 } Q. What would you say was the average speed you may have traveled in the high-rail car to accomplish this?

A. Well, I couldn't tell you the average speed, but I know that we went from, we'll say from twenty miles an hour to as high as forty-five. I wouldn't want to get anybody in trouble if their limit is forty why we may have gone faster.

Q. I see. You averaged from twenty to forty miles an hour?

A. Yes, Sir.

Q. Aren't there defects in rails that are not detectable by visual inspection?

A. Yes, Sir.

Q. Did you examine the Sperry Car Reports of the Norfolk and Western in recent years?

A. I looked at the tabulation that Mr. Caywood had in his report, yes, Sir.

Q. But you did not look at the Railway records themselves as the Sperry Car Eximination?

A. I had no access to any Railroad records at all.

Q. Well, in making this inspection, did the Nor-
page 737 } folk and Western employee in charge of the car
put any limitations on you as to where you went
or to what you saw?

A. No, Sir.

Q. I believe you stated or Mr. Howland, I forgot which, that you got full co-operation.

A. Yes, Sir.

Q. In assigning your condition percents to this rail, did you make any specific use of any general industry standards such as the American Railway Engineering Association Standard?

A. Absolutely not.

Q. And could you base a program of rail renewal for the Norfolk and Western based on this inspection that you made in your opinion?

A. Yes, I could.

Q. You think you could?

A. Yes, Sir.

Q. Well then, summing up about the rail, it is my understanding from your testimony that you stopped every ten
miles and got out and selected a random rail and
page 738 } looked at it and walked around and based on
this, you express your opinion in your testimony
as to the condition per cent of the entire Norfolk and Western?

A. I looked at all rails that we went over, and I noted—

Q. Right.

A. —and made a note in my book where there was any change. If the condition per cent had been good for the last three or four miles and then all of a sudden, it went to fair or to poor, I entered that note.

Q. Yes. But it was on the basis of this moving inspection and the stopping each ten miles you just described that you arrived at the conclusion that the per cent condition of the Norfolk and Western Rail is fifty-two per cent, I believe?

A. If that is what it is—

Q. Yes.

Chairman Catterall: Didn't you stop on each curve?

A. Sir?

Chairman Catterall: I thought you said you stopped on
the curves also.
page 739 } A. Not on each curve, but I observed each
curve.

Chairman Catterall: I see.

Mr. Pasco:

Q. You stopped every ten miles arbitrarily, plus or minus some?

A. Yes. I might say that the condition of the N&W Rail on curves was what I state here in my opinion and there were very, very few curves that were in such a condition that I would have to stop and make a downward revision in what I thought was the condition. In other words, their curves were all maintained in better than a limiting condition.

Q. Do I understand that you on occasion, on maybe a few occasions stop the car on a curve because of conditions?

A. No.

Q. I want to be sure I understand you on that.

A. No, no, I just say that if I had thought that we were approaching a spot where the rails were approaching a limiting condition, I perhaps would have stopped to see what the age was at that point; but I did not find any.

page 740 } Q. So your actual investigation included stopping at approximately every ten-mile intervals?

A. Yes, Sir. Many of those were on curves and tangents.

Q. Yes. Now, turning to your testimony about tunnels, Mr. Dunn, you state on page five that you noted and averaged the condition of the rail ballast, drainage, portals and seepage of the tunnels, how many tunnels did you actually stop at?

A. We did not, generally we did not stop at the tunnels. We went at slow speed through the tunnel and I ended up with a figure that would be applicable to account five tunnels.

Q. Yes. Did you have any special light for inspecting the interior of these teunnels?

A. I did carry a flashlight with me, but I did not find it necessary to use it.

Q. You relied on the headlights of the railroad car?

A. I relied on the headlights of the car, generally it was sufficient.

Q. Were you able with this light to check the

page 741 } spalling or cracking of the lining of the tunnel?

A. Yes, generally if there is any appreciable cracking or spalling, there will be seepage and water dripping; and where there are wet spots in the ballast, there would be indicative that water was entering the track structure

from the side walls of the tunnel; and by noting the condition of the rail and generally the rails in the N&W's tunnels are butt-welded throughout, which makes it very easy to detect a soft spot where there might be water. I used that as a measuring device for determining the wetness or the condition of the lining of the tunnel.

Q. And you could not see cracks or spalling that did not produce some seepage then?

A. I would say that is correct. I did not.

Q. Could you see the cracks well enough to tell whether they were moving laterally or vertically or tell anything about the nature of the cracks?

A. Whether the cracks were increasing in size?

Q. Whether they were running vertically or latterally.

A. No. I did not make that detailed inspection.

page 742 } Q. Now with respect to your condition per cent of the bridges, I believe you said you had no one else with your firm with you on this.

A. That is correct.

Q. —when you made these determinations? How many bridges did you stop on, Mr. Dunn?

A. I would say we stopped at maybe half a dozen.

Q. Stopped at a half a dozen bridges. Then your opinion as to the condition per cent of, I believe, eight hundred sixty-six bridges of the Norfolk and Western is based on stopping at a half a dozen plus a visual inspection as you rode by, those that you went by on the route that you described?

A. Yes, Sir.

Q. Could you tell us where these six bridges were located?

A. Offhand I do not think I could pick that out of my notes.

Q. How about your work papers from your notes? Could you tell us where these bridges were located?

Note: Witness reviewing papers before him.

page 743 } A. I would say that the bridges were at where a ten-mile point came at that location, and I did not—

Q. And you made no special stops at bridges?

A. No, no, that is correct, if that is what your questions aims at. No special stops at bridges.

Q. Can you tell us now or before you complete your testimony today approximately where these six bridges were located?

K. E. Dunn

A. If I looked through here, I might find one or two of them (witness indicating papers before him). I would not say, and I used that six, maybe it was four, maybe it was seven or eight. I certainly at every opportunity I had I observed the amount of corrosion, the condition of the steel, whether I could see any loose rivets, what the condition of the deck was—all of these I could see what the conditions of the back wall is. On many of the bridges, the N&W, because of the raising of the tracks on each side of the bridges, the certain bridges have had to be raised. The back walls have had to be rebuilt, and I observed these conditions and took them into account.

Q. All right, and this was on your inspection moving except the bridges that you hit upon at the ten-mile stops, is that right?

page 744 } A. Yes, Sir, that is right.

Q. Well, I would like before you finish your testimony today if you will locate any of these bridges that you can and let me know where they are—

A. Yes, Sir.

Q. —rather than to delay the examination now.

Now did you examine the lateral bracing system of these bridges?

A. Not in great depth, no, Sir.

Q. Could you see them at all while moving along on a high-rail car?

A. Well, it happens on several of the major structures when we got off the rail and went down a road we would pass under a bridge and I would always try to see what I could see as we went by. It was not what you would call an engineering inspection.

Q. Yes, and you did not examine the bridge shoes and bearing plates in any detail?

A. I looked at the bridge shoes and bearing plates, and just from inspection determined their condition.

Q. How about the vertical stiffeners of the bridges? Did you examine them?

page 745 } A. Well, I did not see any that had been damaged by derailments and I didn't make any particular note of any stiffener condition.

Q. How about the riveted or welded connections? Did you examine those?

A. Rivets I generally try to see if I could determine any loose rivets which are relatively easy to pick out, and I did not see any.

Q. You can determine a loose rivet riding along?

A. Yes, when you go slow over a bridge, yes.

Q. How about the masonry abutments and piers of the bridges? Did you examine them?

A. I saw many bridges while I was on the N&W. The piers as we rode around, maybe passing underneath, I could see piers and formed a general opinion based on what I saw.

Q. But you did not actually get out and get under and look at any particular bridge?

A. No, Sir, that is correct.

page 746 } Q. Now, Mr. Dunn, Mr. Caywood's testimony, which I believe you said you were familiar with, contains as Exhibit No. 2 the components of the Norfolk and Western Line as they are reported to the State Corporation Commission, and I would like to get you to look at that Exhibit No. 2, if you have it.

A. I think so.

Q. It is entitled, "Average Fair Market Value Per Mile"; but I only want to ask you about the first column which lists the components to find out where you went on this inspection. I would like to go through some of the items on this list to see whether you covered some of the items that Mr. Caywood did. For instance, the Knitting Mill Branch, did you go on that Branch?

A. No, Sir.

Q. How about the Norfolk Branch-Water Street?

A. Let me see. I know I did not go on that in this trip, but I may have been on that branch previously.

Q. Yes. I believe you testified in 1968 you made some inspection of the Norfolk—

A. Yes. I covered—everything in Norfolk I have been over on foot.

Q. In 1968?

A. Yes.

page 747 } Q. For what purpose was that examination made?

A. That was to make an acquisition valuation on behalf of the Navy of certain property in Norfolk.

Q. You were doing that for the Navy?

A. Yes, Sir.

Q. All right, let's come down to the City Point Branch, near Petersburg, I believe. Did you see that?

A. No, Sir.

Q. The Roanoke Belt Line?

K. E. Dunn

A. The Belt Line, I did see parts of that in Roanoke, not with the group but on my own.

Q. On your own?

A. When I was walking.

Q. How about the Catawba Branch?

A. We did not cover that.

Q. And the Salem Connection?

A. We did not cover that.

Q. How about the Sewell's Point Municipal Terminal?

A. Yes, I have been on that.

Q. But not on this inspection trip. This was
page 748 } the earlier trip.

How about the Glenvar Connection?

A. No. Now when you say these connections—

Q. Yes.

A. —many of these were tracks in the form of a "Y" that connected with the line that we were going over, and I always made it a point to look at all of the "Y" connections to see again whether there was anything that would be a marked change of an average condition or a good condition or if it was a poor condition.

Q. I understand, but you did not actually go on it. You observed it.

A. I observed all of these connections that I could see as we went by, yes, Sir.

Q. How about the Blacksburg Branch?

A. No, we did not cover that.

Q. And the Kingston Branch?

A. No.

Q. And the Potts Valley Branch?

A. No.

Q. And the Pocahontas Branch?

A. Offhand I think not.

page 749 } Q. And the Western Branch?

A. No.

Q. How about the West "Y" at Walton?

A. I will have to look and see where Walton is now (witness reviewing papers before him). Oh, yes, yes, I looked at that specifically as we went by.

Q. From the switch?

A. Yes, Sir.

Q. How about the Radford Branch?

A. Ratcliffe or Radford?

Q. Radford.

A. No, I know we didn't go to Radford.
Q. Well, how about the Saltville Branch & Wye?
A. I looked at the Saltville Branch for as much as I could see as we went by.
Q. How about the Spur Track-Damascus to the State Line?
A. We did not cover from Damascus to the State Line. We covered from Damascus to Abingdon, Virginia.
Q. And the Cloverdale Branch, Mr. Dunn? Did you get on that?

page 750 } Mr. Epps: What is this one, Mr. Pasco?
Mr. Pasco: The Cloverdale Branch.
Mr. Epps: Is that on—
Mr. Pasco: It's on page three (referring to Exhibit No. 2-JAC).
Mr. Epps: You're skipping around.
Mr. Pasco: I am skipping around a little bit.

A. I did look up again as we were coming in.
Q. You saw that from the main line?
A. Yes, Sir.
Q. And about next the West Leg "Y"?
A. I cannot identify that, but if it was near the main track, I looked at it.
Q. How about the Big Creek Branch?
A. No.
Q. And the Coal Creek Branch?
A. We did not go up that one.
Q. I just have four more, Mr. Dunn. How about the Russell Creek Branch?
A. No, we did not go up that one—oh, I took a good look at that one though as we went by.
Q. How about the Hurricane Branch?

page 751 } A. No, we did not. We went right by the switch.
Q. How far do you estimate you could see up the Russell Creek Branch from the switch?
A. I would imagine about five hundred feet.
Q. Then did you go on the Little Tom Creek Branch?
A. Little Tom?
Q. Little Tom Creek Branch.
A. I think not.
Q. And the Big Tom Creek Branch?
A. I think not.

K. E. Dunn

Q. And finally the Jacobs Fork Branch? Did you get up on that?

A. I guess not.

Q. Now, turning to the subject of ballast, Mr. Dunn, in examining the condition of the ballast, did you dig below the surface of the ballast at any stops?

A. I considered that it was not necessary.

Q. Then you just visually inspected the surface of the ballast that have been washed by the rains through the months, is that right?

A. I took very very carefully into account the purpose for which the ballast is there and determined
page 752 } whether it was satisfying its purpose.

Q. But isn't it true, Mr. Dunn, that the subsurface qualities of ballast is equally important as surface qualities in determining whether the ballast is—what condition it is in and whether it is effectively performing its function?

A. The ballast is used to support the ties, to support the live load, and it is used to hold the track into line; and *particuarly* on a coal road from the shake-out of cars, considerable fine coal dust shakes into the ballast. It tends to foul the void in between the spaces of the clean ballast as originally placed. When such a condition happens and the N&W does so, they get the ballast cleaner and shake out the dirt and throw it away and whatever has been lost in the way of fines, they replace with additional ballast.

And as far as per cent condition, my observations were made and my opinion was based on how adequately the ballast I saw was performing its function.

Q. I do not believe you answered my question as to whether or not the subsurface qualities of any section of ballast are equally important with the surface in determin-
page 753 } ing its condition or the effectiveness by which it is performing?

A. Do you mean the sub-ballast?

Q. That is right.

A. Yes, the sub-ballast has many water pockets. The action of the traffic causes a pumping action, and it will actually pump water plus fines which becomes mud, and that will work its way into the track ballast itself. I observed the condition. My book is full of places where I saw muddy ballast.

Here again, as I say, I took into account the fact that the N&W does—they are modern. They do clean ballast, and the

mere fact that a ballast is dirty is no indication that it is not performing its function.

Q. That is about all you can tell about looking at the surface of the ballast as it is washed by the rain is whether it is dirty or not, isn't it?

A. Insofar as track is concerned, that is all I need to know.

Q. You need to know nothing about the quality of the ballast underneath the surface covering or the condition of it?

A. You are referring to sub-ballast now.

page 754 } Q. If you kick two inches off the top of the ballast, that is what I am talking about. What is below that?

A. You are not in the sub-ballast. You are in the ballast itself. The ballast extends from, we'll say from flush with the top of the tie to maybe twelve inches below the bottom of the tie. Now, you are referring in that area.

Q. That is right.

A. All right, now if the ballast has been cleaned and the evidence on the N&W is such that they are reasonably cleaned ballast with a Speno ballast cleaner. The Speno cleaner does not clean the cribs. This is the ballast that is between the ties. They do clean the ballast on the ends of the ties.

But if you have a program, and the N&W does have a ballast cleaning program, as you periodically cover the track, the fact that you keep the ends of the ties open with good clean ballast or cleaned ballast, it tends to let the water that would normally stay in the cribs run off and not foul up the cribs. Now when the cribs get to a certain point

page 755 } in their foul condition, many times the entire ballast in the crib is removed; and the N&W has machinery to do this, and they do it with Nordberg crib action. I saw where the machines were, and I took that into account with my judgment.

Q. You don't know how frequently though any one section of ballast is cleaned and treated in this way, do you?

A. No, I do not.

Q. So your testimony in this case as to the condition per cent of the ballast is based on the visual inspection of the surface of the ballast plus the knowledge you had of the system you understand that the Norfolk and Western used to clean it, is that right?

A. No, my condition per cent is based on what I saw.

Q. And you did not dig below the surface? You did not feel it necessary?

K. E. Dunn

A. That is right because my experience tells me what it would be below the surface.

Q. Yes. Now, before you examined the ballast, did you familiarize yourself with the Norfolk and Western

page 756 } standard ballast section?

A. I saw the sections that are in Mr. Caywood's testimony.

Q. But you did not examine the Norfolk and Western standard ballast section as such, is that right?

A. Let me make sure I understand your point here. Did I look at their book of standard?

Q. Yes, did you examine their standards?

A. No.

Q. So you do not know—

A. But I did inquire what they are doing. Since the advent of butt-welded rail, it is very necessary to have an increased ballast section, a larger cross section than was required with conventional thirty-nine foot rails; and the N&W, I was told, is strengthening their ballast section and capitalizing the cost of the additional ballast. This is normal in railroad maintenance practice.

As far as the cross section itself is concerned, their cross section is, I would say from my observation, standard with other carriers because they use the same type of mechanized equipment. The ballast distributor will give you a uniform section. It will carry ballast from where it is

page 757 } shy and put it into cribs where it is needed.

Q. I believe you said you are familiar with Mr. Caywood's testimony in this case?

A. I read it.

Q. You read it?

A. I do not know all of his—

Q. Do you consider that with respect to cross ties now, that your method of examination of cross ties was effective and as thorough as his?

A. Certainly I did not take as many measurements, but I would like to say this: that the observations that I made and from watching the ties and rails as I went along the tracks, I felt that my judgment is sound in what I have stated as a condition per cent.

For this reason, that if I have a certain judgment of a tie or the number of ties in a railway, the panel of track, my judgment is the same as I determined what condition per cent they are as whether I looked at one or a thousand.

What I am bringing out is that the number of ties, if my judgment were poor, let's say, then if I had done it a thousand times, then I would have ended up with an
page 758 } incorrect figure. The mere repetition in the case of judging ties is not a controlling factor—

Q. Do I understand—

A. —in judging per cent condition.

Q. Do I understand from your testimony that you think observing a few ties every ten miles will give you the same basis as examining ten ties every half mile?

A. No, I am not saying that. It would be closer if I had done that. I am not discrediting Mr. Caywood's testimony.

Q. And you, according to your testimony, mentally categorized these ties into five categories, I believe you stated?

A. Yes.

Q. Mr. Caywood used ten categories, I believe, did he not?

A. Yes, Sir.

Q. Do you know or can you estimate about how many stops you made on this eight-day trip?

A. No, I did not count them.

Q. And how many ties did you examine each time you stopped?

page 759 } A. What I did was judge the condition of the ties in the rail length because when a track is maintained normally and the N&W was very uniform in their tie applications for new ties, it was easy for me to pick out from the last time they had worked the track, whether they had put in four ties or six ties or eight ties and how many ties there were left that were, we'll say, fail ties, and there were very few fail ties.

Q. I am interested in this evaluation classification that you used, listed on page six. These five categories. Is this a standard basis for grading? That is, the "good," the "good to fair," the "fair," the "fair to poor," and "poor"?

A. Yes, Sir.

Q. That is the standard basis that is not something that you devised for your own benefit?

A. Oh, no, this is generally used.

Q. It is generally used?

A. Yes, Sir.

Q. You said you did not know how many stops you made. You stopped every ten miles roughly, and there are about fifteen hundred miles of track. Would a hundred
page 760 } and fifty stops be about right?

A. Well, if we just go to simple arithmetic, yes.

K. E. Dunn

Q. Well, I am interested in knowing. You did not cover all fifteen hundred miles.

A. Well, I made many observations as we made other stops that are not—when I talked about these every ten miles, this was just something that I made a record of it, we'll say; but when we stopped for a delay, waiting for a train to pass. I would walk down the track as far as I could get until somebody—until they came along and picked me up.

Q. And then you had to stop when you got the car off and on the track?

A. Oh, yes, I would look—

Q. But you kept no record of the actual number of stops you made then?

A. No.

Q. And then when you got through, I believe you testified, that you made no statistical average, you just applied a judgment factor to the notes that you had made on each of these stops, is that correct?

page 761 } A. Yes, Sir.

Q. Now on page seven, Mr. Dunn, you state that you found the track and roadway property of the Railroad in very uniform condition. Do you mean by this that the ties and rails on the Norfolk and Western's main line are of the same quality and condition as those on the branch lines that you saw?

A. No.

Q. I'm trying to find out what you meant by "very uniform condition."

A. What I meant: that type of a meaning would be on my tabulation of the per cent condition on another sheet. Any thing that I saw that the N&W had maintained, it was done on the basis of need. It was in a very uniform condition. There was no, we'll say, mile of track that was over-maintained followed by two miles of very poor track in that sense.

Q. But this does not mean that the branch lines and the spurs were maintained in the same way that the main lines were maintained?

A. It does not say that, no.

Q. Now, on what do you base your testimony

page 762 } about the signals on page seven as to the fact that they were well maintained?

A. Page seven, did you say?

Q. Yes, unless I made an erroneous notation.

A. Oh, yes, right at the bottom.

Q. You say the signals were well maintained? What is the basis of that testimony, Mr. Dunn?

A. Based on their appearance, the way they operated, quite a number of times we were running the rail the high-rail car under signal indications and the—

Q. Did you do that at any place except on the Shenandoah Division?

A. Yes, we were on, I think it was on the Buchanan Branch.

Q. On the Buchanan Branch and the Shenandoah Division, you operated your car by the signal?

A. Yes.

Q. And the fact that they worked and looked good is the basis for your statement that they were well maintained?

A. Well, I looked at all of the signals as we went by them and from time to time—

page 763 } Q. Surely.

A. — I think there were two occasions. There was a dark light and that was a very good indication that they were well maintained.

Q. Well, surely whether or not a light in a signal works does not indicate its condition per cent of new, does it?

A. Oh, I think so.

Q. Whether the light in it has burned out or not, you think has any relation to the—

A. No, it is an indication of what the level of maintenance is.

Q. But it is no indication of the condition per cent of the signal itself, is it?

A. Well, the dark light would be zero per cent condition for that particular light—

Q. But for the—

A. —there were two lights on the indication one of which was dark, so the other one would be one hundred per cent.

Q. Of the bulb, but not of the signal mechanism itself?

A. Well, I am ending up with one figure for

page 764 } the entire signal system as an estimated condition per cent, based on my observation.

Q. Well, you say—

A. Now taking into that, I observed the signal maintainers that were out on the track working and what they were doing, the checking of the bond wires. All signals are subject to ICC inspection, and there is not too much deviation that you can have for any type signal system; and this applies from the CTC to an automatic blocked, manual blocked crossing gates, and so forth.

K. E. Dunn

Q. Mr. Dunn, we are talking about condition per cent of new of this equipment. Now what does the ICC inspection have to do with the condition per cent?

A. If the carrier is qualifying and satisfying all of his signal inspections, he cannot have, for example, a twenty per cent condition new because *it's* capacity, based on new capacity, would be in what in my category would be good condition or fair to good.

Q. How many signals did you actually stop and examine closely?

page 765 } A. I do not recall the number, but I looked at all of them when we made stops to get into the clear or while we were waiting for a man to go to the telephone to get us further clearance.

Q. Tell us exactly what you did when you examined the signal closely as distinguished from just riding by.

A. I looked at the type of signal, whether it was color-light, color-position, or in the case of a branch line, whether it was just a block signal, the manufacturer, whether it was union switch, or GRS. I looked at the switch machines to see how modern they looked to be. Most of them were Model Fives or equal, and it was all based on inspection—

Q. You made no—

A. —just what I saw and related to my experience of having done the same thing on the Central.

Q. You made no detailed examination of any particular signal, did you?

A. No, I did not open any boxes or look at the relays or determine that the point clearance was so much, or anything like that.

page 766 } Q. What sort of work papers or records did you keep of your signal inspection?

A. I do not have any particular—

Q. You do not have any work papers or records?

I believe your testimony contains a statement about the branch lines, yards and sidings, that they were well maintained also. Do you remember that?

A. I do not recall where it is, but I do feel that way right now.

Q. Yes, and what do you mean by saying that they are well maintained, with relation to what?

A. Well, shall I say with relation to a common practice that many carriers find themselves in a position that because of the necessity to maintain their competitive position that they have to put a lot of money on the main tracks to the exclu-

sion of what an engineering officer might think is required for side tracks, yard tracks.

Q. Now, did you examine the Company's yards at Norfolk?

A. Oh, yes.

Q. On this trip?

A. Not on this trip, earlier.

Q. How about the yards at Roanoke?

page 767 } A. Just at one or two locations.

Q. And about the yards up at Norton, did you see them?

A. Where?

Q. At Norton, Virginia.

A. No, in most places I was able to get a good opinion of the percent condition of the rails by inspection. The ties I could not see nor did I have time in the inspection to make a detailed analysis of the ties. So what I did in my per cent condition for side tracks, I divided them into two groups because based on my inspection their major yard tracks and all of their sidings were in better condition for ties than probably were the side tracks; So I applied a, I *beieve* it was, twenty-five per cent. I used a low figure so that I would not distort my overall tie condition.

Q. In fact, you saw very little of the yards of the Company though as compared to the main line you went over, isn't that right?

A. No, that is not correct. Again I am speaking from experience now—

Q. Well, I am talking about what you saw, not

page 768 } your experience.

A. All right, yes. And from what I saw the yard tracks generally have been relayed with heavier rail. Many carriers are still forced to use eighty and ninety pound rail in yards. Most of N&W yard tracks are with heavier rail, a hundred and thirty.

Q. But you do not know anything about the rail in the Norton yard, do you? You didn't see that?

A. As I say—

Q. You did not see that?

A. Right, and for—I divided all of the yards and sidings into two groups, and I estimated the number of miles that I knew I had reasonably seen and that I took to be four hundred miles; and that is the four hundred miles in my report. All of the others, which was maybe seven hundred miles, I used minimal figures so that I would not distort; and I did not at any time see any conditions in any track that would be

what I would call an over-all poor condition that would contribute to a derailment.

Q. But you did not actually see the yard at Norton? You saw something of the yards at Roanoke, not the whole yard?

A. Not the whole yard.

page 769 } Q. And you saw the Norfolk yards in 1968 for another purpose?

A. That is correct, and I saw Crewe also.

Q. Now on page ten, you talk about engineering, I believe, and you state the condition per cent of the engineering on the Norfolk and Western is one hundred per cent. Now isn't it true that a great part of this engineering was performed many years ago?

A. In this case, it all was.

Q. And is it your position that the value never deteriorates or depreciates?

A. In this case, I was perhaps arbitrary. The common practice in applying per cent condition to a reproduction cost new is not to put any depreciation on engineering, and I did not in this case. The hundred per cent there—because of the amount of engineering is so small in comparison to the total, it does not distort, in my opinion, it does not distort the weighted average.

Q. But it is true, isn't it, Mr. Dunn, that engineering has no value unrelated to the property to which it was devoted?

It is not like a rail you can take up and take

page 770 } out?

A. No, I thought I said that in normal cases when a reproduction cost new less depreciation is computed, engineering is not depreciated; so I was following that, shall we say, basis.

Q. But I say in fact though it has no value unrelated to the property to which it has been devoted, has it?

A. Oh, if—

Q. You cannot use it again.

A. Well, now, wait a minute—I'm sorry.

Q. It's a difficult concept.

A. When you say does it have value—

Q. Yes.

A. —we are talking here about a per cent condition.

Q. That is true.

A. I could not see any engineering. Therefore, I do not know whether, as far as condition per cent is concerned, whether it has a condition per cent.

Q. This is an arbitrary hundred per cent assignment by

you because of the ICC Accounting Methods, is
page 771 } that right?
A. Yes, Sir.

Q. Now, Mr. Dunn, on page twelve, you refer to the line and surface as an "element of value"; but I believe you say, isn't it true, later on that would be true only where a railroad has a "going-concern value"?

A. In my evaluation of condition per cent, I made no determination of "going-concern value." I was strictly looking at the track and its condition as a track.

Q. And then on page twelve, when you were asked the question, "In an appraisal of railroad property, would line and surface be a factor in determining the fair value of tracks," and you say, Yes."

A. Insofar as the condition per cent is concerned—

Q. And the question—

A. —of a track as a structure.

Q. And the question that precedes that was—"Do line and surface represent an element of value?", and you say, "Yes."

A. An element of the track, I mean when you
page 772 } say value in the sense of a condition per cent,
they do have a value. Now in my definition of line and surface which is a—

Q. Yes.

Chairman Catterall: What does line and surface mean? I am not familiar with that.

Mr. Epps: Read the definition for that.

A. Let's see. It is on page—I am trying to stay with the glossary of the American Railway Engineering Association, and line is defined as "the condition of the track in regard to uniformity in direction over short distances on tangents, or uniformity and variation over short distances on curves." Surface is "the condition of the track as to vertical unevenness or smoothness."

Simply stated it means there is a track like this (indicating), or there is a smooth uniform structure.

Chairman Catterall: If it looks like a roller coaster, it would be less valuable than if it was smooth?

A. I am not talking about dollar value here. I am talking about a value of condition per cent. Certainly if it looks like
a roller coaster, its per cent condition is not as
page 773 } good as one that has just been built and was absolutely smooth and to a good alignment, a good line. This is what I mean in this case.

K. E. Dunn

Mr. Pasco:

Q. And you are attempting in your testimony to place no opinions of—no value on this line? You are only talking about condition per cent of new, is that right?

A. Yes, Sir.

Q. And yet you answer yes to the question, Does line and surface have a factor? Is it a factor in determining condition per cent, which you interpolate value condition per cent.

A. I just thought I would qualify that.

Q. And you said yes. Now this would only be true if you are going to use it for a railroad, isn't that right?

A. The line and surface?

Q. Yes.

A. As a part of the track, yes.

Q. But as you say further down, if it is dismantled, the line and surface would be destroyed, don't you?

page 774 } A. Yes. If the question would the value assigned to line and surface, meaning again this per cent condition.

Q. Per cent condition.

A. Would that be in addition to the per cent condition of the rails and the ties, and so forth, the OTM for salvage or scrap, but if you had dismantled it, then there is no line and surface.

Q. There is no line and surface. That is right. I think we understand each other now, Mr. Dunn.

Chairman Catterall: You couldn't sell it to a junk dealer, but you could sell it to the Highway Department if it happened to be useful in their highway arrangement.

A. This, I am not qualified in this instance to—

Mr. Pasco: The line has to do with the degree of conformity to the plan that the rail, as laid, achieves. Is that right?

A. Well, let me just—

Q. You tell us again.

page 775 } A. —may I make one statement. In the beginning, line is not alignment. Now, if we say alignment, this means that you are starting from Roanoke and go around a ten degree curve and you go fourteen miles and then you go around another curve. Now, line is over short distances, because we'll say if you operate trains at fifty miles an hour and the line is smooth, the train will go around the curves all right, but if the line is irregular

over a short distance you will start swaying the cars and perhaps have a derailment and this is the line that we are talking about.

Q. Yes, surface is the level of the ballast and ties.

A. The surface is the unevenness of the rail cross level on a curve—elevation.

Chairman Catterall: That is what makes it impossible to run these new metro-liners to Boston at their full capacity.

A. The best—

Chairman Catterall: What you describe as the condition of the road bed that limits the speed at which these high speed trains can operate, is that what you are saying?

A. In order to accommodate the metro-liners, for example, the Central, prior to this time, tried to put a jet on a Budd rail car and they got the speed up to—oh, we'll say a hundred seventy miles an hour, but in order to do that

page 776 } they have to make sure that the condition of the track, insofar as line and surface, is as absolutely in this per cent condition. It has to be ninety to ninety-five per cent and it cannot get down below that or the ride would become uncomfortable.

Chairman Catterall: And that is why you say you are speaking about short distances and not the entire distance.

A. Yes, Sir.

Chairman Catterall: I think I understand.

Mr. Pasco:

Q. Isn't it true, Mr. Dunn, that their brand new rail can be poorly laid and result in poor line, just as well as used rail?

A. It could be, yes, Sir.

Q. So line and surface does not necessarily have anything to do with the life left in the piece of rail track structure you are looking at?

A. What I did was place a per cent condition on the line and surface, which is a per cent condition of the entire assembly; what each rail or each tie might have been in its per cent condition was another judgment.

page 777 } Q. I see. Now on the bottom of page eleven, I believe, you give some statistics as to the amount of money spent by United States Railroads, in maintaining their tracks, and you list for track laying and surfacing two hundred twenty-seven thousand, eight hundred twenty dollars, millions, I guess.

K. E. Dunn

Mr. Epps: Yes, that is right.

Mr. Pasco:

Q. Now, is all of that category devoted to line and surfacing?

A. No, Sir, that is putting in ties, laying rail—

Q. Right.

A. Yes, Sir.

Q. Then your next conclusion isn't necessarily true then, on the next page, that there is a greater—amount of money spent to maintain line and surface is much greater in relation to the other expenditures than is the relationship of account twelve to the other accounts.

A. No, that statement is true.

Q. What figure do you use to make that comparison if the two hundred twenty-seven million contains other

page 778 } items than line and surface?

A. I did not spell out any other factors here, but if a track is built, the cost of the ties and the cost of the rails—cost of the OTM surface and the ballast and track laying and surfacing are relatively in equal amounts. I am broad brushing a little now. In other words, ties may be one fifth of it, to build the track would be one fifth of the cost, the rails would be a fifth of the cost, and so forth. But in order to maintain the tracks in the United States, the track laying and surfacing is so much more than one fifth of the other items that I am merely expressing that to show the carriers do spend, and including the N&W, a high amount of money to keep proper line and surface for the track, because it tends to get out of line and surface from operating conditions.

Q. But you concede that this category of track laying and surfacing isn't all devoted to line and surface? Did you determine what portion of it was devoted to line and surface?

A. I am using a—I still say my statement is correct—that the account twelve in any track construction job is much less in percentage than the amounts of money

page 779 } it costs to take care of the railroad after it is built. I mean—this is all I am saying.

Q. That is what you are saying and the conclusion that you reach after citing these figures?

A. Yes.

Chairman Catterall: The Commission will recess ten minutes at this point. 11:19 A.M.

11:29 A.M. The Commission resumes its session.

Mr. Pasco:

Q. Mr. Dunn, if you would refer to the bottom of page twelve and the top of page thirteen of your direct testimony, I believe it would facilitate the questioning. You list the number of lines of railroads that Coverdale and Colpitts have appraised and then you list three that you have appraised, that you personally took part in. I take it then that you have no personal involvement in the other appraisals, is this right?

A. I was personally involved in the New Haven railroad and the Susquehanna.

page 780 } Q. How about portions of the Lehigh Valley?

A. I did that while I was associated with the division of Day & Zimmerman in Philadelphia.

Q. Then you had nothing to do with the Spokane, Portland and Seattle Railway appraisals?

A. That is correct.

Q. Or the Lehigh and Hudson River?

A. That is correct.

Q. Or any of the other lines listed in the answer to your question at the bottom of page twelve and the top of page thirteen?

A. That's right.

Q. Except the ones you mentioned previously.

A. Yes.

Q. Now you made it clear in your testimony before the break, that you were employed to determine the condition per cent here. I note, however, on page thirteen that you are asked some questions about fair value and fair market value. Have you in any appraisal of railroad property which you have undertaken ever been asked to determine the fair market value of the property exclusive of its franchise or the "going concern" value?

page 781 } A. The portions of the Lehigh Valley and the CNJ and B&H, and these were all situated in Wilkes Barre. At that time I made a reproduction cost new less depreciation appraisal of those tracks. Does that answer your question? I am not sure that I followed, but if—but I did make in that case a reproduction cost new less depreciation.

Q. But that isn't necessarily the fair market value, is it—I say necessarily

A. It is a value that I, as an appraiser, arrived at after

inspecting the tracks and computing the reconstruction (sic) cost new less depreciation.

Q. But my question was whether in any of your engagements to determine—

A. Me, personally? No

Q. —fair market value. If you have been asked to determine the value exclusive of franchise in any of the engagements that you have undertaken.

A. That is correct.

Q. You have not. Now, you state on page thirteen that the highest and best use of the Norfolk and Western is as a railroad in place, with proper line and surface capable of bearing locomotives and railroad cars.

page 782 } A. Yes, Sir.

Q. Isn't what you are saying is the highest and best use is that a part of a going railroad operation?

A. No, I do not think so.

Q. What are you saying then, when you say that?

A. I am saying that the highest and best, just as I said there—the highest and best use of the track would be as a railroad in place, with proper line and surface to haul cars. I mean that, and nothing more.

Q. Suppose you did not have a franchise to operate this property as a railroad?

A. I take no consideration of franchise in my statement.

Q. Well, what would be the highest and best use of the Norfolk and Western if you did not have a franchise to operate as a railroad?

A. I do not know.

Q. Now, at the top of page fourteen, you state that you did not make any attempt to place a value on the franchise of the Norfolk and Western and you just reiterated that. Did you attempt to place a value on anything in your examination of the railroads?

page 783 } A. I did not.

Q. You did not. Now, you state on page fourteen, I believe, at the bottom, that the uniform conditions existing on the Norfolk and Western tracks is better than most other carriers achieve. I take it this means you purport to be familiar with most of the Class One carriers in this country.

A. With quite a few of them, I personally visited their properties and rode their track.

Q. You have some testimony here, Mr. Dunn, about the

slow orders or about the absence of slow orders and the significance of slow orders on the railroad in your determination of condition per cent. In addition to slow orders, did you examine the time tables, operating time tables of the Norfolk and Western to determine what permanent speed limitations they had?

A. Yes, Sir.

Q. And they would be as significant as the slow orders in indicating condition per cent, would they not?

A. No, I do not think they would be. A slow order indicates that a condition has arisen in the condition per cent of the track that is undesirable and generally

page 784 } the railroad will take whatever steps are necessary to eliminate the slow orders. It would detract from an overall condition per cent.

Q. But you could have a railroad with no slow orders and a permanent speed limit of five to ten miles an hour—

A. Yes, Sir.

Q. —which would indicate very poor condition per cent, wouldn't it?

A. It would indicate there are certain conditions that make it desirable to run only fifteen miles an hour.

Chairman Catterall: That would be a slow order applied to the whole plant, wouldn't it, if they couldn't go over ten miles an hour.

A. Yes, Sir, if that was—

Mr. Pasco:

Q. Then that would indicate that the permanent speed restrictions on a railroad might give some indication of its condition per cent, as well as the slow orders.

A. Well, that is a blanket statement. You have never—I have never known any carriers on its main line,

page 785 } we'll say, to carry a—to reduce its permanent speed, we'll say, to thirty or thirty-five miles an hour, rather than sixty-five or seventy, just to avoid increasing the per cent condition of their tracks. Now, a branch line where the distance of—that you have to go from a—say, from a coal mine to the marshalling yard may be three and a half. If you had the railroad maintained for seventy miles an hour, you're wasting money because you could not obtain the benefit of that expenditure, so you would say, well, twenty miles an hour is fast enough.

Q. Then you've got to look at the reason behind these per-

manent speed restrictions to determine whether or not they indicate—

A. The time table itself—

Q. —a condition per cent or whether they indicate some other reason.

A. The time table itself does not tell you the condition per cent.

Q. It does show the permanent speed restrictions

A. It shows the—

Q. Maximum speed permitted.

A. It shows the—well, we'll say yes, the normal

page 786 } speed over a stretch of a division where the railroad has determined that the results from operating at that speed are satisfactory for what they want to do.

Q. If those are particularly low, you ought to investigate the reason before you conclude what the condition per cent is.

A. I am not sure that I am following you in this case, because let's say coming from a coal mine to the top of a hill, bringing train loads of coal from the mines to Roanoke, there would be no point in having a seventy miles an hour railroad in there because you could not afford the money to put power on it to haul the coal seventy miles an hour, so you say, well, we'll go thirty-five miles an hour because of the grade. This is another factor. It has nothing to do with the per cent condition of the track at that point.

Q. Now, Mr. Dunn, on page sixteen you undertake to express an opinon as to so-called minimum cost, I believe the words you used, of constructing a theoretical mile of side track. I want to make sure of this so there is no confusion that you are talking about cost of construction here and not the market value.

page 787 } A. Yes, yes. And that is not the entire cost.

Q. Surely. I understand.

A. I have only picked out a couple of items.

Q. And you are expressing no opinion as to the fair market value of any parts of the Norfolk and Western Railroad, are you?

A. That is correct.

Q. Now, in your opinion as an expert appraiser, do the words "cost" and "fair market value" have the same meaning?

A. In my opinion, cost means the expenditure of money required to acquire something or build it or buy it. Fair market value indicates the value that I might receive if I were selling something.

Q. So those terms are not interchangeable, are they?

A. As we talk right now, they are not.

Q. Right. Now on page sixteen you state you made no determination of the percentage depreciation of the rail of the Norfolk and Western and then in response to a question you expressed the view that the sixty per cent depreciation found by Mr. Caywood, after extensive investi-
page 788 } gation with ties.

A. Yes, Sir.

Q. Now, I understand this is simply your personal, off-hand opinion from observation and not the result of any depreciation studies. Is that right?

A. What I was determining is a per cent condition. Now looking at Mr. Caywood's testimony, he has combined per cent condition with depreciation and this I was not concerned with.

Q. But when asked if you thought sixty per cent was right, you said you thought it was higher.

A. I do. Yes, Sir.

Q. But that is just your personal opinion and not the result of a depreciation study, is that right?

A. It is more than that because I looked at some of the explanations that he gave for basing his opinion as he did and I did not agree with his assumption.

Q. But you made no independent study of the depreciation of the Norfolk and Western?

A. No, Sir, because depreciation does not enter into per cent condition.

page 789 } Q. Right. The condition per cent that we have been talking about is the condition per cent of the new—of the track.

A. Exactly. I am using the glossary of the AREA.

Q. Now, just to clear up one statement on page seventeen that confuses me. You testified, as you will note, on page six that you made no statistical averages in arriving at your opinion as to condition per cent. But then on page seventeen, you state that you were asked about your various computations and whether they included franchise values. Now, I want to know what computations you are talking about there.

A. Computations that I made in this study were to weigh the various per cent conditions and I did similar computations to get per cent condition by districts or lines, as indicated in Exhibit No. 1 and also Exhibit No. 2 contained computations.

Q. Those are the computations you are referring to then?
A. Yes, Sir.
Q. Do you have any work papers on which
page 790 } those exhibits were based?
A. Do you want to see them?
Q. Yes, I would like to see them just a minute, please.

Note: Witness passing work papers to Mr. Pasco.

Mr. Pasco: I don't believe I have any questions about these, but if the Commission please, we would like to tender these as the next exhibit, or photo copies of them.
Chairman Catterall: They will be received as Exhibit No. 20.
Mr. Epps: We would like—well, these belong to this gentleman. They may want to copy them.
Mr. Pasco: Well, I said photo copies.
Chairman Catterall: Do you know of any further use of these things as to this case?
Mr. Epps: I don't know, Sir. He may have.
A. I, personally, well—
Mr. Epps: There is no objection to having a copy filed.
Mr. Pasco: I understand. We'll make up the
page 791 } proper copies.
Chairman Catterall: Are you going to make some Xerox copies? Do you want the originals back?
Mr. Epps: Yes, Sir.
Chairman Catterall: Will somebody make Xerox copies of these?
Mr. Epps: We can get that done.

Mr. Pasco:
Q. Now, Mr. Dunn, on page seventeen you were asked what was your observation of the manner in which the Norfolk and Western is being maintained and your response was a high grade. High grade in comparison to what?
A. Well, I am speaking there of the grade of productivity and effort they get from the personnel that were out on the track. Their uniformity is such that when I went from one point to another, I could not tell that—well, now, here is a poor supervisor—now, I can do that on many railroads, but you have certain of the lines' staff that are not as good as others and it takes a considerable amount of effort on behalf of the management of the carrier to get a uniform expenditure of money, because most anybody can say, "well, there

is a poor tie. I am going to take it out," but maybe you don't have to take it out today. Maybe you can wait page 792 } until six months from today.

Q. Then you would,—in giving the characterization of high grade, you were not comparing it to the other carriers, then.

A. Well, I am in a sense, as I said, I could go on other properties and see where there is over-maintenance.

Q. You found no over-maintenance on Norfolk and Western, did you?

A. I did not find any money being spent needlessly, no.

Q. Now, bearing in mind your finding of high grade, I want to ask you about two pictures that Mr. Caywood exhibited with his testimony. First, Exhibit No. 30 page two, picture number four. You have that, I believe.

Mr. Epps: What is the exhibit number?

Mr. Pasco: Thirty.

Mr. Epps: Number thirty.

Mr. Pasco: The picture in the lower right hand corner, I believe you said you saw the Radford branch, the Abingdon branch. Is that a picture of high grade main- page 793 } tenance in your opinion?

Mr. Shannon: Which one are you looking at, Mr. Pasco?

Mr. Pasco: Lower right hand.

A. Levisa branch?

Mr. Pasco: Abingdon branch.

Q. I ask if you would characterize that as high grade maintenance?

A. Yes, I would say that their analysis of the expenditures that are necessary to keep up the Abingdon branch are very high grade. That rail in there, incidentally, is 1909 or 1916. It is very old and they are getting their money's worth out of it. They are not spending any more money there than they have to.

Q. And then, in Exhibit No. 35, page two, the Buchanan branch, the lower right hand picture.

A. Same question?

Mr. Epps: Lower right?

Mr. Pasco: Yes.

Chairman Catterall: Is that eight per cent you are looking at?

Mr. Pasco: Yes, Sir.

A. From this picture I cannot determine that this is a main track?

Chairman Catterall: Looks like an abandoned

page 794 } spur.

A. It says spur and this leads me to believe this is a side track.

Q. You didn't see many of these spurs and lesser branches, did you Mr. Dunn?

A. No, but as I said, on all the side tracks which would include these, I used a minimal per cent condition for the ties.

Q. Now, I do not believe your work papers showed and if you need them, you can wait for this question until they come back and maybe you can answer without them—Show how you weighted the various components on Exhibit No. 2 of your testimony. I wonder if you could tell us without your work papers.

A. On my Exhibit No. 2?

Q. Yes. You end up with sixty-four as a weighted average. I am wondering if you will tell us how you weighted these various components to come up with the weighted average. What method or what system did you use?

A. I took the book values that were furnished to me by the State Commission and whatever the dollar value was, I multiplied it—in the case of the engineering, by one hundred,

because I did not depreciate that.

page 795 } The values for grading I multiplied by seventy-

five, and so on down, and divided it to get the weight—the weighted average of all the components and that is on that yellow sheet.

Q. It is on the yellow sheet?

A. Yes. I am sure you will find it there.

Q. Right, Sir. Just, I believe, one final question. The first question on page four—

Mr. Epps: This was his testimony, Mr. Pasco?

Mr. Pasco: It is his testimony. It is fairly important, I think, for this Commission to know what limitations, if any, were existing when you were asked to make an assessment of the reasonableness of the Commission's assessment and when I asked you about that earlier, I believe you said you were not present and that one of the senior partners—but I believe a fair reading of that answer on page four

would indicate that you said, "we discussed the case generally with them and pointed out the limitations imposed on any sort of study we could make in the time allotted." Now, I understood your answer later that you were not in on that discussion and I just wanted to be sure
page 796 } this is what you said.

Mr. Epps: I don't believe he said that, Mr. Pasco. I think he said that the principal discussion was with his senior partner and I don't think he indicated that he wasn't present, but that the finances were handled by somebody else. I think that is what he said.

Mr. Pasco: All right, Sir, I thought he said he was not present.

A. Oh, no, I came in—I was not there at the beginning. I was there at the time Mr. Gerlach was there, for example. I came in later. Now, I don't—

Q. Then this "we" is used generally and you have no recollection of the discussions about the limitations, is that right?

A. I do not know what the entire discussion consisted of.

Q. You did not discuss with your partner any limitations as to making this investigation?

A. The limitation was, I would say, in the amount of time that was available. We had to do this before March 15 or whatever it was, the deadline which would preclude maybe looking into each and every track.
page 797 } Q. Which would be necessary to determine the reasonableness of the assessment.

A. No, Sir. No, Sir. I feel fully qualified that I can look at a property and determine its per cent condition.

Q. I am not talking about per cent condition. I am talking about the job you did not do. This testimony, I believe, relates to the reasons why you could not undertake the job of determining the reasonableness of the assessment.

A. All I can say is—

Q. And you say you explained the limitations and I am just trying to get what these limitations were.

A. All I recall is that it was a time limitation.

Q. You didn't have time to do what you thought would be necessary to form an expert opinion—

A. If we were—

Q. —to the reasonableness of this assessment?

A. If we would have to go into the reproduction cost new, for example, no, there was not enough time to do that.

Q. Yes.

page 798 } Chairman Catterall: Well, also he didn't have enough money to pay for a reproduction cost, is what it is. It was time and funds and they are both important.

Mr. Pasco:

Q. One final point I want to endeavor to clear up and that is the location of these estimated number of bridges that you stopped at. Did you end up eventually by testifying your record will not indicate which bridges—

A. Frankly, I could look at my notes and probably pick out a mile-post, which I know there is a bridge common with the mile-post. I have many notations on here of bridges and their condition, where we did not specifically stop, get out of the car, walk up and down the track on the bridge and that is—

Q. You have to examine all of the track charts of the company and mile-posts you stopped at to determine whether or not you saw a bridge while not moving—Is that what I understand your testimony to be?

A. I do not have a set of their charts. My notes are on the time table.

page 799 } Q. And they don't indicate which bridges you stopped at?

A. That is correct. I did not specifically do that.

Mr. Epps: Is this the last, final question you were telling us about, Mr. Pasco?

Mr. Pasco: The last subject matter.

Mr. Epps: Oh, I thought you said you had one more question.

Mr. Pasco: But I had not consulted my colleagues.

Q. Are those time tables that you have there and the notations on them all of your field notes—

A. They are, Sir.

Q. —so far as your inspection is concerned.

A. Yes, Sir.

Chairman Catterall: Next year you must make a list of all of the bridges, so you will be prepared to identify them.

Mr. Epps: We will do it.

Mr. Pasco: Just a minute, if your Honor please.

Q. Do your notes on those timetables indicate the classifications you put on the various parts of the track
page 800 } that you stopped at—good, fair and poor?
A. Yes, Sir.

Q. Could we see those for a minute before we finish and then I think we will be through.

A. Sure.

Note: Above-mentioned notes are handed to Mr. Pasco at this time.

The Roanoke terminal is shy. I should not have given you that.

Mr. Pasco: Right.

That is all. No further questions.

We will return these to you.

Chairman Catterall: Mr. Shannon, do you want to ask any questions?

Mr. Shannon: Yes, Sir, I will try to be brief your Honors. I have a few questions here I would like for Mr. Dunn to clarify for me.

page 801 } CROSS EXAMINATION

By Mr. Shannon:

Q. Mr. Dunn, you mentioned signals. What is CTC?

A. CTC is a form of operating a railroad, whereby a modern system of signals—a greater capacity of the tracks is obtained. Years ago in a double track railroad, the signals were only capable of accommodating traffic in one direction. On tracks in the east where you have multiple three and four track sections of the railroad, it was found that—and it is an economic matter—it was found that it is more economical to put centralized traffic control, which is what CTC stands for, into effect, which in a sense means that you signal each track in both directions so that the signal expense goes up double over a single track and of course one track is released.

Q. It is a pretty elaborate system, is it not?

A. Yes, it is sophisticated, but it is economically desirable at the present time and most carriers adopt that.

Q. How about—

A. It does have limits. It takes perhaps twelve
page 802 } to fourteen operations a day over a particular section of line before it is economical.

K. E. Dunn

Q. Can it be controlled from one central point, Mr. Dunn, by the train dispatcher?

A. CTC itself generally is controlled from one point.

Q. Now, Mr. Dunn, what is an interlocker?

A. An interlocking is an arrangement of signals at some point where there is a diversion or railroad crossing with another branch or foreign carrier where the arrangements have to be positive insofar as the signals are concerned, that one carrier's train does not get precedence over another and causes collisions, causes a derailment. An interlocking signal specifically, if it says stop, it is a positive stop. Now an ordinary red signal out on the right of way is always a permissive signal. This means that the train stops and then he may proceed at fifteen miles an hour. It is not a positive stop.

An interlocking signal is a stop and stay.

Q. Is interlocking necessarily tied into CTC?

A. Sir?

Q. Is an interlocking system necessarily tied
page 803 } into your centralized traffic control?

A. Yes. The signals at the end of sidings are all interlocking signals.

Q. Mr. Dunn, you said something about the Interstate Commerce Commission making periodic checks of the signal system. Are they spot checks made by ICC inspectors?

A. Well, ICC inspectors do make spot checks and they make periodic checks. The carrier, itself, makes certain prescribed reports every month of the number of, for example, fail safes that occur is reported to the ICC. Signals as opposed to track does have restrictions that are beyond the carrier's power to determine. In the case of track, each carrier determines what its own standards will be.

Q. Mr. Dunn, you mentioned something about rail. What is your conception of the life cycles of rail?

A. Well, normally the amount of relay rail that is required determines how much new rail a carrier will buy and apply, with the provisor that an adequate amount of relay rail is not available on the open market. When a carrier needs relay rail, they generally obtain it from the removal of rail which has been laid new in their primary main tracks.
page 804 } Thus they get the benefit of the new rail for as long as possible in its first cycle in the main track and then after removal to a branch line, it can be used for an indefinite period in its second location.

Q. Then actually you could have rail taken out of, say, the

Norfolk and Western main line and put in the Shenandoah division.

A. Yes.

Q. And then, subsequently, it could be taken from the Shenandoah division and put into some branch line where the traffic density would be less. Is that correct?

A. Generally, rail for yard tracks comes from the second cycle of usage.

Q. What did you observe—anything perculiar or particular about Norfolk and Western's yard and side tracks?

A. Well, as I mentioned before it was my opinion that they had a much higher percent. I am not talking about condition per cent now, but they had a much higher ration of heavy rail sections, one hundred thirty and one hundred thirty-one pounds, in their yard as compared to eighty pound rail that most other carriers have in their yards.

page 805 } Q. Mr. Dunn, please refer to your Exhibit No. 1 if you would please, Sir. Now, Mr. Pasco took you over these branch lines on Mr. Caywood's Exhibit No. JAC 2. I have been trying frantically to find these lines in the operating time tables. Are all of these branch lines reflected in the operating time tables that the N&W furnished your prior to making your inspection?

A. They are not designated by miles and in some cases by names such as are indicated on Mr. Caywood's exhibit.

Q. For the most part, then, they would be just short spurs or branch lines, is that correct?

A. They are spurs and connections.

Q. Now, based on your knowledge of how N&W is maintaining its tracks, wouldn't the fact that you did not actually, physically inspect all of these branch lines shown on Mr. Caywood's exhibit have little effect on your overall conclusions as to the per cent condition of the N&W's lines?

A. That is correct. Their mileage is much less in proportion to the miles of track that I did see directly from the high rail car and in most cases where there was a branch line and we were able to look down the track, I

page 706 } did ask the engineer, I said, "Is the balance of the line about the same?" And he would say, "Yes, about the same."

Q. Mr. Dunn, approximately how many miles of N&W's line—

Mr. Pasco: If your Honors please, I think that last answer should be stricken, as it is pure *heresay.*

A. O. K. I'll take it back.

Chairman Catterall: Well, it is a statement by the agent of the plaintiff. Surely, that is not *heresay*. Any admission is admissable per se.

Mr. Shannon:

Q. Mr. Dunn, let me ask you this question, if I may. How many miles of railroad—of N&W's railroad did you cover, approximately.

A. I would say twelve or thirteen hundred miles.

Q. Is that road miles?

A. I would say at least that many road miles.

Q. And there would be considerably more track miles then to the extent that they had double track. Is that right?

A. That is right.

Q. Did you all work on Saturday and Sunday?

page 807 } A. We did.

Mr. Pasco: Eight days. One Saturday and one Sunday.

Mr. Shannon:

Q. Now, would you please refer to Mr. Caywood's Exhibit No. 20. Do you have that there, Mr. Dunn? I believe that is JAC 20.

A. Yes.

Q. Now, if I understand this exhibit correctly, about half-way down he shows headwear of one eighth inch and then he shows a per cent there under the column headed tangents and curves, under two per cent of eleven per cent. In your opinion, Mr. Dunn, is this a reasonable percentage?

A. It is not.

Q. Why.

A. 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. It is certainly not in eleven per cent condition.

Q. Now, hasn't Mr. Caywood in effect here and throughout his testimony which I believe you said you had read, hasn't he mixed percentage condition and depreciation?

page 808 } A. He has and I believe he so states that the per cent condition is a combination depreciation plus per cent condition.

Q. Then as the condition percentage of the rails as they

exist in the tracks—is that consistent with the condition percentage shown as Exhibit No. 24, I believe it is?

A. In my opinion the forty per cent condition that he shows is too low for the per cent condition of the rails as they actually exist in a track as I saw them.

Q. Yes. Now, Mr. Dunn, let's go back to JAC 20 a minute. If you look at the bottom of that—of those columns, you see figures one varying on up to a hundred, but I am primarily concerned about those percentages, say, one up to twenty. After looking at the various percentages one through twenty, do you agree that it is possible to determine such a precise percentage from observation?

A. I think that such a fine percentage cannot be derived either from observation or measurement.

Q. Even if you use measurement, you could not refine it down, don't you agree?

page 809 } A. No, what I am saying here is we can certainly have a zero condition per cent for a tie, meaning that it is a fail. This might, in my observation I did see failed ties and there are certainly some in tracks, but the uniform condition which the Norfolk and Western maintains doesn't permit, we'll say, five failed ties in a row because that might contribute to a derailment. Now, on rails—I do not recall seeing any rails in the main tracks particularly where I would say the condition per cent ever went below twenty. Now, this is a judgment factor of mine, but I think that basing an opinion on the limiting conditions that the N&W have which are in another exhibit here, when they *extablished* these limiting conditions they leave a margin of safety in there and that in no case do they ever intend that rails could be left in tracks down to a one or two or three per cent condition.

Q. Then, it is your opinion that you would never have a zero per cent condition. Is that right?

A. If a rail had a zero per cent, then it is not a rail. I mean it would cause a derailment.

Q. Well, then, Mr. Dunn, if a rail were in a maximum per cent condition, it would be a hundred, would it

page 810 } not? You could have a brand new rail and it would be a hundred per cent. Then if you had a twenty per cent condition, the average would be of the two, wouldn't that be sixty per cent?

A. It would be.

Q. Is that a fair way to—

K. E. Dunn

A. Well, I am not saying that that's how I arrived at any such—

Q. No.

A. I put down the condition per cent based on exactly what I saw and as I say I did not see any that I considered were less than twenty per cent. Therefore, the median had to be some place in between, as a condition per cent, not taking into account any built-in depreciation which would draw the condition per cent, as expressed here down. That brought it down, you see.

Q. Now, when you were talking about condition per cent, and I think you said that overall condition per cent of the N&W was sixty-four per cent, is that correct?

A. Yes, Sir.

Q. That is per cent of new, is that right, Mr. Dunn?

A. Per cent condition as defined in the—in page 811 } here (indicating.)

Q. Yes, Sir.

Mr. Shannon: Just one final question or two and I will be through, your Honors.

Q. Will you refer to Exhibit No. JAC 15—Mr. Caywood's Exhibit No. 15. Now, this is entitled "Norfolk and Western Railway—Limit of Rail Wear and Gauge for Measuring 130 Lb. P.S. and 130 Lb. R.E.H.F. Rail." To the uninitiated, is this showing the vertical wear on the rail or am I in my uninitiated way—am I asking—properly describing what this shows?

A. It does show vertical wear and it shows lateral wear.

Q. Well, now, do you think Mr. Dunn that there is a reasonable per cent condition remaining in a rail which would provide a factor of safety when you get down to a point where you have a reasonable percentage remaining, it has a more or less, a built-in safety factor?

A. Yes, I would say you have to do that to avoid derailment.

Q. What would that factor be, percentage-page 812 } wise?

A. In my setting of the numerical values for good, fair, and poor, I used a value of twenty per cent on rails when it was in its poorest condition.

Mr. Shannon: That is all I have, your Honors.

Mr. Epps: Just a few questions on re-direct.

K. E. Dunn

RE-DIRECT EXAMINATION

By Mr. Epps:

Q. Now, Mr. Dunn, there has been something said about the—your Commission and the original negotiations and limitations and you indicated that time was a factor, but there was at least one other factor, wasn't there?

A. Money. Yes, Sir.

Q. And I believe that there was some correspondence on the subject between your firm and the Counsel in this case?

A. Yes, Sir.

Q. Probably not in your file, because it wasn't directly concerning you, is that correct?

A. No, I do not have that.

Q. All right, Sir. Now, Mr. Pasco inquired about a liquidation study you made. You did not make a liquidation study of the Norfolk and Western road, did you? This
page 713 } was not a liquidation study, was it?

A. No, Sir.

Q. You are not advised that Norfolk and Western is about to be liquidated, are you?

A. No, Sir.

Q. Now, would you tell us the details to which your studies of the Norfolk are of the Norfolk and Western went. Is this a detailed study or was it a cursory study?

Chairman Catterall: This doesn't sound like re-direct.

Mr. Epps: It doesn't? Sir, I thought it was. Direct, re-direct.

Chairman Catterall: That is a new term in the law.

Mr. Epps: Directly flowing re-direct, Sir.

Chairman Catterall: Re-direct is to answer what has been brought out on cross-examination.

Mr. Epps: Exactly. He asked him about what he did in Norfolk and I am trying to ask him to determine the same things. He asked him several times what was his experience.

Chairman Catterall: I thought that was part
page 814 } of his direct testimony.

Mr. Epps: No, Sir, no, Sir, it was Mr. Pasco who asked him about Norfolk and I was just clearing up what I thought may have been—

Chairman Catterall: You want to make it sound better for the witness, then.

Mr. Epps: I want to make it sound better than Mr. Pasco does.

Chairman Catterall: Well, go ahead.
A. Now, I have forgotten the question.

Mr. Epps:
Q. What was the detail of your Norfolk inspection?
A. Well, here again I do not want to not answer the question, but in a sense, we were working for the Navy and it was somewhat—not classified, but they do not want the details spread around too much for public—
Q. I didn't want to ask you the details, but was it detailed?
A. Yes, to the extent that I actually went out and walked all the tracks in the Norfolk area and noted their condition.

Mr. Epps: I don't want to go into that, your page 815 } Honor. This is all I want.

Q. Inquiry was made by Mr. Pasco as to whether you used charts and factors and studies in arriving at your percentage condition, and I should like to ask you whether such things as studies of potential, future spur failures, just to take an example, is that a portion of the determining of the present percentage condition of new in your vocabulary, or is that something else?
A. It is not—the probability of future failures is not in my observed per cent condition.
Q. And in your definitions is that part of it or is that something else?
A. It is not.
Q. Mr. Pasco asked if when you stopped you looked only at a random piece of rail. Is this all you did or did you do more than that?
A. I marked down the year rolled of the random rail on each side of the panel of track, but I looked at the rails in each direction from that particular random panel to determine the condition of the line and surface, the condition of the rail, the per cent condition of the rail, ties, page 816 } other track material and ballast.
Q. And was the method you used to determine the percentage of condition, say, as to tunnels, bridges and tracks, the one that would be used by a maintenance engineer?
A. Yes, I would say even though we were pressed for time, allocations for maintenance money throughout the United States are made on such inspections as we made on this particular week.

Q. Mr. Pasco asked you suppose the Norfolk and Western did not have a franchise to operate this railroad, what would you use it for and I should like to direct your testimony to that and ask you if the Norfolk and Western could not use it, in your opinion could another railroad use it?

A. I do not see why not.

Q. Do you think they would?

A. I would expect them to use it.

Chairman Catterall: We are getting rather far into the realm of speculation. This witness is not an expert on that.

Mr. Epps: Did you get an answer?

page 817 } Chairman Catterall: No.

Reporter: Yes, Sir.

Mr. Epps: I wanted the reporter to get his answer.

Chairman Catterall: The Commission will recess until two o'clock for lunch.

2:00 P. M. The Commission resumes its session.

Mr. Epps:

Q. Mr. Dunn, did you have any associates and subordinates upon whom you relied for your condition percentage that you furnished here?

A. No, Sir.

Q. Is it your own, as a practicing engineer?

A. Yes, Sir.

Q. That is all I have.

RE-CROSS EXAMINATION

By Mr. Pasco:

Q. Mr. Dunn, would you tell us, if you can, what is the determining factor in the age of a rail—determining factor in the life of a rail?

page 818 } A. I do not know.

Q. Would tonnage have something to do with it?

A. Something. Yes.

Q. Would that be the major factor in your opinion?

A. Not necessarily, no.

Q. What other factors?

A. If a particular stretch of rail is in a piece of track that gets very little running maintenance in the form of lining

and surfacing, the rail will become surface bent and it will have to be changed out earlier than it would have been changed out if it had been maintained to a higher degree.

Q. The last question I asked you this morning about various types of measuring devices, and you said you didn't use them. Have you ever made use of that type of measuring device?

A. Do you mean the rail contour machine?

Q. Yes.

A. Yes, Sir.

Q. On what occasion did you use it?

A. Through the Hudson tubes. We were making a study of their condition of port authority—Trans-Hudson Corporation.

page 819 } Q. Why didn't you use them on this inspection?

A. It is not necessary to do that to determine a condition per cent.

Q. That is all. Thank you.

Chairman Catterall: Any more questions of this witness?

Mr. Epps: No, Sir.

Chairman Catterall: You may stand aside and you may be excused.

Mr. Epps: Thank you, Mr. Dunn.

Witness Stood Aside.

page 820 } Mr. Epps: May it please the Commission, we promised the Commission on Friday, I think it was, that we would complete and produce the additional testimony of Mr. McCarthy based on a recalculation of Mr. Tipton's exhibit, using the factors of 1966 and 1967 rather than—they are not factors but multipliers to use the exact term.

We now have these here and should like to file them with Mr. McCarthy's testimony in chief.

Chairman Catterall: They will be received and added to the testimony in the books.

Mr. Epps: In the books, yes, Sir.

Chairman Catterall: And not as an exhibit.

Mr. Epps: No, Sir.

Chairman Catterall: You'll have to identify them so that when the record is put together, they can be put in the proper place.

Mr. Epps: Yes, Sir. It is headed "Additional Testimony of Maurice J. McCarthy on Direct Examination."

Mr. Riely: It goes in the blue book.

Mr. Epps: It goes in the blue book, behind—

page 821 } Chairman Catterall: Well, I think we had better keep some extra ones, so if it is appealed they will be available and put in the proper place.

Mr. Riely: Why don't we put it in the blue book right now?

Note: Mr. McCarthy's additional testimony is inserted, and conversation held in this regard off the record.

Mr. Riely: Shouldn't the record show the additional testimony of Maurice J. McCarthy was presented, accompanied by his Exhibit No. MJM-X and was received and filed?

Mr. Epps: I would welcome that amendment. Thank you.

Chairman Catterall: Now, who comes next? Do you have another witness coming on?

Mr. Epps: Are you ready, Mr. Riely?

Mr. Pasco: Yes.

Mr. Epps: Mr. Pasco, excuse me.

Mr. Riely: Mr. Pasco today.

Mr. Pasco: I work on Mondays, and he works the rest of the week.

page 822 } Mr. Epps: Mr. Howland, please.

Commissioner Hooker: The others have to get over Sunday, haven't they?

Mr. Riely: That is right.

DIRECT EXAMINATION

By Mr. Epps:

Q. You are Mr. Harold H. Howland, aren't you?

A. Yes.

Q. You live in the District of Columbia?

A. Yes, Sir.

Q. You are the Mr. Harold D. Howland whose direct examination has been reduced to writing and who has subscribed that direct examination, is that correct?

A. Yes, Sir.

Q. And because you subscribe that, you are still under the same oath and will not have to take another oath, Mr. Howland.

Mr. Epps: Mr. Howland is presented for your cross examination.

page 823 }

* * * * *

TESTIMONY OF HAROLD H. HOWLAND ON DIRECT EXAMINATION

Q. Please give us your name and address.

A. Harold H. Howland. 5415 Connecticut Avenue, N. W., Washington, D. C.

Q. What is your occupation?

A. Graduate civil engineer.

Q. How long have you been in engineering work?

A. Since 1909.

Q. What was your educational preparation for engineering?

A. I attended Massachusetts Institute of Technology and graduated there in civil engineering in 1909.

Q. What did you then do?

page 824 } A. From 1909 to 1911 I was Assistant on Engineering Corps-Missouri Pacific Railroad Company.

Q. Of what did this work consist?

A. This work was in connection with a program under the supervision of the Chief Engineer, whereby a graduate engineer would start his actual railroad experience as a Section laborer for five or six weeks under special tutelage. Then generally serving with a work train on construction work about the same length of time. Then going into the engineering forces, working on various special projects of the Chief Engineer all over the system, serving a few weeks in some Division Engineer's office, actual experience for a few months with a rail laying gang, likewise on extensive ballasting operations. The work was very inclusive and the intent of the program was to qualify the applicant in five years as a Roadmaster and in two or three years more as a Division Engineer.

Q. Where was your next assignment?

page 825 } A. From 1911 to 1912, Rodman—New York, New Haven and Hartford Railroad Company. This work covered the usual variety of engineering work found in a division of a very busy main line railroad ex-

tending over several hundred miles of line, varying from some 4-track main to connecting single track branch lines.

Q. Upon leaving the New Haven Railroad, what position did you assume?

A. From 1912 to 1914 I was Assistant Engineer, City Engineer's Office, at Bridgeport Connecticut. The City Engineer under whom I served was a former high engineering officer with the New York, New Haven and Hartford Railroad.

Q. In 1914 did you take on another assignment?

A. Yes. In 1914 I became associated with the Bureau of Valuation of the Interstate Commerce Commission in Washinton, D. C.

Q. How long did you remain with that Commission?

A. Until 1959.

page 826 } Q. Would you outline the posts you held and the work you did during that period?

A. From 1914 to 1951 I was with the Bureau of Valuation, as I have indicated. An outline of my work was that I began as Section Chief and Chief of Field Party on original field surveys; routine office work and group chief 1920-1926; cost studies and cooperative work with President's Conference Committee in connection with the same, on many special assignments 1926-1951; Chief of Field Party, 1928-1929 on about 1,000 miles of new railroad work, generally in the far west and southwest, special appraisal work on appraisals of docks, piers, etc.; work on depreciation rates to be used by the Carriers, 1942; special depreciation study on railroad property, etc.

On this work I also testified as an Interstate Commerce Commission witness as to the correctness of certain established prices, etc., before an Interstate Commerce

page 827 } Commission Examiner on the hearings covering the original valuations.

Q. In 1951 did you have a change of assignment?

A. Yes. I became Civil Engineer with the Bureau of Safety at the Interstate Commerce Commission, on work in connection generally with accident investigations as related to railroad tracks and bridges. Also, special assignment as directed by the Director on various railroad track problems.

Q. What happened in 1957?

A. I returned to the Bureau in 1957 as Valuation Engineer and Supervising Valuation Engineer, where I remained until 1959.

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Q. Will you please outline your activities from 1959 to date?

A. Retained by the New York State Board of Equalization and Assessment as Engineering Consultant with respect to Interstate Commerce Commission Methods and Procedures. This was in connection with the new
page 828 } New York State law as it affects the railroads in New York State.

On this assignment I also made a "short form" appraisal of the property of the twenty-one railroads, including their leased corporations, located in New York State, as of 1957.

Retained by one of the townships in Erie County, New York, to make an appraisal of the railroads in the township, as pertinent to the application of this new law. Their cost of reproduction new was about $35,000,000.00.

Retained by various consulting and appraisal engineers on many railroad appraisals, including one major carrier in Chicago, Illinois, on which the cost new was about $125,000,000.00.

Retained by various railroads to make appraisals of various railroad properties under consideration as jointly operated electronic yards and to ascertain the value of two alternate approaches to a terminal in order to
page 829 } determine the more economical means of approach with resulting abandonment of the less economical route.

My appraisal work on railroads during the past five years or so has amounted to a reproduction cost new of between $200,000,000.00 and $250,000,000.00.

Retained by a carrier to testify in a State Court in a tax case, concerning the Interstate Commerce Commission's method of computing the values of railroad properties as shown in a yearly pamphlet, issued by the Interstate Commerce Commission's Section of Valuation, "Giving Certain Elements of Value of Class 1 Railroads, as of December 31, 19 ." Appeared before a state commission as a witness for a protestant in a rate case concerning a unit train. My testimony was wholly on the physical condition of some three hundred miles or more of line over which the "unit train" would operate and the additional cost of maintenance due to its operation; also, an estimate of the annual
page 830 } cost of maintenance on this portion covering the unit train only.

Retained recently by a State to make a physical inspection of some three hundred fifty miles of railroad sought to be

abandoned, and to assist the State's attorney in cross-examination of the carrier's witness on testimony covering their opinion of the physical property before an Interstate Commerce Commission examiner. My contract included (if necessary) testimony in rebuttal and the giving of my estimate as to the cost of bringing this track up to normal maintenance.

Q. You have indicated that from time to time you have testified in court. Would you state whether or not this has been on the side of the railroads or the regulatory commissions?

A. On both sides, from time to time. I have testified on behalf of the railroads and, on the other hand, in certain proceedings I have testified for state agencies. Of course, I have appeared as a witness for the Interstate
page 831 } Commerce Commission on its original hearings.

Q. By whom were you employed in this case?

A. On February 10, 1969 I had a visit from Messrs. Shannon and Younger of the Virginia State Corporation Commission, and Mr. A. C. Epps, representing the individual members of the Virginia Municipal Leauge and the Virginia Association of Counties, Cities and Towns.

Q. What were you requested to do?

A. To attempt to ascertain and to advise upon the following:

1. The historical or original cost of track and roadway properties of the Norfolk and Western Railway Company in Virginia (excluding land), which is to say, I.C.C. Properties Accounts numbered: 1. (Engineering), 5. (Tunnels and Subways), 6. (Bridges, Trestles and Culverts), 8. (Ties), 9. (Rails), 10. (Other track materials), 11. (Ballast), 12. (Track Laying and Surfacing), and 13. (Fences, Snowsheds and Signs), plus signals (cross and track), and grading, including cuts, fills and excavations.

page 832 } 2. The ascertainment of reproduction cost, new, of such properties from the 1952 I.C.C. long form, brought up to date, but less depreciation (determined perhaps by inspection, see Paragraph 3).

3. A determination of the physical condition of the Railroad in Virginia, to be based upon actual inspection of the track and other items involved.

Q. What were your instructions with regard to franchise or going concern value of the Norfolk & Western Railroad in Virginia?

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A. My evaluation was to be exclusive of the franchise or going concern value of the Railroad, which meant that I was to make no additions to my evaluations by reason of going concern value or franchise value. I was asked to try to determine original or historical cost and to determine, in my opinion, the fair market value, indicating what elements entered into my determination of this fair market value.

page 833 } Q. Before you undertook this commission, did you already have some familiarity with the Norfolk & Western Railroad?

A. Yes.

Q. What was it?

A. In the early days during the original evaluation by the Interstate Commerce Commission, in 1918-1920, I was Party Chief of the lines from Bluefield west to Cincinnati and Columbus. On this task I walked the entire line and noted the physical condition of all items in track. In 1942, in connection with life studies of rail in all Class 1 railroads in the United States, I made one for the Norfolk & Western Railroad.

Q. In an attempt to determine fair market value, what is it that you seek?

A. What a willing buyer, under no compulsion to by, will pay to a willing seller under no compulsion to sell.

page 834 } Q. What did you do to ascertain fair market value?

A. I ascertained the cost of reproduction new, and the cost of reproduction new less depreciation.

Q. Did you do anything else to test this?

A. The condition percent was ascertained by life studies and verified on the ground by inspection of the railroad properties involved.

Q. Did you further test your estimate of fair value by ascertaining the original cost of the Norfolk & Western properties in Virginia?

A. Yes. I ascertained the historic or original cost as displayed by the records of the Interstate Commerce Commission, but it should be borne in mind that the records of the Interstate Commerce Commission setting out original or historical costs are based on the Interstate Commerce Commission's uniform system of accounts, and for track properties use the so-called replacement retirement accounting, and hence the figures are not true original cost, but in place

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book cost, plus betterments only, and minus re-
page 835 } tirements and abandonments.

Q. In establishing reproduction cost new, will you describe what you did?

A. I took the latest long-form bringing to date reports of both the Virginian and the Norfolk & Western in Virginia, which dates were 1946 and 1952 respectively, which included all additions and betterments between date of valuation and those respective dates, priced out at 1910 to 1914 prices, to which the 1968 multiplier was applied.

Q. What did you get as the over-all figure for reproduction cost new, for the Virginia properties?

A. $558,615,282.00

Q. What I.C.C. account numbers did you use in arriving at this?

A. Account 1. (Engineering), Account 3. (Grading), Account 5. (Tunnels and Subways), Account 6. (Bridges,
Trestles and Culverts), Account 8. (Ties), Ac-
page 836 } count 9. (Rails, Account 10. (Other Track Ma-
terials), Account 11, (Ballast), Account 12. (Track Laying and Servicing), Account 13. (Fences, Snowsheds and Signs), Account 27. (Signals and Interlockers), and Overhead Accounts 70, Part of 71, and 77, and Account 76 (Interest During Construction).

Q. What is the reason for including Accounts 70, Part of 71, and 76 and 77?

A. Overheads are an integral part of valuation and should be included in order to arrive at a fair valuation. They are regularly used in evaluations by the Interstate Commerce Commission.

Q. Did you formulate a table showing these accounts?

A. I have prepared a table of the computations with multipliers for Accounts 3, 5, 6, 8, 9, 10, 11, 12, 13 and 27 to show reproduction cost new for those accounts as of 1968.

Attorney will now introduce as H.H.H. Exhibit 1 the
aforesaid calculation.

page 837 } Q. How did you obtain the additions for Ac-
counts 1, 70, 76 and 77?

A. I used 4% of the 1968 total from H.H.H. Exhibit 1 for Engineering; for 70, part of 71, and 77 I used 1 1/2% of that same total, plus Account 1; for 76, 9% of the aggregate total. This is in accordance with I.C.C. practice for this carrier.

Q. If you were to break your total into two sub-heads, one for signals and interlockers alone, and for all the remaining track properties, what would the two items be?

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A. The signals and interlockers, together with overheads, would amount to $22,710,056.00, and the Accounts would amount to $360,132,005.00.

Q. Did you make a calculation of what the I.C.C. records, based on reports from the Norfolk & Western Railroad, disclosed as to "original cost" for the Virginia properties, taking into account the fact that betterment-retirement accounting was used?

A. Yes.

page 838 } Q. What was the original cost shown on those figures?

A. $221,369,993.00.

Attorney will now introduce as H.H.H. Exhibit 2 tabulation of Norfolk & Western original cost in the State of Virginia.

Q. Did you make a physical inspection of the Norfolk & Western tracks and track properties in Virginia?

A. Yes, beginning March 24 and continuing each succeeding day, including Saturday and Sunday, we went out on the tracks, through March 31.

Q. Did you prepare a report of your procedures, inspections and findings?

A. Yes, I did.

Q. Will you state it, please?

A. Starting on Monday, March 24, 1969, an inspection trip was made over the lines of the Norfolk & Western Railroad Company lying within the State of Virginia. The purpose of the inspection was to determine the condition of the physical property and the degree to which the property was maintained. Norfolk & Western HiRail Car No. 1201 was used to convey the inspectors over the various lines.

page 839 } In this connection may we say that the carrier's officers extended every courtesy possible and freely answered any questions asked. The following men made up the inspection party:

Over the entire line:

Jesse Kendrick—Engineer/Track—Norfolk & Western Railway Company

K. M. Dunn—Representing the Cities, Counties and Towns of the State of Virginia.

H. H. Howland—Representing the Cities, Counties and Towns of the State of Virginia

Auriel Maynard—Special Engineer, Chesapeake and Ohio Railway Co.

Harold H. Howland

Lee O'Brien—Representing the State of Virginia.

In addition to the aforenamed were the following, who accompanied the party over shorter portions of the carrier:

Trainmaster Richardson, over the line from Roanoke to the Virginia/Maryland State line.

page 840 } Roadmaster R. M. Harnberger—over the line from Lynchburg to the Virginia/North Carolina State line.

Trainmaster Frank Adkins—over the line from the North Carolina/Virginia State line, to Roanoke.

Trainmaster—Roadmaster Robert Cross—over the "Grundy" Lines.

Assistant Division Engineer Earle Wilkerson—over the main line of the original Norfolk & Western Railway Company from Crewe to Norfolk and return over the former main line of the Virginian from Norfolk to Virso and thence to Pamplin.

page 841 } General Itinerary over Norfolk & Western, 1969

			Approximate Miles	
Mon., March 24				
	N. & W. Main Line, Roanoke to Bluefield in Virginia	83		
	Return on former Virginian, Kellysville to Roanoke	85	168	
Tue., March 25				
	Walton to Bristol	111		
	Dora to Galax	52		
	Abingdon to Whitetop	34		
	Glade Springs to Saltville	10	207	375
Wed., March 26				
	Roanoke to Crewe, Old Virginian and B.P. cutoff	120		
	Burkeville to Roanoke, old N. & W.	119	239	614

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page 842 } General Itinerary over Norfolk & Western, 1969 (cont.)

			Approximate Miles	
	Forward			614
Thu., March 27				
	Roanoke to Md-Va. State line (Shenandoah Div.)	207	207	821
Fri., March 28				
	Lynchburg to N.C./Va. State line	71		
	N.C./Va. State line to Roanoke	73	144	965
Sat., March 29				
	Bluefield to Norton	100		
	Dumps Creek	13		
	Dry Fork	16	129	1094
	Big Creek			
Sun., March 30				
	"Grundy" line	75		1169
Mon., March 31				
	Crewe to Norfolk on N.&W. Old line Norfolk to Pamplin (over Virginian old line)	143	275	1444

page 843 } The country traversed by the Norfolk & Western varies from the flat coastal plains of Eastern Virginia to the rolling country as the main lines of this carrier approach Roanoke, to mountainous country at the West Virginia border, where the elevation exceeds 2,000 feet. Long tangents are found in the eastern portion, short tangents and sharp curvature and heavier grades between Roanoke and the West Virginia line. The branch lines as a rule either follow the river valleys, with some sharp curvatures or extend cross country. The branch lines off the Norton branch originate larger quantities of coal; particularly the Dumps Creek Branch, off at Carbo, has a capacity of some 800 cars of coal a day, and the lines around Grundy, coming off the main line of the N. & W. at Devon, W. Va., some 1,300 cars a day. An additional mine of the Pocahontas Fuel Co. is being opened upon this branch, with a 300-car a day capacity. These mines have a supposed life
page 844 } of 40 years. An extension is being built from

these lines over to the end of the Big Creek Branch which comes off the Norton Branch at Richlands. This facility will enable the carrier to transport the coal via Richlands, to Bluefield, W. Va., instead of the much longer haul via Devon, W. Va., and thence east over the main line to Bluefield.

From Walton west, there are some 37 tunnels on this line, varying from a few hundred feet in length, unlined, to one over 8,000 feet long, concrete lined.

Seven switching crews are necessary weekdays to handle the business originated on the Grundy lines.

The carrier limits its passenger trains from Norfolk west to 70 miles per hour for the first 136 miles west of Norfolk, with some restrictions to 60 m.p.h.; with 60 m.p.h. from Mile Post 279; with 60 and 45 m.p.h. from there to Bluefield. The Bristol branch from Walton to Bristol varies from 65 to 45 m.p.h. over various sections, and the Sendandoah

page 845 } Division from Roanoke north to the Maryland/ Virginia State line allows 60 m.p.h., with curve restrictions somewhat lower on both branches. The allowed speed for time freights and empty coal drags over all those lines over which passenger trains run is from 40 to 50 m.p.h. Freight trains loaded with coal—unless 15 cars or more of other material are included—are limited to 35 m.p.h., over over these lines.

Over the other branch lines speed of all freight trains is 35 m.p.h. or lower, depending on the territory traversed and traffic conditions encountered, such as a succession of sharp curves, roller-coaster grades, or, as in the Grundy lines, where some seven switching crews are employed on weekdays to keep the traffic moving. All coal drag crews are prohibited from keeping their trains in a sustained speed ranging between 15 and 21 m.p.h.

page 846 } At the time of our inspection only one "slow order" was called to our attention, and this was caused by some "Sperry rail" where the rail detector car had found various small transverse fissures.

Before beginning the physical inspection of the Norfolk & Western Railway, the carrier had furnished me with a current rail chart of all lines traversed, other than the former Virginian, and from those I had taken off the current rail conditions, such as date rolled and date laid.

In making the actual field inspection, we originally made a stop every 5 miles, where we picked up the date of the rail as found in the track, number of ties per panel, their condi-

tion, kind of angle bars, tie plates, number of anticreepers per panel, condition of the line and surface of the track—whether it was curve worn on the low side pounded down, also the condition of the ballast. After finding
page 847 } for some considerable mileage a very great similarity in the physical conditions, we went to stopping every ten miles for this information, and we believe with equal results. Between stops we continually followed the line and surface, making notes where we found joints low-rail corrugated, where a poor tie condition extended for a short stretch—where the rail joints had been built up—78' rails placed—or ribbon rail laid in the track, also where some corrugated rail had been bettered with a rail grinding machine. We found some number of cuts where the sides had sluffed in, making poor drainage conditions, and contrary, we found small shovels or bulldozers cleaning out similar cuts. The main line tunnels were found to be in very good condition, with the switch timbers likewise, with some being replaced here and there. The rail found in the main lines is 130 lb. per yard, originally placed as early as 1923, or so, followed by 131 lb.—a better section—and then
page 848 } 132 lb. Some small stretches of 140 lb. were also found. There is quite a lot of 132 lb. welded rail in the track which certainly makes for better track and riding conditions. The branch lines are generally laid with this same weight rail, relieved from main track service. The passing tracks are generally of similar weight, with some 100 lb. in a few industry and yard tracks.

The material in Account 10 follows the rail very closely. This carrier went early to large tie plates, which saves the crossties from being heavily cut, and at the present time are using even larger, going up to 20 lbs. per plate.

Ties are all creosoted, first being used in the early 1920's. I found one tie dating nail with a 1922 date.

Ballast is crushed stone, screenings and cinders. Like all coal carrier roads, it has a tendency to get foul
page 849 } from coal droppings, etc. It has been cleaned here and there, and we found conditions varying from very good and clean ballast in the eastern portion, to pretty dirty in some of the western portion, especially in the locality of the coal tipples.

The line and surface is maintained in ample condition for all speed conditions found. This applies to all materials entering into the track structure. It is maintained to a degree

considerably above the speeds allowed. We found no pieces of what one would call "poor track" followed by "good track." The endeavor apparently is to keep as near as possible a "uniform track." We saw no evidence of excessive car swaying in any train that we met out on the road or watched go by. We found and noted many stretches where ties were on the ground for replacements, also one tie gang making, you might say, a major or extensive tie replacement—placing from 500 to 600 ties per mile, using some 10 pieces or so of power equipment. Also, we found various
page 850 } stretches where ballast had been dumped on the track for betterment. We found one small crew laying a stretch of welded rail. Near Suffolk we found some 6 miles of 132 lb. welded rail which had been laid earlier in 1969.

In making this inspection on the Norfolk & Western I had the advantage of knowing the methods used in making the original inventory of this carrier in 1918-19-30—its physical condition then and the lines used on the various track items. In 1942, or thereabout, I made a life study—among other things—of the rail in this carrier's tracks, as found by the carrier's actual experience, as shown on their rail charts or 588's from 1920 to 1942. On former V.S.10 Va. extending from Roanoke to Bluefield, for example, a life of 12 1/2 years had been used for the former 85 lb. and 100 lb. rail In 1942 also I found that on the heavy main line a life of 16 years was used for the first cycle of rail. Today I be-
page 851 } lieve this life can be extended, from conditions as found on the ground on certain portions—due in some cases to changes in traffic handled and also to better maintenance than was found in former days.

In prior periods a life of 25 years was used for creosoted ties. I believe from conditions we found in the ground—better maintenance, machine tamping, built-up rail ends, very large tie plates to better prevent tie cutting—this 25 year life can be slightly extended, probably to 30 years. I found one 1922 tie dating nail in the main line track. We used a 50% condition, as a whole, for the ties in the State of Virginia.

Q. Based on your physical inspections and on your study of the life cycles, did you form an opinion as to the percentage of condition of the various accounts of the Railroad in Virginia?

A. I did.

Q. Do you have a table showing the percent-

page 852 } ages of condition assigned to the various accounts?

A. Yes, I do.

Attorney will now introduce this as H.H.H. Exhibit 3.

Q. In your Exhibit H.H.H. 3 you have a column headed by a percentage sign in which are set out figures relative to various of the accounts. Are these the percentages of condition applied to various of the accounts?

A. They are.

Q. Have you computed and extended these for such accounts?

A. I have.

Q. What total figure of Reproduction Cost New less Depreciation did you get for the track accounts, signal account and overheads in Virginia?

A. $382,842,061.00.

Q. What did you then determine an over-all percentage of condition of the Virginia properties involved?

A. 68.5.%

Q. What part of this figure of $382,842,061.00 page 853 } is attributable to Signals and Interlockers?

A. $22,710,056.00, leaving $360,132,005.00 for the other properties.

Q. When you were on the inspection trip, were there photographs made?

A. Yes, there were.

Q. Have you examined them?

A. Yes, I have.

Q. Are they true and proper reproductions of what they intend to portray?

A. Yes.

Q. Do you have those photographs?

A. Yes.

Q. Would you please explain what they are?

A. They show examples of ballast, cross-ties, rails, drainage and track alignment. The first page consists of three pictures, one taken on the main line of the Norfolk Division, between Roanoke and Crewe, at Milepost 160, and page 854 } demonstrates the welded rail being used. The second photograph, on the righthand side at the top, is taken on the main line of the Norfolk Division, between Roanoke and Crewe, at Milepost 179, and shows 130 lb. track installed in 1929. The third and bottom picture is taken on the main line of the Norfolk Division, between Roanoke and

Crewe, at Milepost 200, and shows 132 lb. track installed in 1957.

Attorney will now introduce H.H.H. Exhibit 4, (Page 1).

Q. What is page 2?

A. Further examples of the same items. Number 1 on the lefthand top shows main line, Norfolk to Crewe, at Milepost 75, where welded rail has been installed in 1966 (132 lb. rail). On the righthand side, on the same line, at Milepost 115, is an example of 132 lb. rail installed in 1954. The bottom picture shows the same line at Milepost 115, with 132 lb. rail installed in 1954.

Attorney will now introduce Page 2 as H.H.H. Exhibit 4, (Page 2).

page 855 } Q. What does Page 3 show?

A. More of the same items, and this contains four photographs. The upper lefthand corner is taken on the Norfolk Division, between Roanoke and Crewe, at Milepost 230, and shows 131 lb. rail installed in 1948. On the righthand top, on the Radford Division, Roanoke to Bluefield, at Milepost 310, is a picture of 131 lb. rail installed in 1945. In the lower lefthand corner, on the Norfolk Division, between Roanoke and Crewe, at Milepost 210, is portrayed 132 lb. rail installed in 1954, while at the lower righthand corner there is shown on the Radford Division, between Walton and Bristol, at Milepost 314, 131 lb. rail installed in 1946.

Attorney will now introduce Page 3, of 4, as H.H.H. Exhibit 4, (Page 3).

Q. What does Page 4 show?

A. Page 4 shows three pictures, one on the Shendandoah Division, at Milepost H.120, showing 131 lb.
page 856 } rail installed in 1935. The righthand top shows a part of the Winston Division, at Milepost 65, showing 131 lb. rail installed in 1957, and the bottom picture is of the Clinchfield District-Dumps Creek Branch, at Milepost 11, showing the condition of the track.

Attorney will now introduce Page 4 as H.H.H. Exhibit 4, Page 4.

Q. What was the condition of line and surface that you observed?

A. The line and surface were excellent.

Q. How do you rate excellent?

A. 80% or better.

Q. What was the condition of the maintenance of the road?

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A. I found the maintenance of the road in very good condition.

Q. How do you rate very good?

A. In the upper third.

Q. In an appraisal of railroad property would line and surface be important to determine the fair value of tracks?

A. Yes, it would.

page 857 } Q. In reaching your fair value, did you add anything for franchise or going concern value?

A. No, I did not.

Q. In arriving at fair cash value, or fair market value, as an appraiser what use do you seek for the property to be appraised?

A. The highest and best use of the property.

Q. What is the highest and best use of the Norfolk & Western rail and track properties which you examined?

A. As a railroad, in place, with proper line and surface, capable of carrying the traffic appropriate to these lines.

Q. Does this use embrace any additional factor for franchise value, going concern value, or good will?

A. No.

Q. If I understand you correctly, are you saying that the railroad has been graded, that ballast is in place, that bridges, trestles and tunnels have been con-

page 858 } structed, that ties have been laid and the track placed thereon in proper line and surface, and that as a result thereof there is a value for the entire property in place that is greater than the sum of the parts or the liquidating value of the parts thereof?

A. Yes, of course there is.

Q. If the Norfolk & Western Railroad would for some reason go out of business overnight, would there be a market for the tracks and roadway properties which you inspected in place as a railroad property?

A. Yes. I have no doubt but that other railroads would vie to purchase the property.

Q. Would the highest and best use thereof be as a railroad in such sale?

A. Yes.

Q. Are you familiar with purchases and sales of railroad track properties?

A. Yes.

page 859 } Q. Will you name some of them, and give some indication of what they are?

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A. Washington and Old Dominion, extending from Potomac yard to Purcellville, Va., and bought by the State of Virginia; the Government railroad extending from Fredericksburg, Va. to Dahlgren, Va., as bought by the Richmond, Fredericksburg and Potomac Railroad.

page 860 } Q. What are "slow orders"?

A. Slow orders are orders placed where tracks are in such condition that the speed is curtailed until repairs can be made.

Q. What situation did you find with regard to "slow orders"?

A. There were very few slow orders, and mostly for a very short duration.

Q. Do you have a list of the "slow orders"?

A. Yes, I do.

Q. What does it disclose?

A. There is only one slow order concerning condition of the track, and this concerns "Sperry rail" on the former Virginian for a distance of 3 miles.

Attorney will now introduce list of "slow orders" as H.H.H. Exhibit 5.

Q. What do you say about the number of slow orders that you have reported and the duration of time shown therein for a system like the Norfolk & Western?

page 861 } A. It shows that the railroad is in fine shape from the standpoint of maintenance, and that in the judgment of the railroad normal speeds can be maintained over the main line with safety.

Q. Do you have an opinion as to the fair value of one mile of Norfolk & Western main line track?

A. Yes.

Q. What is it?

A. $102,622.

Q. Please explain your computation?

A. I have worked up a schedule of reproduction cost new of a mile of main line track. Without grading and overheads it would amount to $110,324. To this would be added grading; an exact figure for grading is difficult because of divergent terrain and the absence of an *exaact* allocation among main line, branch line and siding. There are approximately 1,500 miles of main line track in Virginia which,

page 862 } divided into an approximate figure for grading of 60,000,000 would result in $33,000 per mile. If an arbitrary allowance from that figure for sidings was made, grading for main lines could conceivably be added at

$20,000 per mile, or a new total of $130,324. To this should be added 15% for overheads, giving a reproduction cost new of $149,872, per mile. My condition per cent of 68.5 would produce a fair value of $102,662 per mile. This is without bridges, tunnels, and trestles.

Q. Do you have that schedule?

A. Yes.

Attorney will now offer H.H.H. Exhibit 6.

Q. How about branch lines?

A. I have worked up a schedule of reproduction cost new without grading, overheads, bridges, tunnels and trestles.

Q. What is it?

A. $90,047, to which a 68.5% condition would result in a fair value without the addition of $61,680.

page 863 } Q. What about sidings and yard track?

A. Yes, I did the same thing as for branch lines.

Q. What is it?

A. $63,136 reproduction cost new, and a fair value without the addition of $43,248.

Attorney will now offer H.H.H. Exhibits 7 and 8.

page 864 } Q. In view of your testimony, would you say that the values assigned by the State Department of Utility Taxation to the main line are high or low?

A. Very low.

Q. Would you say that they are excessive?

A. Certainly not.

Q. How about as to branch lines?

A. Low.

Q. How about as to side tracks?

A. Low.

Q. What do you say as to the valuation placed by the State Tax Department as to signals and interlockers?

A. It is reasonable.

Q. What percentage of condition would you assign to the rail of the Norfolk & Western Railroad?

A. 75%. This is applied to the money involved in Account 9 and is not the physical condition percent of the rail.

Q. How was this figure of 75% obtained?

page 865 } A. I conditioned the rail on the Norfolk & Western in two cycles: "new"—as originally placed in the main line, as the first cycle; the second cycle as "relay"—when taken from the main line and relaid either in branch lines or sidings.

In either case it has a condition percent due to the per-

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centage of actual life served to total estimated service life in that cycle. This condition percent is applied to the portion remaining from 100, less its "salvage factor"—this latter never being depreciated. For example, if the rail cost $100 per ton in the new cycle, and was considered worth $71 as relay, the salvage factor would be 71.

The following table gives the breakdown on the various lines:

page 866 }

Line	Age	Service Life	%
Former Virginian:			
Norfolk to Crewe	27	30	26
Crewe to Roanoke	14	25	42
Roanoke West	21	25	28
Former Norfolk & Western:			
Norfolk to Crewe	20	25	30
Crewe to Roanoke	25	30	29
Roanoke West	17	22½	32
Roanoke to Hagerstown	27	30	26

An average condition percent of 30 was assumed, which, with a salvage factor of 71 (new to relay) gives a percent to be applied to the money of 80.

For relay rail I gave a 50% condition, which, with a salvage factor of 41, gave a percent of 71.

I assumed from these two an average of 75 percent to be applied to the money involved in Account 9.

page 867 } Q. Would you say that a 40% condition or a 60% depreciation on Norfolk & Western rails would be excessive?

A. I certainly would.

Q. What type of equipment is the Norfolk & Western employing in its maintenance program?

A. Mechanical or power, as a general rule.

Q. In any of your computations, have you added anything for franchise value?

A. No.

Q. Going concern value?

A. No.

Q. Good will?

A. No.

Q. What was your observation of the manner in which the Norfolk & Western Railroad is being maintained?

A. In a sufficient and excellent condition.

Q. Does that refer to only parts of the system or to all of the system that you saw in Virginia?

A. All of the unused line is not being kept up

page 868 } too well; that is the old Virginian line from Norfolk to Jarratt.

Q. What is your opinion of the valuation of $142,240,268 placed on the Norfolk & Western's track properties in Virginia by the Utilities Tax Division of the State Corporation Commission?

A. As you can see, in my opinion it is low. Certainly it is more than reasonable.

Q. Is that all, Mr. Howland?

A. Yes, sir.

Thank you.

page 869 } I hereby certify that the answers given to the foregoing questions are true and correct to the best of my knowledge and belief.

Harold H. Howland

Subscribed and sworn to before me this 9th day of April 1969.

Francis T. Peary
Notary Public

My commission expires:
July 4, 1971

page 870 } CROSS EXAMINATION

By Mr. Pasco:

Q. Mr. Howland, in describing the purposes for which you were employed in this case, I believe you listed at the outset three undertakings set forth on page nine of your testimony, and the first was to determine the historical or original cost of the track and roadway properties of the Norfolk and Western excluding land; and I want to ask you whether this original cost was the original cost of the original line or the original cost of the line in place today?

A. It purports to be the original cost of the line in place today in the State of Virginia.

Q. Yes, Sir. And your second assignment, I understand, was the reproduction cost new of the Norfolk and Western tracks, and we will come back to that later.

And your third undertaking is described by you as a determination of the physical condition of the Railroad in Virginia, based upon your actual inspection of the track and other items involved.

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Now does this mean that you were asked to express a condition per cent of new of the Railroad in Virginia?

A. Yes.

Q. Now after listing these three undertakings you refer on page fifteen to franchise or going-concern values

page 871 } and say that you were asked to determine the fair market value exclusive of franchise value.

I take it that this really means that you had a fourth assignment of determining fair-market value exclusive of franchise value, is that right?

A. Yes.

Q. Now will you point out to me in your testimony where you express your conclusion as to this fair-market value exclusive of franchise value?

A. I have not given any fair-market value other than cost of reproduction new less depreciation.

Q. Yes, Sir. Now, Mr. Howland, I am curious about this short form that you refer to on page six of your testimony in describing the appraisals you say you made there of twenty-one railroads in 1957. Could you briefly tell me what that is?

A. Well, it was the Interstate Commerce Commission method at that time of making in a very short period an evaluation of certain railroads in this State. Their certain methods, and you might say formula they used, they took the last string to date, took the additions, factored them back to 1910 to 1914, took off the retirement, factored it back to somewhere in the twenties because they came in

page 872 } at a later period presumably and then depreciated it and put a factor on it for the current year.

Q. And this is all shown on the so-called short forms?

A. Yes. It was—it has been issued, I believe; they call it the elements of value in certain railroads in the United States.

Q. Yes, and that is what you referred to when you mentioned the short form appraisals?

A. Yes.

Q. Thank you, Sir. Now on page ten you stated that your evaluation of the Railroad was exclusive of the franchise or going-concern value, and then you just told us that that was, in fact, your reproduction cost new depreciation. How can you make sure that you did not include some franchise or going-concern value in that evaluation?

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A. Because I took the elements in the various accounts only and brought them up to the 1968 prices.

Q. You made no separate—

A. They were simply—those elements would be quantities.

Q. And you made no separate determination

page 873 } of fair-market value then?

A. No.

Q. Or franchise value?

A. No.

Q. And you have expressed no opinion as to what that is with respect to the Norfolk and Western?

A. No.

Q. Now, Mr. Howland, you state that your work in this case was facilitated by your familiarity with the Norfolk and Western back in 1918 and 1920 in the time that you made the study of the line from Bluefield West to Cincinnati and Columbus, I believe.

A. Yes.

Q. There wasn't very much of that line in Virginia, was it?

A. Very small amount.

Q. Would you disagree with five Point forty-eight miles?

A. No.

Q. Well, now, was there much there then that was there that would be there today if you went and looked

page 874 } at it?

A. Probably not other than the grading, some of the bridges and the tunnels.

Q. Well then, did that investigation in 1918 give you any real help in arriving at these 1968 values?

A. Individually, probably not.

Q. Yes. Now, the other source of your familiarity which you mentioned, I believe, is the life study of the Norfolk and Western that you undertook for the ICC in 1942?

A. Yes.

Q. That was twenty-seven years ago. In either of these situations, either the 1942 study or the 1918 inspection, was the purpose of your study or investigation to determine fair-market value?

A. It was the cost of reproduction new and the cost of reproduction new less depreciation.

Q. In 1942, when you made this life study, did you actually investigate the properties of the Norfolk and Western, or did you work from the ICC Reports?

A. We did not investigate on the road. We took the original rail as we found it.

page 875 } Q. In the records?
A. In the records.

Q. Of the ICC?

A. Of the ICC, and followed through from the additions and retirements from the date of the original engineering report through to 1942, which gave us an average age of the date of installation and retirement; and that gave us an average age of the rail as we found it from the carriers experience.

Q. Yes. You made this study from these BV-588 reports?

A. That is right.

Q. Now they don't show all replacements, do they, Mr. Howland?

A. No, but we also, in addition to that, we had presumably a rail chart. We had practically every carrier in the country as far as I know had rail charts to furnish us. Now some of these showed the installations year by year and others, just one sum. In which case, we had to take first in and first out. So I don't remember which was what under Norfolk and Western.

page 876 } Chairman Catterall: Can the Reporter get these words?
Reporter: Yes, Sir.

Chairman Catterall: I just want to make sure that you can hear what he is saying.

Mr. Pasco:

Q. Mr. Howland, on page thirteen of your testimony when you are talking about reproduction cost new you stated, I believe, that you took what you call the latest long form, and will you tell us what that is, please?

A. The Commission made an evaluation of the Norfolk and Western somewhere in the 1900's. I don't remember the date, probably 1915 or 1916; and the carriers reported on the 588 all additions and betterments and retirements by quantities. These quantities were priced at a 1910 to a 1914 basis added to and subtracted from the original engineering report, summarized and then given the index for whatever year they were brought to.

Q. Yes, Sir.

A. The Norfolk and Western brought originally after the date of re-capture when they were quite interested to 1942, I believe. And then there was another long form report made in 1952, which I used.

page 877 } Q. You used the 1952?
A. I used the 1952 report.

Q. Yes.

A. And to that I added the 1946 report on the form of Virginia, added the two together and multiplied by the 1968 index.

Q. Now, you say the 1968 index, or multiplier I think it is called in your direct testimony.

A. Yes.

Q. What is this and where do you get it, the multiplier?

A. Well, I think that was brought out by Mr. Garrett, wasn't it? I don't know what he testified—

Q. Those were the multipliers that Mr. Garrett testified to.

A. Should be.

Q. Because he used a little different multiplier from you. It may have been a different year. I will come to that later, but the multiplier he referred to is the multiplier you referred to, is that correct?

A. The last multiplier that really made officially by the railroads under the Interstate Commerce Commis-
page 878 } sion was 1967.
Q. That is the one that he used, I believe.

A. And I had quite a bit to do with not 1967 but the prior multipliers, and I made a 1968 multiplier myself according to my best ideas, knowledge and practice.

Q. Now what did you base the 1968 multiplier on, what statistics?

A. Well, what I thought was probably the general trend of, the upward trend of prices.

Q. You trended to 1967 into 1968 by your knowledge of what had gone on in the past, is that right?

A. What I thought was my best knowledge.

Q. Yes. You had no statistical information on which to base your 1968 figures over 1967, did you?

A. Not particularly, no, Sir.

Q. Yes, Sir. They were judgment extensions of the 1967 then?

A. That is right.

Q. Now, I believe you said that the 1952 long form that you used was related to or based on the original 1914 evaluation by the Interstate Commerce Commission. Was that evaluation on the basis of the Railroad being a going-con-
page 879 } cern value, Mr. Howland?
A. I think both of them would be considered some.

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Q. Yes. Now this updating of the varied figures in the 1952 long form, that was done on the basis of average railroad figures generally and not on Norfolk and Western figures, is that right?

A. That was done on the basis of figures in the so-called Pocahontas Region, which includes the Norfolk and Western, the C&O; and I think the Virginian, I mean the C&O.

Q. Yes. Did you use a period multiplier in updating the 1952 values?

A. That was spot multiplier.

Q. And that was not applicable only to the Norfolk and Western, is it then? They were all the railroads in the Pocahontas Division?

A. That would be right.

Q. There is no period multiplier applicable to the Norfolk and Western since 1952, is there?

A. One could be worked out.

page 880 } Q. Yes. Now, Mr. Howland, do you have your workpapers that support the reconstruction cost new that you state on page thirteen of your testimony? If so, may I see them briefly.

A. I believe that comes under one of the exhibits, does it not?

Q. You give the figure on page thirteen, five hundred fifty-eight million.

A. That is in Exhibit No. 3.

Q. Yes, and do you have any work papers in support of Exhibit No. 3?

A. They come from Exhibit No. 1.

Q. They come from Exhibit No. 1, and Exhibit No. 1 the figures come from the 1952 long form for the Norfolk and Western in 1946 for the Virginian, is that correct?

A. That is right.

Q. So you require no work papers. You simply took the values off the reports and extended them by the multipliers, is that right, in Exhibit No. 1?

A. Yes. Actually, in back of this, of course, there are some yellow sheets that I did not bring along that supports this.

page 881 } Q. Now, you refer to overheads on page fourteen of your direct testimony and stated that they are regularly used in evaluations made by the Interstate Commerce Commission. What evaluations does the Interstate Commerce Commission actually make, Mr. Howland?

A. You mean today?

Q. That they used these overheads you are talking about.

A. They put a value every year on the Interstate Pipeline.

Q. Yes. What does that have to do with the—

A. Well, you asked about overheads.

Q. Well, your statement on page fourteen stated that the overheads you refer to are regularly used in evaluations by the ICC, and I did not know what evaluations the ICC made that they would make such use of overheads.

A. Well, they make these evaluations of the pipelines due to decisions, I understand, of the Federal Court, some time ago.

Q. They do not make any evaluations of railroads today, do they?

page 882 } A. No.

Q. Now any sale of a railroad, Mr. Howland, exclusive of its franchise, in your opinion, would the purchaser be willing to pay anything additional for the overhead that might be carried on the books of the railroad with respect to the items being sold?

A. In some cases, yes.

Q. What sort of situations would you envisage when they would pay something for overhead, exclusive of franchise?

A. Well, a live-going concern—

Q. But my question was exclusive of franchise.

A. Yes, this overhead simply concerns the engineering, the interest during the construction period, general expenditures in general.

Q. And it is your opinion that a purchase of a railroad exclusive of franchise value would pay something for those values?

A. Yes.

Q. Now, I would like for you to turn please, Sir, to your Exhibit No. 2 and ask you tell us the source of the figures listed in the various accounts there.

page 883 } A. They start with account three, which was engineering report value.

Q. Exhibit 2, Sir?

A. Yes.

Q. Right.

A. Forty-nine million, six hundred thirteen and so forth.

Q. Yes. I believe in the Norfolk and Western evaluation report and one of the ICC dockets shows that the original evaluation could not be definitely ascertained and it was the

general practice back in there to take engineering reports as the start of the original cost today. From that I followed through on each account from the five eighty-eight, the money concerned in additions and retirements and got these answers.

Q. So this column entitled, "Book Cost" came from the 1914 engineering report adjusted in the manner which you just described from the BV five eighty-eight.

A. Yes.

Q. Now, is it your position, Mr. Howland, that the total of the figures shown on Exhibit 2 represents the original cost of the present property of the Norfolk and

page 884 } Western?

A. No, its supposed to.

Q. Supposed to, but they don't.

A. But due to the accounting methods of the ICC while you have in their track accounts the additions and betterments, they do not represent the—we'll say the 1955 cost replacing the 1935 cost.

Q. Yes. Now, at the bottom of page sixteen of your direct testimony you stated that the purpose of your eight day trip of inspection over the Norfolk and Western lines was to "determine the condition of the physical property and the degree to which the property was maintained." Do I understand this to mean that the purpose of your trip was not to make a determination of values, but only the condition per cent?

A. Well, this condition per cent would be applied to the cost of reproduction cost new to give us the cost new less depreciation of the railroad as of 1968.

Q. And that is synonymous with fair market value according to your opinion, is that right?

A. Cost of reproduction new less depreciation is one element of value.

page 885 } Q. Well, what are the other elements of fair market value, Mr. Howland?

A. Probably the original cost to date, we might have the value from financial standpoint of earnings and possibly going concern.

Q. I believe you said earlier, if I did not misunderstand you, that reproduction cost new less depreciation was the fair market value, in your opinion.

A. Well, when you get through with it, the fair market value comes pretty close to it, as a rule.

Q. If not synonymous, it is pretty close to it.

Harold H. Howland

A. Well, the past experience has shown it that way.

Q. What past experience are you referring to now, Mr. Howland? Your experience?

A. No. You take these reports of the Commission and look at their cost new less depreciation and then take the value of the property such as this—I would say, pretty close.

Q. How can you compare it when railroads are not bought and sold on that basis very often?

A. By the value put on it by the Commission.

page 886 } Q. And for what purpose was the Commission putting that value on the property?

A. Theoretically, I think at the time the Commission put the values on, they were put on for rate making purposes. Then they turned around and used it for tax purposes.

Q. But the Commission never has made a determination officially that these were fair market value figures, have they?

A. No, they say the evaluation of the railroad is this.

Q. Now, Mr. Howland, I am interested in your general itinerary on this inspection you made of the Norfolk and Western property as set forth on page nineteen of your testimony. I believe you state that on Monday, March 24 you traveled from Roanoke to Bluefield, a distance of eighty-three miles. Is that correct?

A. Yes.

Q. And on—

A. If the mileage is correct.

Q. Sir?

A. I hope the mileage is correct. I took it

page 887 } theoretically off the time table.

Q. And on Tuesday, you state you traveled from Walton to Bristol, I believe.

A. Yes.

Q. And also on Tuesday you traveled from Abingdon to White Top?

A. Yes.

Q. And also that day you went from Glade Springs to Saltville. Is that right?

A. Yes.

Q. And then I note down on Saturday, the 29th, you say you went from Bluefield to Norton. Is that right?

A. Yes.

Q. Did you investigate or examine the yards at Norton?

A. Not in great detail, no.

Q. Did you see them?

Harold H. Howland

A. Yes and no.

Q. I would like to know whether you saw them or not, Sir, if I may ask.

A. I probably saw one end of them.

Q. You saw one end of them. Now, you also
page 888 } stated on that Saturday that you inspected the
Big Creek branch, is that correct?

A. Yes.

Q. And on Sunday you say you traveled the Grundy line, a distance of seventy-five miles, I believe.

A. Yes.

Q. And then on Monday you traveled from Crewe to Norfolk. Is that right?

A. Yes.

Q. Now, going back, isn't it a fact, Mr. Howland, that on this first Monday you got on the track at Salem and got off at Glen Lyn, which is somewhat short of Bluefield?

A. Yes.

Bailiff: Mr. Howland, will you speak up a little, please.

A. All right.

Mr. Pasco:

Q. I compute that to be about eleven miles difference. Is that about right?

A. Yes.

Q. And on Tuesday you say you went from Walton to
Bristol, but did you actually see the line between
page 889 } Pulaski and Marion?

A. No.

Q. So on that trip, rather than one hundred eleven miles, I believe you covered about sixty-one miles, the time table would show. Does that sound about right to you?

A. I think so.

Q. Now, your mileage, I understand, was listed at approximately, but you wouldn't say sixty-one as approximately one hundred eleven, I do not believe, would you, Mr. Howland?

A. It would not be, in that case.

Q. Now, on Tuesday, the 25th of March I believe you said you traveled from Abingdon to White Top, but isn't it a fact that you went only from Damascus to Abingdon?

A. We picked up the White Top line somewhere below the end.

Q. Below the end. Do I refresh your recollection by saying it is Damascus, or don't you remember?

Harold H. Howland

A. I do not remember. Damascus clicks in some way.

page 890 } Q. And on the 25th you say you went from Glade Springs to Saltville. Now, I do not believe you went on that trip at all, did you?

A. We might have gone up to the beginning of the line, as I recall.

Q. Is it your recollection that you traveled on part of the Glade Springs—Saltville line?

A. Well, I have a note here of Glade Springs, but it doesn't say what mile-post—

Q. You don't recall what part of that—

A. If it was, it would be the lower end toward the main branch.

Q. Now, I asked you about the Big Creek branch. You were with Mr. Dunn, were you not, on this trip, or he was with you?

A. Yes.

Q. I believe he stated this morning, if I recall correctly, that he did not go on the Big Creek branch. Did you, Sir?

A. Well, I didn't put down any mileage for it, anyway.

page 891 } Q. Did you go over any part of it to your recollection or did you just look at it from the switch?

A. More likely, from just a short distance up there.

Mr. Epps: Mr. Pasco, will you tell me where the Big Creek branch is on the Caywood exhibit. Oh, I see it. It is on page three. Thank you, Sir.

Mr. Pasco:

Q. Now, your itinerary shows that you traveled seventy-five miles on the Grundy line on Sunday. Is that an accurate statement of the actual miles traveled, or is that just your estimate, Sir?

A. Well, I think that seventy-five miles is probably the mileage on the Grundy line. It may be short. We did not go clear down to the West Virginia border. We picked up something in there and turned back.

Q. You stopped short at the end of it?

A. Yes.

Q. Now, on Monday you said you went from Crewe to Norfolk. You didn't actually go into the city of Norfolk, did you? You got off at Gilmerton, according to my information, short of the city, is that right?

A. Yes.

Q. Then did you have an opportunity to

page 892 } inspect the extensive yards of the Norfolk at Western at Sewells Point, Lamberts Point and the Norfolk terminal?

A. No.

Q. You did not see those?

A. No.

Q. Now, on page twenty-two, Mr. Howland you state that there are thirty-seven tunnels west of Walton. I am informed by the Norfolk and Western that they only know of twenty-five tunnels. Could that be correct?

A. Well, if they say that I will accept it, but somewhere I gathered thirty-seven tunnels in Virginia on the Norfolk and Western.

Q. Where did you get that information?

A. I don't remember. I acquired it somewhere along the line.

Q. But you did not actually count the tunnels west of Walton?

A. No, I did not count them.

Q. Now, I was intrigued by your reference on page twenty-three to the fact that you say some seven switching crews are employed on a week-day to keep track moving on the Grundy line. What has that got to do with the

page 893 } condition per cent of the track structure?

A. None. It did have something to do with our going up there on Sunday, though.

Q. I see. That clears it up. That statement has been a mystery to me before. Now, you make also a reference that all coal drag crews on this line are prohibited from keeping their trains at a sustained speed between fifteen and twenty-one miles an hour. What is the relevancy of that?

A. That is what the time table says, due to certain cars having a tendency to sway at those speeds.

Q. Does that indicate anything about the condition per cent of the track?

A. It would be more of a condition per cent of the cars, probably.

Q. Yes. High cars and the new cars.

A. I don't know what they are.

Q. Now, I believe you stated that you stopped, at the beginning, every five miles, but then you went to about ten mile stops pretty soon. Was that the first day that you changed this —

A. Yes.

page 894 } Q. —interval of stopping?

Harold H. Howland

A. Yes. Somewhere around the first day.

Q. Now, about how much time did the party spend at each stop?

A. Oh, anywhere from five to ten minutes.

Q. Did everybody get out of the car at every stop?

A. Generally.

Q. Did you get out every stop?

A. Yes.

Q. Did you take any actual measurements of the rail, Mr. Howland?

A. No, Sir.

Q. Did you use any mechanical equipment?

A. No, Sir.

Q. Are you familiar with the devices that are used—have you ever used them?

A. I cannot say that I have used them myself. I have seen them used, particularly in regard to some experiences back on train accident investigations.

Q. Don't they accurately reflect the condition of the rail, more so than the eye?

page 895 } A. Of that particular rail.

Q. Now, you state, I believe, that you believe you achieved the equal results in stopping every ten miles as you would have if you had continued your five-mile stopping intervals throughout the investigation. How is this statistically possible except by sheer coincidence?

A. Well, we followed the general condition of the track as we rode over it.

Q. Yes?

A. We made notes as to maybe a curve was worn as we found it, maybe a lower rail was bedded down or we might say that it was O. K.

Q. How did you select the rail that you would examine when you made one of these stops every ten miles?

A. Well, we generally took the first rail we hit.

Q. Took the first rail you hit. This random selection, then, is not a statistical random in the technical sense of the word?

A. Well, generally Mr. Dunn took another rail, he went one way and I went the other, and I had a take-off of the rail charts showing what we should theoretically

page 896 } find there and we generally did, except perhaps on a curve where a rail or two had been replaced due to the curve wear, and so forth.

Q. Now, you have read Mr. Caywood's testimony in this case.

A. Yes.

Q. I assume you are aware that his inspection crew stopped every half mile?

A. Yes.

Q. Is it your contention that your sampling every ten miles would produce the same degree of accuracy in determining condition per cent that Mr. Caywood's crew would at every half mile?

A. Not necessarily.

Q. There might be substantial difference, might there not?

A. Yes.

Q. Now, you state on page twenty-five that you found some rail in the main lines that had originally been placed there as early as 1923, I believe.

A. Yes.

Q. How many rail sections did you find in that
page 897 } category?

A. I do not remember.

Q. Was there more than one, Mr. Howland?

A. Presumably.

Q. Was it more than two?

A. Yes.

Q. Did you keep extensive notes of your observations during this investigation?

A. Yes, Sir.

Q. Do your notes reflect how many you found?

A. No, simply what they found in that vicinity.

Q. Yes.

Mr. Pasco: Mr. Epps, could we have a copy of those notes for introduction as an exhibit?

Mr. Epps: I will be glad to have a copy made, but I don't have one here.

Mr. Pasco: No, I realize that.

A. I don't know whether you can read them or not. There is grease on them, and so forth.

Mr. Epps: We don't have to say they can read them. We will give them a copy.

Mr. Riely: We will be glad to make it.

page 898 } Mr. Epps: May I look over your shoulder?

Mr. Riely: Yes.

Mr. Pasco:

Q. Could you tell us from your notes where you found some rail that had been put in place in 1923?

A. Probably in some of the branch lines.

Q. You cannot tell us specifically where any particular one was?

A. No. No.

Q. Your notes do not reflect that, to your recollection?

A. Not unless I read through them all.

Mr. Epps: Would you like for him to go through them and see if he can find it?

Mr. Pasco: I think so, because I would like to know if he found more than one rail that had been in as early as 1923.

Chairman Catterall: It would have to be on some obscure branch line. It is like looking for a needle in a haystack.

Mr. Pasco: I don't think they made that many stops, Judge.

page 899 } Chairman Catterall: Do you think that is sufficiently important to recess and let him look through his notes?

Commissioner Hooker: Let's recess for five minutes.

Chairman Catterall: We will recess for ten minutes.

Mr. Pasco: He doesn't have that many notes, I don't think.

Chairman Catterall: The Commission will recess ten minutes and look for the needle in this big haystack.

2:50 P. M.

3:00 P. M. The Commission resumes its session.

Chairman Catterall: Did you find the needle in the haystack?

A. I found two needles.

Chairman Catterall: Two needles.

A. Yes. In 1924 on the Galax branch.

Mr. Pasco: Did you find the 1923?

A. No, that is another needle.

page 900 } Q. Isn't it a fact that you found one in 1923 down on the Durham line, mile-post twenty, I believe?

Chairman Catterall: Do you already have that information?

Mr. Pasco: I now have it.

Chairman Catterall: You had it all this time?

Mr. Pasco: No, Sir, I now have it. He said it was a main line and that is my point.

Chairman Catterall: I didn't understand that. Do you have a 1923 rail in the main line?

Mr. Pasco: That is what he said on page twenty-five.

Commissioner Hooker: They had hand rails in those days, didn't they?

Chairman Catterall: Yes, but they are not supposed to last that long. I suppose they will replace the whole shebang next time around.

A. What mile-post did you say, Mr. Pasco?

Mr. Pasco:

Q. Twenty, I am informed.

A. I have mile-post twenty, one hundred thirty pound rail, 1924 and 1923 and laid in 1936.

page 901 } Chairman Catterall: This is the main line?

A. Branch line.

Mr. Pasco:

Q. Well, that is my next question. Your testimony on page twenty-five was that rail found in the main lines originally placed as early as 1923—this is on page twenty-five. The two that you found were on branch lines, were they not?

A. I think this—I think that statement there means that the Norfolk and Western began placing a hundred and thirty pound rail in the main line in 1923.

Q. Yes. And then followed that up.

Chairman Catterall: When is the first usage of that weight of rail.

Mr. Pasco:

Q. First usage of that weight of rail, according to your testimony, is 1923, but you also found one rail on the Durham line and one up at Galax that old.

A. It is probably some of this right here (indicating) replaced.

Q. Now, with reference to the tunnels that you expressed a condition per cent on, how did you go about

page 902 } inspecting these tunnels, Mr. Howland?

A. Just looked at them as we went through.

Q. You did not stop at any tunnels, particularly?

A. No, no.

Q. Did you have any lights that you used other than the headlights of the car?

Harold H. Howland

A. That was all.

Q. And could you tell—well, then how could you tell whether there had been any spalling or cracking of the lines?

A. Well, by the looks of them and a lot of them are brick lined.

Q. Could you see in these tunnels without anything but the headlights of the car?

A. That is all.

Q. Could you see well enough to see whether these cracks were vertical or horizontal?

A. Most of them were vertical.

Q. But you could see them from the headlights of the car?

A. They were expansion joints, probably.

Q. Could you see the ceilings of the tunnels with the car lights?

page 903 } A. Yes.

Q. Now, did you—how many bridges did you stop at, Mr. Howland?

A. We stopped at no bridges, as I remember, except where we happened to hit a mile-post close to a bridge.

Q. Were there many of those?

A. Not too many, no.

Q. As a matter of fact, there is only one that you came really close to, is that right?

A. I think it was two or three.

Q. Two or three. Did you get down under the bridges and inspect their condition from the underside?

A. No, Sir.

Q. Did you—

A. I made a couple of notes on one or two bridges, mentally, at least, that some of the concrete was falling on the abutments and noticed I think it was a 1924 date on the abutment, but I would not think it was very serious.

Q. Well, did you examine the lateral bracing systems of the bridges?

A. No, Sir.

page 904 } Q. You just took a look at the bridge as you went by.

A. That is right.

Q. What you could see from the high rail car?

A. That is right.

Q. You made no detailed examination of any part of it?

A. No.

Q. Now, as to the condition per cent of cross ties, Mr.

Howland, how many cross ties did you look at these periodically ten-mile stops?

A. Oh, probably three or four rail lengths.

Q. And you looked at a different set from what Mr. Dunn did—he went in one direction and you went the other, is that what I understand—

A. Normally, yes. He went his way and I went mine.

Q. Yes. How did you classify the ties for the purpose of determining condition per cent?

A. I went as far as, theoretically we assumed they were in a fifty per cent condition because they were some forty-

page 905 } odd years of replacing creosote ties, they should be in a state of wear about—they've got some very good ones and some very poor ones ready to come out tomorrow, so it might be fifty-one per cent this year and forty-nine next year or something like that so we assumed fifty per cent, but I did make a note many times of how many poor ties I saw in a panel.

Q. Now, Mr. Caywood had ten categories, I believe, in which he classified the ties he looked at. Mr. Dunn had five categories. You just looked at them and decided whether they were good or bad, is that right.

A. I also said fair in some places.

Q. Good, bad and fair. Now, with respect to the condition per cent of the ballast, how did you go about inspecting the ballast?

A. Just by looking at it.

Q. Did you dig underneath the top surface?

A. No.

Q. Well, isn't it true Mr. Howland, that the sub-surface quality of the ballast is just as important in determining its effectiveness and its condition per cent as the rain-washed surface?

A. Yes.

page 906 } Mr. Epps: Just a minute. Did it rain every day you were out there? I haven't heard about any surface except the rain-washed surface.

Mr. Pasco: I assume the ballast—it has been out there for years and it has rained each year.

Mr. Epps: I didn't know that was the purpose of rain.

Mr. Pasco:

Q. Of course sub-surface is a pertinent factor and you did not look at it, is that right?

A. That is right.

Q. Now, I believe you stated in your testimony you found one tie that had a dating nail of 1922 on it. Do you have any knowledge now of the approximate number of ties the Norfolk and Western has in place in Virginia?

A. No, but I figured it mentally—

Q. If I told you there were around eight million, would you be inclined to agree that sounded reasonable?

A. Somewhere near.

Q. And I believe you found one tie with a date nail as old as 1922 in your sampling.

A. Yes, I found one somewhere else with 1924.

page 907 } I had it a few minutes ago here.

Q. Now, on page twenty-seven, Sir, you state that you observed the line and surface of the tracks and I just want to ask you, isn't it true that brand new rail can be just as poorly laid and in poor line as a well used rail.

A. After a short period of time.

Q. And the same thing is true about new ties and new ballast as compared to old ties and old ballast, isn't it?

A. Yes, in their place.

Q. Now, you say on page twenty-seven that the line and surface is maintained to a degree considerably above the speeds permitted on the line. What speeds do you understand are permitted on the line, particularly east of Roanoke main line?

A. It is seventy miles an hour with sixty miles restriction.

Q. And it is your testimony that the line and surface would permit greater speeds, is that right?

Chairman Catterall: That is what he said.

Mr. Pasco: I want to be sure if he means that.

page 908 } A. Yes.

Mr. Pasco:

Q. Then it is your conclusion that the chief engineer of the Norfolk and Western is maintaining his line and surface to a degree in excess of what he can use it for?

A. What he does use it for.

Q. What he can use it for under the restrictions in the time table.

A. Yes, I believe they reduced the speed in the time tables in the last year.

Q. Now, on page twenty-eight you referred to—do you know why the speed limits were reduced, Mr. Howland, before I go to page twenty-eight?

A. No, no.

Q. You just understand they were reduced, but you don't know why. Now, on page twenty-eight, Sir, you referred to ballast being dumped on the track for betterment. You used the word "betterment." Are you using that term in the ICC accounting sense?

A. It will probably go in as that.

Q. How can you tell by looking at a pile of ballast whether it is a betterment or replacement or an improvement?

page 909 } A. You cannot.

Q. So this was just a surmise on your part, when you described this pile of ballast as a betterment.

Then on page twenty-nine you compared a present day maintenance of the Norfolk and Western to that found in former days. Have you examined the Norfolk and Western any other time besides the 1918 walking trip?

A. No.

Mr. Pasco: Now, just a second, if your Honors please.

Q. Mr. Howland, on page twenty-eight and going over to twenty-nine of your testimony, you say, "In 1942 also I found that on the heavy main line a life of sixteen years was used for the first cycle of the rail," and you say, "Today I believe this life can be extended from conditions as found on the ground on certain portions due in some cases to changes in traffic handled and also to better maintenance than was found in former days." Now, isn't it true that trains operate today at much greater speeds on the Norfolk and Western than they did in 1942?

A. I do not know.

Q. They certainly are much heavier trains,

page 910 } aren't they, with larger coal cars?

A. Well, in the earlier days you had two hundred ten coal cars down there with six wheel trucks that had to be dumped this way (indicating.)

Q. You would agree that the traffic has been increased on the Norfolk and Western since 1942?

A. Yes.

Q. Well, I don't understand how increased traffic and possibly increased weight can extend the life of the rail. I would like for you to explain what you mean at the bottom of page twenty-eight.

A. I do not think they have increased the weight of the

cars. They have increased the total cars hauled—total tonnage in the cars in the train.

Q. Well, isn't one of the determining factors in the life of the rail the tonnage that passes over it?

A. Theoretically.

Q. And there is more tonnage now than there used to be, I believe you agreed with me.

A. Yes.

Q. And yet you say that you believe—on the bottom of page twenty-eight—you believe the life of the

page 911 } rail can be extended on the main line beyond the sixteen years?

A. Well, today they are building up a lot of rail ends and where you have got the corrugated rail in many places they have gone out and grinded the tops down, sort of smoothed it out. I think you have better maintenance under the joints than you have had.

Q. So, it is your testimony that better maintenance gives the rail a longer life, in spite of the heavier tonnage and higher speeds.

A. Well, I do not think they are hauling at any higher speeds today than they did.

Q. I thought you had agreed with me they did, but we are agreed there is heavier tonnage now and in spite of heavier tonnage, it is your testimony that the better maintenance gives a longer life, is that correct?

Mr. Epps: Excuse me, Mr. Pasco. He said he did not know, when you asked him that. He did not agree with you when you asked him about high speeds. He said he did not know, just so it won't be confusing.

Commissioner Hooker: And he didn't say heavier tonnage. He said they had more cars.

page 912 } Mr. Epps: More cars. That is right.

Mr. Pasco:

Q. If you have more cars, you have more tonnage on the rail.

A. Not in one place. Not under one wheel.

Q. You spoke of some of the improved maintenance conditions as welding. You don't know whether the Norfolk and Western had welding gangs operating in 1942 or not, do you?

A. Do you mean ribbon rails?

Q. No. Welding gangs, welding rails as you just referred to the maintenance program—building up rail.

Harold H. Howland

A. No, I don't know.

Q. Now, if you would look at your Exhibit No. 3, please and explain to me why you allocated no depreciation to account number one—

A. It has never been the practice to.

Q. Cost of reproduction new and the cost of reproduction new less depreciation of account number one is the same.

A. Yes.

page 913 } Q. You recognize no depreciation for engineering?

A. That is right.

Q. But wasn't most of this engineering performed years ago on the Norfolk and Western properties?

A. This money here is figured out as figured out in these figures right here, which are 1968 figures (indicating.)

Q. But you give depreciation to the other items and you carry the engineering presumably at a hundred per cent.

A. Yes.

Q. And I ask you—didn't a great deal of this engineering get performed many years ago?

A. Yes.

Q. And it is your testimony then that there has been no depreciation or deterioration in this engineering over the years?

A. That is right.

Q. It doesn't deteriorate as the property to which it was devoted deteriorates?

A. Well, it has been the practice of not depreciating account one.

page 914 } Q. This is the ICC accounting practice, isn't it?

A. Yes.

Q. That is not related to actual fair market value then?

A. Probably not.

Q. Now, I am a little confused about your values on Exhibit No. 3 for account three. You allow no depreciation as a different figure in the right-hand column. Is that a typographical error or was there some change?

A. No, in Exhibit No. 1 on page one you will notice that accounts headed Reproduction Cost New is forty-two million, one hundred eight thousand plus and Cost New Less Depreciation is forty-one million, six hundred twelve thousand—about five hundred thousand dollars less, so I just took off eight hundred thousand dollars off of here—off of the cost new.

Q. Why was it half a million less on Exhibit No. 1?

Harold H. Howland

A. Because undoubtedly on account three the entire account is grading and very little masonry—retaining walls and things of that sort which depreciate.

Q. And so because the difference of five hundred thousand dollars, now you say you deducted about

page 915 } eight hundred thousand over on Exhibit No. 3?

A. That is right.

Q. How do you explain the difference between the five and the eight.

A. Well, I put a factor of one hundred seventy-four on the five hundred thousand and got eight hundred and fifty thousand.

Q. On account number eight which includes ties, you use on Exhibit No. 3 a fifty per cent condition, I believe.

A. Yes.

Q. Now, this fifty per cent, I believe you testified, was an assumed figure which you used.

A. That is right.

Q. Because half of them had over half of the life gone and the other half were one-half new.

A. Yes.

Q. Why wouldn't that apply to the other elements of the track—the rail and the other track materials?

A. Because your rail has always got a factor—a salvage factor—in there which is not depreciated. After a rail has served its entire life in the tracks, it has a fac-

page 916 } tor of scrap value.

Q. I don't understand what the scrap value of the rail that is fully used for the railroad purposes has got to do with the condition per cent. You use fifty per cent for ties because you assume that half of them are over half gone and half of them are less than half gone. Now, I do not understand why the same thing does not apply to the rail.

A. Because you don't depreciate the scrap value.

Q. You mean on the books of the ICC—they don't depreciate scrap value.

A. Well, there is something that is just scrap which is not depreciated.

Q. Well, now, assume a rail that had no scrap value—let's assume that the rail has no scrap value—

Mr. Epps: May it please the Court, I object to that question. Mr. Caywood's testimony has all been that rail does have scrap value.

Chairman Catterall: Yes. I don't know why we would want an imaginary question like that.

Mr. Pasco:

Q. What per cent of this rail value is scrap
page 917 } value, Mr. Howland?

A. The rail is depreciated in two cycles—from new to relay—with a salvage factor of about seventy-one or seven tenths, roughly, of the new rail, the cost of the new rail as relay rail and the second cycle is when it is placed as relay it has a salvage factor of somewhere around forty, so in your case of new to relay you're salvaging—you're only depreciating thirty per cent above the seventy per cent salvage factor.

Q. Well, all of the rail is taken up in the first cycle is not relayed, is it?

A. The greater part is, the greater percentage.

Q. Yes. Now, Mr. Howland, you didn't see the yards of the railroad at Norfolk and at Norton. Did you see them at Roanoke?

A. We saw the leads.

Q. You just saw the leads.

A. We walked down a little distance—enough to get a general visualization of what they were and on the passing tracks I made notes where we found them, where we got off at the passing tracks I made notes. We generally found out
it was either relay rails, oftentimes maybe a little
page 918 } lighter rate.

Q. You didn't see any of the Norfolk yards, I believe. You got off eight miles from Norfolk.

A. No, we did not go into Norfolk.

Q. And you just saw the leads at Norton?

A. Leads at Norton and probably Crewe, without stopping, and we made some investigation inspections at Roanoke a couple of times.

Q. But as compared to yards and lesser branch lines, you saw a much greater percentage of the main line, is that correct?

A. That is right.

Q. Now, if you had seen a representative percentage of these lesser branch lines and side tracks, isn't it quite likely that your condition per cent would be somewhat lower on the elements of the track?

A. I do not think so because I gave a fifty per cent value to the relay rail in these yard tracks. Relay rail can be

relayed two or three times without anybody knowing whether it is in the first cycle or not, as far as the records go.

Q. It depends on where you put it, doesn't it?

page 919 } A. Or the way they handle it too, so we just gave it fifty per cent. It comes very close to that anyway, I think.

Q. When you say "we," you are speaking of your assignment.

A. Yes.

Q. Now, what did you find to be the average age of rail in place on the Norfolk and Western from your inspection, roughly.

Note: Witness reviewing papers before him.

Q. On thirty-nine-B you list some service lives from your testimony.

A. Well, I found an average age in the Virginian. From Norfolk to Crewe, it is twenty-seven years old; from Crewe to Roanoke, it is fourteen; and Roanoke west, it is twenty-one.

Q. Yes.

A. And on the former, from Norfolk to *Crew,* it is twenty; Crewe to Roanoke, twenty-five; Roanoke west, seventeen; and from Roanoke to Hagerstown, twenty-seven and I figured that service life there in condition per cent, I figured an average of that composite up there was about thirty.

Q. About thirty.

page 920 } A. Yes.

Q. And you found according to your Exhibit No. 3 that the rail was in seventy-five per cent condition of new. This means that the life cycle of the rail is one hundred years, if I do my mathematics right.

A. The life cycle is around fifty years, country-wide.

Q. I am talking about the Norfolk and Western. You found that the average life of the rail in the Norfolk and Western's lines to be roughly twenty-five to twenty-seven years, you testified.

A. Yes.

Q. And you found out that the condition per cent of this rail was seventy-five per cent, which means it had three-fourths of its life to go. Is that correct?

A. Not necessarily.

Q. What does a seventy-five per cent condition mean on your Exhibit No. 3 then.

Harold H. Howland

A. Well, this new rail which has gone to relay was given a physical condition of thirty per cent in that cycle. It has a salvage factor of seventy-one new to relay and we are conditioning the twenty-nine per cent above the salvage factor as thirty per cent which gives about eight or
page 921 } nine so I added seventy-one and nine and that gives us eighty. Now, the relay rails we give seventy-one per cent figuring the same way, and I assumed the two together would give about seventy-five per cent.

Q. Did you find any relay rail, to your recollection, in the Norfolk to Crewe lines?

A. I would say not, off-hand.

Q. Then, so your life cycle from that would be correct then, wouldn't it, as testified?

A. Yes.

Q. There is no relay rail to your recollection in the lines from Norfolk to Crewe and you find on page thirty-nine-B that it has an average age—the rail in place has an average age of twenty-seven years.

A. That is on the Virginian.

Q. Right. On that line.

A. 1941 rail.

Q. Twenty-five years old?

A. Twenty-seven.

Q. Twenty-seven years old. And yet you found that average on your Exhibit No. 3 the average of the—the condition per cent of the rail in the overall Norfolk and
page 922 } Western lines in Virginia was seventy-five per cent of new. Now, doesn't this mean that the rail has a life of a hundred years?

A. No.

Q. What does seventy-five per cent of new mean on Exhibit No. 3, then, Mr. Howland?

Mr. Epps: If it please the Court, didn't he just explain that in detail?

Chairman Catterall: I thought he did.

Mr. Epps: I thought he did, too, and added it up and rounded it off.

Chairman Catterall: I think what Counsel is overlooking is that even after it is used up as a relay rail it still has some value lift. It seems to me the witness has said that about six times.

Mr. Epps: I agree with that, Sir.

Harold H. Howland

Mr. Pasco: But that is not the service life, if the Commission please.

Chairman Catterall: No, he is talking about the value of the rail.

Mr. Pasco: His Exhibit No. 3 in the third column, Sir,
page 923 } purports to set forth his findings as condition per cent of the rail in place and he has an average of seventy-five per cent and I am trying to find out what he means by that.

Chairman Catterall: He means the rail they bought for a hundred dollars is now worth seventy-five dollars.

Mr. Pasco: It has nothing to do with what is left in the use of the rail.

Chairman Catterall: It is the number of dollars left in this rail for evaluation purposes.

Mr. Pasco: But he testified it was condition per cent of new.

Chairman Catterall: The monetary per cent of new, as I understand the witness.

Is that what you meant, Mr. witness?

A. We are conditioning money here in account nine.

Chairman Catterall: You are talking about money, are you not?

A. Yes.

Mr. Pasco:

Q. But I thought you said on this inspection
page 924 } that you made you were determining the condition per cent and not making any evaluations.

A. We have got some scrap value in here at all times. When you get through the total life of the rail, it throws away "x" dollars per ton to the scrap dealers.

Q. Then you have not found a condition per cent of new of the life of the rail in terms of service years, is that correct?

A. I said the main line rail condition per cent was about thirty and the relay rail was fifty and when you apply salvage value to both of them, we get eighty and seventy-one, or I used seventy-five for the—

Q. When a rail has got to the point that it is good only for salvage, what is its condition per cent?

A. Zero, physically, and it would be about forty-one actually.

Q. Forty-one actually and physically it is zero. All right, Sir. Now, Mr. Howland on your Exhibit No. 3 the average

of sixty-eight point five that you used there is a total condition per cent figure. Is that a weighted average?

A. That is the cost new less depreciation divided by cost of reproduction new.

page 925 } Q. And that is the way you arrived at this?

A. That is the way I got that one.

Q. On page thirty-one you referred to the photographs which you have included as an exhibit with your testimony. Now, generally speaking, are these photographs intended to depict average conditions as you found them?

A. They were the conditions where we took the pictures.

Q. In your view are they representative of the average of what you saw, or are they the best of what you saw or the worst of what you saw?

A. Well, they could be either way but—

Q. I want you to look at them and tell us whether they are.

Chairman Catterall: Did you take them at random or did you have a specific purpose in each one?

A. They were taken at random.

Mr. Pasco: So they represent roughly an average then, is that right?

A. They could.

Q. Now, on page thirty-four of your testimony, Mr. Howland, you state that you have not added anything to your determination of fair value for franchise or going concern value, and yet you state that the highest and best use of the Norfolk and Western's properties which you examined was as a railroad. Doesn't that of necessity assume the right to operate these properties as a railroad?

page 926 }

A. If they had a franchise.

Q. If there was—now, looking at the last question on page thirty-four of your testimony in which you are asked if the entire property assembled in place does not have a greater value than the sum of the component parts, and your answer is yes. Isn't this true that this is the correct answer only if you can use the property as an operating railroad?

A. We would have to assume that, yes.

Chairman Catterall: If it was used as an operating railroad and lost money year after year, what would the going concern value be?

Harold H. Howland

A. Not very much.

Chairman Catterall: And if they made a lot of money year after year, would it be different?

A. Somebody would want it then.

page 927 } Chairman Catterall: So if the going concern value is what they get by operating it after they build it, is that correct? You understand that the Virginia law, the state taxes the gross receipts of the railroad with the theory that they are thereby taxing a going concern value, and they tax the gross receipts even if they are losing money year after year. That is our system. You have not found that system elsewhere in the United States, have you?

Note: No response.

Mr. Pasco:

Q. All right, Mr. Howland, on page thirty-five and thirty-six you state that you are familiar with certain purchases and sales of railroad track properties and you mention the Washington and the Old Dominion and the Dahlgren lines. Are you familiar with the sale price of these railroads?

A. Only from *heresay* in the Washington and the Old Dominion. I did the engineering work on the Washington and Old Dominion. I kind of assisted at the bringing it together and as I remember, we came up with a figure of between three and four million dollars. I may be wrong, but as I

page 928 } recall they sold it to the state for nearly the figure we put on and what they sold it to the power company for, I do not know. Now, on the Dahlgren we came up with the cost new less depreciation of account nine and ten and we figured that thing—had nothing to go on—and we figured out it was a couple of counties around there that had ambitions as industrial yards, and so forth, and we figured a total figure of—for account nine and ten—eighty thousand dollars for the cost of removal of the material and then in account eight we came up with a figure of salvage of those ties which had been placed, I think, in 1957, and we put the two together and gave the contract a twenty per cent profit and we came up six hundred and seven thousand dollars and then put a figure of six hundred thousand dollars on it and the sale price as I understand it was within about one tenth of one per cent of that figure.

Harold H. Howland

Q. Did those sale prices have any relation to the reconstruction cost new of these lines?

A. No.

Q. And did it have any relation to reproduction cost new less depreciation?

A. They did of the accounts eight, nine and ten. That is the cost of removal and contract profit for re-
page 929 } moving.

Q. How about the other accounts, looking at the overall sale of roads?

A. We threw that out the window.

Q. Had no value at all.

A. They had no value at all.

Q. They had no value at all? Is that why you threw them out the window?

A. Well, we didn't think it at the time.

Q. Well, now, would these sale prices have any relation to the original costs of these lines?

A. No. Well, I don't know about the Dahlgren line. I never knew what the original cost was. They never reported anything. Now the Washington and Old Dominion, that had been built in the very early days and gone through the wringer and sold for a minimum sum and so forth.

Q. Thank you, Mr. Howland. And now, on page thirty-seven, you talk a little bit about slow orders. Do you actually think that the existence of slow orders on a railroad is any real evidence of its condition per cent?

A. State-wide? No. If there was enough of them it might affect it, but we have only one here that really does have any bearing in the matter.

page 930 } Q. And aren't the permanent speed restrictions just as significant or more so than slow orders in indicating condition per cent?

A. Well, you've got—you are running some long trains here and you are running over various conditions of alignment and grade, so that I think the tendencies was that they were having—that it was advisable to hold the speed down to a—possibly—an average of what the line would bear, now, in other words, you wouldn't want a thirty-five mile speed limit on a curve, followed by a mile of sixty mile tangents and another sharp curve and slow down again, you might have some operating conditions.

Q. But it is true that a permanent speed restriction might indicate a condition per cent.

A. It could.

Harold H. Howland

Q. Yes. Now, would you turn to page thirty-eight and tell me how you computed the fair value of one mile of track? I am confused on your explanation there.

A. Well, Exhibit No. 6 gives a breakdown of that figure.

Q. Do you think this is indicative of the fair market value of one mile of the Norfolk and Western, Mr. Howland, or whether it is the fair market value, to be more specific.

page 931

A. No. The fair market value you have got to depreciate this track down.

Q. And consider the other elements that you mentioned earlier?

A. Yes.

Q. Now, on page thirty-nine of your testimony, and I believe my last question, unless my colleagues have some suggestions, you undertook to express a view as to the accuracy of the value as assigned to the Norfolk and Western by the State Corporation Commission.

A. Well, I don't know as I would like to criticize them, but—

Q. You said it was reasonable, I believe.

A. Yes.

Q. And I understood you were there expressing an expert opinion as to values, although your testimony, as I understand it, and your investigation had to do with the condition per cent of the railroad. Is that true?

A. I believe we were asked to figure the cost new and the cost less depreciation.

page 932

Q. Well, I believe you said earlier that that does not necessarily—does not indicate fair market value without considering other items.

A. That is correct.

Q. You expressed—I have overlooked one item, Mr. Howland. You expressed the condition per cent of the signals on this railroad in Virginia, also, I believe. And what was that?

It would be on Exhibit No. 3, I believe, account twenty-seven.

A. Seventy-five per cent.

Q. Seventy-five per cent. All right. Did you actually examine any particular signal or group of signals, other than noting their condition as you passed by?

A. That is all.

Q. That is all.

A. We do know there has been some replacement since the original inventory of 1914.

Q. I would assume so.

A. But probably they have gone through two cycles and we have taken off the additions and betterments I noted roughly where these last monies came—what page 933 } year they came in—so that is where I got my—

Q. You made no actual inspection or investigation of the signal installation from there?

A. No, from the average life which we would give signals and from the old money and the new money, I figured seventy-five.

Q. You are not a signal engineer expert, are you?

A. No, I'm not.

Q. You are an ICC accounting expert, is that right?

A. No, I am an engineer.

Mr. Pasco: That is all, and thank you very much, Mr. Howland.

Mr. Shannon: I have a few brief questions of Mr. Howland, if your Honors please.

Chairman Catterall: Can you finish by 4:00 P. M.?

Mr. Shannon: Oh, yes, I will be through by then.

CROSS EXAMINATION

By Mr. Shannon:

Q. Mr. Howland, let me refer you to page seventy-two of Mr. Caywood's testimony. Down at the bottom, page 934 } what is the figure for the number of tunnels he gives there?

A. He says here at the bottom, next to the last line—thirty-seven tunnels in Virginia.

Mr. Pasco: That is not west of Walton, though.

Mr. Shannon: He said he recalled seeing that figure. I just wanted the record to show that it came from Mr. Caywood's testimony.

Q. Now, Mr. Howland, if you would be so kind as to refer to page twenty-eight in your testimony, did the steam engine's—its pounding of drivers—did that have any affect on rail wear?

A. Improperly handled, yes.

Harold H. Howland

Q. And then with the advent of the diesel, that factor was eliminated, was it not?

A. The wheel pounding was, yes.

Q. And then in 1942 do you recall whether the N&W was fully a steam railroad at that time?

A. I would assume they would be.

Q. Because it was one of the last railroads, wasn't it, to convert over to diesel locomotion—to diesel power.

A. Well, they weren't one of the first ones.

page 935 } Chairman Catterall: Some of their customers were coal people, I believe.

Mr. Riely: They also had large shops to build locomotives.

Mr. Shannon:

Q. Now, Mr. Howland, you refer to, in your Exhibit No. 6, you gave a breakdown of how you arrived at the price of what you considered to be the price of a mile of railroad. In that breakdown you did not include anything for grading, did you?

A. No, Sir.

Q. But if grading were shown in there and excavation, and so forth, it would considerably increase that figure, would it not?

A. Yes.

Q. Mr. Howland, with the dieselization of the Norfolk and Western, isn't it a fact that the damage to ties from fire boxes and water damage was eliminated to a large extent?

A. Yes.

Q. And haven't improved methods of cleaning ballast adopted from the past ten years or so improved

page 936 } drainage, thus eliminated moisture as the major factor in the rottening of ties?

A. Yes.

Q. How about improvements in the design of tie plates and tie pads and the use of continuous rail—has that resulted in a—

A. In the early days, they used tie pads which were say, pretty sorry looking and they had a tendency to cut ties and they have, over a period of years I think—all the railroads have gone now to tie plates.

Q. And haven't the improvements in the mechanized methods of performing track work extended tie life by more precise surfacing and lining of tracks and by placing ballast

under ties, by vibration rather than by hammer blows—hasn't that contributed to prolongation of tie life?

A. Undoubtedly, the mechanization of the ballast has been an asset.

Q. Mr. Howland, on page thirty-two of your testimony—I will withdraw that question. I won't refer to that. I believe that is all I have, your Honors.

Mr. Epps: No re-direct.

page 937 } Chairman Catterall: You may stand aside, Sir.

Witness Stood Aside.

The Commission will recess until 10:00 A. M. tomorrow morning.

page 938 } April 22, 1969

The Commission resumes the hearing in Case No. 18629.

Chairman Catterall: What comes next?

Mr. Riely: Mr. Priest, I believe.

Mr. Epps: Mr. Priest is here for cross examination. I would like to call Mr. A. J. G. Priest to the stand, please

DIRECT EXAMINATION

By Mr. Epps:

Q. You are Mr. A. J. G. Priest, is that correct?

A. Yes, Sir.

Q. Would you state your residence and occupation?

A. Charlottesville, Virginia. I retired from the University of Virginia Law School, but I have the title of Scholar in Residence; and I still occupy an office at the University of Virginia Law School. I am a consultant to my old law firm and practice from time to time when I have the opportunity to do so.

Q. Yes, Sir. You are the A. J. G. Priest whose direct testimony has been transcribed and subscribed by you and filed herein?

A. Yes, Sir.

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* * * * *

TESTIMONY OF A. J. G. PRIEST
ON DIRECT EXAMINATION

Q. Please state your name and address.

A. A. J. G. Priest. My address is Charlottesville, Virginia. My mailing address is: care of the Law School of the University of Virginia, Charlottesville, Virginia, where I have my office.

page 940 } Q. What has been your formal educational training?

A. I was graduated with A.B. and LL. B. degree from the University of Idaho.

Q. What position do you hold at the present time?

A. I am a Scholar in Residence at the Law School of the University of Virginia.

Q. Are you an active member of the University of Virginia faculty at this time?

A. No, I am not. I retired from the University of Virginia faculty in June, 1966, and since that time I have held the title of Scholar in Residence.

Q. In what jurisdictions are you authorized to practice?

A. Idaho, New York, the District of Columbia, and Virginia. The late T. Justin Moore moved my admission here, after I had been teaching at the University of Virginia Law School for three years.

Q. Please state what your professional experience has been particularly in the field of public utility regulation.

page 941 }

A. I began my public utility service as attorney and secretary for the Idaho Power Company, a position which I held from 1922 until 1926. In 1926, I went to New York to become a member of the Law Department of the Electric Bond and Share Company, and in 1935 I became a member of the New York firm of Reid & Murphy, which was particularly active in the practice of public utility regulation. In 1937 the name of the firm of Reid & Murphy was changed to Reid & Priest, and I continued the practice of law in New York as a senior partner in that firm until January, 1953, when I left New York to become a Professor of Law at the University of Virginia. The firm of Reid & Priest continues to practice under that name. I am of coun-

sel to the firm. I served as chairman of the section of Public Utility Law of the American Bar Association in 1951-1952, and I am, and have been for several years, a Life Fellow of the American Bar Foundation.

Q. What was the nature of your New York practice?

A. Our efforts at the time of my active association with my old firm were devoted largely to corporation law, including the issuance of securities, and to the practice of public utility regualtion.

Q. Before what commissions have you appeared?

page 942 } A. I have appeared before several state commissions, among them the Idaho, Utah, Montana, Oregon, Washington and South Carolina regulatory agencies, but the larger part of my time devoted to public utility regulation was before the Securities and Exchange Commission, which was then actively implementing the Public Utility Holding Company Act of 1935, and before the Federal Power Commission, which had jurisdiction over a number of the clients of my law firm. I also helped to represent the Canadian Pacific Railway Company in a 1949 nation-wide freight rates proceeding before Canada's Board of Transport Commissioners which lasted some four months. I have appeared before the supreme courts of two states, before three United States Circuit Courts of Appeals and before the United States Supreme Court.

Q. Have you done any writing in the field of public utility regulation?

A. Yes. I have written articles which have been published in the Law Reviews of the University of Virginia, the University of Iowa, and the University of Mississippi, as well as the Yale Law Journal and the Journal of the American Bar Association, and I have written a number of articles for the "Public Utilities Fortnightly."

Q. Have you written any book or books in this field?

page 943 } A. I have spent parts of the last several years in the preparation of a text about to be published by The Michie Company of Charlottesville, under the title *Principles of Public Utility Regulation: Theory and Application.* This work, which will run to approximately 1100 pages, and will be published as a two-volume set, will deal more or less comprehensively, but not encyclopedically, with the problems of public utility regulation. It is expected to be available the latter part of next month.

A. J. G. Priest

Q. Tell the Commission something about your teaching experience in this area.

A. I taught the law of public utility regulation at the University of Virginia from 1953 until my retirement, with an absence of three semesters in the course of which I was engaged as counsel for a large group of electric utilities which had an unusual problem before both the Federal Power Commission and the Internal Revenue Service.

Q. Have you lectured on the subject of public utility regulation at other institutions?

A. Yes. I lectured each summer from 1953 through 1968 before a group of electric utility executives assembled at Georgia Tech. I also lectured at the University of Kansas, the University of North Carolina, and the University of Michigan.

Q. Please tell the Commission whether you have appeared on any previous occasion in behalf of the non-utility side of of a public utility controversy.

page 944 } A. No. This is my first experience on that side. For a period of approximately forty-seven years I have represented public utilities, and to be quite frank, I have looked upon myself as a public utility lawyer, even though I have sought to achieve substantial objectivity in the preparation of the textbook which is to appear next month.

Q. Are you familiar with the issues which have been raised for presentation to the Commission in this proceeding?

A. I am.

Q. Have you had occasion to read the direct testimony of the Norfolk and Western's witnesses presented to the Commission in what normally is called "canned" form?

A. Yes.

Q. What, if any, reasons for diffidence or reluctance did you express when I first asked you to interest yourself in this proceeding?

A. I was diffident on two counts: first, I have been a public utility lawyer for around 47 years and have never represented the other side and, secondly, John S. Shannon, general counsel for the Norfolk and Western, was one of the most brilliant students I had at the University of Virginia Law School and is a warmly cherished friend. I was obviously reluctant to seem to criticize his client. I may add that Mr. Shannon wrote the background material on railway mergers which appears in Chapter 24 of my

page 945 } forthcoming text on utility regulation.

A. J. G. Priest

Q. How did I persuade you?

A. On the grounds that I also have good friends in your firm and that I have a sense of duty to this Commission.

Q. In what, if any, publication have you written on the subject of going value at any time in the last several years?

A. I discussed going value briefly in an article on the public utility rate base published in the Winter, 1966, issue of the Iowa Law Review. My article begins at page 283 of Vol. 51 of the Iowa Law Review and I make reference to going value at page 318. Substantially the same material will appear in my forthcoming text.

Q. Since your reference to going value is brief, please read it into the record.

A. This is the paragraph in question. I quote:

The concept known as "going value," which was warmly cherished by an earlier generation, deserves no more than a *paragrpha.* Valuation engineers once claimed a rule-of-thumb allowance of ten per cent for the mystic quality possessed by a utility enterprise which had coordinated its property, trained its personnel, and attracted its customers, but no such item will be found on modern utility balance sheets. As the late John F. MacLane, of Idaho, Utah, and New York, observed after testimony in attempted support of "going value" had been thoroughly damned by Chief Justice Hughes in *Los Angeles Gas & Elec. Corp.* v. *Railroad Comm'n,* "they might give us going value if we could prove it, but we can't prove it."

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Q. Do you continue to hold the opinion expressed in what you have just read?

A. I do.

Q. Please invite the Commission's attention to any comparatively recent decisions of our Supreme Court of Appeals which seem to you generally significant in this connotation.

A. Two cases which seem to me to emphasize the decreasing importance of going value in Virginia are *City of Norfolk* v. *Chesapeake & Tel. Co.,* 192 Va. 292, a 1951 decision, and *Arlington County Bd. of Supervisors* v. *Virginia Elec. & Power Co.,* 198 Va. 1102, a 1955 decision.

Q. Why do those cases seem to you important in this connection?

A. Because no claim was made for going value in either case and because both cases were tried by the late T. Justin

Moore, who was a senior partner in what is now the firm of Hunton, Williams, Gay, Powell and Gibson and who was, in my opinion probably the leading public utility lawyer of his time. Mr. Moore had a reputation for leaving no tree unclimbed, no stone unturned, and I think that if he had believed a claim for going value might have produced consequential dollars for either one of his clients, he would have asked for going value and would have sought to
page 947 } establish it. There is no discussion of going value in either decision, but the absence of any reference to that concept seems to me to be strikingly significant.

Q. Are you generally familiar with the decisions, especially the decisions of the Supreme Court of the United States, which have dealt with the going value concept in the public utility area over the past 50 years?

A. Yes, I am. I have been required to become familiar with the rise and decline of going concern value as its history is given expression in major decisions of the past 50 years. I have had to examine the problem as a practitioner, teacher, lecturer and writer in the field of public utility regulation.

Q. Please indicate briefly what the history of the going value concept has been in the past 50 years.

A. The going concern concept reached its apparent zenith in 1917, when the United States Supreme Court adhered, in *Denver* v. *Denver Union Water Co.,* 246 U.S. 178, 191-92, to this statement made in *Des Moines Gas Co.* v. *Des Moines,* 238 U.S. 153, 165, decided in 1915:

"That there is an element of value in an assembled and established plant, doing business and earning money, over one not thus advanced, is self-evident. This element of value is a property right, and should be considered in
page 948 } determining the value of the property, upon which the owner has a right to make a fair return when the same is privately owned although dedicated to public use."

Utility lawyers cited the *Denver Union Water* and *Des Moines Gas* decisions with some confidence in the 1920's and early 1930's when we sought to establish a utility's rate base, but the going value concept came upon evil days at the time of the Great Depression and it has not recovered its former virility.

A. J. G. Priest

Going value is examined at scholarly length by our own Supreme Court of Appeals in *Alexandria Water Co.* v. *Alexandria,* 163 Va. 512, 593-96. This was a 1934 opinion, delivered by Judge Epes. Three of the judges concurred in the result, but none of them wrote on either going value or general overheads.

The Court referred to going concern value as an item of "sales value" in a well managed business, but not an item "the public is accustomed to regard as *capital*". The language of the *Des Moines Gas* case which I have just quoted is set forth and *Los Angeles Gas, etc. Co.* v. *R. R. Comm.,* 289 U. S. 287 (1933), *Columbus Gas & Fuel Co.* v. *Public Utilities Comm.,* 292 U.S. 398 (1934), and *Dayton P. & L. Co.* v. *Public Utilities Comm.,* 292 U.S. 290 (1934), are referred to as "cases which temper to a material degree prior utterances of the Court with reference to 'going concern
page 949 } value'." The Alexandria Water Company's claim of $150,000 for going concern value was reduced by this Commission to $60,000, or about 4.4 per cent of total fair value of $1,350,000 and in this, as in other respects, the Commission was fully affirmed by the Supreme Court of Appeals.

The Commission's attention is respectfully invited to this further language (163 Va. 595-96) from the *Alexandria Water Company* opinion:

"Viewed as a property right for which allowance must be made, directly or indirectly, as an element of the aggregate value of the Company's property used and useful in the performance of its public functions and included in its "rate base,' 'going concern value' is the value added to the bare physical value of the plant, as an inherent element thereof, by reason of the fact that the plant is in successful operation, rendering adequate and efficient service, with customers secured and business established.

"In determining 'going concern value,' it is important to bear in mind that neither the value of the good will [citing the *Los Angeles Gas & Electric* case] of the owner of a public utility property, nor what it would be worth to a purchaser to have the owner removed as a competitior, nor the *value* to the owner or a purchaser of the public franchises held by the owner (in excess of the amount, if
page 950 } any, paid by the original recipient to the government therefor), is a proper element of a rate

base; and that they many not properly be weighed into or reflected in the rate base of a company by giving them weight as factors in determining the 'going concern value' of its property. In the instant case the Alexandria Water Company received its local franchise as a gift, that is, it paid nothing therefor.

"The determination of 'going concern value' is largely a matter of sound judgment, and, taking all the facts disclosed by the record into consideration, we are of opinion that the Commission's estimate of the 'going concern value' of this Company's property is fair and reasonable."

Q. In your opinion, what did the Supreme Court of Appeals mean when it said that going concern value is the value added to the "bare physical value of the plant"?

A. In my opinion, the Court plainly meant the physical value of the company's used and useful plant, as installed, including general overheads, but excluding going concern value.

Q. Why do you say that?

A. That meaning is plainly disclosed by the language of the Court's opinion. I venture to invite the Commission's attention to this excerpt from page 551 of the opinion:

"In considering allowances for general overheads these basic principles are to be borne in mind. (a) Certain administrative and legal costs, (b) engineering and
page 951 } supervision cost, and (c) interest on the money expended in the acquisition and construction from the time expended until construction has progressed to such an extent as to make it usable for the purpose for which the acquisition or construction is designed, are as much a part of the cost of producing or reproducing a property as are the cost of labor and materials that go into the actual construction of the individual items thereof. They are not a loading added to the cost of construction as a make-weight or for good measure. In any estimate of the cost of constructing or reproducing a property, the sums added to labor and material costs and to present value of land for such items should be determined in the same general manner that labor and material costs are determined. Experience interpreted and applied to the case before the Commission in the light of sound judgment is the best criterion. There is no sound reason for being more or less stringent in the de-

termination of these items of cost than in the determination of what is commonly understood by labor and material cost."

Q. Please return to your discussion of the going value concept.

A. The three then current decisions of the United States Supreme Court to which our Supreme Court of Appeals referred in its *Alexandiria Water Company* decision after having quoted language of *Des Moines Gas Co.* v. *Des Moines,* were *Los Angeles Gas and Electric* (1933), *Columbus Gas & Fuel Co.* (1934), and *Dayton P. & L. Co.* (1934).

page 952 } In each of those determinations, the regulatory agency concerned had made no separate allowance for going concern value and the Supreme Court affirmed. The Supreme Court approved the rejection of expert testimony seeking to establish going value as "speculative", "conjectural" and "uncertain". In *Dayton P. & L. Co.* the Court said (292 U.S. at 309), "Going value is not something to be read into every balance sheet as a perfunctory addition." The Court then added this language from *Los Angeles Gas & Electric Co.,* "It calls for consideration of the history and circumstances of the particular enterprise." I think that the Supreme Court was saying, and continued to say, that an enterprise seeking to establish going value has an onerous burden of proof, that, in effect, such an enterprise is like a football team trying to score from the ten-yard line against a peculiarly formidable defense.

The United States Supreme Court has continued to denigrate going value as a separate element of value. For example, in *FPC* v. *Natural Gas Pipeline Co.,* 315 U.S. 575. 589-91 (1942), the Supreme Court said that the financial history of two natural gas pipeline companies had disclosed "no basis for going concern value, both because the elements relied upon for that purpose could rightly be rejected as capital investment in the case of a regulated company" and because it did not appear that the items relied upon, which

page 953 } had never been treated as capital investment, had not been recouped in the companies' preregulatory period. The Federal Power Commission had disallowed the companies' going-value claim of $8,500,000, which had been one of the two grounds for the reversal of that Commission by the Court of Appeals for the Seventh Circuit. But the Court of Appeals was reversed in its turn. The Supreme Court observed:

"There is no constitutional requirement that going concern value, even when it is an *appropraite* element to be included in a rate base, must be separately stated and appraised as such. This Court has often sustained valuations for rate purposes of a business assembled as a whole, without separate appraisal of the going concern element. When that has been done, the burden rests on the regulated company to show that this item has neither been adequately covered in the rate base nor recouped from prior earnings of the business." (Citations omitted).

Nor have public utility advocates of the going value concept derived substantial comfort from other and more recent decisions of the Supreme Court or of the overwhelming majority of the holdings of the state courts of last resort. It seems of some moment that the Supreme Court made no mention of going concern value in its two most recent and most important public utility decisions: (1) the page 954 } Court's strikingly permissive affirmation of the Federal Power Commission's determination of producer rates in *Permian Basin Area Rate Cases,* 390 U.S. 747 (1968) and (2) its approval of the Pennsylvania-New York Central merger (390 U.S. 486 (1968).

Neither going value nor good will is included in utility plant account by such classifications of accounts as those of the Interstate Commerce Commission, the Federal Power Commission or the Federal Communications Commission. That concept apparently must be established by expert testimony, expecially when that concept is not predicated on any substantial recorded investment. Such adjectives as "speculative" and "conjectural" will continue to be used by the critics of going value.

In a footnote to the language on going value which I have already quoted from Vol. 51 of the Iowa Law Review, I refer to *Southwestern Bell Tel. Co.* v. *State Corporation Comm'n,* 192 Kan. 39, 386 P.2d 515, 539, 51 P.U.R. 3d 113, 139-40 (1963), in which Kansas Supreme Court said:

"Going concern value is a proper element to be considered in determining a rate base if the constituting elements are present and the expense has not been recouped. The Company contends for a going concern value of $21,000,000 for business development costs. There was a time when an allowance of 10% on the physical plant was not page 955 } challenged as a reasonable allowance for this

item. The conditions which justified the allowance, as a matter of course, no longer exist. Years ago the cost of acquiring customers and developing business presented a serious problem for public utilities. The consumer was not informed as to the advantages of gas as a fuel compared to coal, he was not informed as to the advantage of electric lights compared to a Coleman lamp, and he was not informed as to the advantage of a telephone call, as compared to a communication transferred by the then means of transportation. No doubt a utility, under those conditions, incurred considerable cost in educating the public, soliciting customers, and idle plant following construction. Under present conditions, a new home is not built, nor a new area developed, unless the owner knows that electricity, gas, and telephone service are available. The utility need not solicity customers. The public is clamoring for service. The utility needs only connect.... A careful review of the record discloses no evidence justifying an allowance for going concern value in this case, nor any reason for it being made an issue in the finding of the reviewing court. This rule appears to be in harmony with that stated in the more recent decisions."

page 956 } Like decisions of New Jersey, Louisana and Pennsylvania appellate tribunals are cited by the Kansas Court.

Q. Please assume that the Norfolk and Western's trackage is dismantled for the purpose of selling its ties, rail and appurtenant equipment, as scrap, to such dealers in used or secondhand trackage materials as Luria Brothers and Company and Gillis and Company. Please state whether, in your opinion, a railroad which had dismantled its trackage would possess significant franchise or going-concern value.

A. No. To apply the criteria suggested in Mr. James E. Carr's letter of May 29th, 1968, to Mr. James A. Caywood, such a railroad would be unable normally to function under its charter, it could not provide railway service, it could have no good will and any values in patronage already secured or in existing contracts would be completely dissipated. It would do violence to common sense to suggest that such a railroad possessed any significant going-concern value.

Q. Could the ties, rails and other constituent parts of a railroad's trackage be sold, as scrap or used material, to Luria Brothers, Gillis and Company or any other junk dealer without dismantling that trackage?

A. J. G. Priest

A. Again I appeal to common sense. Such material plainly could not be sold as scrap unless the railroad's trackage were dismantled. I cannot imagine an offer to purchase trackage material as scrap if that material was page 957 } to remain in place and if rolling stock continued to be operated over it.

Q. Could the Norfolk and Western or any other railroad abandon its Virginia trackage for the purpose of dismantling it and selling its constituent parts without first obtaining appropriate consents from the regulatory authorities having jurisdicition?

A. Of course not. It is generally accepted that utility property dedicated to the public service cannot be abandoned without regulatory consent.

Q. Has the Norfolk and Western made application to the I.C.C., or to this Commission, for authority to abandon all or any substantial part of its Virginia trackage?

A. I am informed that it has not. Of course I have no knowledge of what the railroad's immediately future intentions may be in this regard.

Q. Has the Virginia Supreme Court of Appeals recently been confronted with a problem at least similar to that which is faced by the Commission in this proceeding?

A. Yes. In *Richmond, Fredericksburg and Potomac Railroad Company* v. *Commonwealth,* 203 Va. 294 (1962), this Commission's valuation of certain railroad real estate for tax purposes was challenged by the railroad. One of the contentions made by the railroad was that the value of the land in question should be reduced by the value of the railroad's franchise, but the Court said, at page 301 and 302:

"This position is untenable for several reasons. In the first place, no franchise value was proved and page 958 } therefore there was nothing to deduct. The franchise value does not enter the picture and cannot be taken into account.

In the second place, Section 176 of the Constitution provides that the Commission shall assess, among other things, 'real estate * * * and all other personal property whatsoever (except its franchise * * *).' Thus the franchise value is expressly exluded. Code of Virginia, §58-522."

I think this case clearly holds that even if the railroad could prove franchise value, this information would not be relevant because the franchise value is expressly excluded

from consideration. Before the franchise value can be relevant, the railroad must prove that it was valued in the assessment of tangible property. The burden is clearly on the railroad in this proceeding to prove the assessment included franchise value and then to prove its franchise or going conern value and how much of it was included. The Court also said, at page 302:

"The findings of the Commission are presumed to be correct and the burden was on the railroad to prove otherwise. This it has not done."

I think that the burden is clearly on the railroad in this proceeding to prove its franchise or going-concern value. In my opinion, that burden is an onerous one.

Q. Section 58-522 of the Code refers to valuation for tax purposes at the "same rate as real estate and tangible personal property of natural persons are assessed". Have you any reason to believe that the property of
page 959 } natural persons has been assessed at its scrap value, eliminating costs of installation, including general overheads?

A. No. Of course the Commission is in possession of that information. But, again, common sense would seem to argue strongly against that notion.

Q. Do you know of a decision of any court of last resort which has approved the valuation of public utility property, for the purpose of rate-making or taxation, at scrap or second-hand value? Please assume that such
page 960 } property is part of a utility enterprise rendering efficient service and earning a return.

A. No. I attempted to find such a decision and was unable to do so. I would be surprised to learn that there is such a decision.

Q. Has the significance of franchise or going-concern value changed significantly since the adoption of Section 176 of the Virginia Constitution and Section 58-522 of the Code?

A. Yes. The significance of franchise or going-concern value as an item of the valuation of public utility property for rate making or taxing purposes has steadily declined toward the innocuous, as my testimony has already indicated.

Q. Are you generally familiar with the changes in price levels which have confronted public utilities in this country within the past 40 years?

A. J. G. Priest

A. Yes. I have been required to become generally familiar with such changes in price levels for the purposes of my practice, teaching, lecturing and writing. I have examined the Handy-Whitman Indexes covering certain classes of public utility property and I have been at least aware of the impact of inflation on our economy. However, the steady, persistent and distressing increases in price levels in this country, especially since World War II, the Korean war and the escalation of the Vietnam war, are matters of common
page 961 } knowledge. I am sure that the Commission has much more abundant data on this subject than I could provide.

Q. In your opinion, could the Norfolk and Western's trackage values actually have remained constant for the years 1926 through 1967?

A. No. Any such idea seems to me irrational in the light of what has happened to prices in that period. Price levels went down for several years at the time of the great depression, but they turned upward promptly and have twisted toward the zenith since World War II, the Korean War and our major involvement in Vietnam. I am sure that an examination of recurring prices for ties, rail and other items of trackage equipment would fully justify that observation.

Q. Can you invite the attention of the Commission to what you consider significant language of our Supreme Court of Appeals dealing with the question of bare franchise value?

A. Yes. This language from the *Alexandria Water Company* decision, 163 Va. 512, at 602, seems to me to be significant:

"The bare franchise right to be a corporation is, under the laws of Virginia relating to corporations, of little, if any, greater value than the cost of incorporating a like corporation, including the charter fee required by sec-
page 962 } tion 205 of the Tax Code (Code 1930, Appendix, page 2184), which for a public service corporation having a maximum capital stock of the par value of $200,000 is $325. The record contains no evidence as to the other cost of incorporation, and we shall not make any conjecture as to what they would be."

Q. Has the United States Supreme Court set forth a definition of depreciation which has become a regulatory classic?

A. Yes. This language from the Court's opinion in *Lindheimer* v. *Illinois Tel. Co.*, 292 U.S. 151, at 167 (1934) has

been followed by courts and commissions for a number of years:

"Broadly speaking, depreciation is the loss, not restored by current maintenance, which is due to all the factors causing the ultimate retirement of the property. These factors embrace wear and tear, decay, inadequacy, and obsolescence. Annual depreciation is the loss which takes place in a year. In determining reasonable rates for supplying public service, it is proper to include in the operating expenses, that is, in the cost of producing the service, an allowance for consumption of capital in order to maintain the integrity of the investment in the service rendered....

page 963 } Q. So far as you know has it been the usual regulatory practice to include obsolescence in the determination of depreciation?

A. Yes. Obsolescence is only one of the factors which cause the ultimate retirement of utility property. It certainly has not been the usual regulatory practice to make a separate allowance for obsolescence.

Q. Did our Supreme Court of Appeals refer to the *Lindheimer* opinion which you have just quoted when it decided *Alexandria Water Co.* v. *Alexandria, to* which you have already referred?

A. Yes. At pages 607 and 618 of the *Alexandria* opinion (163 Va.) our Court said that the United States Supreme Court seemed to have held, in *United Railways Co.* v. *West,* 280 U.S. 234, 253-4, that a depreciation allowance must be based on the present cost of replacement of property, but that the Court's pronouncement in that case had been overruled, at least inferentially, in *Lindheimer.*

Q. Has there been a confirmation of what our Court called the infernetial overruling of *United Railways Co.* v. *West?*

A. Yes. The Supreme Court expressly overruled *United Railways Co.* v. *West* in *F.P.C.* v. *Hope Natural Gas Co.,* 320 U.S. 591, 606-07, in which that Court recognized the propriety of basing annual depreciation on cost and said "By such a procedure the utility is made whole and the integrity of its investment maintained. No more is required".

page 964 } Q. Is retirement and replacement depreciation usually practiced by utilities other than the railroads at this time?

A. No. The electric, communications, gas and water companies usually practice straight line depreciation based on

age-life studies. Among my own clients were several electric companies which did not have adequate depreciation reserves and Haskins & Sells would not give them unqualified auditors' certificates until those reserves measured up to straight-line standards.

Q. Do you think that utilities generally will return to the retirement and replacement concept?

A. No. The bad, old days when a valuation engineer could look at the shell of a thirty-year-old turbine and say, "Just slap some paint on the old girl and she'll be in 98 per cent service condition" have gone forever.

Q. What was the major practical objection to retirement and replacement depreciation?

A. I think that the major practical objection was the tendency of some utility managements to skimp depreciation when they wished to fatten up earnings available for the payment of dividends. Consistency was one of the virtues of straight-line depreciation, while appropriations for retirement and replacement depreciation too often differed widely from year to year.

page 965 } Q. How does the Illinois Commerce Commission value utility property for rate-making purposes?

A. The Illinois Commission is required by the courts of that state to grant a reasonable return on the present fair value of the property comprising a utility's rate base and to consider reproduction cost as well as original cost.

Q. Has scrap value been a basis for utility valuations made by the Illinois Commerce Commission in recent years?

A. Not so far as I can determine by examination of the recent cases.

Q. Do you know of a valuation of public utility property made by the Illinois Commerce Commission for any purpose within the last 20 years and affirmed by either the Supreme Court of Illinois or an Illinois Circuit Court which included as much as 50 per cent of the value of physical property as going value?

A. No. I do not.

Q. What have you to say as to a going value allowance of 40 per cent, 30 per cent, 20 per cent or even 10 per cent made by the Illinois Commerce Commission within the last twenty years?

A. My answer is the same as to all four percentage allowances. For example, in the notable *City of Alton* determination, examined by an Illinois Circuit Court in 1958 and by the

Illinois Supreme Court in 1960, no allowance whatever was made for going value.

Q. In the bad, old days to which you have referred, how was going value determined?

page 966 } A. The utility's valuation engineer or engineers claimed that an additional allowance, usually of 10 per cent, should be made when a regulatory agency was valuing an enterprise which had integrated and coordinated its property, trained its staff and attached its customers. The figure was usually arrived at by rule-of-thumb. In the Los Angeles Gas and Electric case, the going value claim was for 15 per cent, but the expertise offered to sustain it was slapped down by Mr. Chief Justice Hughes as speculative and conjectural.

Q. Did you hear or have you read the testimony of Edward F. Koncel in this proceeding?

A. Yes, sir.

Q. Do you agree with Mr. Koncel that railroads are seldom sold, so that there are no comparable sales available to the assessor.

A. Yes, sir.

Q. Do you agree with Mr. Koncel's apparent suggestion that obsolescence is to be accounted for in addition to depreciation?

A. No, I do not. The term depreciation is ordinarily used as comprehending and including obsolescence.

Q. Do you agree with Mr. Koncel's statement that income is "attributable almost entirely to franchise value" and that at least 50 per cent of "stock and debt is attributable to franchise value"?

A. No, I do not. I believe that income arises from and is attributable to that portion of a utility's actual

page 967 } plant account which is used and useful in providing its service. I think it is elementary that a utility's net income, representing the wages of the dollars invested by the utility in plant and recorded in its plant account, is earned on its physical property, including all costs of installation and general overheads. The portion of that plant account representing an investment in its franchise is comparatively miniscule. Furthermore, the items once included in going concern value ordinarily have long since been recovered through operating expenses. If the Norfolk and Western's franchise or charter to operate its properties were to expire tomorrow, that franchise or charter could readily be replaced through an appropraite filing made under the

Virginia Code and the requisite charter or franchise fee would be of the order of $5,010.00.

Q. Do you agree with Mr. Koncel that "at least half of the fair market value of railroad tracks is franchise or going concern value"?

A. No, sir, I believe that such a 50 per cent valuation, or even a twenty per cent valuation, of franchise or going concern value cannot be demonstrated to have been approved in any substantial proportion of decisions of courts of last resort. Furthermore, I believe that Mr. Koncel's valuation of franchise or going concern value, which makes no distribution whatever between the constituent items comprising franchise or going concern value plainly is arbitrary and conjectural. If such a valuation of franchise or going

page 968 } value were offered in a proceeding before the Illinois Commerce Commission, I think that proceeding before the Illinois Commerce Commission, I think that Chairman James W. Karber's gusty laughter probably could be heard throughout the Illinois State Office Building.

Q. Do you believe that there is no such a thing as franchise or going concern value inherent in a public utility enterprise?

A. Not at all. I believe that when there is a market for a public utility enterprise, a water company for example, going concern value represented by the additional amount that a purchaser would be willing to pay a seller under no coercion to sell might be demonstrable, but no such proof seems to be available in this proceeding. As I have already indicated, the basic problem which faces a utility seeking to show going value is the burden of proof. The late T. Justin Moore apparently decided that he could not satisfactorily prove going value in the Chesapeake and Potomac and Vepco cases I have already referred to, and it is my opinion that since the courts have so firmly kicked going value in the predicate, most other public utility lawyers have come to the same conclusion.

Q. Please state whether going value is looked upon as an intangible when public utility property is valued.

A. Of course it is an intangible. It couldn't be anything else. It does not appear in a utility's plant ac-

page 969 } count and, where it exists, it arises out of the coordination of a utility's plant account, the training of its staff, etc.

Q. Which comes first: used and useful tangible property, or going value?

A. Tangible property, quite obviously. No utility can have going value until its facilities are installed and functioning. Intangible values rise out of tangible values, not the other way around.

Q. What have you to say about the valuation of a public utility's property that begins by computing the value of a utility's outstanding securities, then determines going value and deducts that going value figure from a value predicated on the current value of outstanding securities, in order to arrive at the value of a utility's tangible property?

A. That process has an "Alice-in-Wonderland" quality that I find irrational. It does violence to basic concepts developed in the course of my 47 years as a public utility lawyer.

Q. Has the Supreme Court of Appeals of the Commonwealth indicated where, in its opinion, original cost stands as one of the methods for determining the value of public utility property?

A. Yes, sir. In its 1955 *Vepco* decision, our Court said, at page 1111 of 196 Virginia:

page 970 } "In the performance of its duty the majority of the Commission in ascertaining a rate have adhered to the original net cost investment theory in making their valuations of the Company's property. All of the Commissioners rejected the evidence offered by the Company as to reproduction cost, despite the objection of the Company. The method adopted by the Commission . . . is predicated upon the net original cost of plant and property, less depreciation, plus a proper allowance for working capital. Such a base is among the lowest, if not the lowest, elements to be taken in consideration in determining the fair value or rate base."

Q. What has the effect of that decision been upon the Commission's procedure?

A. The Commission has consistently used the original cost technique, as it has done in this case, and as it apparently feels free to continue to do.

Q. When an original cost appraisal is made, what is ordinarily the order of procedure?

A. The original cost of plant or property, as actually installed and including general overheads, is determined, and depreciation is deducted, then appropriate additions are made for working capital and materials and supplies, and then such intangible values as going concern values which have been proved by the utility protagonist are added.

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Q. Do you know whether this procedure was adopted for the purpose of determining the Commission's valuation of the trackage of the Norfolk and Western?

page 971 } A. I am informed that substantially that procedure was adopted, except that no additions were made for working capital or materials and supplies.

Q. What is your opinion as to the propriety of such valuation procedure?

A. I agree with the Supreme Court of Appeals that the fair value of utility property arrived at by the application of that technique would be "among the lowest, if not the lowest" fair value determinations to be made by this Commission.

page 972 } I hereby certify that the answers given to the foregoing questions are true and correct to the the best of my knowledge and belief.

A. J. Priest

Subscribed and sworn to before me this 8th day of April 1969.

Virginia C. Haigh
Notary Public

My commission expires:
April 7, 1971

page 973 } Mr. Epps: Mr. Priest is now presented for cross examination.

CROSS EXAMINATION

By Mr. Riely:

Q. Professor Priest, may I start this cross examination by asking you whether you are a Certified Public Accountant?

A. No, Sir.

Q. Are you a Professional Economist?

A. No, Sir.

Q. Are you a Professional Engineer?

A. No, Sir.

Q. Well, what is your field of expertise then?

A. My field of expertise in an area such as this is a broadly-based experience with regulations and experience which includes many years of practice before regulatory

agencies which includes also rather a great deal of writing, teaching, and lecturing in this field.

May I add this, Mr. Chairman? I made reference in my direct testimony to my friendship with Jack Shannon, John S. Shannon, who is general counsel for the Norfolk and Western. The same considerations apply with my relationship to Mr. Riely. He took over my course in public utility regulation at the University of Virginia on two occasions, and for whom—

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Chairman Catterall: You recognize him as an expert in this field.

Mr. Riely: I do not think that should be in the record.

A. I have the warmest admiration for him as a lawyer and as a person and I realize that won't get me anywhere because I know perfectly well that if the occasion arose and Mr. Riely considered it appropriate, he would press his own grandmother.

Mr. Riely: That is a terrible reputation to have.

Chairman Catterall: That is going to make you a little milder than you otherwise would be, I am sure.

Mr. Riely: If your Honors please, I have always been very sweet.

Q. Well, let me say then, Professor, primarily wouldn't you say that your field of expertise so far as this matter is concerned is in the law?

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A. Oh, yes, yes, Sir, in the law and in my—in the experience—I beg your pardon, Sir. In the law and in the experience in regulations that a long time that my long time practice and teaching, et cetera in the law has brought me somewhat specialized knowledge of economics.

Q. Could I aptly summarize your testimony in this case as a legal brief?

A. No, I don't think so. As you know, Mr. Riely, I have been a lawyer for almost fifty years, and I tend to write and think as a lawyer. I think my testimony has attempted to appraise from the lawyer's point of view because that basically is my point of view, has attempted to appraise from that point of view what the objectives of this Commission apparently are in this proceeding.

Q. Well, you have written this testimony from a legal point of view.

A. I am a lawyer, Mr. Riely, as you well know; and I have

written from the point of view of one who has had long experience in public utility regulations—

Q. Now—excuse me—

A. —which has included all the aspects of pub-
page 976 } lic utility regulations.

Q. Now, Professor, this is an *ad valorem* tax case. I feel quite certain that you have represented clients in *ad valorem* tax cases during your career. Have you before ever testified in an *ad valorem* tax case either on behalf of the utility or on behalf of the taxing governmental agency?

A. No, Sir.

Q. But you have represented many utilities in rate cases?

A. Oh, yes.

Q. And you have represented utilities many times before the Federal Power Commission?

A. Yes, Sir.

Q. And you have represented utilities before state commissions on many occasions in various utility matters?

A. Yes, Sir.

Q. Have you as a matter of fact represented utilities in *ad valorem* tax cases?

A. No, Sir, only by indirection. I mean the problems have come up from time to time in my office, but I have never represented utilities in *ad valorem* tax cases. I
page 977 } might add that I have had to do with evaluation of utilities for rate-making purposes. I have also had to do with evaluation of utilities for the purpose of issuing securities.

Q. But not an *ad valorem* tax case yourself directly before?

A. No, Sir.

Q. Now you are acquainted with Doctor J. Rhoads Foster?

A. He was a witness, and Doctor J. Rhoads Foster is an old friend. He was a witness in several cases that I tried as a matter of fact.

Q. How did he happen to come to testify in this case, do you know?

A. Yes, I do know. I think he came to testify in this case because Mr. Epps asked me if I knew of any one in this area who had the experience and genuine expertise in this field, and I recommended Doctor Foster.

Q. Have you read Doctor Foster's testimony?

A. Yes.

Q. On page ten of his prepared testimony, Doctor Foster

page 978 } stated and I quote, "'Fair value' in utility rate regulation is a type of rate base determined by reference to cost evidence, not by reference to market value." Will you agree with that conclusion?

A. Yes.

Q. And on the next page, page eleven, "Market value," he said, "should not be the measure of a public utility rate base because that value depends upon earnings, and it is the reasonableness of the earnings which is at issue in rate regulation." Would you agree with that statement?

A. Certainly.

Q. And further still on page eleven, let me read you two more sentences. "Rate regulation looks to cost evidence, either"—

A. What? I did not get that.

Q. "Rate regulation looks to cost evidence"—

A. Yes, Sir.

Q. "either original cost or some variant of current cost, in order to avoid circularity of analysis and reach a basis for decision-making which is independent of market value.

page 979 } "On the other hand, it is a basic economic principle that the market value of a going business concern, whether a railroad, a public utility, or a competitive enterprise, depends solely upon prospective earnings."

I judge that you would agree with these conclusions?

A. Yes. As a matter of economics, I am sure they are professionally sound.

Q. And on page fifty-six on his cross examination, I asked Doctor Foster this question: "Then would you not consider, Doctor, that cases, decisions and the statements regarding rate regulation have little significance in a fair value determination for tax purposes?"

And Doctor Foster's answer: "I think that is perhaps true, but particularly if there is a clear recognition of the meaning with which the words and phrases have been used in these respective or separate disciplines."

Will you agree with that?

A. I am not sure I do altogether, Mr. Riely. I think that the same principles are generally applicable in each of those situations. For example, in this very case this Commission values and has done so consistently values utility

page 980 } property for rate base or rate-making purposes on an original cost basis.

My understanding is that it has done the same thing here, and I would think there would be a tendency on the part of regulatory agencies which have both responsibilities; that is, the responsibility of determining rate base and the responsibility of determining valuation for purposes of taxation would tend to apply and use the same principles because there is no market value. Mr. Koncel said that. There is no market in which railroads are bought and sold; and, therefore, other techniques must be applied and a common and to-be-expected technique would be original cost. Perhaps some other technique might be applied, but it seems to me that the same principles are generally applicable; and I was not in the least surprised to find this Commission using original cost for the purpose of its evaluation of railroad property for taxation purposes and it has used original cost for the purpose of arriving at rate bases.

Q. Well, for taxation purposes what is the value that this Commission is seeking?

A. Well, I think the Commission is seeking

page 981 } what it would seek in a determination of value for purposes of rate making; that is—

Q. Is it not—

A. Let me finish, please.

Q. I beg your pardon.

A. That is, it is seeking a fair or reasonable evaluation, an evaluation which is fair both from a point of view of taxing authorities involved and the point of view of the railroad or the utility.

You will remember that Justice Douglas said in his opinion on the Hope Natural Gas Case that there must be a balancing as between investors and consumers. I think that here there must be a balancing as between the railroad, the utility, and the taxing authorities; that each should be treated with fairness and consideration and that the end result is one which is fair and reasonable and generally non-arbitrary as affects both parties to the proceeding.

Q. What is, however, the statutory standard that is imposed upon this Commission in a tax case?

A. Well, I realize that the standard is fair

page 982 } value. I realize also that the going value is required to be deducted.

Q. It is not the fair value, is it, Professor? It is fair market value or fair cash value.

A. J. G. Priest

A. Well, it is fair value. I accept your correction.

Q. Now what are the standards that this Commission applies in a rate case? Is it required to find fair value?

A. In earlier years, it did not find fair value.

Q. Well,—excuse me—

A. All right, Sir. It has been enabled by decisions of the Supreme Court of Appeals to use original cost and has done so consistently over a period of some years.

Q. But is there any statutory standard imposed on this Commission in rate cases that it shall find fair value?

A. No, Sir, I do not think so.

Q. What is the *statuory* standard imposed on this Commission?

page 983 } A. The statutory standard imposed on this Commission is the value of the property for—value of a utility property for purposes of rate making.

Q. Is there anything in the Virginia Statute that says that this Commission must value property?

A. Mr. Riely, I would have to check the statute. I have not read it in some time.

Chairman Catterall: It says the rates must be just and reasonable.

A. Yes.

Mr. Riely: It says the rates must be reasonable and just.

Chairman Catterall: Reasonable and just.

A. Well, I mean the usual criteria, Mr. Riely. As you well know, and this is true of the Federal Power Commission of regulatory agencies generally is that the rates must be fair and reasonable or reasonable and just, if you prefer.

Mr. Riely:

Q. Well, are you telling me then that an original cost determination is synonymous with fair cash value or fair market value?

page 984 } A. No, Sir, I am not.

Q. But you still feel that an original cost determination that would be made in a rate case is the standards that should be applied by the Commission in reaching fair market value or fair cash value?

A. I did not say that, Mr. Riely. I feel that original cost is a criterion which may be applied for the purpose of determining just and reasonable rates, and I think it may.

A. J. G. Priest

Q. Well, it may likewise be applied in determining fair market value or fair cash value.

A. I think the two are not synonymous. I have said that, Mr. Riely.

Chairman Catterall: Fair market value would be what would have to be paid if the State condemned the property, may be higher or *slower* than the cost value.

A. Surely, it may be higher. It's lower in some cases, lower in the Market Street Railway Case, which I am sure you know about, but it might be very substantially higher in other cases.

Q. It might be very substantially higher in other cases, and let's take your house for example.

page 985 } A. I mean a fair market value would be substantially higher, sure.

Q. Let's take your house, for example. It might have a fair market value that might be substantially higher than the cost that you paid for it.

A. Certainly it would, and if when I sold it I was told that I could collect nothing but original cost my screaming could be heard in Siberia. That is quite right.

Q. But again you say that you think contrary to Doctor Foster that cases, decisions and statements regarding rate regulations have significance in a fair value determination for tax purposes?

A. Certainly, because I think that the regulatory agency is confronted with problems which are at least generally similar in both instances, because you have got to apply some yardstick or yardsticks. You don't have a market value for a railroad. There is no market for railroads as your witness Mr. Koncel said, and some technique must be applied.

Q. And the best technique from your point of view is to—not equate—that word is too strong, but at least

page 986 } to use original cost as a technique to reach fair market value?

A. I did not say it was the best technique from my own point of view. I have been an advocate of the present fair value for rate-making purposes, as I am sure you know.

Your former partner, and my very dear friend, Justin Moore, and I were agreed on the point; but an original cost determination was made in the Chesapeake and Potomac Case and an original cost evaluation was made in the VEPCO Case.

Q. I am coming to both of those.

A. Surely.

In those two cases, the Virginia Supreme Court of Appeals did not reverse the Commission for having given no consideration for fair value as you well know.

Q. Well, let me ask you this. You said original cost is one method, one path toward the determination of fair market value or fair cash value. What are others in connection with the railroad property?

A. I suppose that the application to the inventory of the railroad of modern price levels. Price levels

page 987 } determined either on a custom basis that is determined from the railroad's own records or price values fixed by, Oh, Handy Whitman or some other evaluators with whose work you are fully familiar.

Q. That might be succinctly stated as reproduction plus new less depreciation.

A. No, No, not necessarily.

Q. Well, trended original cost.

A. Well, trended original cost, that is quite right.

Q. Trended original cost.

A. I would—as between—You are asking for my own opinion?

Q. Yes, Sir.

A. It seems to me that original cost has to be considered. It is considered in all cases except sofar as I know in the jurisdiction of the Ohio Public Utility Commission that some consideration invariably is given to original cost.

Q. How about depreciation? You would depreciate original cost or adjusted original cost, wouldn't you?

page 988 } A. Well unfortunately from my point of view and yours as public utility lawyers, the Supreme Court has said in the Hope Natural Gas Case.

Q. A rate case.

A. A rate case. That depreciation is to be computed on original cost basis.

Q. Now, Doctor Foster said that the best way to find the fair value of a property such as we are here considering was the consideration of the prospective earnings. In your view are original costs and trended original costs the best way to make an estimate of prospective earnings?

A. No, no, original cost and the application of adjusted price levels are the techniques it seems to me to be most applicable to the evaluation of utility property, certainly for rate-making purposes and by analogy which seems to me to be appropriate.

A. J. G. Priest

Also, the determination of the value of railroad property for the purpose of taxation. I think there is a substantial circularity of thinking in the use of the value
page 989 } of securities for the purpose of evaluing the properties of a railroad. For example, if a particular railroad were earning a two per cent rate of return and if another and generally comparable railroad, when operating in the same territory, were running a rate of return of eight per cent. Now certainly the property of the second utility, or the railroad, the eight per cent utility or railroad would not be valued at four times the value of the property of the two per cent utility railroad.

Q. Would they be valued equally?

A. Not necessarily. I think that the Commission conceivably might be moved by consideration of earnings, but I would think that in those circumstances the regulatory agency would be required to proceed certainly with original cost and be required—that is it might, and I am speaking of original cost as a permissible technique, a technique that has been permitted, as you well know, certainly in rate-making cases, a technique that has been permitted to be used almost exclusively in jurisdiction after jurisdiction throughout this country.

Q. For rate cases?

page 990 } A. For rate cases, yes, that is right.

Q. You have not read Doctor Foster's testimony before the Board of Taxing Appeals of Ohio?

A. No, Sir. Ohio has reproduction cost new less depreciation.

Q. This is a tax case.

A. For rate-making purposes, it has, you know that it has reproduction cost new less depreciation as the statutory predicate, as you well know.

Q. So I judge your conclusion to be, and please correct me as I'm wrong, that capitalization of earnings is a measure of fair market value as in your view less reliable than original cost or trended original cost?

A. Certainly, because it varies among other things, and I do think that among the desiderata to be considered when property is valued for purposes of taxation, it is not only reasonableness, fairness and a satisfactory end result, but also a substantial measure of stability so taxing authorities will know what they have to rely upon when they prepare their budgets and so on.

Q. I would like to just—I don't suppose this

page 991 } is a question, Professor, but the railroad feels very much the same way about that stability. Let me ask you this—

A. I think stability is desirable, and we have had the urge for stability for a long time. We have had the urge for stability ever since the dissenting opinion of Mr. Justice Brandis in the Southwestern Bell Case in which he laid the groundwork for the use of regulatory agencies throughout the country of the original cost technique, you know that.

Q. On false premises.

A. Sir.

Q. On a faulty premise?

A. I think his only faulty premise was that he felt that price cycles would operate—

Q. That is correct.

A. —and that prices would return ultimately to their 1914 level. As to that, he was wrong. With that single exception, his opinion is a perfectly magnificent one.

Q. I agree with you, but that infects his conclusion in the footnote, do you not agree?

page 992 } A. That is the conclusion stated in his footnote, of course. I think it is footnote fourteen.

Chairman Catterall: At that time utilities were paying twenty per cent on their bonds, were they not?

A. I do not know about that, Judge Catterall.

Mr. Riely:

Q. Let me get back to this—

A. Paying twenty per cent? I am not sure I understand what you mean.

Chairman Catterall: I think some of the utilities were paying twenty per cent to get the necessary money at that time.

Commissioner Hooker: Inflation would have something to do with stability, wouldn't it?

A. Of course, it does. Of course, it does.

Mr. Riely:

Q. As you well recall, another former partner of mine was receiver of the Seaboard for many years. At the time that the Seaboard had no net operating income, the Coastline during that period covering approximately the same territory in Virginia was earning money. Would you tax those two

properties the same looking to a fair market value standard?

page 993 } A. I would think that in those circumstances the Commission would, in any event, have to begin with original cost.

Mr. Epps: May I ask that counsel make the question a little more specific because I don't think—

Mr. Riely: The witness has agreed—

Chairman Catterall: He is making a legal argument, and I think for this witness a legal argument is perfectly permissible.

Mr. Epps: But if you are talking about taxing the railroad, I wonder whether he is talking about the property or the whole railroad. I—

Chairman Catterall: Mr. Riely is arguing for a tax base on reproduction cost obviously.

Mr. Riely: Excuse me, Sir.

Chairman Catterall: That is why some people want to transfer the taxing jurisdiction to Mr. Morrissett.

Mr. Riely: May the record show that the Commission's statement of my views is not necessarily in accordance with my own.

page 994 } Chairman Catterall: I am just analyzing your argument as I understand it. I mean you are talking about—

Mr. Riely: I will try to make it more comprehensible from now on.

A. Well you repeat the question, Mr. Riely, or have the Reporter repeat it?

Mr. Riely (To Reporter): Can you find the question? I couldn't repeat it.

Chairman Catterall: Maybe Mr. Riely could phrase it better if he starts fresh.

Mr. Riely:

Q. The Seaboard is in receivership and earns nothing. The Coastline is making money. They serve approximately the same area of Virginia. Would you value their physical properties on the same basis for tax purposes?

A. Well, when you say you, I am not exactly sure what you mean.

Q. I mean the Commission and you advising the Commission.

A. No. The Commission has to make that de-

page 995 } termination. I would say that if I were advising the Commission that it certainly has to start with original cost; and I would say that it might well also consider admission because of our long acquaintance that it probably also should consider the fair value concept; that is, it should consider re-pricing inventory, and we have discussed that before. But I do say that under the highly-permissive decisions of the court that the regulatory agency in those circumstances could stop with original cost—

Q. What highly-permissive decisions of the court are there in the field of *ad valorem* taxation?

A. I don't know of any. I was talking about the highly permissive—I was referring to the highly-permissive decisions in the field of rate making.

Q. Now as I read your testimony, I will go back to my script, which consists of thirty-one pages. I find that you have cited sixteen cases. Is that about right, more or less?

A. I do not remember. I have just written a text in which I cited a great many cases; and when I am thinking about these problems, I tend to refer to my cases. That page 996 } is obvious.

Q. Now of those sixteen cases, as I read them, fourteen are rate cases; one is a merger case; and one is an *ad valorem* tax case. Do you recall in your testimony another case which was an *ad valorem* tax case other than the RF&P Case, which is first quoted on page eighteen of your testimony?

A. No, I do not.

Q. May we turn to the RF&P Case for a moment?

A. Yes, Sir.

Q. First of all, Professor, is it customary—

A. May I get my testimony.

Q. Yes, Sir, please do.

A. What page is that, do you know?

Q. It starts on page eighteen, I believe. It is cited there for the first time.

A. Yes, Sir.

Q. First of all, Professor, is it customary to assess railroad property such as tracks by the use of values of comparable properties?

A. If it is, I do not know that to be a fact.

Q. Well, you don't know anything that is cus-
page 997 } tomarily bought and sold on a continuous basis that is comparable to railroad tracks?

A. No, Sir.

Q. Do you recall what the property was that was involved in the RF&P Case?

A. It was land.

Q. It was the land on which the Potomac Yard lies.

A. Yes, Sir.

Q. And do you recall how the Commission went about to assess that real estate?

A. I do not recall in detail, no, Sir.

Q. Would you look at the second paragraph under the table of page two ninety-six and two zero three Virginia? It is a very short paragraph, and may I read it to you. The assessment was made by the Commission's chief public utility appraiser.

"The assessment was arrived at by first determining the square foot value of various adjacents parcels of locally assessed industrial land. Then reducing this square foot value in order to compenste for the difference in topography and size of the railroad's real estate and then
page 998 } applying the reduced square foot value to the property."

So the real estate at issue in that case, Professor, was assessed on the basis of value of comparable real estate owned by persons other than railroad companies, isn't that correct?

Chairman Catterall: It is not the real estate in the general acceptation of the term. It was the land, solely the land.

Mr. Riely: Solely the land.

A. Well, the same thing happens in cases which are brought for the purpose of determination of utility rates. Land is valued separately, as you well know. In a public utility rate case, a separate evaluation is placed upon land even in a case in which the original cost concept is adopted. Fair value or values of comparable lands are usually issued as the criterion for the purpose of determining the value of land.

Q. May I underline that in the record for future reference.

Chairman Catterall: You may put it in red typewriting.

Mr. Riely:

Q. Well, let's get back to RF&P.

page 999 } Chairman Catterall: Virginia is not one of the cases he referred to.

Mr. Riely: It hasn't been up until this time.

Q. Let's get back to the RF&P.
A. I certainly wasn't referring to Virginia.

Chairman Catterall: No, we give the lowest rates possible so as to make everybody happy.
A. All that I was trying to do was to state what my experience has been in evaluation proceedings in which land has been valued separately. You know that happens elsewhere, Mr. Riely.
Chairman Catterall: We value it entirely separate for tax purposes, just as described in that case
A. Yes, Sir.

Mr. Riely:
Q. That is just what I want to come to, if I can get there. Now those pieces of comparable real estate that Mr. Dickinson referred to, in the paragraph that we have read from that decision, those pieces of comparable real
page 1000 } estate don't have any railroad franchise to them when they are owned by an industrial company?
A. Well, I assume not because I understand that Mr. Dickinson did not include any franchise value when he valued that land.
Q. Now wouldn't you agree with me that what the court actually held in that case plus the brief is that the franchise value never got in the assessment and, therefore, did not have to be taken out?
A. Well, the franchise value was not in the assessment. It was not taken out, nor, I understand, was there any effort to prove franchise value.
Q. But this Commission is directed by the court to exclude franchise value in valuing tangible property, is it not?
A. In valuing tangible property—
Q. In valuing tangible property.
A. Yes, it is so directed by the Constitution by a statute.
Q. So there was no railroad franchise value in the method evaluation used by the Commission for Potomac Yard Land?
A. I do not know whether there would have
page 1001 } been, had franchise value or going-concern value been proved. I know there was no franchise value in the case because it was not proved among other things because not proved by the RF&P.

A. J. G. Priest

Q. But there would not have been any franchise value in the comparable land which was used to value the property?

A. No, and I can understand why no franchise value got into the case, but I am still strongly of the opinion that franchise values cannot be deducted until it has been proved.

Q. Now you have been familiar with the course of the utility rate regulations as it has developed ever since *Munn* against *Illinois,* have you not?

A. I was not there, Mr. Riely.

Q. I didn't expect you were there. You have read the decision.

A. Oh, yes, I read the decision.

Q. And many, many times.

A. And have been generally familiar with that particular decision of the Supreme Court of the United
page 1002 } States and the decision of a good many other courts of last resort.

Q. And as I recall the public utility case book that we used to use, *Munn* against *Illinois* was the first case.

A. Yes, Sir.

Q. Now would you not agree with me that up until the Natural Gas Pipeline Case perhaps or the Hope Case, it was customary to believe that reproduction cost new less depreciation was the constitutionally required rate base for public utility rate regulations?

A. No, I think you have to go to Los Angeles Gas and Electric Case in 1933.

Q. In 1933?

A. Yes.

Q. Well, up until that time everybody said reproduction cost new equates fair value?

A. Sure, and the high-water mark was reached in the Indianapolis Water Company.

Q. Now beginning with those cases—

A. Beginning with Los Angeles.

Q. Los Angeles.

page 1003 } A. Yes, and the cases that are immediately following.

Q. It has been constitutionally permissible to establish rates on original-cost rate bases, is it not?

A. Yes, Sir.

Q. And original-cost rate base is normally determined by original cost as reflected on the books of the utility kept in accordance with the Uniform System of Accounts prescribed

by the pertinent governing regulatory body for the utility which is subject to rate regulations, isn't that true?

A. I think that is right with an addition for working capital, materials and supplies, and so on.

Q. Working capital, materials and supplies plus original cost of property and service?

A. Certainly.

Q. Now do you know a Uniform System of Accounts that permits the recordation of any item in an account entitled going-concern value?

A. No, Sir.

Q. So would you not agree with me that the concept of going-concern value in a rate case is traditionally conducted with the reproduction cost new approach?

page 1004

A. Not necessarily. Not necessarily. You remember that in the Hope Natural Gas Case, in that case it was decided in—no, it was the Natural Gas Pipeline Case decided in 1941, but, of course, a good many years after Los Angeles Gas and Electric Company, in that case, for example, the pipeline sought to establish a going-concern value of eight and a half million dollars.

Q. It was not allowed.

A. It was not allowed, and the Court of Appeals reversed the Commission on that ground and another, but the Court of Appeals was in turn reversed by the Supreme Court.

Chairman Catterall: Isn't it a fair to say that while the going-concern value is not in the rate base it does control the rate of return in order to keep the concern going?

A. Well, we used to try to prove it another way, Judge Catterall. I am talking about what I refer to in my testimony as the "bad old days". After the testimony was in as to value of the tangible property, personal property, we did put on an expert who attempted to prove going value by showing the additional value to be ascribed to seasoned and integrated property. The additional value to be ascribed to customers attached to the lines and the additional value to be ascribed to the trending of a staff, a staff which has become an expert staff, which functions efficiently, those were the criteria which we ordinarily presented to a regulatory agency in those days for the purpose of demonstrating going-concern value. It was a percentage allowance, a rule-of-thumb allowance. And up to the

page 1005

Los Angeles Gas and Electric Case, we, and you will forgive me for saying "we," Mr. Riely, we characteristically were allowed going-concern value. A separate allowance was made for going-concern value, but that was stopped promptly by the—reasonably, promptly in 1933 by Los Angeles Gas and Electric Case and the cases that immediately followed and subsequently decisions including many determinations of state courts of last resort.

Q. You do not know of a rate case which has used a cost rate base—an original cost rate base in which additional allowance of going-concern value has been permitted, do you?

page 1006 } A. No, I don't, and I say that because certainly since the Los Angeles Gas and Electric and that is thirty-six years ago, going-concern value has not been allowed. Even though I would feel reasonably sure without knowing, I am just speculating.

Commissioner Hooker: They haven't asked for it, have they?

A. Oh, they haven't asked for it in recent years, no, Sir. Of course not any more than they asked for it when the Chesapeake and Potomac and VEPCO rates were before you, but I would guess that without knowing that there were a good many cases in which original cost was used and some consideration was given to fair value in which some allowance was made for going-concern value.

Mr. Riely:

Q. Some allowance—consideration was given to fair value so that the rate base was not equated to original cost?

A. Well, it was not equated to original cost exclusively. Now you know what the jurisdictions are, Pennsylvania, for example—

Q. Certainly.

page 1007 } A. —which arrives at a compromise as between fair value and original cost, and I would think that in such a state there probably have been decisions, although I cannot cite them, there probably have been decisions since the Los Angeles Gas and Electric Case, in which some allowance may well have been made for going-concern value. I can't cite—

Q. But not in a case where the rate base was equated to original cost that you know of?

A. Not where the sole criterion was original cost, sofar as I know.

Q. Now one of the cases that you cited in your testimony is the Alexandria Water Company Case—

A. Yes, Sir.

Q. —which is reported in one hundred sixty-three Virginia page five-twelve. Now in that case the rate base was the subject of the consideration by the court was a reproduction cost new rate-base, less depreciation.

A. It was a fair value rate base.

Q. Yes.

A. Yes.

page 1008 } Q. And it was in that frame of reference a fair value rate base that going concern value was considered by the court, isn't that correct?

A. Going-concern value was considered by the Commission, and a figure was allowed for fair—I mean going-concern value amounting to four point four per cent of the fair value of the property.

Q. And that was in a case where there was a fair value rate base and not original cost base?

A. Certainly. The Commission referred to a figure of something like a million three hundred fifty thousand dollars, representing the fair value of the property.

Q. Now, Professor, you refer to two cases on page seven of your testimony which you say and I quote, "Two cases which seem to me to emphasize the decreasing importance of going value in Virginia," and they are the 1951 telephone case and the 1955 VEPCO case. Have you read the records in those cases?

A. No, Sir.

Q. Did you participate in those cases?

A. No, Sir, I did not.

page 1009 } Q. Do you know if the reproduction cost new less depreciation was offered in evidence in those cases?

A. I know it was.

Q. It was. Do you know what action the Commission took in each of those cases when that evidence was offered?

A. They rejected it.

Q. They rejected it, and do you know whether the utility was successful in those case in obtaining the rates or substantially the rates they sought?

A. They were.

Q. Do you know whether in either of those cases or in any

other utility rate case in Virginia that has reached the Supreme Court of Appeals since World War II the utility has been the appealing party?

A. I do not happen to know of any. It might well be. I referred to those two cases as probably the most important in the electric and telephone appeals, oh, since the early 1950's.

Q. Would you accept subject to check that there has been no cases since World War II appealed from this

page 1010 } Commission by a utility, no rate case?

A. I accept it because I accept the statement made by you.

Chairman Catterall: Well, that is correct. They haven't appealed.

A. It sounds reasonable, Mr. Riely. I would expect that to be the case. Let me put it that way.

Chairman Catterall: You wouldn't expect anybody to appeal from a reasonable and just decision anyhow.

A. Of course not, and I particularly—

Mr. Riely: Oh, Judge, you break me up.

A. —and I particularly wouldn't expect T. Justin Moore to appeal from a case in which he got reasonable rate relief.

Chairman Catterall: Of course not, he would take with him the rejected exhibit on reproduction cost as an ace in the hole that he could bring out if things went too far against him, but he never had to bring it out.

A. Yes, but he would not bet too much money on that hole card, I don't think.

page 1011 } Chairman Catterall: I don't believe he had any real bets on it.

A. No, Sir.

Mr. Riely:

Q. Having known the gentleman in question as intimately as you, I suggest his idea of what was a reasonable result might not be exactly what you *made* in mind, particularly if it was not what he asked for.

A. Well, sofar as rates were concerned, I thought Mr. Moore got pretty well what he asked for.

Q. He did. There's no question about it. Does it strike you as odd that no utility has sought to reverse the Commission because it refused to receive reproduction cost evidence because it refused to give a fair value rate case?

A. J. C. Priest

A. Certainly. Mr. Justin Moore told me one time that Judge Hooker, I think, had told him that the Virginia Commission was going to operate on the original cost concept, and Mr. Moore accepted that statement.

Q. And he didn't—and no case was appealed because reproduction cost evidence was not admitted. Do you think it odd that no case was, therefore, appealed because no allowance is made for going-concern value?

page 1012

A. Well, I don't know the circumstances. I am not in a position categorically to answer that question.

Chairman Catterall: Mr. Riely can testify if he wishes to. We are in the field of law now, and not the facts.

A. Well, it is—if you want me to answer the question, I shall, of course. If the utilities in those circumstances, and I assumed that other cases similar to Chesapeake and Potomac and VEPCO, if the companies get what they wanted substantially, I am sure they did not appeal on any ground. Why should they have?

Mr. Riely:

Q. That is right. That is right. Now would you agree with me that original cost is not synonymous with fair market value?

A. Of course, I would agree to that. It may be at a particular moment.

Q. Except as a coincidence?

A. It may be at a particular moment of time. It might well have been at the time of the Great Depression, for example; but certainly not since the recovery from the Great Depression, not since, say, 1940, would original cost probably be the same as fair value.

page 1013

Q. Do you know how much the Norfolk and Western pays annually for franchise tax to Virginia?

A. Sir?

Q. Do you know how much the Norfolk and Western pays annually for franchise tax to Virginia?

A. No, Sir.

Q. Would you accept that this amount is in excess of two million dollars a year?

A. Well, I will accept your statement, if you tell me that is what the tax is; I will accept that statement.

A. J. G. Priest

Chairman Catterall: It was two million dollars and it should have been three million dollars.

Mr. Riely:
Q. That, Professor, is another story.
A. Do you want my answer to that question?
Q. No, I do not want your answer to that question. That relates to a former conflict.

page 1014 } Does the fact—franchise tax is a property tax, isn't it?
A. Well, I thought it was gross earnings tax.
Q. But isn't it a tax on property, and hasn't it been so denominated by the Virginia Supreme Court of Appeals?
A. It may be—I suppose it has to be property tax; it is also called a franchise tax.

Chairman Catterall: It had to be denominated as a property tax in order to get by the Supreme Court of the United States. We lost the case, the railway express agency, because the statute taxing the railway express agency had in it the word "privilege." Therefore, the Legislature changed it to make it a property tax and the Supreme Court of the United States accepted that.
A. Well, Mr. Riely, let me say this. I have always felt it was an earnings tax. It is predicated on earnings.

Mr. Riely:
Q. Earnings?
A. I mean—

page 1015 } Chairman Catterall: Gross receipts.
A. That tax is so-called what is now or will be in 1970 the one and a half per cent tax, one and a half per cent tax of earnings.
Q. Of earnings or of revenue?
A. Of revenue, I beg your pardon.
Q. There is a difference.
A. Well, there is a difference, a tremendous difference, of course.
Q. Yes.
A. Well, I misspoke when I said revenue.

Chairman Catterall: That was so we could collect from the Seaboard Railway when it was losing money every week. We still collected the taxes on the gross receipts. They were

practically bankrupt and they could not give the property away, but we still collected the gross receipts tax.

The Government has to have money even if other people are poor.

A. I think that is a very significant point, Judge Catterall.

Mr. Riely:

page 1016 } Q. Doesn't this indicate to you that the Commonwealth feels that a franchise, which is property on which it levies a tax of two million dollars a year, must have some value property?

A. Well, it may have had value at the time the taxes were levied, but certainly it is in effect earnings tax, as you know; and there has been a very grave decline or detumescence in the significance of going-concern value since the statute was passed and the Constitution was adopted.

Q. So in your view, the Commonwealth is levying a tax of two million dollars a year on the property which has no value?

A. Well, I don't know—I have difficulty with that. I do not know it is levying that tax on property except as a matter of form of phrasing.

Q. Well, if it is not levying on property, it is unconstitutional.

A. Well,—

Chairman Catterall: That is our dilemma. We have to levied on property.

Mr. Riely: So we're caught on the horns.

A. But strictly between ourselves, Mr. Riely, the tax seems to me to be levied on earnings.

page 1017 } Mr. Riely:

Q. Well, that is very interesting. Maybe we have a constitutional question.

A. Please don't ask me about the Virginia Constitution. I am not an expert on that.

Q. Well, now, this is a—

Chairman Catterall: This is the Federal Constitution you are talking about.

Mr. Riely:

Q. Professor—

A. By the way, you are a professor too, Mr. Riely. Don't forget that.

Q. No, Sir. I have never achieved that rank.

I have one very small matter on page twenty-seven of your testimony—

A. Yes, Sir.

Q. Which I certainly want to indicate a correction I think that should be made in your testimony, and that is about the middle of the page; and we talk about a fee.

A. Let me say as to that: that is the only part of my testi-
page 1018 } mony that I am not directly responsible for. I would admit that in that case my testimony was prepared in Charlottesville and sent over with that particular figure blank, and I understand that counsel went to a person whom he considered an authority and that the figure he supplied was inserted upon the basis of that information. That six hundred ten dollars is not mine.

Mr. Riely: May I put Mr. Epps on the stand.

Mr. Epps: You won't get anywhere. I didn't do it, Mr. Riely.

A. If you wish to correct the figure to what you deem to be an appropriate figure, I will accept it, of course.

Mr. Riely:

Q. Now look at Section 58-442, a copy of which I hand you.

A. It came from the Clerk's Office, Mr. Riely.

Q. The Clerk was wrong.

A. I will accept your figure. What is the correct figure?

Q. The figure is five thousand and ten dollars. It is not
page 1019 } significant.

A. Yes, five thousand is miniscule in any event.

Q. But I did think that the testimony should be proper.

Chairman Catterall: We collect five thousand dollars for—

Mr. Riely: Public service corporations.

Chairman Catterall: That is the maximum.

Mr. Riely: Yes.

Chairman Catterall: Same as the maximum on a foreign corporation coming in.

Mr. Riely: Yes, and six hundred dollars in a non-public service.

Chairman Catterall: Right.

A. J. G. Priest

A. As a matter of fact, I might add that my eyebrows were arched a bit at the figure, but I accepted it.

Mr. Riely:

Q. Professor, I am nearly through. Will you agree with me that in reviewing the opinion of a judicial body just as an interpretation of the statute, it is important if possible to give meaning to every word of the opinion?

page 1020 } A. Sure.

Chairman Catterall: It is seldom possible.

Mr. Riely: I said if possible.

Q. Now would you take this book and you might be interested to look inside the front cover and then turn to page forty-one.

Mr. Epps: Did you say forty-one, Mr. Riely?

Mr. Riely: Yes, Mr. Epps.

Q. I want to read to you two paragraphs from the opinion of this Commission.

A. You told me to look at the inside—

Q. The front cover, you have gone one page too far.

Mr. Epps: Right here is what he made reference to (indicating).

A. Yes.

Chairman Catterall: What do you see there?

A. I recognize the signature. It is the signature of my old and cherished friend, T. Justin Moore, I recognize it, of course.

Mr. Riely:

Q. I want to read to you two paragraphs

page 1021 } from the opinion of this Commission in Case Six Six Four Zero *"Commonwealth of Virginia at the Relation of the County Wise* Against *the Interstate Railroad Company."*

A. Yes, Sir. It was signed in 1941 and the paragraphs appear on page forty-one of the Annual Report of the Commission for the year 1941 from the opinion of Chairman Ozlin.

Q. There is a caption that starts off, "Franchise Value Excluded."

"It must be borne"—

A. I'm sorry. I was looking—

Q. It is on page forty-one.

A. Yes, Sir. "Franchise Value Excluded," yes, I see that.

Q. "It must be borne in mind that, in assessing the physical properties of railroads for taxation, the franchise value is excluded. This is so by express constitutional mandate. The franchise is taxed separately by the State, and based upon the gross receipts of the company."

A. Gross receipts? I thought you said revenue.

Q. Gross receipts, revenue.

page 1022 } A. Well, there is a difference between the two you said a moment ago.

Q. Yes.

"This franchise includes the value of the charter or privilege of serving the particular community being served, or the value of being first in possession of the particular location, the good will of the business already established, the patronage already secured, the value of all existing contracts, and all those values which are usually comprehended in the term, 'going-concern value.'

"Therefore, in making the assessment of the physical properties, we are assessing the tracks, track structures, cuts, fills, tunnels, bridges, and the like, or, in other words, the bare bones of the property, denuded of the intangible evidence of value which may be attributable to them. It should also be borne in mind that the franchise value is assessed at 100%."

Now, Professor, on the assumption with which you agree that it is important, if possible, to give meaning to every word in a judicial opinion and on the further assumption which you have stated that the franchise value

page 1023 } of the Norfolk and Western is zero, what in the world—

A. I did not say that.

Q. Well, it is unascertainable.

A. You know I didn't even say that. I said it was up to you to prove it.

Q. Well, you said it was unascertainable as I read your testimony.

A. No, I didn't say it was unascertainable.

Q. Well, how would you ascertain it?

A. I do not know.

Q. Well, if you don't know how to acertain it, isn't it unascertainable as far as you are concerned?

A. Well, not necessarily. I have not attempted to ascertain it. I know that in Chesapeake and Potomac and VEPCO Justin Moore did not attempt to ascertain it, and I gathered from that that it was darn difficult to ascertain.

Q. Franchise value?

A. That is as far as I went, going-concern value.

Q. Have you ever heard of a franchise value in a rate case?

page 1024 } A. For many, many years, no value has been assigned to franchises except the actual cost incurred in obtaining the franchises.

Q. Well, if no value is assigned to franchises, what in the world does Commissioner Ozlin mean in that opinion?

A. Well, he is referring to going-concern value. I mean franchise value as concerning—all those terms that are usually comprehended in the term going-concern value. Going-concern value is what he is talking about, isn't it?

Q. You don't know how to ascertain it?

A. I don't know how to ascertain it now. I thought I knew how to ascertain going-concern value in the old days when we talked about a seasoned property and we talked about training a staff, that is the way we did it in the old days.

Q. So the Commission is required to exclude a value in this tax case, which you do not know how to ascertain?

A. I do not know how to ascertain it, and I think it is tough to ascertain it.

Q. And it is property of which a state levies

page 1025 } a tax of two million dollars a year?

A. Well, I do not know—I have difficulty with that, as I told you before, Mr. Riely.

Q. And the Commission must value the property without the franchise, isn't that right? Isn't that what Commissioner Ozlin said?

A. I gathered from that language, Mr. Riely, that he was attempting to value the property including the franchise value, and then excluded the franchise value.

Q. But it must exclude it?

A. Oh, yes.

Chairman Catterall: I believe that it works the other way. As you point out, the franchise value has not been identified in dollars and cents; and, of course, treating the franchise value the way that opinion does and the way the

Supreme Court of the United States does; for example, in the Railway Express Case, Mr. Riely's firm made a great play of the fact that the Railway Express Agency owned only about two thousand dollars worth of property in Virginia, and Mr. Younger soaked him with a tax

page 1026 } of one hundred and forty thousand dollars and Mr. Riely's firm did not see how that could be possible.

But in this case, valuing the bare bones value of the property on the cost of the property, we have not included any separate value for this franchise value we are talking about; and since that has not been included there is nothing to subtract, so we don't have to know what it is.

Mr. Riely is arguing that we have to get a complete value and then subtract this.

A. I do not see how you can get that.

Chairman Catterall: You can't do that.

A. I don't see how you can get a value, Mr. Chairman, until franchise value or going-conern value has been proved; and in addition to that, I may say that I prefer the language of the Supreme Court of Appeals in the Alexandria Water Company Case, which discussed going-concern value at great length to the particular language that Mr. Riely quoted to me here.

Mr. Riely: If it please the Commission, I think the colloquy between you and the witness is really what we

page 1027 } reserve for the argument.

Chairman Catterall: Yes, strike it from the record.

Mr. Riely: I can answer it now.

Chairman Catterall: No, leave it out.

Mr. Riely: But he does not state our position.

Mr. Epps: May it please the Court, I do not want to strike it because that is my re-direct examination; and I think if it goes as re-direct, we don't have to strike it.

Chairman Catterall: Well, leave out what I said.

A. I really was trying to answer you Mr. Riely.

Mr. Riely: What the Judge said is, our position to be is exactly contrary to what it is, and I simply would like the record to show that. I have no further—

Chairman Catterall: Let the record show that I don't know what Mr. Riely's position is.

Mr. Riely: Let the record further show that I hope some day to be able to show him.

A. Somebody in your firm, Mr. Riely, I have forgotten

who it was, said that a Richmond lawyer was before a court that asked questions very freely; and the ques-
page 1028 } tions were favorable, and the lawyer was delighted. Then the questions took an unfavorable turn. This lawyer rose and said, "If the court please, of course, your Honor may ask such questions as seems to him to be appropriate; but for God sakes, don't lose the case."

Mr. Riely: You would be surprised at how many times I have almost said that myself during the course of this hearing.

Mr. Shannon: I have a few questions, your Honors, of Professor Priest, if I may.

Chairman Catterall: You may ask a few questions.

CROSS EXAMINATION

By Mr. Shannon:

Q. Professor Priest, the Virginia law doesn't require the subtracting or taking out the franchise value, does it?

A. Well, I think that the statute talks about excluding the franchise value, but I assume excluding the franchise value after it has been proved. I mean you can't exclude franchise value unless it can find that the franchise value was based on substantial evidence.

page 1029 } Q. All right, Sir. Professor Priest, what, if any, are the similarities between the valuation for taxation and rate making?

A. Well, I think the similarities are in the first place, are in a public utility property does not have market value in the sense that utility property can be bought and sold, and there can be no exchange between a willing buyer and uncoerced seller; and, therefore, other techniques must be adopted and I indicate some similarities in my cross examination by Mr. Riely. That is, that the evaluation must be fair and reasonable, that a fair and reasonable result must be achieved, and that that result must be fair taking into consideration interest of both parties; and in this case I think there must be a balancing between the interest of the Railroad and interest of the taxing authorities.

Q. Yes, Sir. Professor Priest, let me put to you a hypothetical situation. You have a railroad line A to B. No trains have operated over it, but the line is in place ready for operation. What in your opinion would be the value of this railroad?

A. Well, the value of the railroad would have

page 1030 } to be determined upon the value of its tangible property in place.

Q. Then you would agree, would you not, that you would not determine the value of the railroad on the net-salvage worth of the ties, rails and the other track materials, would you, Sir?

A. I do not wish to be unkind to the other side of the table, but that notion seems to me to be—

Reporter: I am sorry, would you speak a little lounder?

A. That notion—I beg your pardon, Madam Reporter—AS I said, that notion seems to me to be aberrant, a-b-e-r-r-a-n-t.

Q. In other words, it's nonsense?

A. Well, I am inclined to accept that.

Q. One final question, Professor Priest. If the corporate charter of a railroad would expire, say by reason of a time limitation, would the remaining track have any value?

A. Of course, it would. I assume that a new franchise can be obtained. I mean in the old days of corporation activities, corporate charters were frequently

page 1031 } restricted as to time. They might be for thirty years, or fifty years, or a hundred years; and there are a good many cases in the books which deal with the renewal of a charter after that charter has expired and I would assume the circumstances you cite, that another charter, another so-called franchise would be obtained without too much difficulty.

Mr. Shannon: I believe that is all I have, your Honors.

Thank you very much, Professor.

Mr. Epps: No re-direct.

Mr. Riely: May I ask him one further question.

Chairman Catterall: Another new question?

Mr. Epps: We're not having re-direct. Do we have to have re-cross?

Mr. Riely: Well, I should think that we have opposing parties cross examining the witness—

Chairman Catterall: We are so informal here. There is no jury, so Mr. Riely may ask one more question.

Mr. Epps: That is all right, Sir.

Mr. Riely: I do not think Mr. Shannon and

page 1032 } I are on the same side of this case.

Mr. Shannon: I have an independent status in this case.

Mr. Riely: Thank you, Mr. Shannon. We love that independent status.

RE-DIRECT EXAMINATION

By Mr. Riely:

Q. Didn't you answer Mr. Shannon's question by saying that there was no obligation to exclude the franchise value from the property?

A. Oh, no, I say if the franchise value was proved, if it was in the evidence of franchise value, it had to be excluded.

Q. But without evidence of the franchise value, the Commission has no obligation to exclude the franchise value?

A. I do not see how it can exclude any figure if that figure has not been demonstrated.

Q. And that is true even though the franchise tax is levied on the property right of the franchise?

A. I think so.

page 1033 } Q. But there is no duty to exclude in the absence of proof?

A. No duty to exclude in the absence of proof. You cannot—it does not do you any good to exclude a zero figure, Mr. Riely.

Chairman Catterall: I believe my interpretation of the word "exclude" means the same thing as ignore. That is a possible meaning of "exclude" semantically.

Mr. Riely: I have no further questions.

Mr. Epps: No further questions.

Thank you, Mr. Priest.

Chairman Catterall: You may stand aside.

The Commission will recess ten minutes, if we are at the end of his testimony. 11:11 A. M.

Witness Stood Aside.

page 1034 } 11:21 A. M. The Commission resumes its session.

Mr. Epps: May it please the Commission, we will call Mr. Maurice J. McCarthy to the stand. Will you come around, Mr. McCarthy.

Maurice J. McCarthy

DIRECT EXAMINATION

By Mr. Epps:

Q. You are Mr. Maurice J. McCarthy?

A. Yes, Sir.

Q. Where do you live, Sir?

A. The address is 5201 Abingdon Road, Washington, D. C. and the code is 20016, please.

Q. Now, you are the Maurice J. McCarthy whose direct testimony has been reduced to writing and which has been subscribed by you and filed in this case, is that correct?

A. That is right.

Q. I remind you, Mr. McCarthy, because you subscribed by direct testimony, you are still under oath for the purpose of cross examination and hence the Commission will not have to administer another oath.

Mr. Epps: Mr. McCarthy is presented for cross examination.

page 1035 }

* * * * *

TESTIMONY OF MAURICE J. McCARTHY
ON DIRECT EXAMINATION

Q. What is your name and address?

A. Maurice J. McCarthy. My address is 5201 Abingdon Road, Washington, D. C. 20016.

Q. What is your principal occupation?

A. Accountant.

Q. What is your interest in this proceeding?

A. I have been engaged as a consultant and analyst in connection with accounting and related matters in this proceeding with particular respect to the rules of the Interstate Commerce Commission applicable to railroads and to accounting practices and procedures followed by railroads.

Q. Please state your education and ex-
page 1036 } perience?

A. I attended Columbia University for three years and studied accounting and business administration. I was employed as an accountant and statistician for a short time by the Sourthern Pacific Company and the Continental Transportation Company. Later, I was appointed special

agent and examiner of accounts by the Interstate Commerce Commission and worked with that Federal agency for more than 35 years in various assignments as accountant, auditor, statistician and in related work. During that time I examined the accounts, records and financial reports of many of the large railroads and other regulated common carriers. I appeared as expert witness in proceedings before the I.C.C. and the Federal Courts. My last assignment with the I.C.C. was Chief, Section of Accounting. I retired from the I.C.C. about four years ago. Since that time I have accepted engagements as self-employed consultant and analyst in accounting and related matters. I hold degrees BCS. in accounting and business administration, and LLB. and LLM. in law. I am a member of the bar of the Federal courts, District of Columbia, the Tax Court of the United States, the Supreme Court of the United States, and the bar of the Interstate Commerce Commission.

page 1037 } Q. Are you familiar with the accounting rules of the I.C.C. applicable to acquistion of property, maintenance and depreciation, including track property?

A. Yes.

Q. Are you familiar with the report and decision of the I.C.C. relating to betterment and depreciation accounting, in 309 I.C.C. 289?

A. Yes.

Q. Were you Chief of the Section of Accounting of the I.C.C. when the decision was issued?

A. Yes.

Q. Was the subject matter in that report and decision processed through the Section of Accounting?

A. Yes.

Q. Do the I.C.C. accounting rules prescribe depreciation accounting for track property, such as ties, rails, ballast?

A. No.

Q. Will you please explain how the matter of depreciation of track property is treated in the I.C.C. accounting rules?

page 1038 } A. The track structure, as a whole, is considered to be semi-permanent in the sense that the end of its life span is not foreseeable. As pieces of the track structure, such as a rail or tie, need to be replaced, the replacement is treated as a repair to the track structure, the same way as a repair part applied to a freight car, locomotive, or a building; except that betterments (improved parts) are treated as investments in

property and the cost of the improved part in excess of the cost to replace in kind is not treated as repairs.

Q. Will you please explain this further?

A. The underlying principle is that the wearing out of track parts, such as ties, and rails, is restored through replacements and there is no consequential depreciation of the track structure as a whole.

Q. How is the treatment of track replacement as repairs similar or dissimilar to the treatment used in replacement of parts of other classes of property, such as replacing a roof on a building or repair parts on a locomotive or freight car?

A. Replacements of track parts, such as ties and rails, and replacements of parts on buildings and equipment (rolling stock), similar in that, in both cases, the parts are treated as repairs. However, in the case of track property, where the end of the life span of the track structure, as a whole, is not foreseeable, and is considered to be semi-permanent, the replacements of parts is treated as a continuing process of repairs, thus keeping the whole track structure in good condition on a permanent basis, with no

page 1039 } need for recognizing inconsequential depreciation in the structure. This is dissimilar to replacement of parts of other property, such as a building or a unit of rolling stock, which has a limited life span and where depreciation, or obsolescence, is occurring notwithstanding replacement of worn out parts. This depreciation, or obsolescence, must be recognized apart from the replacement of parts.

Q. Are these points of similarity and dissimilarity, which you explain, referred to in the I.C.C. report in 309 I.C.C. 289, previously mentioned?

A. Yes.

Q. Please refer to the I.C.C. report in 309 I.C.C. 289 and point out the principal statements in that report concerning the treatment of replacement of parts of the track structure as repairs?

A. Page 289 indicates briefly that, under the rules, expenditures incurred for track work, other than the portion for superior parts applied, shall be treated as repairs. This provision is affirmed in the decision.

Page 291 points out that railroads favor continuance of procedure for treating cost of replacing track property as maintenance (repairs); that expenses incurred to keep the track in condition for safe operation are maintenance "in

page 1040 } every sense of the word" and should be so treated; that depreciation accounting cannot be properly employed because "there is no depreciation of the track structure as a whole."

Page 292 points out that the railroads assert that depreciation techniques are not applicable to track structure due to the unique characteristics of such property, its physical nature, how it functions, and its indefinite life span. Also, at Page 292, the report states that, unlike ascar, building, or locomotive, the useful life of the composite track structure is sem-permanent in the sense that, when properly maintained, the end of the life span is unforeseeable.

Page 294 quotes statements made by the railroads to the following effect:

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. All railroads must meet the standard of safety. For this reason, if no other, there can be no deterioration in the railroad track structure; 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.

page 1041 } Q. I believe you pointed out that the I.C.C. decision affirmed the accounting rules which treat the replacement of track material as a process for keeping the track structure in good working condition, and that depreciation deduction is not necessary. Is that correct?

A. Yes, that is correct.

Q. Are these I.C.C. rules you have been referring to now in effect?

A. Yes.

Q. Are you familiar with I.C.C. rules in effect prior to the present rules?

A. Yes.

Q. As background information, for a clearer understanding of the present rules, can you explain briefly the earlier I.C.C. accounting rules relating to repairs and depreciation?

A. The first comprehensive system of accounts was issued in 1914. At that time depreciation accounting was made mandatory for *equioment* (rolling stock) but optional for other property. In 1942, depreciation accounting was made

mandatory for other classes of property but not for track property. The I.C.C. report and decision in 309 I.C.C. 289 affirmed the rule treating replacement of parts, such as ties and rails, in the track structure, as repair work.

page 1042 } Q. Now, Mr. McCarthy, I ask, Are you familiar with the basis on which the amounts shown in the property investment accounts for track property, such as ties and rails, are computed?

A. Yes.

Q. Will you please explain the basis?

A. The amounts in the property investment accounts for track property represent the original cost of the initial ties, rails and other property, plus the cost of subsequent additions and betterments to date. When ties, rails and other track property are replaced without betterment, the replacement is treated as repairs, regardless of the current cost of the replacement, and no change is made in the property investment account. The effect of this procedure is that the cost of the original ties and rail material remains in the property investment account, even though the original items have been replaced with like items at higher prices. This fact becomes important when track material is to be adjusted to reflect the higher present-day level of prices in situations relating to current value of the property.

Q. Do you know whether the I.C.C. annual price indices for track property for 1967 are higher or lower than for prior years?

A. The 1967 indices indicate a higher level of prices for that year compared with earlier years. The indices indicate progressively higher prices over many years.

page 1043 } Q. Would the application of these I.C.C. price indices for 1967 to the original cost of track property result in a higher or lower adjusted amount?

A. A higher amount.

Q. Would this adjusted amount have any significance in relation to the cost or valuation of the track property?

A. Yes. In my opinion, the original cost, adjusted consistent with the I.C.C. price indices, will produce a reasonable approximation of the current, or present-day cost of the property.

Q. Have you prepared a statement, using the relative I.C.C. price indices for 1967, showing the relationship between (1) the indices for that year, and (2) indices for prior years when track property at its original cost was included in the property investment account and continues to be carried in that account, even though replaced?

Maurice J. McCarthy

A. Yes, such a statement was prepared, identified as M. J. M. Exhibit 1.

Attorney will now introduce as M.J.M. Exhibit 1 the aforesaid statement.

Q. Please explain the material in the statement?

A. The statement shows (1) original cost as carried in the investment account for several classes of Norfolk & Western track property and other property in Virginia; (2) price level indices; (3) adjusted original cost, page 1044 } or current cost at present-day prices; (4) deduction allowance for condition, on the non-track property accounts; and (5) current cost at present-day prices, after deducting allowance for condition, on the non-track property accounts.

Q. Your statement No. 1 does not show a separate deduction from original cost at present prices for condition of road properties. Please explain this.

A. The amount shown in the first column for original cost on the books for track properties is representative of the depreciated cost, or adjusted cost. Under the I.C.C. accounting rules applicable to track properties, the costs of replacing rails, ties and other track properties are treated as repairs (except for betterments), and the first cost remains in the track properties investment accounts for track (Accounts 3, 8, 9, 10, 11, 12), without increase for the higher costs of the replacements. This is known as betterment and replacement accounting.

Q. What is the effect of such accounting in respect to your computation of cost of track property at present-day prices, shown in your Statement No. 1?

A. The effect is that the amount in the several track property investment accounts is about equal to (1) the actual higher cost of the track material applied in replacement, less (2) depreciation on a straight line basis, page 1045 } or depreciated cost. By applying the price indices to this depreciated cost in column (1), the resulting amount is the depreciated cost of the track property at present-day prices. If a separate or additional reduction were to be made for condition of property, this would result in double or duplicate reduction for condition of property and a material understatement of the amounts shown in the right-hand or end column on Statement 1 for cost of track properties at present-day prices.

Q. Explain the method of determining the price level indices shown in the statement?

Maurice J. McCarthy

A. Sheet 2 of the statement shows (1) the I.C.C. price indices for each 5 years, from 1915 to 1965; (2) the aggregate of such indices for the several years consisting of 11 periods; (3) the average or one-eleventh of the aggregate; and (4) the ratio of the average to the I.C.C. price indices for 1967.

Q. What is the next step in the statement?

A. The ratio just described is carried over to sheet 1. By appling this ratio to the original cost of the property, the adjusted original cost, or current cost based on present-day prices, is determined and is shown in the statement. This adjusted original cost is, of course, a constructed mathematical or statistical original cost based on in-
page 1046 } formation in the accounting records and the I.C.C. price indices. Nevertheless, in my opinion the method used produces a reasonable approximation of the cost of the property at present-day prices.

Q. Will you summarize briefly the basic procedure used in determining the final adjusted amount in the statement?

A. The procedure is designed to develop the present-day cost of the several classes of property now in the track and certain other property. Only the aggregate original cost of the several classes of property is available in the accounts. However, the I.C.C. price indices for classes of property are available back to 1914. These show the annual indices up to 1967 of prices in relation to the I.C.C. 1910-1914 prices in the I.C.C. basic valuation (1910-1914 prices being index 100). The ratio of the 1967 price indices to the average 1915-1965 indices produces weighted price indices for the several classes of property. These weighted price indices when applied to the total original cost of each class of property acquired during the several years produce a reasonable approximation of present-day costs.

Q. Now, Mr. McCarthy, can you tell me whether the term "fair value" or "cash value" of property is known and used in accounting terminology?

A. Yes. My understanding is that accounts employ the term in the same sense as in law, that is, sales
page 1047 } of property involving a willing seller and a willing buyer.

Q. Do you see a relationship between such "fair value" or "cash value" and the adjusted original cost, or present-day cost, shown in your statement?

A. Yes, I do. In my opinion as an accountant, in general the cost, at present-day prices, of reproducing a piece of

property is a dominant factor to both a prospective buyer and a seller, and strongly influences the "fair value." From this premise I conclude that present-day cost is a reasonable basis for computing "fair value" or "cash value" for railroad track property or other property where no sales of comparable property occur.

Q. Now, Mr. McCarthy, I have a few more questions about original cost of property?

A. Yes, sir.

Q. You have explained that, using the original cost shown on the books as a base, you have applied price adjustment indices and computed present-day prices for track property and certain other property; is that correct?

A. Yes, that is correct.

Q. Do you have a comment, under I.C.C. accounting rules, as to depreciation with regard to the original cost of track property as shown in the books?

A. Yes. The original cost figure, or book figure, for track property has depreciation already built in.

page 1048 } Q. Mr. McCarthy, have you read Mr. Tipton's testimony?

A. Yes, I have.

Q. Have you also examined the schedules prepared by Haskins & Sells in connection with the Norfolk & Western Railroad's report to the State Corporation Commission in January of 1968?

A. Yes, I have examined them.

Q. Do the figures that occur on Schedule 1 in the first or left-hand column roughly approximate or parallel the cost figures which appear on Account 611 of the Road and Equipment property within the State of Virginia, filed by the Norfolk & Western Railroad?

A. Yes.

Q. Now, on Schedule 2, what do you take it they have done?

A. As I understand the figures in this study, Schedule 2 represents the application of a 1966 price level index to the cost, with built-in depreciation of track accounts applied on the properties over a long period of years.

Q. If that is correct, then what is your opinion as to the amounts by which depreciation is shown on the various track accounts, which is to say, Accounts 8, 9, 10, 11 and 12?

A. On the basis of my understanding of the figures which I have just explained, the original cost shown on that Schedule 2 with respect to track property has de-

page 1049 } preciation built into that original cost figure.

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Therefore, the deduction for accrued depreciation shown in the Schedule 2 would result in a duplicate deduction for depreciation and the resulting understatement of the original cost shown in the last, or third, column of Schedule 2.

Q. If a 1952 bringing-to-date report for those accounts was expressed in 1910-1914 base dollars and a 1968 multiplier was used, what result would be achieved?

A. The 1968 value of the dollars in the 1952 track properties.

Q. What would be omitted?

A. Any additions, new lines, new and different structures, and abandonments.

Q. If a line remained stable, would this method produce an accurate picture of the 1968 road?

A. It would, and the amount would be approximately equal to today's value.

Q. Did you use any overheads?

A. No.

Q. Did you use any addition for interest during construction?

A. No specific amounts.

Q. Did you use any additions for franchise?

A. No.

Q. Did you use any additions for going concern?

A. No.

page 1050 } Q. Did you use any additions for good will?

A. No. According to Section 1 of 19-a of the I.C.C. Act no valuation shall be added for these intangible items of franchise, good will and going concern.

Q. That is all, Mr. McCarthy?

A. Yes, sir.

page 1051 } I hereby certify that the answers given to the foregoing questions are true and correct to the best of my knowledge and belief.

Maurice J. McCarthy

Subscribed and sworn to before me this 10th day of April, 1969.

Hazel M. Walther
Notary Public

My commission expires: November 15, 1969

Maurice J. McCarthy

page 1052 } 1. Q. Mr. McCarthy, since preparing your statement already filed in this proceeding, have you had an opportunity to examine and analyze the statements prepared by Mr. Tipton, being Exhibit 17 herein?

A. Yes.

2. Q. Will you please state what your examination and analysis disclosed?

A. The amounts in Columns (1), (2) and (3), Part 2, Schedule 2 are based on amounts in the ICC basic engineering report plus net changes to 1966 for additions and betterments, under ICC valuation rules, or the total investment as of December 31, 1966, adjusted to 1910-1914 values.

The amounts in Column (1), plus such net changes to 1966 before adjustment to 1910-1914 prices shown in Schedule 2 (except for Account 9 (Rails)) is not materially different from the total investment for property as carried in the account records and in the report to the State. (Form A, Schedule 611 for the State of Virginia).

3. Q. Please continue with your explanation.

A. Column (3) states that the amounts shown therein are the total investment as of December 31, 1966 stated in 1910-1914 values. This means the total investment as of December 31, 1966 is computed under ICC valuation rules stated in 1910-1914 values. However, contrary to Mr. Tipton's procedure the appropriate procedure to determine the 1966 values would be to apply the full 1966 ICC indices to the amount in Column (3), subject to a fair allowance for any depreciation in the property. This fair allowance would be based on the condition of the property as observed by the engineers in their inspection of the properties. This will be the computed value as of December 31, 1966. Use 1967 ICC indices to determine the value for the later year.

page 1053 } Q. Did your examination of the working papers supporting Mr. Tipton's Exhibit 17 disclose information which was not available to you when your statement on direct testimony was filed?

A. Yes. I stated at page 14 of my earlier testimony that I understood, at the time, the figures in schedule 2 of the Haskins and Sells summary, described as "original cost", to be the cost figures which appear in schedule 611 of the road and equipment property within the State of Virginia filed by the Norfolk & Western Railroad. The figures in that schedule 611 for track property are commonly regarded as having "built-in" depreciation, because of the system of

replacement accounting for such property followed by railroads. Examination of the supporting working papers in Exhibit 17 discloses that the "original cost" figures therein for track property are designed to show accumulated gross costs without "built-in" depreciation.

As a result of this additional information I was able to obtain from working papers in Exhibit 17, the
page 1054 } comments on page 14 and 15 in the statement in my direct testimony previously submitted regarding the "original cost" figures in the exhibit as containing "built-in" depreciation for track property should be disregarded and eliminated from my statement. In other respects my earlier statement on direct testimony remains unchanged. This concludes my testimony concerning modification of statements made in my earlier testimony.

Q. Earlier in this additional testimony you indicated that, contrary to Mr. Tipton's procedure in Exhibit 17, the appropriate procedure to determine 1966 values for track property would be to apply the full 1966 indices to the amount in column (3) of schedule 2, subject to a fair allowance for any depreciation in the property, such allowance to be based on the condition of the property as observed by the engineers in their inspection. Have you computed the value of the track property, except for account 3, Grading, on the basis you consider to be appropriate procedure?

A. Yes, I have. The value of the track property which I computed by applying the full 1966 indices to the "Total Investment as of December 31, 1966 stated in
page 1055 } 1910-1914 value" shown in column 3, schedule 2 of the working papers in Exhibit 17:

I.C.C. Account	*Total Value for* 1966, *At Full* 1966 *Indices*
8. Ties	$28,734,178
9. Rails	82,903,169
10. Other Track Material	55,131,319
11. Ballast	38,888,121
12. Track Laying and Surfacing	34,621,721
Total Value 1966	$240,278,508
Increase in value based on I.C.C. full 1966 indices	$ 94,022,273

Q. Have you computed the value of the track property

by applying the comparable I.C.C. indices for 1967, not shown in Exhibit 17?

page 1056 } A. Yes, I have computed value for track property for 1967. As I previously indicated a fair allowance should be made for any depreciation in the track but, in my opinion, any allowance should be based on the condition of the track property as observed by the engineers in their inspection of the property for the specific purpose of this proceeding. Continuing with my answer, the computed value of the track property based on the 1967 indices, but without deducting allowance for any depreciation, is as follows:

I.C.C. Account	*Total Value for* 1967, *Based on* 1967 *I.C.C. Indices, Without Allowance for Depreciation*
8. Ties	$ 29,282,802
9. Rails	83,883,112
10. Other Track Material	57,762,067
11. Ballast	39,532,676
12. Track Laying and Surfacing	35,265,846
	$245,726,503

Q. This value of $245 million for 1967 *without* allowance for depreciation, is about $85 million in excess of the $160 million based on accounting records, shown in the statement presented with your direct testimony, or about 34 percent excess. Do you have any comment on this?

page 1057 } A. Yes. The value of $160 million based on the accounting record is a net figure, with built-in depreciation. After allowance is made for depreciation from the $245 million gross value, based on valuation records, the difference of $85 million, or about 34 percent, will shrink materially.

Q. Mr. McCarthy, during your 35 years with the I.C.C. and as Chief of its Section of Accounting, have you had experience with both accounting and valuation records?

A. Yes.

Q. In your earlier statement on direct examination you submitted a statement of cost of track property adjusted to present-day prices based on accounting records, and now you are presenting value based on I.C.C. price indices and

other valuation records. For the purpose of clarifying the record in this proceeding, will you please comment on this point?

A. The *firs* statement is based on an accounting approach to valuation, constructed on mathematical or statistical original cost figures based on information in the accounting records and I.C.C. price indices, as explained page 1058 } at pages 11-12 of my earlier statement. The second statement is a valuation approach based on cost in the basic valuation engineering report and subsequent year-to-year track property changes, then adjusting the net changes first back to 1910-1914 prices and then applying price indices to update the value of the track property. This is the regular I.C.C. valuation procedure.

Q. Now, Mr. McCarthy, based on your knowledge and experience, what is your view with respect to using I.C.C. valuation records as contrasted with accounting records in determining value of track property?

A. Where suitable valuation records are available, as in the present proceeding, my opinion is that the appropriate procedure to determine value is through use of the valuation records and applying the I.C.C. price indices. For example, the figures for total investment in track property as of December 31, 1966, stated in 1910-1914 values, have been presented in this proceeding. The applica- page 1059 } tion of the full I.C.C. 1966 price indices to this base, adjusted for a fair allowance for depreciation in the property based on condition of property observed by engineers in their inspection, will, in my opinion produce the fair value for that year. The application of 1967 indices will produce the value for this later year.

Q. Mr. McCarthy, do you have a statement comparing values of track property shown in Mr. Tipton's Exhibit No. 17 with values based on full 1966 and 1967 indices and values based on accounting records?

A. Yes, I have a three page statement entitled "Comparison of Values of Track Property Shown in Exhibit 17 with Value Based On Full I.C.C. For 1966 Indices (Also Value for 1967 Without Allowances For Depreciation and Value Based on Accounting Records" bearing the symbol MJM-X in the upper right corner which I have requested be marked for identification as Exhibit No. (MJM-X). This statement sets forth the computations which I have just discussed in some detail.

Q. That is all, Mr. McCarthy?
A. Yes sir.

page 1060 } CROSS EXAMINATION

By Mr. Riely:
Q. Mr. McCarthy, I believe in your testimony you state that you worked for the Interstate Commerce Commission for thirty-five years. Is that correct?
A. Yes, Sir.
Q. And except for that employment for a short time by Southern Pacific and Continental Transportation Company, your whole business life prior to your retirement was with the Commission, was it not?
A. Substantially all of it, yes, Sir.
Q. And you retired from the Commission about four years ago?
A. Yes, Sir.
Q. Since that time you have been engaged as a consultant and analyst in accounting and related matters, is that correct?
A. Yes, Sir.
Q. Now, since retiring from the Commission, have you ever testified before a Court or *regulartory* commission?
A. Yes, Sir.
page 1061 } Q. What court or what *regulartory* commission?
A. Before the Tennessee Commission.
Q. And what was the subject matter of that proceeding?
A. It had to do with abandonment—proposed abandonment of a section of railroad and related features involving the cost and revenues, and so forth.
Q. Is that the only case in which you have testified since your retirement?
A. In which I have actually testified in a case.
Q. Yes, Sir.
A. Yes, Sir.
Q. Have you ever before testified in a case involving *ad valorem* taxes of a railroad company?
A. I believe I have been involved in cases which indirectly concerned the value of property.
Q. For tax purposes? *Ad valorem* tax purposes?
A. No, Sir.
Q. No. This is your first occasion to testify in an *ad valorem* tax case.

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A. To the best of my recollection, it is.

page 1062 } Q. Now, Mr. McCarthy, I wonder if you could define certain terms as you used them in your testimony. First of all, how do you define original cost?

A. Original cost as used in the ICC regulations and I use here means the cost to the property when it is first purchased and used in transportation service.

Q. Is that true under the ICC accounting principals?

A. I think that general question is asked, we have to think in terms of what type of property we are talking about.

Q. I am talking about track property, Mr. McCarthy.

A. Yes, well, now in the case of track property, the term "cost" is generally used—

Q. What do you mean by original cost when you use it in regard to it?

A. Original cost and evaluation of the ICC work would mean the definition that I initially gave. I made my first cost of the property when it applied to transportation use.

page 1063 } Q. Is that true of property that was built in 1905?

A. Let me put it this way: that the cost of property in 1905, the actual cost of it in terms of what it cost when it was constructed by the railway company who may have built it, is probably not known by anybody.

Q. What if it were known.

A. And then what is the question?

Q. If it were known, would that be the cost that you refer to as original cost, of a railroad track property?

A. In this particular proceeding, we are talking about the original cost in relation to the Norfolk and Western.

Q. I am trying to find out what you mean by original cost. Do you mean by original cost the actual dollars expended by the persons who first devoted the properties for transportation use?

A. Yes, Sir, it is a general meaning of original cost.

Q. And that it's true even as to property that was constructed in 1905?

page 1064 } A. To the extent that it is determinable, but my position is that the original cost of property prior to the evaluation of the property cannot be determined. As a matter of fact, the ICC has said in just about all of its evaluation cases that the original cost could not be determined—

Q. So your—

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A. —from the records.

Q. So your definition of original cost is not the definition that you initially gave, but it begins with the ICC 1916 evaluation, does it not?

A. Yes, and I would like to explain that by saying this: the ICC, again quoting the ICC, I understand that the evaluation figures in the basic engineering cost are fairly representative of the original cost of the property when it was first constructed. Now that is the term in which I am using original cost in this case.

Q. But isn't it true that the evaluation report showed the property priced at 1910 to 1914 prices, and not at the prices at which it was originally constructed?

A. Well, again I say that—

Q. Can you answer that question?

A. Yes. That is true. Priced at 1910 and 1914 prices.

Q. So when you refer to original cost on page 1065 } books as you do in the third column of page one of your MJM Exhibit No. 1, you are referring, I believe, to the 1916 evaluation, broad base, isn't that correct?

A. To be precise I am referring to original cost as it is used in the literature in the ICC, namely the original cost in terms of 1910, 1914 prices as being synonymous.

Q. And that was a current cost of 1910 to 1914 prices, was it not?

A. Yes, it was.

Q. So it does not conform to original cost in the sense that we first used it as the cost to the person who first devoted the property to public use?

A. Well, I say they are analogous.

Q. They are analogous, they are not synonymous.

A. They are treated as being synonymous.

Q. Do you consider them to be identical?

A. In my use of the term, they are identical, yes.

Q. Would you answer my question, please, Mr. McCarthy? Are they in fact identical?

page 1066 } A. I am not sure that they are because the original cost cannot be determined.

Q. All right, Sir, how do you define current cost?

A. Current cost would be the cost of the property as of a current date.

Q. Would it be the cost of constructing the property as of a current date?

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A. Constructing or purchasing?

Q. Well, purchasing depends upon whether a willing buyer and willing seller—would it not?

A. Well, I am saying that the current cost means what it would cost you to construct the property or to buy property where you actually purchase property.

Q. But that might not be the same, mightn't it?

A. Well, we are talking about different things. In one instance you would construct property and in another case you would purchase property.

Q. If you were buying an existing line of railroad would it be mandatory that the purchase and sale be made at the price that you would call current cost?

A. Did you say, "is it mandatory?"

page 1067 } Q. Yes.

A. Under the ICC rules?

Q. Under the ICC rules or under anything you want to think about.

A. Well, I think I would have to see some background in which I could answer that question.

Q. Well, the cost of purchasing a going concern is not necessarily the equivalent of your current cost, is it?

Mr. Epps: May it please the Court, I think that the witness answered the question. He said you build some property and you buy some property in track properties and now I think that this is a confusion factor and I believe Counsel—

Chairman Catterall: The word "mandatory" has no meaning in this context, that is the trouble with the question.

Mr. Riely: If the Commission is satisfied with what the witness says, I am happy, but I do not understand the witness and I am merely trying to understand what the witness means.

Chairman Catterall: Well, tell him what you

page 1068 } mean by the word "mandatory."

Mr. Riely:

Q. The witness has said, as I understood the witness to say, that the current cost or present day cost of property is what property would be bought and sold for. Now, I—

Mr. Epps: No, I think he said—Mr. Riely, I am not trying to heckle Counsel, but I believe I can help us along a little bit.

Mr. Riely: I wish you would.

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Mr. Epps: I think he said that you build some of your properties, such as excavations and these things, but you buy some track properties, such as your rail which comes from say, a steel mill.

Mr. Riely: What I was trying to do was to determine whether he was saying that with regard to individual items of property—

Mr. Epps: That is the point.

Mr. Riely:—Or a completely constructed property.

Mr. Epps: It is clear to me that he is talking about the components and not the whole track.

page 1069 } Mr. Riely:

Q. Is that correct, Mr. McCarthy?

A. Yes, Sir, that is correct.

Q. Good. Now, what have you shown on the fourth column of the first page of Exhibit MJM-1 that is in essence current cost as we have just defined it, is that correct? This column headed "Cost at Present Day Prices?"

A. As I stated in my testimony, that is a constructive figure based on accounting data and statistical data.

Q. Is that figure substantially synonymous with reproduction costs?

A. Well, I think it is stated "Cost at Present Day Prices."

Q. What does reproduction cost mean?

A. You can use that term "reproduction cost." I like the term, "Cost at Present Day Prices."

Q. They mean substantially the same, don't they?

A. It probably does.

Q. Now, original cost as you define it and current cost are two quite different matters, aren't they?

A. Oh, yes.

page 1070 } Q. Now, your original cost on books as shown on page one in Exhibit MJM-1 is as of what date?

A. That was in 1967.

Q. December 31, 1967? There is no date on the schedule that I can find. Is that correct?

A. That is right. That is the figure in the schedule filed with the State of Virginia.

Q. Now, I hand you Schedule One attached to Exhibit No. 2 RDT introduced by Mr. Tipton and I ask you whether his book balance at December 31, 1966 is not substantially the same as your original cost on books, except that you have in-

cluded forty-nine million, seven hundred eighty-three thousand, three hundred ninety-four dollars for grading.

A. That difference exists also, I believe. His book balance, as he states, is December 31, 1966.

Q. Yes, I said that.

A. I have used 1967 figure.

Q. And you have included approximately fifty million dollars for grading and he has not, is that correct?

A. Correct.

page 1071 } Q. Now, how about engineering. You have included seven million, seven hundred thousand for engineering and he has included two million, four hundred seventy-seven thousand. Can you explain this difference?

A. Yes. I have included the total cost shown on the books and also reported to the Commonwealth of Virginia by the Norfolk and Western railroad. Mr. Tipton's schedule one, as I understand it, has indicated by the asterisk on account one engineering is the portion of the engineering attributed to account five through thirteen.

Q. Where did you get your figure seven million, seven hundred forty-two thousand dollars?

A. That is the amount that appears in the record.

Q. What record?

A. Of the company.

Q. What records—

A. Reported to the Commonwealth of Virginia by the railroad.

Q. In what report?

A. I believe that is on that schedule six eleven.

Q. In the Form A report?

A. Yes.

page 1072 } Q. Why did you divide it between track and other?

A. Well, I assumed that some of engineering applies to the track account and the balance applies to the non-track account.

Q. Why did you include the amount of four million, one hundred eighty thousand dollars that applies to other than track accounts in this statement of original cost of track property?

A. That is the amount that related to the remainder of the road property accounts.

Q. What accounts would they relate to?

A. Excuse me, please.

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Note: Witness reviewing papers in brief case.

The four million, one hundred eighty thousand, seven hundred twenty dollars refers to all of the structure accounts such as shops and engine houses.

Chairman Catterall: Can you speak a little bit louder? That raised portion of your brief case between you and the reporter makes it harder for her to hear you.

page 1073 } A. To repeat the amount, three million, five hundred sixty-one thousand, three hundred fifty-four dollars applies to track accounts. The remaining amount refers to all of the other road property accounts, including such accounts as—

Q. Buildings?

A. Stations and office buildings.

Q. All of the other physical property accounts in roadway business?

A. Yes, Sir.

Q. Well, why did you put it in the original cost of the track. Isn't that what this Exhibit MJM-1 is supposed to show?

A. Well, I show the portion that I have allocated to track.

Q. Yes, but you add in the whole seven million, seven hundred forty-two thousand, don't you?

A. The total as shown there, yes, to balance off with the amounts shown in the schedule six eleven.

Q. So there is four million, one hundred eighty thousand dollars in your one hundred seventy-seven million, six hundred twenty-six thousand dollars that doesn't relate to track at all, is that not correct?

page 1074 } A. That is correct.

Q. All right, Sir. Now, if you took out fifty million dollars of grading and four million dollars of engineering, you would come out to one hundred twenty-three million dollars, roughly, wouldn't you?

A. Did you say one hundred twenty-three million?

Q. Roughly, yes.

A. Yes, Sir.

Q. Mr. Tipton, on his schedule one of Exhibit No. RDT 2 shows a book balance of one hundred twenty-two million, six — is that correct?

A. Yes, Sir.

Q. These are roughly comparable figures, then, a year apart.

A. Well, the two totals agree, yes, Sir.

Q. All right, Sir. Now, and these are both the investment on the books of the Norfolk and Western in these accounts? Is that correct?

A. Yes, Sir.

Q. Now, will you turn to schedule two of Mr. Tipton's Exhibit No. RDT 2 which I believe is the next piece of paper behind there (indicating.) Do you have a copy of it?

A. I do. Yes, Sir.

page 1075 } Q. What is the caption on this exhibit, will you read it, please, Mr. McCarthy?

A. Norfolk and Western Railway Company original cost, State of Virginia, December 31, 1966.

Q. Now, Mr. Tipton, in making the computations reflected on this schedule two, was not seeking to obtain reproduction cost or current cost, was he?

A. He is using the same—some of the same figures that appears in my schedule page one we have been referring to.

Q. What does the caption say he was seeking? It says he was seeking original cost, doesn't it?

A. Yes.

Q. And you have agreed with me before that original cost and reproduction cost are different things, aren't they?

A. Oh, yes.

Q. Now, let's turn to the fifth column of page one of your Exhibit No. MJM-1 and that is headed, "Cost at Present Day Prices," isn't it?

A. Yes, Sir.

page 1076 } Q. And I believe we have agreed that this is essentially the equivalent of reproduction cost at present day prices. Is that right?

A. Well, that column that you refer to has some deductions for condition of property, so that the column really represents costs at present day prices, less allowance for condition of property.

Q. And that is in accounts eight, nine, ten, eleven and twelve.

A. It does embrace those accounts, yes.

Q. Yes. Now, Mr. Tipton on his schedule two was not seeking to do in the fifth column on your page one, is that correct?

A. I am not sure what he was trying to do.

Q. You have examined his work papers, have you not?

A. Yes, I have examined the work papers.

Q. And you do not know what he is trying to do?

A. I know what he did.
Q. And what he did was wrong.
A. I do not agree with what he did, as I have indicated in my testimony.
page 1077 } Q. Well, what did Mr. Tipton do? Tell us.
A. I will give my understanding of what Mr. Tipton did by referring to his—to Mr. Tipton's working papers, and that is in—

Mr. Epps: I think that is in Exhibit No. 17.
Mr. Riely: Yes. Exhibit No. 17.

Q. All right, Sir.
A. And incidentally, I have already described that in my direct testimony.
Q. I would like to have you describe it again, Mr. McCarthy, if you don't mind.
A. Yes, Sir. Yes, Sir. In column one of his schedule two he shows the investment—described as investment—as of June 30, 1916, from ICC basic engineering reports.
Q. Yes, Sir.
A. In column two he refers to schedule two and he carries over into column two the basic material in his schedule two, which refers to schedule two supporting schedule, shows the additions and betterments to property since the basic engineering inventory. Then he shows the in-
page 1078 } creases year by year, from 19—he groups it from 1916 to 1920 and from then on to 1966, year by year, he shows the additions and betterments on the track property accounts eight, nine, ten, eleven and twelve. Then having arrived at the cost of the property during those several years, he applies the ICC indices to bring those costs back to the 1910-1914 level of prices.
Q. Yes, Sir.
A. Those additions and betterments, then, are inserted in column two. Then taking the figures in the basic engineering report, plus the net changes to 1966 of 1910-1914 prices, he has in column three, the total investment of property at the end of 1966 at the 1910-1914 level of prices. Now, that, I might add, is the basic ICC method of proceeding up to that point.
Q. And you agree with that method of procedure?
A. Yes.
Q. All right, Sir. Continue, if you will.

A. Well, column four shows what is stated to be the average service life of ties, rails and other track material, ballast, track laying and servicing. Then the material in the schedule indicates that taking half of that aver-
page 1079 } age service life and to give an example: in the case of ties there is a service life of thirty-two years. Then half of that service life would be sixteen years; then that sixteen years is deducted from the 1966 ICC indices, presumably to give you the 1950 indices which is supposedly the mid-life of the ties, theoretically, they are fifty per cent used. Then Mr. Tipton applies the so-called mid-point in life indices to the 1910-1914 values, column three, and he arrives at, in column six, value trended to a point in time mid-way in life of the account plus undepreciated ledger value of the account.

Then in column seven in respect to the track property, he deducts fifty per cent depreciation, which he calls "Depreciation Sustained," and then in column eight he arrives at the depreciated value for those track accounts.

Q. Let's go back to column six of Mr. Tipton's schedule two, the supporting document to schedule two. Do you think that was a proper computation as shown in that column?

A. No, Sir.

Q. Why not? What would you have done?

A. Well, what I did—

page 1080 } Q. What did you do?

A. What I did do and as indicated in my exhibits, I took the amount in column three, which is the total investment as of December 31, 1966, at 1910-1914 prices, and then I applied the ICC 1967 in my statement; but in this case if you are going to use 1966, well then, use the 1966 ICC price indices to bring the 1914 values up to the 1966 or 1967 level of prices, and that agin is the ICC procedure.

Q. That would have reduced current cost or reproduction cost, would it not?

A. Largely it would, but some of the property in here represents cost at the secondhand prices, for example, of relay rail.

Q. How does that affect the result?

A. Well, you have a different price, of course.

Q. But if you had used your 1966 or 1967 multiplier, you would essentially have come up with reproduction cost, would you not?

A. Reproduction cost, yes, present level of prices of the rail

that was in the track as of a given date considering, of course, that some of the rail is priced as relay rail.

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Q. Well, that is not what Mr. Tipton was trying to do to produce a reproduction cost result, was he? What does he say on his schedule he was trying to produce?

A. Well, his schedule indicates—is labeled "Depreciated Value."

Q. No, Sir, turn to the page before on that exhibit that you have, which is the conclusions of his work. What cost was he attempting to produce? Wasn't it original cost, Mr. McCarthy?

A. Well, in one case he calls it "Depreciated Value," and another case he calls it "Depreciated Original Cost."

Q. But it was a study of original cost and not of reproduction cost, was it not?

Mr. Epps: I object to this question. I do not know how this witness can know what Mr. Tipton's study was.

Mr. Riely: He has seen his work papers. He has examined them. He has seen everything that Mr. Tipton—

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Mr. Epps: But you are asking him now about schedule two and various items on there, original cost, accrued depreciation, depreciated original cost.

Mr. Riely: I asked him simply what Mr. Tipton was attempting to do as shown by the caption at the top of his schedules.

Chairman Catterall: The witness said he knew what Mr. Tipton said he was doing, but he couldn't look into his mind. Haven't we already gone over that?

Mr. Riely: I did not think we had. The witness has criticized Mr. Tipton because of his failure to follow the path that the witness followed, and all that I am trying simply to show is that the witness and Mr. Tipton were seeking different results.

Chairman Catterall: Well, it is like the witness said. He did not follow the same path that Mr. Tipton did.

Mr. Riely: But the witness has said that Mr. Tipton was in error in seeking the results—in the method that he took to try and reach the results that he reached.

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Chairman Catterall: Did you use the word "error" or did you just say that you did not agree?

A. I believe I used the term "contrary" to Mr. Tipton's approach or something of that sort.

Maurice J. McCarthy

Chairman Catterall: You have two different approaches here, and the record seems to be fairly clear.

Mr. Riely: But we are going to different ends. That is the point I am trying to bring out through the witness. We are not hitting the same idea.

Chairman Catterall: That has been brought out.

Mr. Riely: Well, does your Honor understand it? I understand you have not understood most of what I said.

Chairman Catterall: Yes, you have got the present-day values, and Mr. Tipton said he got the values fifty years ago or whatever the number of years would be.

Mr. Riely: The values of original cost.

page 1084 } Chairman Catterall: Well, he calls it original cost, but, then, he has those various life expectancies of ties and rails.

Mr. Riely: That was the method by which he reached original cost, which is all I am—the witness has testified is different from his reproduction cost.

Chairman Catterall: It is different. Of course, it's different. The figures are different. Everything about it is different. The witness says he differs, and he shows how he differs. Of course, fair value in every statute that I have ever read means "reproduction cost new less depreciation."

Mr. Riely: Fair market value.

Chairman Catterall: Fair market value obviously means present-day costs. It seems to me you are arguing for a higher assessment than we made.

Mr. Riely: No, your Honors. What I am trying to do is to show that when the witness uses cost at present-day values on his Exhibit No. MJM-1—

Chairman Catterall: Present-day prices it says.

page 1085 } Mr. Riely: Present-day prices. He is producing a reproduction cost and not original cost. What Mr. Tipton prepared at the request of Mr. Younger was a statement of original cost and that was what was submitted to the Commission in this case.

Chairman Catterall: And that is why you have two different figures.

Mr. Riely: That is why we have two different figures.

Now, Mr. McCarthy has testified that his original cost is one hundred seventy-seven million dollars as shown on the first page of his schedule, which is substantially the same as the book balance as shown on schedule one of Mr. Tipton's No. 2-RDT, but it is not original cost.

Chairman Catterall: They both start off on the same basis.

Mr. Riely: They both start off with a book balance.

Chairman Catterall: Right.

Mr. Riely: Now, that is the course of my examination of this witness.

page 1086 } Chairman Catterall: And this witness gives you the cost at present-day prices, and Mr. Tipton gives you his opinion as to the—he takes those life expectancies and cuts them in half and then takes off something else of—

Mr. Riely: But he is—well, again, I think we are getting into argument a bit, but original cost in the utility sense, which was what Mr. Younger asked for—

Chairman Catterall: Is a hundred and twenty-two million, except we did not include the grading.

Mr. Riely: —was ninety-two million in the utility sense of a ratable depreciation applied to all of the accounts as shown on schedule two of Mr. Tipton's exhibit.

Chairman Catterall: Well, I am simply looking at this exhibit you have been discussing with this witness.

Mr. Riely: That is a different form. It is not original cost in the utility sense.

Chairman Catterall: Well, everybody knows that original cost of the railroads built between 1830 and 1900 are lost in the mist of time. Nobody knows what it was.

page 1087 } Mr. Riely: This is not the problem. This problem does not go back before 1916. It goes back—

Chairman Catterall: In 1916 is when they started for the first time trying to figure out a rate base for railroads, and they could not get the original cost; so they guessed at it as best they could using the price ranges of 1910 to 1914 as the basis for pricing in an effort to determine as near as they could this original cost figure. From then on, they built it up.

Mr. Riely: But this difference does not go back beyond 1916, your Honor.

Chairman Catterall: No, of course not.

Mr. Riely: This difference goes back because of the difference in the method of accounting between the Interstate Commerce Commission System of Accounts and the method which is followed in normal utility practice. Mr. Younger sought—

Chairman Catterall: We have gone through that several times.

Mr. Riely: Well, but these two exhibits ex-

page 1088 } emplify most dramatically the difference in that the results from those differences in accounting procedures, and that is what I want now to develop.

Chairman Catterall: Well, it has been developed. They are dramatically different.

Mr. Riely: But I want to show the Commission where the differences are.

Chairman Catterall: All right, proceed.

Mr. Riely:

Q. All right, Mr. McCarthy, will you turn again to the hundred and seventy-seven million shown on your Exhibit No. MJM-1 and deduct the grading and the engineering applicable to accounts other than the track structures, and I believe we agree that came out to a hundred and twenty-three million approximately, is that correct?

A. Yes, Sir.

Q. Now, if you look on schedule two of Mr. Tipton's Exhibit, his original cost comparable to your one hundred twenty-three million, is one hundred eighty-seven, almost a hundred and eighty-eight million, isn't that correct?

A. Those figures are correct, but we are talk-
page 1089 } ing about different things here.

Q. But what he calls original cost compared to what you call original cost is sixty-five million dollars more than yours approximately, isn't that correct?

A. Yes. What he is calling original cost in this schedule two is the same figure that appears in column six of his long schedule two, so that schedule two that you are referring to now is one hundred eighty-seven million dollars is the trended original cost.

Q. It is a trended original cost of what?

A. Of 1910-1914 prices as trended by Mr. Tipton to a figure to which I have indicated I do not agree.

Q. But it is the property in place in the Railroad at the time that he has trended it, isn't *isn't* it?

A. It is the property in place, but I question the indices.

Q. Well, the difference in essence between you and Mr. Tipton is that the track structure, as you view it, that is, accounts eight, nine, ten, eleven, and twelve are
page 1090 } not depreciable while Mr. Tipton has created a depreciation reserve for these track accounts, is that correct?

A. I could not answer that as correct, no. There are too many qualifications.

Maurice J. McCarthy

Q. Well, suppose you give me the qualifications, Mr. McCarthy.

A. Yes. Now the original cost that you are referring to of one hundred seventy-seven million dollars on my schedule is an accounting approach to original cost based on the replacement method of accounting.

Q. Yes, Sir.

A. The figure that Mr. Tipton is using is an engineering approach, and he takes the property back to 1910-1914 prices based on the changes throughout the years, year by year; and then he trends back 1910-1914 price and he calls that original cost.

Q. You say that Mr. Tipton adopted an engineering approach. In what respect is it an engineering approach rather than an accounting approach?

A. Based on engineering records.

Q. What engineering record is it based on?

page 1091 } A. So-called evaluation forms 588, which are prepared largely by the office engineers of the railroads.

Q. But they come from the accounting department, do they not?

A. I suppose you would say it is a composite figure. Every figure that is used in a railroad comes through the accounting department, so it is a composite figure but these are primarily engineering figures that Mr. Tipton has used; and in the second set of statements that I have used submitted in this statement, I have used that same approach and I have indicated what the difference is in the two approaches.

Q. But Mr. Tipton does have on his schedule two "*accured* depreciation for the accounts eight, nine, ten, eleven, and twelve" whereas you do not have it on your schedule one, isn't that correct?

A. With respect to the track accounts, that is correct because under the accounting approach and under the replacement method of accounting, the amount in the books for cost of property, track property, is commonly thought of as being a depreciated cost. It has depreciation built in to the amount that is reported in the schedule.

page 1092 } Q. But Mr. Tipton restated or at least attempted to restate that account on the basis of a ratable depreciation with a write-in and write-out method of accounting. Is that not correct?

A. That was one of the steps he took, yes, Sir.

Maurice J. McCarthy

Q. Now, Mr. McCarthy, let's view the track structures. You don't contend, I assume, that the individual components of the track structures are not subject to wear and tear?

A. I think I could point out and have pointed in this case that railroads have represented that the track is as good at any time as it was when it was originally built. Now I think that I would readily agree that there is wear and tear on the track; obviously there is wear and tear.

Q. So the difference between Mr. Tipton and you lies in the accounting concept of ratable depreciation on the one hand and retirement replacement accounting on the other, isn't that correct?

A. Will you repeat that please.

page 1093 } Reporter: So the difference between Mr. Tipton and you lies in the accounting concept of ratable—

Mr. Riely: —depreciation on the one hand for Mr. Tipton and retirement replacement on the other for you?

A. With respect to the comparison in his, what I have described as an engineering approach and what I call accounting approach, there is that difference. When I make an engineering approach to it, then that difference doesn't exist.

Q. Now, Mr. McCarthy, on page six of your testimony, you quote from the ICC Report on ratable depreciation, and you refer to it as the position of the railroads, and the first sentence of that quotation is the following: "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." That is the end of the quotation.

Does that mean to you that if a stretch of track of several miles has been in service for twenty years and there have been no replacements of ties, tracks or other

page 1094 } track materials, it is in as good state of condition as it was on the day it was constructed?

A. No, Sir.

Q. Well, you agree with me then that a particular length of rail wears out?

A. Yes, Sir.

Q. And that a particular length of rail thirty-nine feet of it can support cars when its condition from a physical point of view is half as good as when it was originally laid?

Maurice J. McCarthy

A. That was the statement of the railroads to which I am referring in the particular ICC case to which I referred.

Q. I do not think that answers my question, Mr. McCarthy. May I repeat it.

You would agree with me, would you not, that a particular length of rail, thirty-nine feet of rail, can support cars when its condition from a physical point of view is half as good as when it was originally laid?

A. I think you are asking me an engineering question. When you talk about weight and half as much, I am not prepared to answer that question.

Q. You don't know the answer to that question?

A. As an accountant, I do not think I should
page 1095 } try to answer that question.

Q. But you have been with the ICC for thirty-five years, and you don't know the answer to that question?

A. I do not know who does know the answer to that question.

Q. You don't know that a particular length of rail from a physical point of view can support cars when its condition is half as good as when it was laid?

Mr. Carter: If your Honors please, I think he is belaboring the point. This man said he doesn't know the answer to the question, and I think that ought to be the end of it.

Chairman Catterall: Yes, I thought we could always shut off questions by just saying we don't know.

Mr. Riely: Very well, Sir.

Q. Do ties split and decay, Mr. McCarthy?

A. What did you say, please?

Q. Do ties split and decay?

A. Yes, I have seen ties split and decay.

Q. And you have seen a split tie that still performs its functions in the railroad, haven't you?

page 1096 } A. Yes, in some tracks.

Q. Some physical deterioration occurs in tracks, does it not, Mr. McCarthy, regardless of whether you account for depreciation in the ICC System of Accounting?

A. Well, I think we should have an understanding what we mean by depreciation under ICC System of Accounting. Now the depreciation of track is a recognized evaluation work of the Commission. It is not used in the accounting be-

cause of the replacement method of accounting, but replacement method of accounting is sometimes called the retirement-and-replacement method of depreciation of tracks.

Q. Well, physical deterioration occurs in the tracks regardless of whether you use a ratable method of depreciation or not, does it not?

A. Oh, yes.

Q. And the physical condition of a mile of the Norfolk and Western's track even though its ability to carry trains is as good as it can be when it was constructed is not as good as when it was first constructed, is it?

page 1097 } A. Obviously the tie is not in as good shape, condition, on the basis of condition and neither is the rail.

Q. Now, Mr. McCarthy, next is there such a thing as functional obsolescence in the line of railroad?

A. Is there functional—

Q. Obsolescence.

A. I think there probably is in some track property, yes.

Q. Wouldn't you agree with me that a branch line leading to a depleted coal mine does not have the value in it as it had before the depletion occurred if there is no other customer on the line?

A. Yes, I would agree.

Q. On this basis, Mr. McCarthy, cost of reproduction is an effective evidence of fair market value only if the property has not lost its service-giving capacity as a result of competition, technological changes, or other causes of obsolescence. Isn't that true?

A. That question is too much for me in one bite.

Q. Well, you can use cost of reproduction as

page 1098 } an effective evidence of fair market value, and it is fair market value we are after in this case, is it not?

A. I believe that is what the statute says.

Q. But you can use cost of reproduction only if the property has not lost its service-giving capacity as a result of competition, technological changes, or other causes of obsolescence? Isn't that correct?

A. I do not think any suggestion has been made that you should use the total cost of present prices as a fair value of this property. Any figures that I have used has given consideration to the condition of the property or a statement that depreciation should be given to it by the engineers before the ultimate figure is determined.

Maurice J. McCarthy

Q. But, Mr. McCarthy, as I read your testimony on page fifteen, you state that the cost of reproduction at current market prices would be approximately equal to the present value of railroad line, isn't that true, it would; and the amount would be approximately equal to today's value?

A. On page fifteen?

page 1099 } Q. Yes, Sir.

A. Well, we will have to go back to the promise here.

Q. Excuse me, Sir.

A. We would have to go back to the premise. We are talking about the 1968 value of the dollars and the 1952 track property.

Q. Yes.

A. And we are saying here that if you had no change in the property, no additions, no betterments, nor retirements, same property, and you adjusted to 1968 prices, then you would get the value of 1968.

Q. The value. So your 1952 track properties brought up to date by your multiplier to produce a reproduction cost new figure would be today's value of those track properties, is that not what you say?

A. Well, you see you are getting into a series of questions here that are not related to the statement that I have prepared and to which you are making a comparison. This reference here to page fifteen has to do with a particular situation involving no change in the property. It is a

page 1100 } theoretical case with no change in property between 1952 and 1968.

Q. All right, Sir, suppose there had been changes and you had brought the intervening changes up by the intervening multipliers, would you have the 1968 value of the property?

A. Yes.

Q. Well, then, you are in essence saying, are you not, Mr. McCarthy, that your reproduction cost new determination is the value of the property at the time that the computations were made, are you not?

A. Yes.

Chairman Catterall: I thought he had agreed to that about a half dozen times.

Mr. Riely: Well, he just told me a few minutes ago as I understood it that reproduction cost new was not the equivalent of value. Now I believe he says that it is the value of the property.

Maurice J. McCarthy

Q. Now in your work with the Interstate Commerce Commission for thirty-five years, Mr. McCarthy, you are familiar with the accounting records and results of operations of most of the Class One railroads in the United States, were you not?

page 1101 } A. Yes, Sir.

Q. And I judge these included the results of the Boston and Maine, for example?

A. Yes.

Q. Now, would you now say, Mr. *McCarhy,* in the light of what you just told me that the fair value of the Boston and Maine's physical properties would be approximately equal to the current reproduction cost new less depreciation of its facilities?

A. I don't believe that in the case of the B&M that if you took the present-day value of the properties in place and made adequate provision for the condition of the property, you would get that current price of the bare bones property.

Q. And that would be equally true of the New Haven?

A. Same consideration.

Q. The New Haven has just been sold.

A. Yes, it all goes into the question of making provisions for the condition of the property.

Q. Are you familiar with the sale price established by the Interstate Commerce Commission for the Bos-

page 1102 } ton and Maine property?

A. The evaluation did you say?

Q. The sale value placed on the Boston and Maine property, exchange value in the current proceeding.

A. Are you talking about the exchange ratios?

Q. Yes.

A. Now here again, we are talking about values. Now to me as an accountant, values mean they need to be expressed in terms of what value you are talking about, or in what relation are you using the term.

Q. On page fifteen of your testimony, were you not talking about value, today's value?

A. I am talking about value, Mr. Riely, and that is today's—

Mr. Carter: Let him finish, please.

Mr. Riely: Forgive me, Sir.

A. —values at current-day prices, yes.

Maurice J. McCarthy

Mr. Riely:

Q. And that is today's values?

A. Yes.

Q. And that is fair value; is that what you mean?

A. Fair value, for what purpose and what

page 1103 } respect?

Q. Well, I'm talking about a tax case, Mr. McCarthy.

A. I am not going to try to interpret what fair value means under your statute. I have not attempted to do it. I thought that—I feel that is the problem for the Commission.

Q. But the value that you were talking about on page fifteen was reproduction cost new, is that not correct?

A. It is value at current-day prices.

Q. Now on page three of your additional testimony, in answer to a question which reads as follows: "Contrary to Mr. Tipton's procedure in Exhibit 17, the appropriate procedure to determine 1966 values for track property would be to apply the full 1966 indices to the amount in column three of schedule two," and you agree that that is your conclusion. Would that not again, Mr. McCarthy, have brought Mr. Tipton up to a reproduction cost new rather than to an original cost?

A. The contrary—the word "contrary" to which I refer there deals with the matter of indices.

page 1104 } Q. Yes, Sir.

A. Mr. Tipton used an intermediate years' indices upon which to adjust the 1910-1914 prices to bring them up to 1966.

Q. Yes, Sir.

A. I applied the 1966-1967 indices to bring the 1910-1914 prices up to date.

Q. And you think that Mr. Tipton ought to have done what you did?

A. Well, I know what I would do, and I find what I would do is contrary to what he did.

Q. What you did was produce the reproduction cost new value, did it not?

A. The present-day prices, yes, Sir.

Q. Now, turn to your Exhibit No. MJM-X. On sheet two of that exhibit, you have applied to Mr. Tipton's exhibit 1966 price indices, have you not?

A. Yes, Sir.

Q. And that produces a current value or reproduction cost new, does it not?

Maurice J. McCarthy

A. Yes.

page 1105 } Q. And now turning to sheet three, you have applied the 1967 indices to Mr. Tipton's 1910-1914 prices again to produce a current value or reproduction cost new, is that not correct?

A. It is the value of the property before depreciation at 1967 prices.

Q. Well, you would agree on this method, would you not, that some depreciation should be applied to the two hundred forty-five million dollars' figures on the third sheet, and that is the reason you put in this depreciation not computed statement, is that correct?

A. I would assert that, yes, Sir.

Q. Yes, Sir, and what you would have had had you computed a depreciation would be a reproduction cost new less depreciation, would it not?

A. Yes, Sir.

Q. And the figures in the next column are simply the book figures again taken from the books without deduction for any depreciation because of the retirement-replacement method of accounting?

A. Built-in depreciation.

Q. Yes, but they are taken from the books, is that correct?

page 1106 } A. Yes, Sir, and then they are adjusted.

Q. They are adjusted? Where are they adjusted?

Mr. Riely: Excuse me, your Honors, one moment.

Chairman Catterall: This might be a good time to knock off for lunch.

Mr. Riely: All right, Sir.

Shall we return—

Chairman Catterall: Are you going to ask some more questions of this witness?

Mr. Riely: I haven't finished yet.

Mr. Epps: I haven't asked him any questions.

Chairman Catterall: Well, let's recess until two o'clock.

12:29 P.M.

2:00 P. M. The Commission resumes its session.

Mr. Reily: If it please the Commission, I believe I have completed my cross examination of Mr. McCarthy.

Maurice J. McCarthy

Chairman Catterall: Do you have any questions of this witness?

Mr. Shannon: I have one or two questions I
page 1107 } would like to ask Mr. McCarthy.

CROSS EXAMINATION

By Mr. Shannon:

Q. Mr. McCarthy, based on your knowledge of railroads, do you have any knowledge that the N&W Railroad is losing service-giving capacity?

A. I have no reason to believe that they are.

Q. Mr. McCarthy, would you now refer to Mr. Tipton's work papers, which I believe has been identified in the record as Exhibit No. 17?

A. Yes, Sir.

Q. I refer you to schedule two, I believe it is—

NOTE: Witness reviewing Exhibit No. 17.

Q. Mr. McCarthy, as I understand your analysis of what Mr. Tipton did, he took the 1910-1914 prices and he trended those up to a point half way in the life cycle of ties, rails, and the other items shown in column four, is that correct?

A. Yes, Sir, that is my understanding of what has been done here.

page 1108 } Q. And after he did that, he took his total over in column six, did he not?

A. Yes, Sir.

Q. And then in column eight, he took the depreciated value, which is approximately half of what is shown in column six, did he not?

A. Yes, Sir.

Q. Hasn't he in effect taken double depreciation here?

A. Not necessarily in amount, but in principle.

Q. In principle?

A. It amounts to that.

Q. As far as these track properties are concerned, accounts eight, nine, ten eleven, and twelve, they are the accounts that he used, multipliers, to what he considered to be the halfway point in the life of those particular items. Is that right?

A. Yes, Sir.

Q. And by doing that, he has in effect depreciated those accounts?

A. Yes.

Q. And then he went on further and he de-
page 1109 } preciated it further over in the last column, did he not?

A. Yes.

Q. Now, Mr. McCarthy, you are familiar with the Betterment-Replacement Case in ICC Docket No. 32153?

A. Yes, Sir.

Q. And isn't it a fact under that concept, and I believe it was supported by the AAR, wasn't it, the Association of American Railroads, the existing accounting rule?

A. Yes.

Q. And I believe that included the Norfolk and Western, did it not?

A. They are a member of the AAR and presumable they participated—

Mr. Riely: If it please the Commission, if the witness doesn't know the answer to that question and says presumably, I object to it.

Chairman Catterall: I think "presumably" is a very favorite word among expert witnesses.

Mr. Riely: The question is a question of fact, not an expert opinion, if your Honors please.

Chairman Catterall: Use some different
page 1110 } word, so that Counsel cannot complain.

Mr. Shannon:

Q. But you are familiar with that proceeding, are you not, Mr. McCarthy?

A. Yes, Sir.

Q. I will show you a copy of the report. Isn't it a fact that you had something to do with that when you were expended for track maintenance, for maintenance of road and with the Interstate Commerce Commission?

A. Yes, Sir.

Q. All right, Sir, and isn't it a fact, Sir, that under this so-called Betterment-Replacement Accounting theory, monies expended for track maintenance, for maintenance of road and track property are charged to operating expenses in the year in which the expenses are actually incurred?

A. Yes, Sir.

Q. And that is considered in lieu of depreciation or setting up a reserve in the Interstate Commerce Commission Accounts for these various track items, is that correct?

A. It is frequently called the "Replacement-Retirement Method of Depreciation of Accounting."

page 1111 } Mr. Shannon: That is all I have of Mr. McCarthy.

Chairman Catterall: Any other questions?

Mr. Epps: I have one on re-direct.

RE-DIRECT EXAMINATION

By Mr. Epps:

Q. Reference was made to Exhibit No. 1, to your so-called book cost, original cost on the books; and I should like to ask you if that is original cost on books in the Betterment Accounting sense of book cost?

A. Yes, Sir.

Mr. Epps: That is all I have.

RE-CROSS EXAMINATION

By Mr. Riely:

Q. Mr. McCarthy, referring again to your first exhibit, you show original cost on the books of a hundred seventy-seven million dollars, is that not correct?

A. Yes, Sir.

Q. Now what Mr. Tipton was doing on schedule two resulted in a figure that was higher than your book cost, isn't that correct, for his original cost?

A. His original cost trended.

page 1112 } Q. Trended?

A. Yes, Sir.

Q. Was higher than your book cost?

A. Yes, Sir. He also has a statement which gives original cost without being trended.

Q. Yes, but the schedule two was the original cost as determined by him on this schedule to which Mr. Shannon was directing your attention just a moment ago, isn't that correct?

A. That is trended original cost in column three.

Q. Column three?

A. Pardon me, column six.

Q. Column six. Now if that cost has been trended up as you say, wouldn't depreciation have to come out of it to get original cost less depreciation?

A. I disagree with the trended cost.

Q. But if you agreed to the trended cost, wouldn't depreciation have to come out to get original cost less depreciation?

Mr. Epps: Does he have to answer that question assuming something that is contrary to his belief, your Honors?

page 1113 } Chairman Catterall: That is a hard problem. Let's see what he can say.

Mr. Epps: All right, Sir.

A. I would say no for this reason: that applying these indices he used in column five, which is an intermediate basis that in itself takes care of depreciation.

Mr. Riely:

Q. That just gets into the midpoint of the life of the property, doesn't it?

A. That is right.

Q. That doesn't take care of depreciation?

A. Yes.

Q. How does it take care of depreciation?

A. Well, because you are depreciating property on the basis of fifty per cent.

Q. You are depreciating property on a basis of fifty per cent of its current cost, aren't you?

A. Yes, Sir.

Q. But not on the basis of the cost of what it was when it was put into the property?

A. Yes.

page 1114 } Mr. Riely: I have no further questions.

Chairman Catterall: Thank you, Sir, for coming.

You may stand aside and you may be excused.

A. Thank you.

Witness stood aside.

page 1115 } Mr. Riely: Mr. Younger.

Mr. Epps: Now Mr. Younger is going to take the stand. You have been waiting for him for a long time.

Mr. Riely: Yes, Sir, and I am going to so put that on the record.

Chairman Catterall: You haven't been sworn, have you?

Mr. Younger: I have signed an affidavit.

Mr. Shannon: I would like to make a few corrections here, a few minor changes in Mr. Younger's statement.

Will you turn to page sixty-three.

Chairman Catterall: What book is it in, in the red book?

Mr. Shannon: The red book, your Honor.

On page sixty-three of Mr. Younger's statement five lines from the bottom, the line reading, "replaced with 130." That should read one hundred and twenty.

Commissioner Hooker: What page?

Mr. Shannon: Page sixty-three, your Honor,
page 1116 } of Mr. Younger's statement, five lines from the bottom.

Chairman Catterall: One-thirty should be what?

Mr. Shannon: One-twenty, Sir. One-thirty should be changed to one-twenty. In other words, it should read that "a hundred and twenty pound rail replaced with a hundred and twenty pound rail."

Chairman Catterall: Oh, I see, a hundred and twenty.

Mr. Shannon: And if you will refer to Exhibit No. LBY-E—

Mr. Riely: That will take forever. Is that before or after LBY-ZZ?

Mr. Shannon: Gee, I don't know, Mr. Riely.

Mr. Epps: It follows "C" I know that.

Mr. Shannon: On sheet one of LBY-E under the column headed, "Total number of ties laid in replacement in Virginia," there was a dollar mark value there that should be struck out. The column is headed, "Total number of ties laid in replacement in Virginia." It is next to the last column from the right side of the paper. Just scratch the dollar mark out.

Mr. Epps: The five hundred and twelve thou-
page 1117 } sand six thirty-one?

Mr. Shannon: That's correct.

LBY-A, which happens to be the first exhibit in the caption, third line—

Mr. Riely: The first one I have is LBY-Y.

Mr. Shannon: That is the second exhibit.

Mr. Riely: That is LBY-1.

Mr. Shannon: Well, it's LBY-A. It is the long spread-out, three or four exhibits down, in the caption, third line, and it says, "Structures for Accounts." Scratch out two zero one, two zero two, two zero six, and two zero eight.

Chairman Catterall: I can't find it, LBY-1?

Mr. Shannon: LBY-A. This is LBY-A (indicating).

Chairman Catterall: Is that before or after LBY-1?

Mr. Shannon: It is after, Sir.

Mr. Epps: It is immediately after.

Chairman Catterall: After one? LBY-2 comes after LBY-1. LBY-A, I found it; now what are the corrections?

page 1118 } Mr. Shannon: The caption, the third line, and "Structures for Accounts." Scratch out two zero one, two zero two, two zero six, and two zero eight; and at the bottom of that exhibit, same exhibit, where it shows the years 1964, 1967, twenty point five per cent average operation in Virginia, then it shows the figure, seventy-six thousand six thirty-one five thirty-six.

Mr. Epps: Million.

Mr. Shannon: Million, times twenty-four point five. The proration on those was figured incorrectly. It was a mistake against us in favor of the Railroad, but I want the record to be accurate so Iwill give you the corrected figures on that.

The first figure instead of the seventy-six million figure, it should read seventy-one million one hundred ten thousand three hundred sixty dollars times twenty point five per cent equals instead of fifteen million seven hundred nine thousand four hundred and seventy, it should be fourteen million five hundred seventy-seven thousand six hundred and twenty-four.

page 1119 } Now dropping down to the next line in that same group through 1960-1963 fifty-five point zero average operation in Virginia, the present figure reads thirty-five million odd thousand dollars, which should read thirty-three million four hundred eighteen thousand two hundred eighteen dollars times fifty-five point zero per cent equals—

Bailiff: What was that figure again, Mr. Shannon?

Mr. Shannon: Thirty-three million four hundred eighteen thousand—I am repeating—two hundred and eighteen dollars times fifty-five point zero equals eighteen million three hundred and eighty thousand one hundred twenty dollars.

Then the last line 1926-1959, fifty-two point five per cent average operation in Virginia is a figure now reading two hundred forty-two million plus. That should read two hundred fifty million one hundred sixty-two thousand seven hundred nine dollars times fifty-two point five per cent equals one hundred thirty-one million three hundred thirty-five thousand four hundred twenty-two dollars. Now the total in the

page 1120 } column to the left reads three hundred fifty-four million six hundred ninety-one thousand two hundred eighty-seven dollars. That is correct as it is. The total in the righthand column should read

one hundred sixty-four million two hundred ninety-three thousand sixty-six dollars instead of one hundred sixty-two million five hundred seventy-eight thousand four hundred fifty-four as shown.

Did you get that?

Mr. Riely: Yes, Sir.

Mr. Shannon: Now on page thirty-four, we will have to change a figure in consequence of these changes on the exhibit.

Mr. Epps: Back to the testimony?

Mr. Shannon: Back to the testimony.

If you will turn to page thirty-four, the first figure in the top line after the word "amount" reading from the left side should be instead of the one hundred sixty-two million five seventy-eight four fifty-four shown, it should read one hundred sixty-four million two hundred ninety-three thousand zero sixty-six.

page 1121 } And on page sixty, there is a typographical error I want to correct in the middle of the page. The third line from the paragraph beginning with "Continuing on LBY-L " says "ICC Account 6—Bridges." The next word says "Tunnels." It should be bridges, trestles, and culverts. In other words, trestles should be substituted for the word "Tunnels."

Now one final change on Exhibit LBY-C.

Chairman Catterall: Is that before or after "Z"?

Mr. Shannon: Well,—

Mr. Riely: Here, it is, right after "B."

Mr. Shannon: The second line in the caption says, "and the cost thereof for each of the years," it reads 1926. That should read 1928-1967.

Mr. Epps: In the second line?

Mr. Shannon: Yes, second line.

And then drop down to the third line in the caption, over on the left side, the same change should be made there. 1926 should be changed to read 1928—1958.

Mr. Riely: Excuse me. I've lost you. I changed the wrong exhibit.

page 1122 } DIRECT EXAMINATION

By Mr. Shannon:

Q. Mr. Younger, do you subscribe to those changes?

A. Yes, Sir.

Q. Would you please state for the record your name?

A. Lee B. Younger, State Corporation Commission, Richmond, Virginia.

Lee B. Younger

Q. Mr. Younger, are you the same Lee Younger who submitted a statement consisting of some eighty-three pages together with various exhibits in this proceeding?

A. Yes, I am.

Q. And they are true and correct to the best of your information, knowledge, and belief?

A. Yes.

Mr. Shannon: I tender the witness for cross examination.

page 1123 }

* * * * *

Testimony of Lee B. Younger
on Direct Examination

Q. Please state your name, position and address.

A. My name is Lee B. Younger, I am Director, Public Utilities Taxation Division, State Corporation Commission. My address is Room 900, Blanton Building, Richmond, Virginia.

Q. Please state for the record your educational and professional background.

A. In June, 1930 I received a Bachelor of Science degree in Engineering from Virginia Polytechnic Institute. From July, 1930 to May, 1932 I served in an engineering capacity with Western Electric Company. From July,
page 1124 } 1932 to November, 1933 I performed engineering duties with the Virginia State Highway Department and U. S. Forestry Service. From November, 1933 to August, 1934 I was employed as an engineer with the firm Slaughter, Saville and Blackburn, Consulting Engineers, engaged in the appraisal of public service corporations. In August, 1934 I began working as Valuation Engineer in the Engineering Division of the State Corporation Commission. In April, 1940 I was transferred to the Public Utilities Taxation Division of the State Corporation Commission where I continued valuation work for *ad valorem* tax purposes until 1942.

During the period March, 1942 to October, 1945 I was on leave of absence from the State Corporation Commission and served as a line officer in the United States Navy holding the rank of Commander at the time of my release from active duty.

In October, 1945 I returned to my position in the Public Utilities Taxation Division of the State Corporation Commision and in June, 1959 I was appointed Assis-

page 1125 } tant Director of the Division and subsequently on October 16, 1963 was appointed Director of the Public Utilities Taxation Division, which is my present position.

I am a licensed professional Engineer in the Commonwealth of Virginia, having held my certificate since February 5, 1940. I am a member of the following organizations: National Tax Association, National Association of Tax Administrators, Southeastern Association of Tax Administrators, International Association of Assessing Officers, and Virginia Association of Assessing Officers.

Q. Would you please give a brief resume of your principal duties during the years you have been employed by the State Corporation Commission.

A. In 1934 the State Corporation Commission created a Valuation Section within the Engineering Division of the Commission to appraise the properties of public sevice corporations; such appraisal work had formerly been performed by contract with Slaughter, Saville and Blackburn, Consulting Engineers. When the Commission's Valuation Section was established I was employed, along with two En-
page 1126 } gineers from the Consulting firm, to appraise property of public service corporations.

My work with the Commission involved field inventories, pricing, installation cost and depreciation studies. In 1940 I was assigned to the Public Utilities Taxation Division where I continued to appraise property of public service companies for *ad valorem* tax purposes and the assessment of State Taxes. My duties with respect to the valuation of property for *ad valorem* taxes entailed spot inventorying of public service companies' property to assure reporting of units of property to the proper political subdivision in which located, conducting depreciation studies, correlating public service companies' annual tax and operating reports to the Commission, reviewing maintenance programs as well as construction and retirement programs of such companies, all of which require a general knowledge of utility accounting.

In October, 1963 I was appointed Director of the Public Utilities Taxation Division and the above per-
page 1127 } formances of duties of the division have come under my supervision and direction. Under my supervision, the 1968 assessments of property for local taxation amounted to $184,666,466 for twenty-two railroads; $476,218,005 for twenty-five electric companies; $129,096,305 for twenty-five gas and pipeline transmission companies; and $365,947,700 for thirty-six telephone companies. The 1968

total assessed value for the above public service companies and, in addition thereto, water, telegraph, express and sleeping car companies, for local taxation amount to $1,177,653,634 and a total assessment of State Taxes in the amount of $30,088,146.87.

Q. Are you familiar with the issues involved in this proceeding?

A. Yes, I am.

Q. In your position as Director of Public Utilities Taxation, do you have general supervision over the assessment of railroad property for *ad valorem* and other taxation?

A. Yes, I do.

page 1128 } Q. Would you please explain the mechanics of how railroad Tax Reports are filed with the State Corporation Commission of Virginia?

A. Within a few days after January 1st of each year the Commission mails, in duplicate, the Annual Tax Report form for Railroad Companies to all railroads operating in Virginia. The reports must be filled in completely, and be certified as correct by the appropriate official of the reporting company. The tax report must contain a listing of all of the reporting railroad's real and personal property together with a statement of the fair cash value thereof by political subdivisions as of December 31st preceding. The report form also provides for the filing of gross transportation receipts and its rolling stock and fair cash value thereof for State Taxes. The above completed reports are required to be filed in duplicate on or before April 15th of each year.

Q. Are the railroads' Tax Reports to the State Corporation Commission submitted on forms prescribed by the Commission?

A. Yes, the forms are prescribed by the Commission to set forth information required by Statute.

page 1129 } Q. Would you explain briefly the makeup of the Tax Report forms.

A. The front cover sheet shows the name of the railroad company making the report and the year.

Page 1 of the reports contains spaces for filling in the location of principal office, name of officer making the report and name of officer to whom tax bills should be sent. The bottom half of Page 1 is the Oath to be completed by an officer of the company, stating the report has been prepared from original records of the company and is true to the best of his knowledge, information and belief.

Page 4 of the report, Class 3, is the reporting of land

listing of the miles of various track classifications by political subdivision and the fair cash value reported by the company and space for value assessed by the Commission.

Page 3 of the report, Class 1, Schedule 2 and Class 2, is the reporting of land and structures and other improvements and the fair cash value by political subdivisions, with a space for value assessed by the Commission.

Page 4 of the report, Class 3, is the reporting of land and improvements not devoted to railroad operation and the fair cash value by political subdivisions, page 1130 } with a space for value assessed by the Commission. This class of property is referred to as non-carrier property.

Page 5 of the report, Class 4, is the reporting of telephone and telegraph lines, equipment and apparatus, power transmission and distribution lines, equipment and apparatus, water pipe lines and the fair cash value for the above by political subdivisions, with a space for value assessed by the Commission.

Page 6 of the report, Class 5, Summary Sheet, is the reporting for State Tax purpose the rolling stock of the railroad by types and the fair cash value by types, with a space for the assessed value by the Commission.

Page 7 of the report, Class 5, is a continuation of reporting of rolling stock.

Page 8 of the report, Class 6, Schedule 1, is the reporting of boats and other floating property by political subdivisions, giving description, informative details and fair cash value, with space for the assessed value by the Commission.

Page 9 of the report, Class 6, Schedule 2, is the reporting of shop machinery, power plant and power sub- page 1131 } station machinery and apparatus, miscellaneous machinery, office furniture and equipment, and the fair cash value of each classification by political subdivision, with space for the assessed value by the Commission.

Page 10 of the report, Class 7, is the reporting of stores, fuel, and materials and supplies, and the fair cash value by political subdivisions and with space for assessed value by the Commission.

Page 11 of the report, Classes 10 and 11, the Money section, has been repealed by the Legislature and not required. The remaining section of Page 10, Franchise Tax, is the reporting of gross transportation receipts. Class 11 is the reporting of all other personal property of the company not enu-

merated at fair cash value and by political subdivisions, with space for the assessed value by the Commission.

Q. Now, with respect to that part of the report you just described, particularly sheet 1, identified as Class 1, Schedule 1, are roadway and track values exclusive of right-of-way, terminal and yard lands shown on this schedule?

A. Page 2 of the report, identified as Class 1, Schedule 1, is for reporting of the roadway and track by
page 1132 } miles and fair cash value, exclusive of right-of-way, terminal and yard land and improvements thereon and by political subdivisions.

Q. What is encompassed in the term "roadway and track property?

A. Track, track appurtenances, track structures, including cuts, fills, track surfacing, excavation, ballast, bridges, trestles and tunnels are encompassed in the term "roadway and track property".

Q. Would you explain generally how railroad property is assessed in Virginia for *ad valorem* taxation?

A. The Commission, as its objective, determines the "fair market value" as required by Section 169 of the Constitution and repeated as "fair cash value" in Chapter 12, Section 58-524, Tax Code of Virginia. The "fair market" or "fair cash" value having been determined, an assessment ratio of 40% was applied to arrive at the assessed value of railroad property prior to 1967. In 1967, to carry out the intent of Section 58-512.1 of the Code of Virginia, any increase in the "fair market value" as of the year of assessment to the "fair market value" as of January 1, 1966,
page 1133 } is assessed on the local true ratio and 1/20th of the January 1, 1966 "fair market value" each year is assessed on the true local ratio and the remaining January 1, 1966 "fair market value" is assessed on 40% ratio. The above annual changing from the 40% ratio to the true local ratio will result in all property being assessed on the true local ratio at the end of twenty years.

The "fair market value" or "fair cash value" of roadway and track property is determined by finding the average value per mile of each class of rail line and *multipling* by the number of miles in such political district. Having found the total value in the taxing district, the methods outlined above for application of an assessment ratio are applied.

Q. Mr. Younger, do you have knowledge concerning the method used by the State Corporation Commission in deter-

mining the per mile value of railroad property in Virginia in 1926?

A. Yes, I do.

page 1134 } Q. Please explain how the 1926 valuation was made.

A. I understand, as set forth in Judge Epes' letter dated September 17, 1927, which has been filed as Exhibit 3, the Commission tried to determine the 100% value of the physical properties as of January 1, 1927, exclusive of any "franchise value", "good will", "going concern value", and then applied a 40% assessment ratio to arrive at the assessed value of carrier property. Notwithstanding the January 1, 1927 date used in Judge Epes' letter the Commission first determined the reproduction cost new less depreciation as of June 3, 1926, based on information from the Bureau of Valuation of the Interstate Commerce Commission, and used this as a maximum limit for the 100% of actual value before application of the assessment ratio. The Commission having established the above value which should not be exceeded, then considered other information available to arrive at a value less than the reproduction cost new less depreciation and then applied the 40% ratio. The records as to the assessed value for main line track in 1926 show the Commission used the same unit assessed value per mile of single

page 1135 } track and double track for the three east-west operating railroads and the same unit value for the two railroads operating north and south along the eastern part of the state and unit values less than the east-west railroads.

Q. Did the State Corporation Commission change the roadway and track values reported by the Norfolk and Western Railway Company in its 1926 and 1927 Tax Reports to the Commission?

A. Yes, it did.

Q. Have you prepared a statement of the fair cash value which Norfolk and Western used in reporting the assessed values of its roadway and track properties in Virginia for each of the years 1928 through 1966?

A. Yes, I have prepared a statement bearing the symbol (LBY-Y) in the upper right corner which shows the fair cash value used by Norfolk and Western and the assessed value reported by the Railway Company for its roadway and track properties in Virginia for each of the years 1928 through 1966. It is requested that it be marked for identification as Exhibit No. (LBY-Y).

Lee B. Younger

page 1136 } Q. Will you please explain your Exhibit No. (LBY-Y)?

A. Column I of Exhibit No. (LBY-Y) shows the year of the tax report. The second column headed, "Reported Assessed Value" shows the total assessed value of the roadway and track properties reported by the Norfolk and Western Railway to the Commission. Column three shows the fair cash value determined by converting the reported assessed value, which is on a 40% statewide average ratio, to 100% fair cash value by multiplying the assessed value by 2.5. While this exhibit speaks for itself, you will observe from the figures shown therein that in 1928 the fair cash value of Norfolk and Western's roadway and track property in Virginia was $77,454,855, and in 1959, the last tax report year before the Virginian Railway was merged with the Norfolk and Western, the fair cash value of Norfolk and Western's roadway and track property in Virginia was $75,730,845. My understanding of the explanation for the 1959 fair cash value being lower than that shown for 1928 is that the per mile track values of Norfolk and Western's road and track property, as will be shown in

page 1137 } a subsequent exhibit, were reduced by the Commission during the depression years and were never restored to the 1928 level.

Q. Have you studied the testimony submitted in behalf of the Norfolk and Western in this proceeding by Mr. J. A. Caywood to the effect that of the property listed in I.C.C. Primary Property Accounts 1, 3, 5, 6, 8, 9, 10, 11, 12 and 13, only the items in Accounts 8, 9, 10, namely, ties, rails and other track material, have any fair market value and the values assessed to these items of property are based on estimates of what the Norfolk and Western could get for such items at prevailing scrap prices after deducting the cost of salvaging the material?

A. Yes, I have.

Q. Do you agree with this statement?

A. No, I do not, for as long as a piece of property is in use and actually serving the purpose for which it was intended it has value in excess of its scrap value regardless of age.

page 1138 } Q. Has the Norfolk and Western filed with the State Corporation Commission over the years sworn tax reports reporting the fair cash value of its property in Virginia, including track and roadway property?

Lee B. Younger

A. Yes, although prior to the 1967 tax report, the Norfolk and Western, under the column headed "Fair Cash Value" reported the assessed value of its property based on 40% statewide average ratio of its fair cash value. By reporting in this manner, the Commission was relieved of making the mathematical computation necessary to reduce the fair cash value to the assessed value of property in each political subdivision. This procedure was consistent with the method followed by other major public service companies in assisting the Commission's staff. However, since 1966, in consequence of the enactment of Code Section 58.512.1 converting the assessment of public service property from a statewide average ratio to the true local assessed ratio the fair cash value is used in reporting property value to the Commission.

page 1139 } Q. Then, is it a fact that the basic per mile track values of Norfolk and Western lines of railroad in Virginia, as well as other lines operating in the state, generally remained unchanged between 1926 and 1967, inclusive?

A. Yes, generally speaking that is correct.

Q. Have you prepared an exhibit showing the trend of the average assessed value per mile of main line track of selected railroads in Virginia during the period 1926 through 1967?

A. Yes, I have an exhibit showing this information bearing the symbol (LBY-1) in the upper right corner which I request be marked for identification as Exhibit No. (LBY-1).

Q. Please explain your Exhibit No. (LBY-1).

A. The assessed values per mile for the two track classification of selected railroads as shown on this exhibit were taken from the tax reports filed by the railroads, with the Commission's assessments shown thereon.

First, I would like to explain the 1967 assessed values as

page 1140 } shown were computed on an assessment ratio of 40% to relate the assessed value to prior years, whereas, in reality the assessed value was determined by using a ratio either less than or greater than 40%, depending on the true ratio of the political subdivision in which the track was located. Since there was no change in the 100% "fair cash value" between 1966 and 1967 for roadway and track, the only change in 1967 would be 1/20th of the 100% "fair cash value" being assessed on the true local ratio and 19/20ths being assessed on the 40% ratio.

to single track and double track shows the Commission assessed main line single track at $23,000 per mile and this same assessed value continued for 42 years through 1967 with the explanation I have given for the year 1967. The double track assessed value per mile was $40,000 in 1926 and continued at this rate until 1934, at which time it was reduced to $38,000 and has remained at this assessed value through 1967 with the explanation I have given for 1967.

The change in the 1961 assessed value for single track shown for the Virginian was due to the re-
page 1141 } classification of former main line track, resulting from the merger of the Norfolk and Western and the Virginian. The assessed values as shown since the Norfolk and Western and the Virginian merger in 1959 are continued to show the same Virginian assessed value per mile has continued after the merger, with the exception stated as to the change in the assessed value for single track in 1961.

The exhibit further shows the assessed value per mile for roadway and track for other railroads by years from 1926 through 1967 and the same explanation for 1967 that I have stated applies to these other railroads.

Q. Mr. Younger, in your supervision of the assessment of railroad properties, are you required to be familiar with the Interstate Commerce Commission's Uniform System of Accounts?

A. Yes, I am.

Q. Under the Interstate Commerce Commission's Uniform System of Accounts, is track property, i.e., ties, rail, ballast and other track material depreciable?

page 1142 } A. No. Ties, rail, ballast and other track materials are not depreciable accounts under the Interstate Commerce Commission's Uniform System of Accounts for Railroads.

Q. Then, is it proper ICC accounting practice to allow normal expenditures for repairs and replacements as an expense of the business to be charged to operating expenses?

A. Yes, it is and such expenses are shown in the Annual Operating Reports filed annually by the railroads with this Commission and the Interstate Commerce Commission.

Q. Mr. Younger, will you now please explain, in detail, the background events leading to the Commission's decision concerning reassessment of track values of Virginia railroads in 1968?

page 1143 } A. For some years the Commission received

complaints from some of the counties, cities and governmental groups in the State concerning the fact that the assessed value of roadway and track of railroads remained unchanged over the years, when new rails, ballasts, ties and other track materials were being added each year at costs above those incurred in prior years. Consequently, a study was deemed necessary to arrive at the assessment for 1968. Accordingly on October 3, 1967 the Commission forwarded a letter to all railroad companies in Virginia, requesting representatives from each to attend a conference in the Commission's Law Library on October 18, 1967, regarding the assessment of roadway and track property in Virginia. At the October 18, 1967 conference the railroads' representatives were informed that the Commission would make a study of the assessment of roadway and

page 1144 } track of railroads operating in the State. Since the Railroads' Annual Operating Reports filed with the Commission do not show the original cost of certain property items in place when first devoted to public service, the carriers were informed that the Commission would seek their cooperation in furnishing the desired information. The railroads' representatives were requested to furnish by Primary ICC Accounts the original cost of the roadway and track property now in place in Virginia.

Q. Then, is it correct that the information you requested from each of the railroads operating in Virginia was the original cost of the line of railroad now in service in Virginia?

A. Yes, that is correct.

Q. In your professional judgment as a Tax Assessor, is it reasonable to assume that the overall percentage operating condition of the various classes of property considered in assessing N&W's railroad tracks is 80%?

page 1145 } A. Yes, in my judgment, upon giving consideration to the various classes of property and the information pertaining to them, the overall operating condition would be 80%.

Q. Do you follow this method in arriving at depreciation for numerous items of property of other public service corporations?

A. Yes. 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.

The staff of the Commission finds it necessary to disregard the book reserves for depreciation or amortization and to determine its own allowable depreciation for various classes of property. Depreciable property for *ad valorem* tax purposes does not follow straightline book or accounting depreciation which is an equal amount each year but develops the condition that exists. The maintenance and replacement of property play an important role in depreciation. It has often been found that items of property have been completely depreciated on the books of the company and such items were still in use by the company and subject to *ad valorem* taxation.

page 1146

Q. Mr. Younger, would you explain for the record exactly what you mean by the original cost of the line of railroad now in service?

A. The original cost of the line of railroad now in service is the cost of the original grading of the roadbed and the installed cost of existing items of property when first devoted to public service use.

Q. Did each of the Virginia railroads supply you with the information requested as to the original cost of its track and roadway property in Virginia?

A. No. Only the Norfolk and Western, Southern, Clinchfield and the Pennsylvania furnished the information requested and, in doing so, each omitted the original cost of grading ICC Account 3.

page 1147

Q. What information did the Norfolk and Western furnish you?

A. The Norfolk and Western furnished three statements: the first shows the book balance, State of Virginia, as of December 31, 1966 for various ICC property accounts and the depreciated book balance; the second shows the original cost, State of Virginia, as of December 31, 1966 for various ICC property accounts and the depreciated original cost; and the third statement shows the book balance, State of Virginia, as of December 31, 1926 for various ICC property accounts and the depreciated book balance. I should point out that these three statements are attached as schedules 1, 2 and 3 to Haskins and Sells January 9, 1968 letter to the Norfolk and Western Railway, already identified in the record as Exhibit No. 5 The accounts listed in these statements with dollars assigned to each of the three schedules were Account 1, Engineering; Account 5, Tunnels and Subways; Account 6, Bridges, Trestles, and Culverts; Account 8, Ties;

page 1148 } Account 9, Rails; Account 10, Other Track Materials; Account 11, Ballast; Account 12, Track Laying and Surfacing; and Account 13, Fences, Snowsheds and Signs.

Q. Mr. Younger, after asking for the original cost of the Norfolk and Western roadway and track structures, did you make an inspection of the Norfolk and Western line in Virginia?

A. Yes, accompanied by a Commission Engineer and representatives of the Norfolk and Western, I inspected Norfolk and Western's line of railway.

Q. When was this inspection made?

A. The inspection trip began at Norfolk on May 20, 1968 and continued through May 23, with a break over the weekend; resumed on June 3 and continued through June 6, or approximately 2 weeks.

Q. I assume that you took notes on your observations during your inspection trip, did you not?

A. Yes, I did.

page 1149 } Q. Please explain your conclusions as a result of your inspection of the Norfolk and Western's line in Virginia.

A. During my inspection of Norfolk and Western's line of railroad, I made numerous stops to permit me to have a good sampling of track structures and determine the condition of the roadway and track. The major portion of the time was spent walking the track for distances up to a mile at each stop during which stops I observed the condition of ties, wear and dates of the rail and noted ballast, other track materials, bridges, tunnels. Also I noted the operating speed limits permitted over the various track divisions. 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.

Q. Mr. Younger, have you prepared a statement showing how the State Corporation Commission arrived at its determination of value of railroad's roadway and track property in Virginia?

A. Yes, I have prepared an exhibit bearing the symbol LBY-2 in the upper right corner, which I request be marked for identification as Exhibit No. (LBY-2).

page 1150 } Q. Will you explain in detail your Exhibit No. (LBY-2)?

A. The Exhibit shows by ICC Property accounts the original cost as of December 31, 1966 as furnished in Schedule

2 of Norfolk and Western's letter of January 9, 1968, identified as Applicant's Exhibit No. 5. The original cost totaling $177,800,335 was accepted as filed to which the 80% operating condition factor explained earlier was applied, giving $142,240,268 as original cost less depreciation. The next step was to relate the total fair cash value in the amount of $91,644,710 for roadway and track structures as reported by Norfolk and Western in their 1967 Tax Report to the depreciated cost figure of $142,240,268 which produced a factor of 1.5520837. The factor was rounded off to 1.55 and applied to the 1967 fair cash value per mile for the various track classifications such as single track, double track, branch line track, siding and yard track, to arrive at the fair cash value or full value per mile for 1968 for the various track classifications.

page 1151 } Q. Mr. Younger, had the Norfolk and Western furnished you with the original cost of grading in Virginia as reflected in ICC Primary Property Account No. 3, would it have made a difference in the factor which you applied to the 1967 fair cash value per mile to determine the value of Norfolk and Western's single track, double track, branch line track, and siding and yard tracks in Virginia?

A. Yes. The value of grading of Norfolk and Western's road and track property in Virginia as of December 31, 1966, amounted to $49,783,394. Had this amount been included in Norfolk and Western's original cost, the factor used would have been 2.11, instead of 1.55.

Q. Did you endeavor to obtain from the Norfolk and Western its original cost of grading in Virginia?

A. Yes. By copy of my letter dated March 18, 1968, to Mr. Melvin Strouse I requested Norfolk and Western to furnish this information. I would like to offer it at this time as Exhibit No. (LBY-Z) a copy of the letter

page 1152 } I wrote to Mr. Strouse requesting this information.

Q. Did you receive a reply to this letter from Mr. Strouse?

A. Yes, after writing a follow-up letter dated June 20, 1968, I received a letter from Mr. Strouse dated July 8, 1968, in which he advised that the original cost of Norfolk and Western's grading in Virginia as of December 31, 1966 was $45,843,700. I have a copy of these letters which I would like to have identified as Exhibit Nos. (LBY-Z-1) (LBY-Z-2).

Q. Mr. Younger, will you explain for the record exactly

what items of track and roadway property were affected by the assessment increase the State Corporation Commission made for the year 1968.

A. The items of track and roadway property affected by the assessment increase for 1968 were tunnels, bridges, trestles, culverts, ties, rails, other track materials, ballast, fences, snowsheds and signs.

page 1153 } Q. Prior to 1968 did the railroads submit to the State Corporation Commission a sworn report setting forth the fair cash value of their roadway and track structures in Virginia, including the items just enumerated?

A. Yes, such sworn Tax Reports were filed by the railroads prior to 1968.

Q. Have you prepared a statement showing by primary Interstate Commerce Commission accounts the amount of money Norfolk and Western has spent on roadway and track maintenance from 1926 to date?

A. Yes, I have prepared a statement entitled "Statement Showing Relationship between Cost Incurred by Norfolk and Western Railway Company for Maintenance of Track and the Total Operating Revenues and the Total Operating Expenses for the Years 1926-1967", bearing the symbol (LBY-A) in the upper right-hand corner which I would like to have marked for identification as Exhibit No. (LBY-A).

page 1154 } Q. Will you please proceed to explain in detail the statement which has just been marked for identification as Exhibit No. (LBY-A)?

A. The statement is prepared from information taken from Annual Operating Reports, Form A, filed by the Norfolk and Western Railway Company with the State Corporation Commission for the years 1926 through 1967 inclusive. The Form A Report filed with the State Corporation Commission contains the same information filed with the ICC except a supplement is added to Form A to the State Corporation Commission furnishing additional information pertaining to Virginia only.

Column 1 of the statement indicates the year as related to the amounts shown on the same line.

Column 2, Acct. 501, Railway Operating Revenue, is taken from Form A, Page 300, Schedule 300—Income Account, line 3, for each year.

Column 3, Account 531—Railway Operating Expense, is

taken from Form A, Page 300, Schedule 300—Income Account, line 4 for each year.

page 1155 } The column headed by Account Nos. 212, 214, 216, 218 and 220 were taken from the Form A Annual Operating Reports, Page 304, Schedule 320—Railway Operating Expenses filed with the Commission.

The column headed Total is the total of the accounts listed.

The column headed Percentage of Operating Revenue is the percentage of the total operating expenses for the company for the various accounts shown to the total operating revenue of the company for each year; i.e., total operating expense for the accounts shown in the amount of $8,213,320 for 1926 amounted to .068% of the total operating revenue in the amount of $120,409,038 for 1926.

The column headed Percentage of Operating Expense is the percentage of the total operating expenses for the company for the various accounts shown to the total operating expenses of the company for each year.

From Exhibit (LBY-A) it will be noted that during the period 1926-1967 the Norfolk and Western spent a total of $354,691,287 for ties, rail, other track material, ballast and track laying and surfacing. Of this amount

page 1156 } $164,293,066 represents the sum spent in Virginia based on a road mileage proration of Virginia road miles to system road miles. Significantly the entire $354,691,287 spent by Norfolk and Western for these accounts was charged to operating expenses or put in other words, the total amount shown in Accounts 212, 214, 216, 218 and 220 during each of the years between 1926 and 1967 were charged to operating expenses during each of the years the expense was actually incurred. Thus, it can be seen that the Norfolk and Western has spent considerable money in renewing rails and ties in kind and replacing ballast and other track materials without reflecting any of these expenditures in the primary property accounts by charging these items to operating expense rather than capitalizing such expenses. Accordingly, Norfolk and Western's original cost of roadway and track property now in place is not fully stated on the company's books.

Q. Do you have a statement showing the relationship between expenses incurred for maintenance of

page 1157 } roadway and structures by Norfolk and Western for Accounts 201, 202, 206, 208, 212, 214, 216, 218, 220 and 221 and the total operating expenses for the years 1926 through 1967?

Lee B. Younger

A. Yes, I have a statement bearing the symbol LBY-B in the upper right corner showing this information which I request be marked for identification as Exhibit No. (LBY-B)

Q. Mr. Younger, will you please explain for the record what this Exhibit shows.

A. Yes. This exhibit includes the same maintenance of track expenditures previously discussed in connection with my Exhibit No. (LBY-A). In addition, it shows the amount spent by Norfolk and Western Railway during each of the years 1926 through 1967 for superintendence, roadway maintenance, tunnels, bridges, trestles, and culverts and fences, snowsheds and signs. It will be noted during the period 1926-1967, inclusive, Norfolk and Western's total expenditure for Accounts 201, 202, 206, 208, 212, 214, 216, 218, 220 and 221 amounted to $492,061,578. Again prorating of Virginia road miles to Norfolk and Western's
page 1158 } total system road miles, $227,772,333 of total expenditures was for maintenance of property in Virginia.

Q. Have you prepared a statement showing the total tonnage of rails laid in replacement in Norfolk and Western running tracks and yard tracks during the period 1928 through 1967, inclusive?

A. Yes, I have prepared a statement bearing the symbol (LBY-C) in the upper right corner which I request be marked for identification as Exhibit No. (LBY-C).

Q. Mr. Younger, will you please explain your statement which has been marked for identification as Exhibit No. (LBY-C).

A. Yes. We reviewed the statistics reported in the Norfolk and Western and old Virginian Railway Companies' Annual Operating Reports filed with this Commission and determined for each of the years 1928 through 1967, inclusive, the number of tons of rail laid in replacement and prorated this figure to the number of tons of rail laid in replacement in Virginia on the ratio of which the total road miles in Virginia bears to the total road miles in the System. This exhibit consists of three pages.

page 1159 } Page 1 shows the rail laid in replacement in Norfolk and Western running tracks and yard tracks and the cost thereof during the period 1928 through 1958, inclusive. This, of course, covers the period prior to the merger of the Virginian Railway into the Norfolk and Western System.

Page 2 shows the same information for the period 1959 through 1963 and includes the tonnage of rail laid in replacement in the merged Virginian-Norfolk and Western Sys-

Page 3 covering the period from 1964 through 1967, inclusive shows the statistics pertaining to replacement rail laid after the Norfolk and Western's unification with the Nickel Plate and Wabash Railroads.

From this exhibit it will be noted that the average cost per ton of replacement rail laid by the Norfolk and Western in its running track in 1929 was $38.65. By 1967 the average cost per ton of rail laid in replacement in its running track in Virginia had increased to $107.74 a ton. Similarly, it will be noted from Exhibit No. (LBY-C) that in 1929

page 1160 } the average cost of replacement rail laid in yard tracks was $22.54 per ton and by 1967 the average cost per ton of such rail had increased to $73.03.

Q. Do you have a statement showing the number of miles of welded rail laid by the Norfolk and Western during the past 13 years?

A. Yes, I have prepared a statement showing the total number of miles of welded rail laid by the Norfolk and Western Railway Company during the period 1955 through 1967, inclusive and I request that it be marked for identification as Exhibit No. (LBY-D).

Q. Will you please explain your Exhibit No. (LBY-D).

A. This exhibit is largely self-explanatory and shows that during the thirteen year period 1955 through 1967 the Norfolk and Western laid a total of 423.64 miles of welded rail of which 149.16 miles were laid in Virginia, as indicated on the exhibit.

Q. What is the significance of putting down welded rail?

page 1161 } A. To the extent that this rail was used to replace the same weight rail the rail property account would not be distrubed, although the track is a better structure as a result of laying welded rail.

Q. Have you made a study of cross tie renewals made by the Norfolk and Western Railway each year 1928-1967, inclusive, with figures demonstrating the total tie population of the railroad in 1928 and the percent of total ties replaced each year?

A. Yes, I have prepared a statement showing the cross tie renewals each year 1928-1967, inclusive, grouped by a span of years, showing the total tie population and the per-

centage of total ties replaced each year. This statement bears the symbol (LBY-E) in the upper right hand corner and I would like to have it marked for identification as Exhibit No. (LBY-E).

Q. Please explain your Exhibit No. (LBY-E).

A. Referring to my Exhibit No. (LBY-E), you will note in 1928 the total number of ties in Norfolk

page 1162 } and Western System was 13,964,864. For some unexplained reason this total number was reduced in 1929 to 13,357,838 ties. During the period 1928-1937, inclusive 40.6 percent of the ties in place in 1928, or 5,671,341 ties were replaced. During the ten year period 1938-1947, inclusive, an additional 18.9 percent of the ties in place in 1928, or 2,647,685, ties were replaced, for a total of 8,319.026, thus representing 59.5 percent replacement of the total ties in the System in 1928. During the period 1948-1957, inclusive, an additional 4,878,684 ties were laid and in 1958 the last full year in which the Norfolk and Western operated before its merger with the Virginian Railway in 1959, 241,733 ties were laid, making the total number of ties laid during the period 1928-1958 inclusive, amount to 13,439,433, which was just 525,421 ties fewer than the total ties in the Norfolk and Western System in 1928 and 81,605 ties more than were in the entire System in 1929, thus indicating that the total number of ties in the Norfolk and Western System in 1928 had been replaced by

page 1163 } 1958.

It is also of more than ordinary importance to note from Exhibit No. (LBY-E), that the average cost per tie in 1928 was $1.60 and the average cost per tie in 1958 had increased to $3.82.

In this same connection you will observe that in 1967 the railway company's average cost per tie had further increased to $5.11. Here it should be emphasized that although the railway company in 1967 was replacing ties which were laid in the late twenties and early thirties, the average cost of which then ranged from a low of 99 cents to a high of $1.60, with ties which in 1967 had an average cost of $5.11, the difference in the value of the ties used in replacement is not reflected in primary property Account 8 setting forth the railway company's investment in ties.

Exhibit No. (LBY-E) further shows that during the years 1959-1963, inclusive, after the Norfolk and Western had merged the Virginian into its System but before the Nickel

Plate-Wabash unification, an additional 906,436 ties were laid in replacement of ties in its System. And, during the years 1964-1967, inclusive, after the Nickle Plate merger, the Norfolk and Western laid 1,637,093 ties. This ex-
page 1164 } hibit also shows the number of ties put down in Virginia based on a ratio of the total road miles in Virginia to the total road miles in the System.

Q. Have you made a study comparing Norfolk and Western's cost of constructing new lines in Virginia with the State Corporation Commission's determination of full value and assessed value of such lines in Virginia?

A. Yes, I have prepared a statement comparing Norfolk and Western's estimated per mile cost of constucting new lines in Virginia with the State Corporation Commission's full and assessed values of such property which bears the symbol (LBY-G) in the upper right hand corner and I request that this statement be marked for identification as Exhibit No. (LBY-G).

Q. Mr. Younger, will you please proceed to explain what is shown on your Exhibit No. (LBY-G)?

A. Yes. It will be noted from Exhibit No. (LBY-G) that, based on information taken from the railway company's Return to Questionnaire filed on May 28, 1959 in ICC Docket No. 20626, it cost the railway company an
page 1165 } estimated $425,373 per mile to construct its Vinton connection. The Commission's 1968 determination of full value for this line was $89,000 per mile and its 1967 determination of full value was $57,500 per mile. The Commission's 1967 assessed value per mile for this line of railroad amounted to just $22,000.

Also, from this Exhibit it will be noted that the per mile estimated cost of constructing the track and roadway structures in its extension connecting its Buchanan and Clinch Valley lines in Tazewell and Buchanan Counties, Virginia is $686,035. This information is taken from the railway company's Return to Questionnaire filed on October 13, 1966 in ICC Finance Docket No. 24284 which line, according to my information, has not been completed and is not yet in operation. However, it will be noted that the cost of constructing track and roadway structures substantially exceeds the Commission's determination of the per mile cost of single track, main line of railroad in Virginia, which is
page 1166 } $89,000.

Q. Mr. Younger, do you have a narrative account of the construction of this line of railway connecting

Norfolk and Western's Clinch Valley and Buchanan lines February 24, 1969 edition of the *Norfolk and Western Magazine* which you would like to introduce in this proceeding?

A. Yes, I have a copy of an article which appeared in the February 24, 1969 edition of the *Norfolk and Western Magzzine* which sets forth in some detail the technique employed by the Norfolk and Western in constucting the track on this line, together with pictures showing the high quality of the track and roadway being placed in the line. I have had this article reproduced and placed by symbol (LBY-ZZ) in the upper right hand corner and request it be marked for identification as Exhibit No. (LBY-ZZ).

Q. Have you also conducted a study comparing Norfolk and Western's per mile loss write-offs for non-depreciable property retired and the per mile value of salvage recovered from lines of railroad recently abandoned in Virginia with the State Corporation Commission's determination of full and assessed values for such abandoned lines?

page 1167 } A. Yes, I have prepared a statement consisting of 3 pages comparing Norfolk and Western Railway Company's per mile write-off for non-depreciable property retired and the salvage value (Materials and Supplies—Account 712) therefrom with the State Corporation Commission's full and assessed value of such property when last operated bearing the symbol (LBY-H) in the upper right hand corner and request that it be marked for identification as Exhibit No. (LBY-H).

Q. Would you please explain what is shown on your Exhibit No. (LBY-H).

A. Yes. From this Exhibit you will note that the Norfolk and Western recently abandoned a portion of its Blacksburg Branch near Christiansburg, Virginia pursuant to authority granted by the Interstate Commerce Commission in Finance Docket No. 22902. I obtained from the Interstate Commerce Commission copy of the journal entry (Sheet 2 of Exhibit No. (LBY-H) which the railway company was required to file when the abandonment of the involved portion of this line was affected. The total salvage

page 1168 } value of materials and supplies recovered from abandonment of 5.7 miles of this line amounted to $68,373, or $13,225 per mile. In addition, the railway company charged $56,496.35, as a loss to Account 267 for non-depreciable property retired, or $10,928 per mile making the total per-mile benefit realized by the Norfolk and Western from abandonment of the considered portion of this line

amount to $24,153. It is important to note that in 1966 the full cash value assigned to this line of railroad by the State Corporation Commission was $12,500 per mile and the 1966 assessed value of the Blacksburg Branch was only $5,000 per mile. Also, it will be noted that applying the 1968 increased values to that portion of the line still in operation, the full value of the remaining portion is $19,500 per mile.

Exhibit No. (LBY-H) further shows that in 1965 the Norfolk and Western retired a 6.83 mile portion of its main line in Campbell County in the City of Lynchburg pursuant to authority granted by the Interstate Commerce Commission in Finance Docket No. 23024. According to the journal entry (Sheet 3 of Exhibit No. (LBY-H),

page 1169 } submitted by the railway company to the Interstate Commerce Commission the value of the materials and supplies recovered, Account 712, amounted to $239,829, or $35,114 per mile. In addition, the Norfolk and Western charged as a loss write-off to Account 267 for the non-depreciable portion of this line retired $301,880, or $44,199 per mile. Again, it will be observed that the total benefit the Norfolk and Western derived from the abandonment of the considered portion of its main line in Campbell County amounted to $79,313 per mile. From the Exhibit you will note that the State Corporation Commission's 1965 determination of the full value of this line of railroad was $57,500 and the 1965 assessed value was just $22,000. The two foregoing examples demonstrate conclusively the reasonableness of the Commission's determination of both the full and assessed values of these lines of railroad.

Q. Mr. Younger, do you have any information concerning the amount of money Norfolk and Western paid the Carolina, Clinchfield and Ohio Railway for Clinchfield's Dumps Creek Branch extending 2.3 miles from Clinchfield to Carbo, Virginia?

A. Yes, I have.

page 1170 } Q. Would you please explain what you have developed regarding the purchase of the Clinchfield's Dumps Creek Branch by the Norfolk and Western?

A. Yes, I will. According to the report of the Interstate Commerce Commission, Division 4, in Finance Docket No. 19186 decided on February 24, 1956, Dumps Creek Branch was originally owned and operated by Carolina, Clinchfield and Ohio Railroad and extended from Carbo through Clinchfield to Wilder, a distance of 8.4 miles. The portion of Dumps Creek Branch extending from Clinchfield (2.35 miles north

of Carbo) to Wilder, a distance of 6.05 miles, was abandoned pursuant to ICC Authority in Finance Docket No. 14007, 254 ICC 817, decided December 26, 1942. Subsequently, there remained of the Dumps Creek Branch only the segment from Carbo to Clinchfield, a distance of 2.35 miles. In Finance Docket No. 19186, *Clinchfield Railroad Abandonment, etc.* Norfolk and Western applied to the Interstate Commerce Commission (1) for a certificate of public convenience and necessity permitting abandonment by the Carolina, Clinchfield and Ohio Railway of its Dumps Creek

page 1171 } Branch extending approximately 2.53 miles, and (2) Authorizing construction and operation by Norfolk and Western Railway Company of an extension of its line of railroad. N&W proposed to purchase all of the right-of-way of the portion of CC&O's Dumps Creek Branch previously abandoned together with the 2.35'miles segment remaining. The only use Norfolk and Western proposed to make of CC&O's for which it sought abandonment authority was to utilize part of the right-of-way for construction of an entire new line.

As stated in both the Norfolk and Western's Return to Questionnaire and on Sheet 4 of the Report of the Interstate Commerce Commission, Division 4: "The Dumps Creek branch has not been maintained for a number of years and is not in operating condition. The Clinchfield has performed no service over the line since 1940, and the track is in a deteriorated condition.

I have obtained certified copies of the pertinent portion of Norfolk and Western's Return to Questionnaire filed in Finance Docket No. 19186, together with copies

page 1172 } of the journal entries recording the retirement of the remaining portion of the Dumps Creek Branch which was sold by the Carolina, Clinchfield and Ohio to the Norfolk and Western, together with a letter from Mr. C. W. Emken, Director of the Interstate Commerce Commission's Bureau of Accounts to Mr. R. Y. Wallace, General Auditor of the Clinchfield Railroad Company, approving the journal entries submitted to the Commission by CC&O and Clinchfield Railroad covering the retirement of the remaining portion of the Dumps Creek Branch.

Q. Do you wish to offer the certified copies of the document you have just described, together with a copy of the Report of the Interstate Commerce Commission. Division 4, entered in Finance Docket No. 19186, *Clinchfield Railroad Company Abandonment, etc.* as Exhibits in this proceeding?

Lee B. Younger

A. Yes, I would like to offer as Exhibit No. (LBY-T) the certified copies of the cover page, Pages 1 and 5 of the Norfolk and Western Return to Questionnaire,
page 1173 } copy of Mr. C. W. Emken's January 25, 1957 letter to Mr. R. Y. Wallace, General Auditor of the Clinchfield Railroad Company, and copies of the three journal entries from the books of the Carolina, Clinchfield and Ohio Railway Company and Clinchfield Railroad Company recording the retirement and sale of the Dumps Creek Branch to the Norfolk and Western. This Exhibit, consisting of seven pages, bears the symbol (LBY-T) in the upper right hand corner. Also, I would like to offer as Exhibit No. (LBY-U , a copy of the Report of the Interstate Commerce Commission, Division 4, entered in Finance Docket No. 19186 on February 24, 1956, which carries the symbol (LBY-U) in the upper right hand corner.

Q. Mr. Younger, referring to the certified copies of the journal entries you obtained from the ICC recording the retirement and sale of the Dumps Creek Branch on the Clinchfield's books, will you please state what these entries show?

A. Yes, gladly. The first journal entry shows that the book investment in the road property retired by the CC&O was $273,013.20. Significantly, included in this
page 1174 } amount was $49,125.23 for Engineering—Account 1; $61,476.41 for Account 3—Grading; and incidentally, I should point out that Account 2 for land, which is a separate account, lists only $8,815.74. For Account 6—Bridges, Trestles and Culverts, $76,768.26 is shown as the book value of property retired from this account. The journal entry shows for Account 8—Ties—$5,529.61. Account 9—Rails—shows $21,617.46. Account 10—Other Track Material—discloses an amount of $5,485.49. Account 11—Ballast—is $1,003.09. The book value of Track Laying and Surfacing—Account 12—for the line is shown as $8,958.41. Account 13—Fences, Snowsheds and Signs—reflects $201.22. Now, turning to the second and third journal entries recording the sale of the Dumps Creek Branch to the Norfolk and Western for $550,000, you will note that, despite the fact that the line in question admittedly had not been maintained for a number of years and was not in operating condition, the Norfolk and Western's purchase price was almost twice the book investment carried in CC&O's accounts for this line. The third journal entry included in my Exhibit No. (LBY-T), you will observe, compares
page 1175 } the book value in each primary account with

the portion of the sale price assigned to that particular account. For example, as previously indicated, the book value of Grading—Account 3, was $61,476.41, however, it will be noted $122,772.14 was assigned as a portion of the sale price to this account. Moreover, you will note that although Clinchfield showed the book value of Account 8—Ties, as $5,529.61, it reported in its books $11,042,97 as a portion of the sale price of the line for this account. Similarly, Account 9 showed a book value for Rails of $21,617.46, however, $43,171.38 of the sale price is apportioned to Account 9—Rails. Continuing further, you will note that Account 10—Other Track Material, shows that the Clinchfield's book value in this account was $5,485.49, however, it assigned $10,954.86 for the selling price to Account 10. Thus, it can be seen that where Norfolk and Western purchased a line of railroad having absolutely no economic value the "fair and reasonable" price paid for this line, together with other properties, was almost 100% in excess of the book value in Clinchfield's accounts for such line and substantially more than the salvage value of Rails, Ties and Other

page 1176 } Track Material contained in the non-operating line.

Q. Mr. Younger, continuing on your Exhibit No. (LBY-T), if you were to prorate the $49,125.23 shown in the Carolina, Clinchfield and Ohio's December, 1956, journal entry for Account 1—Engineering—to each of accounts 3, 6, 8, 9, 10, 11, 12 and 13 what would be the total book investment of the roadway and track structure of the line Clinchfield sold to the Norfolk and Western?

A. Yes, I have made this calculation. By prorating the engineering investment shown in Account 1 to each of the Accounts 3, 6, 9, 10, 11, 12 and 13, I have determined that Carolina, Clinchfield and Ohio's book investment in the Dumps Creek Line's roadway and track structures sold to the Norfolk and Western, would be $220,584.

Q. I believe you stated earlier that the involved portion of the Dumps Creek Branch for which Norfolk and Western sought abandonment authority was 2.35 miles in length, is this correct?

A. Yes, that is correct.

page 1177 } Q. Then, Mr. Younger, how would the per mile book investment for Accounts 3,6,8,9,10,11, 12 and 13 compare with the Commission's 1967 and 1968 determinations of the full value of the line of railroad which

Norfolk and Western subsequently constructed over part of the right-of-way acquired from the Clinchfield Railroad?

A. By dividing 2.3 miles into the $220,584 which represents CC&O's book investment in its Dumps Creek Line's roadway and track structures, a per mile book investment of $93,865 for roadway and track structures is produced. In 1968 the Commission found that the fair market value of Norfolk and Western's Dumps Creek Line was $70,000 per mile and in 1967 the Commission's determination of the fair market value of N&W's Dumps Creek Branch was only $45,000.

Q. Have you prepared under your direction a statement comparing the weight and size of equipment operated by the Norfolk and Western in Virginia in 1926 with the weight and size of equipment currently operated in Virginia?

page 1178 } A. Yes, I have prepared a statement showing this information which bears the symbol (LBY-I) in the upper right corner which I request be marked for identification as Exhibit No. (LBY-I).

Q. What is the source of the information shown on your Exhibit No. (LBY-I)?

A. The 1926 data shown on my Exhibit No. (LBY-I) were taken from the Official Equipment Register, Volume XLII, No. 7, dated December, 1926—I.C.C.-R.E.R.— No. 172 showing by car numbers the marked capacity, length, dimensions and cubical capacity of freight cars used to transport freight. This tariff was issued by G. P. Conard, Agent, 424 West 33rd Street, New York. The 1969 data were taken from the Official Railway Equipment Register, Volume LXXIV, No. 3, dated January 1969,—I.C.C.-R.E.R.—No. 370, showing by car numbers the marked capacity, length, dimensions and cubical capacity of cars to transport freight. This tariff was issued by the Railway Equipment and Publica-Company, Agent E. J. McFarland, Issuing Officer, 424 W. 33rd St., New York, New York 10001.

page 1179 } Q. Will you please explain your Exhibit No. (LBY-I)?

A. Yes. We lifted from the 1926 Equipment Register the information shown on the left side of the Exhibit. Next, we endeavored to tie in by appropriate car numbers the type of equipment listed in the 1926 Equipment Register with that listed in the 1969 Equipment Register. It will be noted that many of the cars in operation in 1926 carry the same car numbers in 1969. I would surmise that where the car num-

bers are identical for 1926 and 1969 the cars have been rebuilt to carry a heavier capacity. From this Exhibit, by dividing the aggregate capacity in pounds by the number of cars, I have arrived at an average capacity per car of 119,825 pounds in 1926. Following a similar procedure in 1969, I have determined that the average capacity per car for 1969 was 144,650 pounds per car, or an increase of 24,825 pounds per car for 1969 over 1926. This representative showing demonstrates that the Norfolk and Western is handling heavier loads and larger capacity equipment over its tracks today as compared with the capacity and equipment moved over its tracks in 1926.

page 1180 } Q. Mr. Younger, have you prepared a series of graphs comparing the relative cost of Account 1—Engineering; 3—Grading, 5—Tunnels and Subways; 6—Bridges, Trestles and Culverts; 8—Ties; 9—Rails; 10—Other Track Material; 11—Ballast; 12—Track Laying and Surfacing; and 13—Fences, Snowsheds and Signs for each of the years 1915 through 1967?

A. Yes, I have prepared a series of eleven graphs showing the relative cost for I.C.C. Accounts 1, 3, 5, 6, 8, 9, 10, 11, 12 and 13 for each year 1915 through 1967. I request that this document carrying the identifying mark (LBY-L) in the the upper right corner be marked for identification as Exhibit No. (LBY-L).

Q. Mr. Younger, what is the source of the cost showing for each of the years shown on your Exhibit No. (LBY-L)?

A. To each of the ICC primary property accounts shown in my Exhibit No. (LBY-L), I applied the index for each year 1914-1967, inclusive shown for Region IV in the *Schedule of Annual Indices for Accounts by Railroad,* 1914-1967, which has been previously identified as Exhibit No.

page 1181 } (BEG-1) and charted in graph form the particular ICC primary property account. The indices are on the basis of 1910-1914 period prices equal 100. The Indices in Region IV were used since they relate to the operation of the Norfolk and Western Railway in Virginia and West Virginia. After preparing such graphs for each of the primary roadway and property track accounts, I then prepared a summary of all the accounts listed on the exhibit, demonstrating the upward trend in the total dollar costs. My summary chart is based on weighted average of cost for roadway and track accounts for each year 1915-1967, inclusive.

Lee B. Younger

Q. Mr. Younger, will you now please explain in detail what is shown on each of the charts in your Exhibit No. (LBY-L)?

A. Yes, I will be glad to. As I just stated, Sheet 1 is a weighted aggregate summary of all the increased cost shown for each separate account on Sheets 2-11. Turning to Sheet 2 you will observe that this relates to ICC Property Account 1—Engineering. Here it will be noted that the

page 1182 } 1926 index cost in connection with Engineering was 163 and by 1967 the index cost had increased to 393 or an increase of 230 for Engineering.

Turning to Sheet 3 which pertains to ICC Account 3—Grading, you can see that the cost index in 1926 was 143 and in 1967 increased to 167. Sheet 4 pertaining to ICC Primary Account 5—Tunnels and Subways, shows that in 1926 the cost index was 184 and in 1967 it had increased to 424 or an index increase of 240.

Continuing on Exhibit No. (LBY-L), you will observe from Sheet 5 that the index with respect to ICC Account 6—Bridges, Trestles and Culverts, increased by 340, comparing 1926 with 1967.

Sheet 6 shows the index figures with respect to Account 8—Ties. Here it will be noted that the 1926 index cost was 188 above the 1914-1916 level and the 1967 index cost for Ties was 427 above the 1914-1916 level and 239 above the 1926 level.

Sheet 7 sets forth the graph pertaining to Account 9—Rails. From this graph it will be noted that in

page 1183 } 1926 the index cost for Rails was 143 above the 1914-1916 level and in 1967 it had increased to 428 poings above the 1914-1916 level and 285 points above the 1926 index cost.

Similarly, Sheet 8 sets out the cost showing for Account 10—Other Track Material. Here it will be noted that the 1967 index is 337 points above the 1926 index.

Sheet 9 shows the trend in the Indices for Ballast. In 1926 it will be observed the cost index was 171 and by 1967 it had increased to 368. Sheet 10 shows the Indices trend for Account 12—Track Laying and Surfacing. In 1926 the index for this Account was 188 and by 1967 it had increased to 438.

The last sheet of this Exhibit shows the trend of the Cost Indices for Account 13—Fences, Snowsheds and Signs. In 1926 the cost index for this account was 156 and by 1967 it had increased to 370.

It can, therefore, be seen from Sheet 1 of my Exhibit show-

ing the weighted aggregate summary of the Cost Indices for accounts 1, 3, 5, 6, 8, 9, 10, 11, 12 and 13 that the Cost Indices for the roadway and track account costs in Region IV, the Pocahontas Region, which involved principally the Norfolk and Western and Chesapeake and Ohio Rail-
page 1184 } ways in Virginia and West Virginia, increased by 235, 1967 over 1926.

Q. Mr. Younger, at your request did the Norfolk and Western Railway Company furnish the Commission a statement showing by Primary ICC Property Accounts Norfolk and Western's book investment in road and equipment property in Virginia as of January 1, 1967?

A. Yes. At this time I would like to offer a copy of Norfolk and Western's Schedule 611 showing its *investement* in road and equipment property in Virginia which bears the symbol (LBY-M) in the upper right corner. Attached to this schedule is copy of letter dated November 5, 1968 from H. J. Brinner, Comptroller of the Norfolk and Western to me. I respectfully request that this be marked for identification as Exhibit No. (LBY-M).

Q. Referring to the schedule which has just been marked for identification as Exhibit No. (LBY-M), Mr. Younger, will you state for the record the amounts set forth thereon for the various road and track accounts in Virginia?

A. Yes. Schedule 611 shows that as of the beginning of the year 1967, which I understand is the same
page 1185 } figure which would be shown for December 31, 1966, the following: Account 1—Engineering—$7,742,074; Account 3—Grading—$49,783,394; Account 6—Bridges, Trestles and Culverts—$27,558,045; Account 8—Ties—$9,238,325; Account 9—Rails—$23,991,057; Account 10—Other Track Material—$20,906,840; Account 11—Ballast—$14,012,079; Account 12—Track Laying and Surfacing—$12,613,907 and, finally, Account 13—Fences, Snowsheds and Signs—$969,635.

Q. Do the amounts shown on Exhibit No. (LBY-M) for Track and Roadway Accounts reflect the capitalization of track and roadway property replaced in kind?

A. No, they do not, for under the Interstate Commerce Commission's Uniform System of Accounts for Railroads where property is replaced in kind, for example, 120 pound rail replaced with 120 pound rail, the primary investment account is not disturbed. As Mr. Edward Johnson has previously stated in his testimony, the cost of the replacement less the amount of the salvage value attributed to the

page 1186 } rail removed is charged to operating expenses and the original cost of the rail removed remains undisturbed in the investment account.

Q. If you prorate the amount shown in Account 1, covering Engineering to all accounts listed on Exhibit No. (LBY-M), what would be the total book investment shown on Norfolk and Western's books for road and track property in Virginia?

A. I have prepared a statement restating the amounts shown on Exhibit No. (LBY-M) showing the prorata share of Engineering in Account 1 to each of the other track accounts. I have taken Norfolk and Western's Schedule 611 which has already been introduced as Exhibit No. (LBY-M) and broken down the $7,742,074 shown for Engineering in Account 1 and added the prorata share of the Engineering cost to each of the primary road and track accounts. This additional information is shown on a statement which you will recognize as Sheet 1 of Exhibit No. (LBY-M) and which bears the symbol (LBY-M[1]). I request that this be marked for identification as Exhibit No. (LBY-M[1]).

page 1187 } Q. Mr. Younger, you have already indicated what is shown on your Exhibit No. (LBY-M[1]), now where on this Exhibit is this information set out?

A. Column 1 of my Exhibit (LBY-M[1]) shows what the Norfolk and Western's book investment for each of the primary track accounts would be if the prorata share of the Engineering expense set out in Account 1 is added to each of these accounts. Column 2 shows the breakdown of the Engineering expense prorated to each of the accounts listed on the Exhibit.

Q. Then, restating each of the primary roadway and track accounts to include the prorata share of Engineering shown on Exhibit No. (LBY-M), what is the Norfolk and Western's total book investment for roadway and track properties as of the beginning of the year 1967?

A. If you will refer to my Exhibit No. (LBY-M[2]), you will observe from Column 1 thereof Norfolk and Western's total book investment for roadway and track properties in Virginia, including a prorata share of engineering, is $174,648,691, as of January 1, 1967.

page 1188 } Q. Mr. Younger, isn't it a fact that the $68,148,301 shown on Exhibit No. (LBY-M) for Roadway and Track property in Virginia, namely rails, ties, ballast and track materials, includes nothing

spent by the Norfolk and Western for road and track property replaced in kind?

A. Yes, that is correct.

Q. Was the statement identified as Exhibit No. (LBY-M) showing Norfolk and Western's book investment in road and equipment property in Virginia furnished you prior to making your 1968 *ad valorem* tax assessment?

A. No. As will be observed from Mr. Brinner's letter, Exhibit No. (LBY-M), this information was not forwarded to us until November 5, 1968.

Q. When you received the Norfolk and Western's Schedule 611 showing its investment in road and equipment property in Virginia, i.e. Exhibit No. (LBY-M) did it come to your attention that there was a difference of $3,939,694 in the investment figure for Grading as shown on this statement and that furnished you in Mr. Strause's July 8, 1968 letter previously identified as Exhibit No. (LBY-Z²).

A. Yes, upon receiving Schedule 611 I immediately noticed that there was a difference in the amount for

page 1189 } Grading set forth on this schedule and that furnished by Mr. Strause in his July 8, 1968 letter.

Q. In his letter what amount did Mr. Strause state as the original cost of Grading for Norfolk and Western's Roadway and Track property in Virginia?

A. Referring back to Exhibit No. (LBY-Z²) you will note that Mr. Strause furnished a figure of $45,843,700.

Q. What amount is shown for Grading in Norfolk and Western's Schedule 611, Road and Equipment Property within Virginia, Exhibit No. (LBY-M)?

A. This statement shows the book investment for Grading of Norfolk and Western in Virginia as $49,783,394 as of the beginning of 1967 and the balance in this account at the close of 1967 is $50, 514,301.

Q. Were you furnished any explanation for the difference in the value of Grading as shown on Exhibit No. (LBY-M) and that furnished in Mr. Strause's July 8, 1968 letter to you, Exhibit No. (LBY-Z²)?

A. No. I have been furnished no explanation for this difference.

page 1190 } Q. Continuing on Exhibit No. (LBY-M), what amount is shown thereon for Norfolk and Western's investment in signals and interlockers in Virginia?

A. Referring to Page 1, Line 24 of this Exhibit, you will note that Norfolk and Western's book investment in Virginia

for ICC account 27—Signals and Interlockers, as of the beginning of 1967 was $16,679,634.

Q. Did you request Norfolk and Western to furnish you with its total investment in Account 27—Signals and Interlockers, for Virginia as of December 31, 1967?

A. Yes, I directed a form letter to all railroads operating in Virginia requesting this information on or before May 24, 1968 so that the Commission could complete its 1968 assessment of railroad property. I have a copy of this letter which bears my symbol (LBY-N) and request that it be marked for identification as Exhibit No. (LBY-N).

Q. Was the requested information furnished to the Commission by the Norfolk and Western?

A. Yes. Mr. E. L. Butler, Norfolk and Western's Manager of Property Taxes, furnished the requested in-
page 1191 } formation in a letter to me dated June 11, 1968. Attached to this letter were seven pages setting forth the mileage of such property in the various political subdivisions in Virginia.

Q. Do you have a copy of Mr. Butler's June 11, 1968 letter, together with enclosures, which you would like to introduce into the record?

A. Yes, I have a copy of this letter which bears the symbol (LBY-O) in the upper right corner and request that it be marked for identification as Exhibit No. (LBY-O).

Q. Why was this information requested?

A. For a number of years the railroads operating in Virginia had not been reporting the value of highway grade crossing protection signal devices throughout the State, although under the Code Section 58-524, all such property is required to be reported in the carrier's Annual Tax Reports to the Commission. When this omission was brought to my attention, I requested the railroads to furnish this information.

Q. Do you have any information as to why the railway companies were not reporting the value of
page 1192 } highway protection devices at grade crossings? A. According to the best information I can develop, sometime in the past the railroads took the position that they derived no benefit from such property and, consequently, should not report it for tax purposes.

Q. In your professional judgment, do the railroads derive any benefit from highway grade crossing protective signals?

A. Let me answer your question in this way. First, under Section 58-524 of the Code of Virginia, railroads are re-

quired to report such property in their Annual Tax Reports to the Commission. Secondly, and equally important, the ultimate payoff in any grade crossing protection device is a reduction in accidents, injuries and deaths and, correspondingly, a reduction in personal injury and death by wrongful act verdicts against the railroad companies. Where such devices are used they definitely inure to the benefit of the railroad. In this connection I have reproduced an article which appeared in the March, 1969 issue
page 1193 } of the *L&N Magazine* entitled "Grade Crossing Programs Really Pay Off", prepared by James B. Clark, Chief Engineer of the Louisville and Nashville Railroad, which I would like to introduce as Exhibit No. (LBY-Q).

Q. Mr. Younger, do you have any information concerning the value of Norfolk and Western's highway crossing signals and protection devices in Virginia?

A. Yes. Referring to Mr. Butler's June 11, 1968 letter, Exhibit No. (LBY-O) you will note that in answering the sixth question, he states this value is $1,922,802.

Q. Have you made a study concerning Norfolk and Western's capital and maintenance expenses on signal and interlocker equipment in Virginia from 1926 to 1967, inclusive?

A. Yes, I made a study of Norfolk and Western's capital and maintenance expenses on signal and interlocker equipment in Virginia from 1926 though 1967 which I have set forth on a sheet entitled "Statement Showing the Additions and Betterments of the Norfolk and Western Railway Company's Signals and Interlocker Equipment in
page 1194 } Virginia for the years 1926-1967, Inclusive. Also, Showing Expenses Charged to Account 249, Signals and Interlockers for Each of the Involved Years." This statement bears the symbol (LBY-J) in the upper right corner and it is requested that it be marked for identification as Exhibit No. (LBY-J).

Q. What is the source of the information set out on your Exhibit No. (LBY-J)?

A. All of the figures shown thereon were taken from the Annual Operating Reports, Form A, filed by the Norfolk and Western Railway Company with this Commission for the years 1926 through 1967.

Q. Please explain your Exhibit No. (LBY-J).

A. This Exhibit shows the additions and betterments to Account 27—Signals and Interlockers for Virginia. It will be noted that in the period 1926-1967 the Norfolk and West-

ern spent $29,507,934 for additions and betterments to Signals and Interlockers in Virginia. In addition, this Exhibit shows Norfolk and Western's cost of maintenance of Signals and Interlockers as reported in Account 249 for
page 1195 } the System. During the forty-two year period 1926-1967 Norfolk and Western incurred expenses which were charged to Account 249 in the amount of $43,826,024. By prorating this figure on the basis of the ratio of the road mileage operated by the Norfolk and Western in Virginia to its total System mileage I allocated $19,073,254 of Signal and Interlocker maintenance expenses to the State of Virginia.

Q. Have you made a determination of the average life of Norfolk and Western's Signal and Interlocker property in Virginia?

A. Yes, the Norfolk and Western's Form A Report filed with the Commission for the year ended December 31, 1967, Schedule 211-B, entitled "Depreciation Base and Rates" shows an annual composite rate of 2.93% for Account 27—Signals and Interlockers. Using this percentage, I determined the average life of Signals and Interlocker equipment to be thirty-five years.

Q. Have you made a study to determine the average dollars age of Norfolk and Western's present Signal and Interlocker property in Virginia?

page 1196 } A. Yes, I have made a study to determine the average dollar age of Norfolk and Western's Signal and Interlocker property in Virginia which I have prepared in Exhibit form in a statement bearing the symbol (LBY-P) in the upper right corner. I request that this statement be marked for identification as Exhibit No. (LBY-P).

Q. Please explain the statement just identified as Exhibit No. (LBY-P).

A. This statement shows the average dollar age of Norfolk and Western's $16,775,021 book investment in Signals and Interlockers. This was furnished by Mr. Butler as of December 31, 1967. (See Exhibit No. (LBY-O). Using the method which is sometimes described as "first in—first out", you will observe that between 1952 and 1967 a total of $16,775,021 was invested in Additions and Betterments to Signals and Interlockers. In other words, the present investment has been incurred within the last sixteen years. Column 1 of Exhibit No. (LBY-P) lists the years in which the Additions and Betterments were made; Column

page 1197 } 2 shows the amount of Additions and Betterments for each year; Column 3 indicates the age of investment dollars and, by multiplying Columns 2 and 3, you obtain the dollar years. The next step is to add the total dollars expended for Additions and Betterments to a point where the total investment in Account 27 for Virginia as of December 31, 1967 is reached. Then a total is found for Column 4, thus producing the total dollar age which is $126,947,368. This figure is divided by the total investment ($16,775,021) as of December 31, 1967. This produces an average dollar age of 7.56 years. Having arrived at the average dollar age and using a thirty-five year life for Signals and Interlockers, I divided thirty-five into the average dollar age (7.56 years) and determined that accrued depreciation on a straight-line basis would be 21.6% or, stated differently, Norfolk and Western's Signal and Interlocker property in Virginia is in a 78.4% condition.

Q. Mr. Younger, did you employ another method for determining the percent condition of Norfolk and Western's Signal and Interlocker property in Virginia?

page 1198 } A. Yes, I did. I have prepared a statement entitled "Present Worth of Account 27—Additions and Betterments of Signals and Interlockers as of December 31, 1967" which bears the symbol (LBY-R) in the upper right corner which I request be marked for identification as Exhibit No. (LBY-R).

Q. Would you please explain the method set out in the statement which has just been identified as Exhibit No. (LBY-R)?

A. This statement shows the present worth method of estimating depreciation as taken from the *Condition-Percent Tables for Depreciation of Unit and Group Properties published* in Iowa State College Bulletin 156 in 1942. In preparing this statement, for the reason previously stated, I used a thirty-five year probable life for Signals and Interlockers. Also, I used a 5% interest rate since this rate, in my judgment, would be both conservative and fair. Column 1 shows the amount in dollars spent for Additions and Betterments and Column 2 shows the year in which these Additions and Betterments were installed. Column 3 shows the

page 1199 } age of Additions and Betterments as of January 1, 1968. Column 4 shows the percent condition as taken from the 5% worth tables. Multiplying Columns 1 and 4 for each year gives the depreciated book investment as of January 1, 1968. The total of Column 5 di-

vided by Column 1 discloses the percent condition of the property as of January 1, 1968 which, it will be noted, is 89.45% under this method.

Q. Mr. Younger, is this same method used in assessing property of other public service corporations?

A. When the information is available from the company's Operating Reports the methods employed in Exhibits No. (LBY-P) and No. (LBY-R) are used as guides in determining depreciation of property of other public service corporations.

Q. In determining the fair market value of this class of property why did you use 80% as the operating condition of Norfolk and Western's Signal and Interlocker equipment in Virginia?

A. From observation of Signals and Interlockers made during my inspection of Norfolk and Western's

page 1200 } road and track properties during May and June of 1968 and using the guideline results set out in Exhibits No. (LBY-P) and No. (LBY-R), in my judgment, Signals and Interlockers are in an 80% operating condition.

Q. On all items of railroad operating property—other than Land and Track accounts—included in the Commission's annual assessments for *ad valorem* taxation in past years, what basis was used in determining the fair market value of such property?

A. The value of property other than land and roadway and track accounts has been assessed on the basis of original cost less depreciation.

Q. In appraising railroad property, do you consider land and grading separately?

A. Yes, I do. In the first place, the Interstate Commerce Commission's Uniform System of Accounts for Railroads recognizes a difference between land for transportation purposes which is listed under Account 2 and the value of grading which is provided for in primary account No. 3. Land for transportation purposes includes the cost

page 1201 } of land of necessary width acquired for roadway and for other transportation purposes, Grading includes the cost of clearing and grading the roadway and the cost of constructing embankments, including cuts, fills and excavation. Such costs are reported in Class I, Schedule 1 of the Annual Tax Report to the Commission which schedule includes roadway and track values exclusive of lands and improvements thereon. Land and improvements

are reported separately and assessed under Class I, Schedule 2 and Class 2 of the Annual Tax Report form. Finally, it should be emphasized that, under Section 58-532 of the Code of Virginia, in making an assessment of roadway and track property, I am required to include, among other things, the value of cuts, fills, track surfacing and excavation.

Q. In making your appraisal of the road and track property of the Norfolk and Western Railway in Virginia, did you include any amount whatsoever for going concern or the value of the railroad company's franchise?

A. No, I did not. I inspectecd Norfolk and Western's road and track properties in Virginia, and, in my best judgment, determined what I considered was the fair mar-

page 1202 } ket value of the Railway Company's road and track properties in Virginia.

Q. Mr. Younger, to the best of your knowledge has the State Corporation Commission, in assessing the public service company property in Virginia for *ad valorem* taxation, ever given any consideration to going concern or franchise value?

A. 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 values in assessing the property of public service corporations for *ad valorem* taxation.

Q. Mr. Younger, have you made a study to determine the number of applications filed by the railroads with both the Interstate Commerce Commission and this Commission for authority to increase their interstate and intrastate rates and charges since 1946?

A. Yes, I have.

Q. According to testimony presented to this Commission by the railroads seeking general increases in

page 1203 } their freight rates and charges since 1946, what justification was submitted in support of such increases?

A. The railroads contended that the freight rate level had not kept pace with the substantial increases in consumer prices, wholesale prices and other prices including annual railway construction costs.

Q. Have you prepared an exhibit showing the number of general freight rate increase proceedings the railroads had before both the Interstate Commerce Commission and this Commission since 1946?

A. Yes, I have prepared a statement entitled "Statement Showing the General Freight Rate Increase Cases Pre-

sented by the Railways to Both the Interstate Commerce Commission and the State Corporation Commission of Virginia—July 1, 1946 to October 14, 1968" which carries the symbol (LBY-V) in the upper right corner. I request that this be marked for identification as Exhibit No. (LBY-V).

Q. What is the purpose of your Exhibit No. (LBY-V). Mr. Younger?

A. The purpose of this exhibit is simply to show that both the Interstate Commerce Commission and this

page 1204 } Commission, in approving the railroads' petitions for general increases in their freight rates and charges, have recognized the claimed need of the railroads for such increases to meet constantly rising costs of labor and material.

Q. Finally, Mr. Younger, did you have occasion to review a portion of the record in Interstate Commerce Commission Finance Docket No. 23832 involving the pending merger of the Norfolk and Western and Chesapeake and Ohio Railway Companies?

A. Yes, I did.

Q. What part of the record did you examine?

A. Among other testimony and exhibits, I examined the statement of Mr. Herman H. Pevler, President of the Norfolk and Western Railway Company, which is identified in the record before the Interstate Commerce Commission as Exhibit No.(A-1).

Q. Do you have a verified copy of Mr. Pevler's Exhibit (A-1) submitted to the Interstate Commerce Commission in Finance Docket No. 23834, *et al*?

A. Yes, I do.

page 1205 } Q. How did Mr. Pevler characterize the Norfolk and Western Railway in his testimony in the merger case?

A. I have reproduced the cover sheet and Pages 19 and 20 of Mr. Pevler's verified testimony which I woul like to offer as Exhibit No. (LBY-S). You will note that on Page 20 Mr. Pevler states "... The Norfolk and Western-Chesapeake and Ohio merger will further increase the efficiency of what *is already the finest coal transportation machine in the world.*" (Emphasis mine).

Q. From your observation of Norfolk and Western's road and track structures, do you agree with Mr. Pevler's characterization of his line?

A. Yes, I do. From my inspection of this line I found it to be an exceptionally well-maintained line of railroad.

Lee B. Younger

page 1206 } VERIFICATION

State of Virginia
City of Richmond ss.

Lee B. Younger, being duly sworn, deposes and says that he has read the foregoing statement, knows the contents thereof, and that the same are true as stated.

Lee B. Younger

Subscribed and sworn to before me, a Notary Public for City of Richmond this 14th day of April, 1969.

Alma Newbury, Jr.
Notary Public

My Commission Expires August 8, 1970.

page 1207 } CROSS EXAMINATION

By Mr. Riely:

Q. Mr. Younger, I believe I shall start my examination by asking you the very simple questions that I proposed to ask you at the beginning of this proceeding rather than at this late date. Primarily they relate simply to the identification of exhibits. I believe that the record will speak better if these exhibits are formally identified.

I hand you a document that has been marked Exhibit No. 1 and ask you whether you can identify it.

A. This exhibit identified as Exhibit No. 1 is a copy of the certified assessment made by the Corporation Commission of railroads, express and sleeping car companies for the year 1968.

Q. This is the document published by your office annually, is it not, showing your assessments for taxation of railroad property in Virginia locality by locality?

A. It is published by the Commission showing the Commission's assessment.

Q. Yes. Now I hand you document marked page 1208 } as Exhibit No. 2 and ask you to identify that.

A. The exhibit identified as Exhibit No. 2 is a copy of the printed, certified assessment of railroad, express, and sleeping car companies for the year 1967.

Q. That is the same document for the preceding year as Exhibit No. 1?

A. Yes, Sir, that is correct.

Lee B. Younger

Q. Now I hand you a document that has been marked Exhibit No. 3 and ask you whether you can identify that.

A. Exhibit No. 3 is a copy of a letter on State Corporation Commission stationery addressed to Honorable James T. Barron, State and City Bank and Trust Building, Richmond, Virginia, signed by Berkley D. Adams, Chairman.

Q. What is appended to that top letter, Mr. Younger?

A. Attached to the cover letter is a letter addressed to Mr. W. L. Stanley, Vice President, Seaboard Air Line Railway Company, Atlanta, Georgia, dated September 17, 1927, and signed by Louis S. Epes, Commissioner.

page 1209 } Q. And that is the letter that has been referred to as the Epes letter on several occasions, and I believe you refer to it on page twelve of your testimony.

Chairman Catterall: May I make a procedural suggestion.

Mr. Riely: Yes, Sir.

Chairman Catterall: Ask the question stating how you want the exhibits to be described and let the witness just say "yes."

Mr. Riely: All right, Sir. I will be glad to do that.

Q. Now I hand you a document marked Exhibit No. 4. and ask you whether it is not a copy of a letter addressed by you under date of October 3, 1967, to Mr. M. J. Strouse, General Manager of Property Taxes, Norfolk and Western Railway Company, stating that a conference would be held on October 18 in this building regarding the assessment of track property, railroad property operating in Virginia.

Chairman Catterall: You can safely say "yes" because Mr. Riely isn't going to put one over on you with Mr. Shannon here.

Mr. Shannon: Yes, I am not going to object to this, your Honor.

page 1210 } Mr. Riely:

Q. And the addressee of that letter is the same Mr. Strouse who has already testified in this case, is it not?

A. Yes.

Q. This meeting was held and referred to on page twenty-one of your testimony I believe, is that correct?

A. Yes, that is correct.

Q. Now at that meeting did you request the representatives of the railroads who were present to supply you with certain information?

A. Yes.

Q. What information did you seek?

A. It was an oral request that they supply the original cost of their roadway and tracks.

Q. In Virginia?

A. In Virginia—as of December 31, 1966.

Q. You didn't ask for the book cost?

A. No, Sir, I asked for the original cost.

Q. You didn't ask for the reproduction cost?

A. No, Sir, I asked for original cost of the

page 1211 } property that is now in place.

Q. And I don't want to belabor this point but I want to make sure Judge Catterall understands it. The original cost that you meant was something different from book cost as carried on the books.

A. Yes, Sir.

Q. It was the dollars invested in the track accounts?

A. No, not invested on the books.

Q. No, not invested on the books, but actually spent on the track accounts for capital improvements.

A. I asked for the cost installed of the—the original cost installed of the property that was in place as of December 31, 1966.

Q. And you were using original cost in the public—in the electric and gas utility sense of the dollars spent for the investment of the time it was first devoted for the public service, is that correct?

A. At the time the present property in place was first devoted.

Q. All right, Sir. Now I hand you a document which is is marked Exhibit No. 5 and ask you whether it

page 1212 } is not a copy of a letter addressed to the Commission on January 9, 1968, by Mr. Strouse and to it is appended a copy of a letter dated January 9, 1968, addressed to the Norfolk and Western Railway Company by Haskins & Sells, is that correct?

A. Yes, that is correct.

Q. And that was the Norfolk and Western's reply to your request made at the meeting of October 18, was it not?

A. Yes.

Mr. Epps: No. 5?
Mr. Riely: Yes, it is No. 5, I beg your pardon.
Mr. Epps: That's all right.

Mr. Riely:
Q. Now I believe it is on the basis of the statements appended to Exhibit No. 5 that you made the arithmetical computations that are shown on Exhibit No. LBY-2. Your starting point was the information contained on the schedules appended to Exhibit No. 5.
A. It is based on one of the schedules that was—
Q. The schedule that was entitled, "Original Cost"?
A. Yes, Sir, that is correct.

page 1213 } Q. Now I hand you a document that has been marked Exhibit No. 6 and ask you whether or not this is a letter addressed by you under date of February 6, 1968, to Mr. Strouse of the Norfolk and Western in which you state, "We request the enclosed values be used in reporting the full value of trackage in your 1968 and future Tax Reports unless advised otherwise by this office," and to which is appended a schedule of five pages giving values per mile for various lines in the United States of the Norfolk and Western in Virginia.
I summarized that letter as well as I could, your Honors.
A. This appears to be a correct copy.
Q. Now I hand you a document that has been marked Exhibit No. 7 and ask you whether it is not the report of the Norfolk and Western for 1968 to your office?

Mr. Shannon: What kind of report? Tax report?
Mr. Riely: Yes, to his office.
A. This appears to be a correct copy of the annual tax report filed by the Norfolk and Western Railway for the year 1968.

page 1214 } Mr. Riely:
Q. Now did the Norfolk and Western—

Chairman Catterall: Mr. Riely doesn't like the word "appears." Is it it?
A. So far as I can tell it is.
Chariman Catterall: Well, now, is there any doubt in your mind.
Mr. Riely: Well, he hasn't checked every page, your Honor. I tender it as a true copy of the exhibit, and I believe he ac-

cepts it as such in spite of the fact that I may be in error.
Chairman Catterall: Fine.

Mr. Riely:
Q. Isn't that a correct statement, Mr. Younger?
A. Yes.
Q. Now did the Norfolk and Western use the figure shown on the schedule appended to Exhibit No. 6?
A. Let me have that back a minute, please.

Note: Bailiff returns Exhibit No. 7 to the witness.

Q. Exhibit No. 6 is your letter to the Norfolk
page 1215 } and Western telling them—
A. No. Excuse me.
Q. —they did not report on that basis?
A. No, Sir.
Q. They used a figure that was higher or lower?
A. Much lower.
Q. Now what figure did you use in determining the assessment? Did you use the figures on Exhibit No. 6 or the figures reported by the Norfolk and Western on Exhibit No. 7?
A. I used the figures developed by the fact that—excuse me. I used the figures as shown on the exhibit filed.
Q. Exhibit No. 6?
A. Yes, Sir.
Q. Now, Mr. Younger, I hand you another rather large document, and I think contrary to the Judge's orders I will ask you to tell me what it is. It has been marked as Exhibit No. 8.
A. If these figures here shown on Exhibit No. 8 are the
figures by a member of my staff, not knowing
page 1216 } the handwriting, recognizing it, I would say it
is a copy of our computations to determine the assessed value in accordance with that new statute converting over to the true local ratio of increase in the value of property.
Q. This in essence is a copy of your office work sheet, isn't it?
A. Yes, Sir.
Q. Now, keep it, Mr. Younger. Don't hand it back because —

Chairman Catterall: That is the work sheet to comply with the Bemiss Bill.

Mr. Riely: Yes, your Honor, and at the risk of being tedious, I am going to ask Mr. Younger to go through one of these computations with me because I do not think their method is apparent on the face of the document; and I think it important that the record show how this computation is made.

Chairman Catterall: We have gotten to the Bemiss Bill, which involves arithmetic. Do we have to go through all of that arithmetic?

Mr. Riely: Yes, your Honor. If your Honors will recall, we are asking for changes in specific assess-
page 1217 } ments locality by locality.

Chairman Catterall: Well, if the case is decided in your favor, it will mean doing that exhibit over again.

Mr. Riely: It would be doing it over again on the basis that it is done, and we've got to see how it is done. I don't see how the Commission can make a determination unless it is shown how it is done. It will not take long, and unfortunately it is not very exciting.

Chairman Catterall: Well, go ahead. The point I am trying to develop is that unless Mr. Younger's assessment is set aside, that work will not have to be done all over again.

Mr. Riely: Well, we are not going to do it all over again. We are just going to take one example to see how Mr. Younger in fact did it.

Chairman Catterall: Go ahead. It will save time. Go ahead and do it. Tell him how it works, Mr. Younger.

Mr. Riely:

Q. Mr. Younger, let's look at the first page
page 1218 } of this exhibit, the top of the page under the City of Bristol; in the *frist* column on the left is Bristol, City of. Is that not correct?

A. Yes, Sir.

Q. Then there are a number of headings; "1966 full value base" is the first heading. Is that correct?

A. That is correct.

Q. And opposite that in the second column entitled, "Class one, schedule one" is the figure two hundred seventy-six thousand four hundred dollars. Is that correct?

A. Yes.

Q. The next heading in the column on the left is "1968 full value," and opposite that is four hundred twenty-nine thousand one hundred and seventy dollars. Is that correct?

A. Yes, Sir.

Q. Now the four hundred twenty-nine thousand one hundred seventy dollars was derived by applying the ratio of one point fifty-five to the 1967 appraised value per mile of the various types of trackage of the Norfolk and Western in the City of Bristol. Is that correct?

page 1219 } A. That is correct.

Q. So that except for rounding off the four hundred twenty-nine thousand one hundred seventy dollars about one point fifty-five times two hundred seventy-six thousand four hundred.

A. Yes.

Q. Now the next item in the column is one hundred fifty-two thousand seven hundred seventy dollars, which is merely the difference between four hundred twenty-nine thousand one hundred seventy dollars and two hundred seventy-six thousand four hundred dollars? Isn't that correct?

A. Yes.

Q. Now then, Mr. Younger, the next four columns relate to "line use of carrier purposes," "telephone and telegraph equipment and power lines," "machinery," "materials and supplies," is that not correct?

A. Yes, Sir.

Q. So then you come over to the column headed, "total," and what is shown there is the total 1967 full value for these categories of eight hundred twenty-nine thousand eight hundred thirty dollars, isn't it?

page 1220 } A. Did you say 1967 or 1966?

Q. The total 1968 value. Excuse me, the total 1966 value—

A. Yes, Sir.

Q. —of eight hundred twenty-nine thousand eight hundred thirty dollars. Then the 1968 full value of nine hundred eighty-six thousand and two dollars is shown, isn't that correct?

A. Yes, Sir.

Q. The difference is one hundred fifty-six thousand one hundred seventy-two dollars shown as the third figure in that column?

A. Yes, Sir.

Q. Now, let's keep going down the total column. You applied to the net additions of one hundred fifty-six thousand one hundred seventy-two a percentage of thirty-four point one per cent, is that correct?

A. We applied the true ratio for the City of Bristol.

Lee B. Younger

Q. Which is thirty-four point one per cent?
A. Thirty-four point one per cent.
Q. As shown in the first column?
page 1221 } A. Yes, sir.
Q. And that gave you fifty-three thousand two hundred fifty-five dollars, isn't that correct?
A. That is correct.
Q. Then, as I understand it, you continued to apply Section 58512.1 of the Code, and the application of that section is shown in the next two items, isn't it?
A. Yes, sir.
Q. First, you took two-twentieths of the eight hundred twenty-nine thousand eight hundred thirty and assessed that at thirty-four point one per cent, which is the local assessment ratio?
A. Yes, sir.
Q. And then you took eighteen-twentieths of that same figure and assessed it at forty per cent, is that correct?
A. Yes, sir.
Q. And this gave you a total assessment for the City of Bristol of three hundred eighty thousand two
page 1222 } hundred ninety-one dollars as shown under the total column, is that correct?
A. Yes, sir.
Q. Now you had to spread this back over the various classes, didn't you?
A. Yes, sir.
Q. And you did this by determining that the three hundred eighty thousand two hundred ninety-one dollars was thirty-eight point fifty-six eight ninety-eight percent of nine hundred eighty-six thousand two dollars? Is that correct?
A. Yes, sir. That is correct.
Q. And the percentage of three eight point five six eight nine eight is applied to the 1968 full value in each class to determine the assessment of that class?
A. That is correct.
Q. Thank you, Mr. Younger.
I apologize to the Commission, but I think—

Chairman Catterall: You don't think we took that in just by listening?
page 1223 } Mr. Riely: No, of course, you didn't; but it is in the record.

Lee B. Younger

Q. Now the figures that appear opposite that total of those columns headed—

A. Excuse me. I thought you had finished with it.

Note: Bailiff returns Exhibit No. 8 to the witness.

Mr. Riely:

Q. I'm sorry. I have one question about it. The figures that appear across from the heading "total" the first column of your work sheet, those red figures there, are the same figures that appear in your 1968 assessment for the City of Bristol, is that not correct?

A. They should be identical.

Q. And that was done throughout for every locality, the same computation?

A. That is correct.

Q. Now, Mr. Younger, how did you work this assessment for the other railroads other than the Norfolk and Western? How did you work it for the C&O, for example?

A. I worked it the same way as I worked the

page 1224 } Norfolk and Western.

Q. Did you apply the same factor of one point fifty-five for the C&O?

A. Yes, Sir.

Q. I believe you applied a different factor for the Southern, isn't that correct?

A. Yes, Sir.

Q. And I don't recall what that factor was, but it was something less than one point fifty-five, was it not?

A. Yes, Sir.

Q. And you applied a different factor for the Pennsylvania, am I not correct in that?

A. Yes, Sir.

Q. And you applied a different factor for the Clinchfield?

A. No, Sir.

Q. No, you didn't?

A. No, Sir.

Q. Well, aside from the Southern and the Pennsylvania and I may be wrong about this, I am not examining you from knowledge but from questioning, aside from the

page 1225 } Pennsylvania and the Southern, you apply the one point fifty-five factor to all of the other railroads in Virginia, is that correct?

A. Yes, Sir. The other railroads did not furnish original cost information.

Lee B. Younger

Q. So you used the Norfolk and Western, the factor that you determined for the Norfolk and Western?

A. Yes, Sir.

Q. Now have you and your staff had an opportunity to review Exhibit No. 1-ELB that has been introduced in this case by Mr. Butler?

A. Let me see it, please.

Note: Exhibit No. 1-ELB handed to witness.

A. I have not examined it.

Q. Has your staff examined it to your knowledge?

A. Not to my knowledge.

Q. All right, then, we won't ask you anything more about it. I was merely going to ask you whether you had checked it arithmetically.

A. No, Sir.

page 1226 } Q. Now I hand you a document that has been marked as Exhibit No. 9 and which is a request by you, I believe, addressed on May 14, 1968, to all railroad companies in Virginia requesting certain information as to signals. Are you familiar with that document?

A. Yes, I am.

Q. Now you asked the carriers in that letter to supply you with the total investment in certain accounts. Isn't that correct?

A. Yes, sir.

Q. Did you mean original cost in the sense that you and I discussed it just a few minutes ago?

A. Yes, sir.

Q. That is what I thought you did.

I now hand you a document, which has been filed as Exhibit No. 10 and ask you whether it is not a letter to you from Mr. Butler from the Norfolk and Western supplying you the information that you requested?

A. Yes.

Q. And you used the information from Norfolk and Western contained in that letter, Exhibit No. 10, in making your assessment of signals, didn't you, for 1968?

A. No, sir.

page 1227 } Q. How did you make your assessment for signals and interlockers for 1968?

A. There is a difference in the mileage in the letter from Mr. Butler to the mileage contained in the sheets attached

to it. When you added up the sheets attached to it, there is a difference in mileage to apply to the dollars.

Q. So you used the same dollars, though, did you not, and prorated them back on a different mileage?

A. Yes, Sir.

Q. Was this difference Mr. Butler's failure to add properly or was it a difference in theory?

A. I do not know. It was prepared by someone else, I expect.

Q. All right, Sir, on page twelve of your testimony, you refer to Exhibit No. 3, which is the letter from Commissioner Epes to Mr. Stanley. Have you examined the work papers and records which are the basis for the determination made by Judge Epes as set forth in Exhibit No. 3?

A. No, Sir, sofar as I know, I have never been able to find them in the records of the Commission.

page 1228 } Q. You have looked for them?

A. Yes, Sir.

Q. And you have been unable to find them?

A. Yes.

Q. And they have somehow disappeared, is that correct?

A. Well, I haven't been able to find them.

Q. Yes.

You state first that the Commission first determined reproduction cost new less depreciation as of June 3, 1926. What is the basis for that statement, Mr. Younger, because I don't find it in the Stanley letter?

Chairman Catterall: That is called the Epes letter.

Mr. Riely: The Epes letter. I beg your pardon.

A. Upon obtaining the original tax reports from the archives of the Library, we found that in the 1926 Annual Tax Report the values reported by the railroad, Norfolk and Western, were not used; and the values that appeared in Judge Epes' letter, his methods were used in place of them. That took place, I believe, the report is June 3,

page 1229 } 1926; that took place in 1926, and not in 1927 that the letter might indicate.

Q. I see, so June 3, 1926 was just the date that some report was made which you found in the Library?

A. The Annual Tax Report is filed by the Norfolk and Western.

Q. I see.

A. The Commission didn't use the figures filed, but inserted

figures that were in accordance with Judge Epes' letter, explaining which to me is kind of misleading. My reading of the Epes letter, I thought it first occurred in 1927; but it actually occurred in 1926.

Q. It occurred in 1926 and he was explaining in 1927 what he did in 1926?

A. Yes, but the letter doesn't clearly—

Mr. Riely: Judge Hooker, you haven't got those work papers tucked around somewhere, have you?

Commissioner Hooker: No, Sir.

Mr. Riely:

Q. What the determination was in that letter and I am not sure I can state it properly, but I want to see if I can.

page 1230 } It was the value found in the engineering report of 1916 plus additions and retirements after that date less a twenty per cent allowance for depreciation plus a thirty per cent increase for the inflation that occurred following World War I, is that correct?

Would you like for me to go over my idea of that again?

A. The way you have stated in general, I—

Q. The 1916 value plus additions and less retirement thereafter, less twenty per cent for depreciation plus thirty per cent for inflation?

A. Yes, Sir, which I believe he referred to as being something less than reproduction cost new.

Q. Now, Mr. Younger, you state further on page twelve that the Commission then considered other information available. That is the fifth line at the bottom of the page. What other information did the Commission in fact consider at that time, do you know?

A. I was taking that from Judge Epes' letter.

Q. From Judge Epes' letter. But what other information the Commission considered is not available?

A. No, Sir.

page 1231 } Q. Now at the bottom of page twelve beginning third line from the bottom, you state as follows:

"The records as to the assessed value for main line track in 1926 show the Commission used the same unit assessed value per mile of single track and double track for the three east-west operating railroads and the same unit value for the two railroads operating north and south along the eastern

part of the state and unit values less than the east-west railroads."

Now is that shown on your Exhibit No. LBY-1?

A. Yes.

Q. In fact, what the exhibit shows is that Seaboard and the Coastline were assessed at the same values in 1926, were they not, seventeen thousand dollars a mile single track in 1926?

A. Yes, Sir.

Q. And that the Norfolk and Western, C&O, the Virginian, Southern, and the RF&P were assessed at the same value for each of them, but at different values from those used for the Seaboard and Coastline, is that correct?

A. Yes, Sir.

page 1232 } Q. Now do you know of any studies that were made in 1926 to reach the conclusion that the values of the Seaboard and Coastline should be different from the values of the other railroads?

A. The best information I—

Q. Other than what's mentioned in the letter?

A. Yes, that is right. The east and west railroads would be assessed at the same value and the Coast Railroad, RF&P and—excuse me. The Seaboard and the Coastline would be assessed at the same value, and the Southern which is in between goes down through the middle part of the State. The value for that road was in between those.

Q. But it was valued the same way as the C&O and Norfolk and Western in 1926, wasn't it?

A. I do not know.

Q. Your statement so shows, doesn't it?

A. Well, the assessed value per mile, yes, Sir.

Q. Yes, but you don't know of any particular studies that were made that reveal the difference between the Coastline and Seaboard and others?

page 1233 } A. No, the only thing I know that they put the same unit value per mile on the east-west railroads and the same unit value per mile on the railroads operating along the coast.

Q. As a matter of fact, they put the same unit value per mile for not only the three east-west railroads but also for the RF&P and Sourthern in 1926, is that correct?

A. As far as double track is concerned.

Chairman Catterall: You mentioned the ones that got the lower value, the Coastline and Seaboard.

A. Yes, Sir.

Chairman Catterall: Those two got lower values than the others?

Mr. Riely: Yes.

Chairman Catterall: And that was because they didn't have mountains and streams to cross.

A. Yes.

Chairman Catterall: And, therefore, the cost is necessarily less.

Mr. Riely: Well, the RF&P doesn't go through very many mountains.

page 1234 } Chairman Catterall: It goes over a lot of water places so far as I am concerned. That was the only possible theory as I was told many years ago, if you allow me to testify.

Mr. Riely:

Q. Now by the use of the forty per cent ratio, the Commission's determination that the fair market value per mile for the five railroads in 1926 must have been identical, isn't that true?

A. Would you mind repeating—

Q. By the use of the forty per cent ratio, the Commission's determination in 1926 was the fair market value per mile for these five railroads must have been identical?

A. Yes, Sir.

Q. Now let's refer to your Exhibit No. LBY-Y, and I believe that the figures shown on that exhibit were the assessed values contained in the Norfolk and Western's report for each of the years shown and the full value as determined by multiplying the assessed values by two point five, is that correct?

A. Yes, Sir, that is correct.

page 1235 } Q. Now the reported assessed values which this exhibit is entitled, the values reported by the Norfolk and Western?

A. Yes, Sir.

Q. The reported assessed values were the values in fact, used by the Commission in each of these years for its assessment, is that correct?

A. The value reported by Norfolk and Western?

Q. Yes, Sir.

A. Being the assessed value was used.

Q. Right. Now turning to page fifteen of your testimony, you state towards the bottom of the page, "as long as a

piece of property is in use and actually serving the purpose for which it was intended it has value in excess of its scrap value regardless of age."

Would you please explain exactly what you mean by that statement?

A. Well, what I mean as long as any item of property is in place and is performing a service, it is certainly worth more than scrap value.

Q. Well, let's take a branch line of five miles built to serve a coal mine. The coal mine has become completely depleted, and there is no other customer on the line. The

page 1236 } tracks are still available for use and capable of serving the function of carrying rail cars and locomotives. Would you say this branch line has value in excess of its scrap value regardless of its age?

A. I say it would have; but while it is in place and there for a potential use rather than being taken up for scrap and then later having to be replaced in case there is potential business.

Q. Even when there is no customer on the line?

A. Yes, Sir.

Q. How do you measure that value, Mr. Younger?

A. That value would be measured by the condition of it in place; and certainly not in use, it would be in very poor condition but it would certainly, being in place for possible use, it would be more than scrap value.

Q. Well, would that value be affected by the fact that the railroad was losing money on the line since it was not in use?

A. I have not taken any economic conditions into any of my calculations.

Q. So that the simple fact that it was there

page 1237 } and could be used even though there was no use for it gave it in your mind a value higher than scrap value?

A. Yes, Sir, otherwise the railroad would take it up and scrap it.

Q. Now on page twenty-one, you state about the middle of the page, "a study was deemed necessary to arrive at the assessment for 1968." Is that correct?

A. Yes, Sir.

Q. And on this basis, you held the meeting with all of the railroads on October 18, 1967, is that correct?

A. Yes, Sir.

Q. And you asked for the original cost of the railroad trackage?

Lee B. Younger

A. Yes, Sir.

Q. And you in your letter of February 6, 1968, wrote to Norfolk and Western and told it what values to use for its track in Virginia, is that not correct?

A. I requested them to use them.

Q. Requested them?

A. Yes, Sir.

page 1238 } Q. And those are the figures that were in your letter of February 6, which is Exhibit No. 5, I believe. Those are the figures that were actually used in the assessment of the track of the Norfolk and Western for 1968?

A. Yes, Sir.

Q. So your study was completed by February 6, 1968, wasn't it, because that was the date of the letter you wrote the Norfolk and Western giving them the figures?

A. If that is the date I sent the values to them, yes, Sir.

Q. Now what did this study consist of, Mr. Younger?

A. Which study is that, Sir?

Q. The study that you made to arrive at the assessments for 1968. What did you study? Did you study anything other than the original cost figures that were supplied you by the Norfolk and Western?

A. I studied the original cost figures as furnished me in there, and then later went out over the road and—

page 1239 } Q. I am coming to that.

A. Yes.

Q. But did you make any study of the earnings of the Norfolk and Western?

A. No, Sir.

Q. Did you make any study of the market value of stock or bonds of the Norfolk and Western?

A. No, Sir.

Q. Did you make any study of the reproduction cost new of the Norfolk and Western?

A. No, Sir, I made a study; looked at the operating reports to try to get some idea. Although the accounting practice, not being the same of new property being added and the increase in book value from year to year—

Q. But you didn't make any reproduction cost, did you?

A. And also my judgment of the conditions of major utilities in the maintenance of their property and the maintenance expenses by the Norfolk and Western. It is my judgment that a railroad such as Norfolk and Western was maintained, and, in my opinion, operating per cent conditions about eighty per cent.

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