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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.

§6. Size and Type. Briefs shall be nine inches in length and six inches in width, so as to conform in dimensions to the printed record, and shall be printed in type not less in size, as to height and width, than the type in which the record is printed. The record number of the case and the names and addresses of counsel submitting the brief shall be printed on the front cover.

HOWARD G. TURNER, Clerk.

IN THE

Supreme Court of Appeals of Virginia

AT RICHMOND

Record No. 7425

VIRGINIA:

In the Clerk's Office of the Supreme Court of Appeals at the Supreme Court of Appeals Building in the City of Richmond on Tuesday the 17th day of February, 1970.

NORFOLK AND WESTERN RAILWAY COMPANY,
Appellant,

against

COMMONWEALTH OF VIRGINIA;

STATE CORPORATION COMMISSION OF VIRGINIA;

COUNTIES OF ACCOMACK, ALBEMARLE, ALLEGHANY, AMELIA, AMHERST, APPOMATTOX, ARLINGTON, AUGUSTA, BATH, BEDFORD, BOTETOURT, BRUNSWICK, BUCHANAN, BUCKINGHAM, CAMPBELL, CAROLINE, CARROLL, CHARLES CITY, CHARLOTTE, CHESTERFIELD, CLARKE, CULPEPER, CUMBERLAND, DICKENSON, DINWIDDIE, FAIRFAX, FAUQUIER, FLUVANNA, FRANKLIN, FREDERICK, GILES, GOOCHLAND, GRAYSON, GREENSVILLE, HALIFAX, HANOVER, HENRICO, HENRY, ISLE OF WIGHT, JAMES CITY, KING GEORGE, KING WILLIAM, LEE, LOUDOUN, LOUISA, LUNENBURG, MECKLENBURG, MONTGOMERY, NANSEMOND, NELSON, NEW KENT, NORTHAMPTON, NOTTOWAY, ORANGE, PAGE, PITTSYLVANIA, POWHATAN, PRINCE EDWARD, PRINCE GEORGE, PRINCE WILLIAM, PULASKI, ROANOKE, ROCKBRIDGE, ROCKINGHAM, RUSSELL, SCOTT, SHENANDOAH, SMYTH, SOUTHAMPTON, SPOTSYLVANIA, STAFFORD, SUSSEX, TAZEWELL, WASHINGTON, WARREN, WISE, WYTHE AND YORK;

CITIES OF ALEXANDRIA, BRISTOL, BUENA VISTA, CHARLOTTESVILLE, CHESAPEAKE, CLIFTON FORGE, COLONIAL HEIGHTS, COVINGTON, DANVILLE, EMPORIA, FRANKLIN, FREDERICKSBURG, GALAX, HAMPTON, HARRISONBURG, HOPEWELL, LEXINGTON, LYNCHBURG, MARTINSVILLE, NEWPORT NEWS, NORFOLK, NORTON, PETERSBURG, PORTSMOUTH, RADFORD, ROANOKE, RICHMOND, SALEM, SOUTH BOSTON, STAUNTON, SUFFOLK, VIRGINIA BEACH, WAYNESBORO, WILLIAMSBURG AND WINCHESTER;

TOWNS OF ABINGDON, ALBERTA, ALTAVISTA, AMHERST, APPALACHIA, APPOMATTOX, ASHLAND, BEDFORD, BERRYVILLE, BIG STONE GAP, BLACKSTONE, BLUEFIELD, BOONES MILL, BOYCE, BOYDTON, BOYKINS, BRANCHVILLE, BRIDGEWATER, BROADWAY, BRODNAX, BROOKNEAL, BUCHANAN, BURKEVILLE, CAPRON, CEDAR BLUFF, CHASE CITY, CHATHAM, CHILHOWIE, CHRISTIANSBURG, CLARKSVILLE, CLEVELAND, CLIFTON, CLINCHPORT, CLOVER, COEBURN, COLUMBIA, COURTLAND, CRAIGSVILLE, CREWE, CULPEPER, DAMASCUS, DAYTON, DILLWYN, DRAKES BRANCH, DRAPER, DUBLIN, DUNGANNON, EDINBURG, ELKTON, FARMVILLE, FRIES, FRONT ROYAL, GATE CITY, GLADE SPRING, GLASGOW, GLEN LYN, GORDONSVILLE, GRETNA, GROTTOES, GRUNDY, HALIFAX, HALLWOOD, HAYMARKET, HAYSI, HOLLAND, HONAKER, HURT, IRON GATE, IVOR, JARRATT, KENBRIDGE, KEYSVILLE, LaCROSSE, LAWRENCEVILLE, LOUISA, LURAY, McKENNEY, MANASSAS, MARION, MINERAL, MT. JACKSON, NARROWS, NEWSOME, ORANGE, PAINTER, PAMPLIN, PARKSLEY, PEMBROKE, PENNINGTON GAP, PHOENIX, POCAHONTAS, POUND, PULASKI, QUANTICO, REMINGTON, RICH CREEK, RICHLANDS, RIDGEWAY, ROCKY MOUNT, RURAL RETREAT, SALTVILLE, SCOTTSVILLE, SHENANDOAH, SOUTH HILL, ST. CHARLES, ST. PAUL, STANLEY, STEPHENS CITY, STONY CREEK, STRASBURG, TAZEWELL, TIMBERVILLE, THE PLAINS, TOMS BROOK, TROUTVILLE, VICTORIA, VIENNA, VINTON, VIRGILINA, WAKEFIELD, WARRENTON, WAVERLY, WEBER CITY, WEST POINT, WINDSOR, WOODSTOCK AND WYTHEVILLE,

Appellees.

From the State Corporation Commission

Upon the petition of Norfolk and Western Railway Company an appeal of right was awarded it by the Chief Justice of the Supreme Court of Appeals on February 13, 1970, from an order entered by the State Corporation Commission on the 21st day of November, 1969, in a certain proceeding then therein depending under the short style of: Application of Norfolk and Western Railway Company for Review and Correction of the Assessment for Taxation of its Property, etc., upon the petitioner, or some one for it, entering into bond with sufficient security before the clerk of the State Corporation Commission in the penalty of $500, with condition as the law directs.

RECORD

page 1 } Before the

STATE CORPORATION COMMISSION

Richmond, Virginia

Application of Norfolk & Western Railway Company for Review and Correction of The Assessment for Taxation of Its Property Subject to Local Taxation for the Year 1968 and for the Right to Recover From Local Authorities Excess Taxes Paid

Norfolk & Western Railway Company applies pursuant to Section 58-672 of the Code of Virginia for a review and correction of the assessment for taxation for the year 1968 of the value of its property subject to local taxation in the applicable local taxing jurisdictions within the Commonwealth, and for the right to recover from such local authorities all excess taxes paid on account of the erroneous assessment of the value of such property, and for its grounds states as follows:

1. Applicant is a public service corporation organized under the laws of the Commonwealth of Virginia.

2. Applicant is subject to tax pursuant to Article 2 of Chapter 12 of Title 58 of the Code of Virginia.

3. Applicant made timely filing with the State Corporation Commission of Virginia (Commission) on the forms prescribed by it, of Applicant's report of all of its real and tangible personal property in Virginia as of December 31, 1967 as required by Section 58-524 of the Code of Virginia, including the location thereof and its fair cash value exclusive of its franchise value. In such report Applicant reported as of December 31, 1967, the total fair cash value of page 2 } its roadway and track (Class 1, Schedule 1, of such report) to be $28,155,660, and the total fair cash value of its signal, car retarder and interlocker equipment (included in Class 1, Schedule 2 and Class 2) to be $5,913,400, and reported the local taxing jurisdictions in which such property was located.

4. The Commission assessed the value of Applicant's property for taxation pursuant to Sections 58-512.1 and 58-529 of the Code of Virginia, and the Clerk of the Commission forwarded a certified copy of such assessment to Applicant, which was received by it on August 19, 1968. In making such assessment, the Commission erroneously valued Applicant's

roadway and track at $141,851,035 and erroneously valued its signal, car retarder and interlocker equipment at $11,661,001, and thereafter applied to such valuations percentages established by law (Section 58-512.1 of the Virginia Code) to produce an erroneous assessment for taxation by the relevant local taxing jurisdictions of all classes of property subject to such taxation. The assessment of the value of such property for taxation was erroneously and unconstitutionally made by the Commission because it was not based on the fair market value of such property as required by Section 169 of the Constitution of Virginia and because it failed to exclude therefrom the franchise value of such property as required by Section 176 of the Constitution of Virginia and Section 58-522 of the Code of Virginia.

5. The correct and proper fair cash value of the Applicant's roadway and track is $34,368,774 and of its signal, car retarder and interlocker equipment is $2,000,000, and the action of the Commission in fixing the value thereof at larger amounts was erroneous.

6. The erroneous assessment for taxation of the value of Applicant's property has resulted or will result in Applicant paying to the local taxing jurisdictions in Virginia where its properties are located excess taxes in the approximate aggregate amount of $1,253,055, which it is entitled to page 3 } have refunded.

7. The names and addresses of the parties in interest are:

State Corporation Commission
Richmond, Virginia
Attorney General of the Commonwealth of Virginia
Richmond, Virginia
Norfolk & Western Railway Company
Roanoke, Virginia
The counties, cities and towns of Virginia listed on Exhibit A of this Application.

Wherefore, Applicant prays for a review and correction of the aggregate assessment for taxation of the value of its property subject to local taxation for the year 1968 based on the fair market value thereof from $75,016,300 to $41,240,839, which is its proper value for tax assessment purposes exclusive of the value attributable thereto on account of Applicant's franchise and that the Commission order that the Applicant recover the excess taxes paid from the local authori-

ties to whom such property taxes were paid, with legal interest thereon from the date of payment, and its costs in this behalf expended.

Respectfully submitted,

Norfolk & Western Railway
Company

By James E. Carr
James E. Carr, Vice President—
Taxation and Real Estate

page 4 } Melvin J. Strouse
David R. Goode
Guy K. Tower
Norfolk & Western Railway Company
8 North Jefferson Street
Roanoke, Virginia 24011

H. Merrill Pasco
John W. Riely
Hunton, Williams, Gay, Powell & Gibson
700 East Main Street
Richmond, Virginia 23212

Counsel for Applicant

STATE OF VIRGINIA
CITY OF ROANOKE, To-wit:

I, James E. Carr, do solemnly swear that the statements and items set forth in the foregoing Application are to the best of my knowledge and belief true and correct in each and every particular.

James E. Carr
Vice President-Taxation and Real Estate

Subscribed and sworn to before me in my City and State aforesaid this 7th day of November, 1968.

R. T. Anderson
Notary Public

My commission expires November 3, 1969.

page 5 } Exhibit A

COUNTIES, CITIES AND TOWNS OF VIRGINIA IN WHICH NORFOLK & WESTERN RAILWAY COMPANY'S PHYSICAL PROPERTY IS LOCATED

COUNTIES

Amherst
Appomattox
Augusta
Bedford
Botetourt
Brunswick
Buchanan
Campbell
Carroll
Charlotte
Clarke
Cumberland
Dickenson
Dinwiddie
Franklin
Giles
Grayson
Greensville
Halifax
Henry
Isle of Wight
Lunenburg
Montgomery
Nansemond
Nottoway
Page
Pittsylvania
Prince Edward
Prince George
Pulaski
Roanoke
Rockbridge
Rockingham
Russell
Smyth
Southampton
Sussex
Tazewell
Warren
Washington
Wise
Wythe

CITIES

Bedford
Bristol
Buena Vista
Chesapeake
Galax
Hopewell
Lynchburg
Martinsville
Norfolk
Norton
Petersburg
Radford
Roanoke
Salem
South Boston
Suffolk
Waynesboro

TOWNS

Abingdon
Alberta
Altavista
Appomattox
Berryville
Blackstone
Bluefield
Boones Mill
Boyce
Brookneal
Buchanan
Burkeville
Cedar Bluff
Elkton
Farmville
Fries
Front Royal
Glade Spring
Glasgow
Glen Lyn
Grottoes
Grundy
Halifax
Honaker
Hurt
Ivor
Phenix
Pocahontas
Pulaski
Rich Creek
Richlands
Ridgeway
Rocky Mount
Rural Retreat
St. Paul
Saltville
Shenandoah
Stanley
Tazewell

Chilhowie	Jarratt	Troutville
Christiansburg	Kenbridge	Victoria
Cleveland	Luray	Vinton
Coeburn	Marion	Wakefield
Crewe	Narrows	Waverly
Damascus	Pamplin	Windsor
Draper	Pembroke	Wytheville
Dublin		

page 6 } At Richmond, November 13, 1968

Application of

Case No. 18629

Norfolk and Western Railway Company

For review and correction of the assessment for taxation of its property subject to local taxation for the year 1968 and for the right to recover from local authorities excess taxes paid.

On November 13, 1968, came the Norfolk and Western Railway Company, by counsel, and filed its application for review and correction of the assessment for taxation of its property subject to local taxation for the year 1968 and for the right to recover from local authorities excess taxes paid, such application being verified by affidavit.

In Consideration whereof,

It Is Ordered that the application be set for hearing before the Commission at its Courtroom in the Blanton Building, Richmond, Virginia, on March 10, 1969 at 10:00 A.M. at which time the Commission will hear such testimony with reference to such application as the applicant or any other party may desire to introduce.

It Appearing further that applications of similar tenor have been this day filed with the Commission by Carolina and Northwestern Railway Company, The Chesapeake and Ohio Railway Company, Chesapeake Western Railway, Clinchfield Railroad Company, Interstate Railroad Company, Louisville and Nashville Railroad Company, Norfolk, Franklin and Danville Railway Company, Norfolk and Portsmouth Belt Line Railroad Company, Norfolk Southern Railway Company, Richmond, Fredericksburg & Potomac Railroad Coast Line Railroad Company, Southern Railway Company, Company, Richmond Terminal Railway Company, Seaboard

(jointly with Virginia and Southwestern Railway Company, lessor), Winchester and Potomac Railroad Com-
page 7 } pany and Winchester and Strasburg Railroad Company, And It Further Appearing that the principles established in this case may apply to the cases of such other railroad companies.

It Is Ordered that Norfolk and Western Railway Company serve upon each county, city and town whose revenue is or may be affected by the application herein, or by the applications of any of such other railroads, a copy of this order and of the application of the Norfolk and Western Railway Company, together with a copy of the application of each of such other railroads whose property lies within the limits of such county, city or town.

An Attested Copy hereof shall be sent to John W. Riely, counsel for the applicant, 700 Building, 700 East Main Street, Richmond, Virginia; and, to the Director of the Public Service Taxation Division of the Commission.

A True Copy

Teste: William C. Young
Clerk of State Corporation Commission

page 8 } Commonwealth of Virginia

State Corporation Commission

Application of Case No. 18629

Norfolk and Western Railway Company

For review and correction of the assessment for taxation of its property subject to local taxation for the year 1968 and for the right to recover from local authorities excess taxes paid.

Present:

Commissioners
Ralph T. Catterall (Chairman)
H. Lester Hooker
Jesse W. Dillon

(Chairman Catterall presiding)

Appearances:

John W. Riely,
H. Merrill Pasco,
David R. Goode,
Guy K. Tower,

Counsel for the Applicants

Stuart B. Carter,
A. C. Epps,
J. Edward Betts,
Hullihen W. Moore,

Counsel for the Defendants

Preston C. Shannon,

Commerce Counsel for the Commission

page 9 } Chairman Catterall: Mr. Riely, you may proceed.

Mr. Riely: If it please the Commission, I should first like to introduce to the Commission Mr. Guy K. Tower, of the Roanoke Bar who will be associated with us in this case.

Chairman Catterall: Mr. Tower, we are delighted to have you.

Mr. Tower: Thank you, Sir.

Mr. Epps: May it please the Commission, I should also like to introduce two of my associates, Mr. J. Edward Betts and Mr. Hullihen W. Moore, who will be associated with us.

Chairman Catterall: We are delighted to have you practice before us, gentlemen.

Mr. Betts: Thank you, Sir.

Mr. Moore: Thank you, Sir.

Mr. Riely: If it please the Commission, first of all I should like to file as Exhibit A the return of service in this case.

page 10 } Chairman Catterall: That will be marked and received as Exhibit A and do not open it unless somebody wants to.

Mr. Riely: May it please the Commission, this is an application of the Norfolk and Western Railway Company for review and correction of the assessment by the Commission of certain of the company's properties for the year 1969. The properties involved are all the properties subject to local taxation in Virginia. The parties and interest are all of the counties, cities and towns in which the properties of Norfolk and Western are located.

Chairman Catterall: You don't mean all the properties. You mean the right-of-way.

Mr. Riely: No, Sir, all of the properties subject to local taxation are the subject of this case and it is a complicated matter, but I will explain it to you as the case goes on, if your Honor please.

Chairman Catterall: Well, I wish you would, because I don't think that is in the petition.

Mr. Riely: Well, it is in the petition. The State has no interest in this case, however. No state taxes are at issue in this case.

Although I have said that assessment of all properties subject to local taxation is at issue in this case, we are
page 11 } primarily concerned with only two categories of property. They are, and this is the principal item, the track accounts and, less significant only because the dollars are less, signals, interlockers and car retarders. Our evidence will show that from 1927 until 1969, a period of forty years, the Commission used the same method for the assessment of trackage. This method was described in a letter sent in 1927 by Commissioner Epes to Mr. Stanley of the Seaboard Airline Railroad and Commissioner Hooker was on the bench at that time and no doubt remembers when it was sent. A copy of this letter will be introduced in evidence, but in 1968 the Commission changed its assessment method in a very radical way. Instead of using the 1927 method, the Commission, in 1968, valued trackage at eighty per cent of the original cost. The result was that the full value of the Norfolk and Western track in Virginia on which the assessment for 1969 was based was increased over the 1967 full value by about fifty-five per cent. It is this radical increase in track assessment that is the principal reason for this case.

Commissioner Dillon: Can't you use "substan-
page 12 } tial" instead of "radical"?

Mr. Riely: Your Honor, I don't mean "radical" in the sense that you mean. I know what you are referring to. Certainly the fair market value of the Norfolk and Western tracks in Virginia did not increase by fifty-five per cent between 1967 and 1968, nor was there any change in the relevant statute in that period. The Commission undertook an—excuse me, your Honor—radical reversal of its past practice and that radical reversal brings on this case. Signals and related equipment are of course less material, because their value is materially less. For 1967 the Commission had valued signals at fifty per cent of the original cost and signal investment at public crossings was excluded. In 1968, again without change of statute, the Commission undertook to increase the signal valuation to eighty per cent of

original cost and to include signal investment at public crossings. This change also is the reason for this case. As a result of these actions by the Commission, the Norfolk and Western began its investigation of what, in fact, was the fair market value at January 1, 1968 for trackage and sig-
page 13 } nals in Virginia. The results of this investigation are quite remarkable. In fact, the Norfolk and Western has, for forty years, been over-assessed on its Virginia trackage. In fact, the Norfolk and Western should have sought a review of these assessments years ago. In fact, the fair market value of the Norfolk and Western trackage is materially less, not only than the 1968 full value found by the Commission, but materially less than even that found in the years prior to 1968. The scheme of Virginia taxation of railroads is simple. As the Commission knows better than I, it was devised in 1902 when the present constitution took effect. It was designed to subject the franchise value of the railroads to taxation by the State. Physical properties, other than rolling stock, was set apart exclusively for local taxation, but as the Supreme Court of Appeals has often held, franchise value is to be excluded from the value subject to local taxation. The franchise tax payable to the Commonwealth is a very heavy tax. It is not the constitutional or the statutory scheme to include any franchise value in the valuation of the property subject to local taxation. It is
page 14 } the constitutional and statutory scheme to assess such property as if its value as operational railroad property were entirely excluded.

We shall then present two main points. The first point is that the fair market values of the Norfolk and Western property, subject to local taxation in 1968, was one hundred two million, three hundred ninety-four thousand, six hundred sixty-two dollars. The Commission found that the full value of this property was two hundred twenty-one million, fifty-nine thousand, seven hundred four dollars. The full value found by the Commission exceeded the fair market value by one hundred eighteen million, six hundred sixty-five thousand, forty-two dollars. When these figures are related to assessed values, the assessment made by the Commission was too high by thirty-five million, fifty-three thousand, seven hundred fourteen dollars. The Commission's assessment is excessive in this amount and its assessment should be reduced by that amount, but in any event the Commission started on the wrong theory. It started on original cost and that is the wrong place to start and then it compounded its error.
page 15 } It purported to use twenty per cent depreciation or an eighty per cent condition for the track and signals. This conclusion can be supported neither on the basis

of actual observation of the property nor on any accounting theory. In fact, the per cent condition of this property is not in excess of fifty per cent. The Commission's assessment, therefore, violently understates the depreciation actually to be found on the Norfolk and Western property. I should point out that this case involves only the Norfolk and Western, but other railroads have an interest as the Commission pointed out in the order setting this case for hearing. The principals determined here in this case may well apply to the cases involving fourteen other railroads now pending before the Commission. We shall present nine witnesses. The testimony of each has been prepared, except in one case and this prepared testimony will be made available to the interested parties in a few minutes, but first of all we shall ask Mr. Younger to take the stand as an adverse witness, in order that we may see what the Commission has done in 1968 in contrast to what it did in prior years. It is only when we
page 16 } know what the Commission did, that we can show the Commission what was done in error, so on this basis I shall, at the beginning ask Mr. Younger to take the stand and we are now prepared to go ahead.

Mr. Shannon: Your Honors, I am going to interpose an objection to Mr. Younger's taking the stand at this point. We had a pre-trial conference here at the Commission on February 7, which Mr. Pasco and associates from the railroad—I don't believe Mr. Riely was at that conference, but Mr. Carter and Mr. Epps were also there. At that time we discussed the procedure for handling this case. Special rules were agreed to for the filing of verified statements, both by the railway applicants and by the interveners and by the Commission. Nothing was said at that time about Mr. Younger being called to the stand, either as an adverse witness or a witness for the Applicants. Now, it would certainly disrupt the logical order of this proceeding to call Mr. Younger at this time. He will testify. He is going to testify on April 15, or shortly thereafter. As this Commission knows, the special rules were that the Applicants would submit their
page 17 } testimony in verified form on March 10, then the hearing would be adjourned until April 15, at which time the Interveners for the cities, counties and towns and the Commission, itself, would put in their case and that was the understanding.

It comes as a complete surprise to me that Mr. Younger has been asked. As Counsel for the Commission I have not been approached on this subject and my two associates here, likewise, do not have any knowledge of this development. Now, I would like to also say that we do not agree with Mr. Riely's statement of the case. We feel that the sole issue here, aside

from the signals and interlockers, has to do with the increased assessment of roadway and track property and that will be the basis on which we will defend the case.

I think that we will be able to show, very convincingly, that the Commission has not been overbearing on the railroads. In fact, the increased assessment is very conservative, in the light of the known facts which will be developed on this record, so with that statement I would like to re-

page 18 } new we object strenuously to Mr. Younger being called at this time.

Mr. Carter: If your Honors please, we join with the counties, cities and towns. I have some notes here that I took at that pre-trial conference and of course Mr. Epps does too and we have no indication that Mr. Younger would be called. I understood that the railroad today would put on ten or twelve witnesses and probably two or three experts, but I understood that to be the railroad's witnesses and not any Commission members.

Chairman Catterall: Yes, that was the understanding. Of course, the orderly procedure is for the witness to testify and then be cross-examined, instead of being cross-examined before he testifies. Don't you agree with that?

Mr. Pasco: No, Sir, I distinctly recall at our meeting in February when it was understood that we would prepare the testimony, I said that we would also get out of the way that day any oral testimony that we might have and I turned to your Honor and said that we would probably call one or more members of the Commission staff, and I con-

page 19 } sidered that adequate notice and proceeded with that understanding. Our whole case is premised on a—first—a description by Mr. Younger of what he had done.

Chairman Catterall: I don't remember what was said—

Mr. Pasco: I am quite certain that is correct, your Honor.

Chairman Catterall:—but whatever you said, the orderly procedure is to cross-examine the witness after he has testified, so proceed with the introduction of the prepared testimony.

Mr. Riely: That depends on Mr. Younger's statement, your Honor. It is basic to our case. We have got to find out what the Commission did and until we can find out what the Commission did, there is no way that we can present our case.

Chairman Catterall: You have been talking with the Commission for months and we have tried to make you understand—

Mr. Riely: But we are trying to make a record, your Honor. That is the point.

Chairman Catterall: Well, we are not keeping

page 20 } you from making a record.

Mr. Riely: Well, may I call Mr. Younger to make the record?

Chairman Catterall: No.

Mr. Riely: I cannot? You will not permit me to call Mr. Younger to make a record for the Commission and for the Supreme Court?

Chairman Catterall: That is correct. Well, he is going to testify in due course, but the purpose of today's proceeding—

Mr. Riely: The purpose of today's proceeding in trying my case, your Honor, is to get Mr. Younger on the stand and tell us what the Commission did.

Chairman Catterall: We were going to have your prepared testimony and exhibits—

Mr. Riely: And Mr. Pasco also mentioned at the hearing, as he has said, that we would call a member of the Commission staff.

Mr. Carter: We will put him on in due course.

Chairman Catterall: I don't—I do not know what was said, but certainly the orderly procedure is to testify and then to cross-examine.

page 21 } Mr. Riely: How can I base my case, if your Honor please, on what the Commission did, unless we have in the record what the Commission did.

Chairman Catterall: You are going to have in the record what the Commission did, Mr. Riely.

Mr. Riely: We have got to have it in the beginning and I submit, your Honor, that I have a right to—

Chairman Catterall: What the Commission did was to raise the assessment.

Mr. Riely: But how it did it is important, your Honor. That is the basis of the case, and I submit to you that I have a right to call a Commission staff member to the stand.—

Chairman Catterall: Well, I cannot agree with you—

Mr. Riely:—And—

Chairman Catterall: And we will proceed without calling any Commission witnesses today. He will take the stand as soon as we convene in April or in due course, whenever we convene—

Mr. Shannon: April 15, your Honor.

Chairman Catterall:—And of course he will ex-
page 22 } plain in detail his argument—you are really talking about argument, rather than fact, Mr. Riely.

Mr. Riely: But, if your Honor please, I submit to you that I have a right to call as witnesses whom I choose. You have a right to say that their testimony—to rule that their testimony is not relevant or that it is immaterial and I submit to you that I have a right to call Mr. Younger to the stand.

Chairman Catterall: The ruling is that it is out of order.

Mr. Riely: Out of order. Then may I state to the Commission that the prepared testimony that we will present will be to a large extent meaningless, without Mr. Younger's testimony first, and I would like to express to you as forcefully as I know how, my objection to this procedure, because I still suggest to you that I have the right to call before the Commission the witnesses that I want to have and you are ruling that I may not do so as I understand it.

Chairman Catterall: That is correct.

Commissioner Hooker: I don't understand, Mr. Riely, how you could be—you prepared your testimony, your
page 23 } canned testimony that you state you are going to submit today, yet Mr. Younger's testimony now you are talking about—

Mr. Riely: I have ten exhibits—

Commissioner Hooker:—was essential.

Mr. Riely: I have ten exhibits that I wish to put in through Mr. Younger, your Honor.

Commissioner Hooker: And now you say your case relies on what Mr. Younger says.

Mr. Riely: It does rely on what Mr. Younger says.

Commissioner Hooker: As I understand it, you already have your testimony canned.

Mr. Riely: And it relies on the—

Commissioner Hooker: That is inconsistent.

Mr. Riely:—on the ten exhibits that were to be put in through Mr. Younger.

Chairman Catterall: The exhibits will be received now and will be numbered from one to ten. Hand them to the bailiff.

Mr. Carter: Your Honor, he has the right to rebut what Mr. Younger says after the fifteenth, after Mr. Younger takes the stand.—

page 24 } Chairman Catterall: Yes, of course.

Mr. Carter:—he has got every opportunity in the world.

Chairman Catterall: Certainly. It is just a question of orderly procedure. There is no question of merit involved here.

Mr. Riely: Well, if your Honor please, this is, we think, a very substantial question on the merits of the case and again I would like to renew my objections.

Chairman Catterall: Well, you have made the motion nine times and it has been overruled nine times.

Mr. Riely: I feel it very strongly.

Chairman Catterall: You have made that very clear.

Mr. Pasco: I would like for the record to show, if the Commission please, that this is contrary to the understanding in which I clearly put to Judge Catterall—

Chairman Catterall: Well, I don't remember any such understanding.—

Mr. Pasco:—on notice. We had planned from the outset to do it this way.

page 25 } Chairman Catterall:—But I will take your word for it.

Mr. Shannon: Your Honor, I am going to take objection to Mr. Pasco, there. I wrote a memorandum and sent it to all parties of what the understanding was. Mr. Pasco, at that time, had some corrections which he called to my attention, which I readily acknowledged and admitted, but nothing, whatever, was said about Mr. Younger being their lead-off witness. Had it been stated at that time that Mr. Younger was going to be a witness for the Applicants, we probably would not have agreed to the procedure that we did. It was our understanding that they were coming in and put in their canned testimony and it would be a very perfunctory sort of thing. It would be in verified form. We even agreed that certain of the witnesses who could not be here that day, we would still permit their testimony to come in and we would ask them to return later for cross examination if necessary. So nothing was said, whatever, about Mr. Younger being a lead-off witness.

Mr. Pasco: Your letter—

page 26 } Mr. Epps: May it please the Court, I have an office memorandum which I dictated immediately following that, which was not the official exchange of correspondence, but I would say I personally have no recollection of what Mr. Pasco's understanding was. My memorandum indicates that when they were asked to reveal the names of their witnesses, they said that they would lead off with Mr. Strouse and second, they plan to use Mr. Caywood and the man from Gillis and Company; next, a man named Kelly; next, Mr. Tipton; next, Mr. Johnson; then Mr. Koncel and then Mr. Kiley, and then he said also present witnesses who will testify verbally, company witnesses who will testify verbally and at the close of the hearing on the tenth there will be an adjournment until the fourteenth.

Now, our note quite clearly indicates that—I certainly am not disputing Mr. Pasco's understanding and I would never do that, but one of the reasons for the pre-trial is that we had our ears open and we thought attuned to try to find out what the Railroad was going to put on today.

Chairman Catterall: Didn't you also agree that you would give them your exhibits as soon as possible before

page 27 } the next hearing?

Mr. Epps: Yes, Sir, yes, Sir.

Chairman Catterall: That was a preliminary hearing to narrow the issues.

Mr. Pasco: Judge Catterall, as his notes indicate, we clearly contemplated oral testimony today.

Chairman Catterall: Yes.

Mr. Pasco: And we never had any idea of ever putting any oral testimony on, except from witnesses we did not have a right to sit down and can it. We canned everything we could do with our witnesses. We would not bring our witnesses up here to testify orally and I am just as certain of it as I am standing here that I said that we may and probably will call one or two members of the Commission staff, because we had planned to do it from the outset and this is the basis on which we proceeded for the last two months and I would like the record to show that.

Mr. Epps: I understand that they were company witnesses.

Mr. Pasco: No, Sir.

Mr. Epps: I am certainly not disputing you.

page 28 } Mr. Pasco: The Commission staff—

Mr. Epps: I am telling you what my understanding was.

Mr. Pasco: There would be no point in bringing Company witnesses here to testify orally. Our undertaking was to put all of that in writing, which we have done.

Chairman Catterall: The point that Mr. Riely makes is that he doesn't know what it is all about, but we discussed it with him and you for hours.

Mr. Riely: We are trying to make a record, if your Honor please.

Chairman Catterall: Well, you are going to make a record. You are going to make a record.

Mr. Pasco: Our case is premised on what Mr. Younger will testify, as we understand from our conferences but without that testimony in the record, it does not make—

Commissioner Dillon: Let me ask you a question, Colonel, or Mr. Riely. What difference does it make whether his testimony goes in today or the fifteenth? You have your canned testimony here—you have already prepared it.

page 29 } You are certainly not going to change your canned testimony.

Mr. Riely: No, we are not going to change our canned testimony, your Honor, but the canned testimony becomes incomprehensible without the basis of what the Commission did.

Commissioner Dillon: We'll try to comprehend the canned testimony after we have heard him.

Mr. Riely: If I cannot have Mr. Younger testify orally, may I tender the ten exhibits which I prepared in this case?

Chairman Catterall: Yes, they will be received. We are going to receive everything you offer, of course.

Mr. Shannon: Excuse me, Mr. Riely, but in connection with this pre-trial conference, there was a further understanding that we had. I asked that the N&W furnish us with copies—

Mr. Riely: They are in the mail, Sir, all of those items.

Mr. Shannon: I got those this morning, Mr. Riely, but I did not get copies of the journal entries. I got a state-
page 30 } ment here which—

Mr. Riely: They were only—

Mr. Shannon:—I do not know what it purports to be, but it probably would have connection with the retirement of the portion of the main line in Campbell County and the City of Lynchburg. I got nothing involving a journal entry, insofar as the Blacksburg branch abandonment was concerned; I got nothing concerning the abandonment of the White Thorn Line in Giles County.

Mr. Riely: Let me answer your questions one at a time, because I forgot, Mr. Shannon. I am not smart enough to remember all of these things. I am told, as far as the main line in Campbell County is concerned, the journal entry is what you have. The Blacksburg branch abandonment has not been completed and the journal entries have not been made. What is the next one?

Mr. Shannon: The next one was the eleven point mile portion of the White Thorn Line in Giles County.

Mr. Riely: That has not been abandoned.

Mr. Shannon: Even though the Interstate Commerce Commission granted authority?

Mr. Riely: Yes.

Mr. Shannon: All right. Now, what about the
page 31 } copies of the annual reports to stockholders that he asked for.

Mr. Riely: They were mailed Friday.

Mr. Shannon: We have not received those yet.

Mr. Riely: Well, I am sorry that the United States mail—

Mr. Shannon: All right.

Mr. Riely: When I spoke, I thought I had, but I note for the record my exception to your Honor's ruling.

Chairman Catterall: No, you do not have to note an exception. You can appeal anything without objections and without exceptions.

Mr. Riely: Exhibit No. 1 is a statement of assessed values prepared by the Commission for the year 1968. Exhibit No. 2 is a statement of the assessed values prepared by the Commission for the year 1967.

Exhibit No. 3 is a copy of a letter signed by the Honorable

Berkley D. Adams, addressed to Mr. James T. Barron, dated November 9, 1927, and enclosing a copy of a letter dated September 17, 1927, from the Honorable Louis S. Epes to Mr. W. L. Stanley, Vice President of the Seaboard Airline Railway.

page 32 } Exhibit No. 4 is a copy of a letter dated October 3, 1967, addressed to Mr. M. J. Strouse, General Manager Property Taxes, Norfolk and Western Railway Company and signed Lee B. Younger, Director Public Utilities, Taxation Division.

Exhibit No. 5 is a letter addressed under date of January 9, 1968 to the State Corporation Commission, Attention the Honorable Ralph T. Catterall and which was in fact signed by Melvin J. Strouse and which follows to the Commission a copy of a letter and certain other material dated January 9, 1968 addressed to the Norfolk and Western from the accounting firm of Haskins and Sells.

Exhibit No. 6 is a letter dated February 6, 1968, signed by Lee B. Younger, Director of Public Utilities, Taxation Division, addressed to Mr. M. J. Strouse, General Manager Property Taxes, Norfolk and Western Railway Company, together with certain additional material enclosed therewith.

Exhibit No. 7 is a portion of the report of the Norfolk and Western Railway Company to the State Corporation Commission of Virginia for the year 1968.

page 33 } Exhibit No. 8 is a number of work sheets prepared by the Commission staff, thirty-five in number, on which the computations of the Norfolk and Western assessment for 1968 in the various taxing jurisdictions is prepared.

Exhibit No. 9 is a letter dated May 14, 1968, addressed to all railroad companies, signed by Lee B. Younger, Director, Public Utilities Taxation Division.

Exhibit No. 10 is a copy of a letter dated June 11, 1968, addressed to Mr. Lee B. Younger, Director, Public Utilities Taxation Division and which was in fact signed by E. L. Butler of the Norfolk and Western Railway Company.

Those are the ten exhibits, if your Honor please. Now, if your Honor please, in accordance with our agreement, I tender the prepared testimony and exhibits. The first copy has the manual signatures in it, and I suppose should be the record copy.

Chairman Catterall: That will be—if you are going to have a typewritten record—that will all have to be copied into the record.

page 34 } Mr. Riely: Yes, Sir, your Honor, we propose that.

Chairman Catterall: That will be treated as testimony of these witnesses whose names appear therein.

Mr. Riely: The related exhibits are numbered with the witnesses' initials in consecutive arabic numerals and I suggest that method of numbering the exhibits be preserved in order that the whole record may be clear.

Chairman Catterall: You mean that they do not begin with eleven?

Mr. Riely: No, they do not begin with eleven, your Honor.

Chairman Catterall: Well, how were we going to avoid confusion about that?

Mr. Riely: They have the witnesses' initials. There are forty exhibits for Mr. Caywood. The first one is numbered Exhibit No. 1 JAC. The second is numbered Exhibit No. 2 JAC.

Chairman Catterall: I guess we will have to do that in a case like this. They will be received according to page 35 } those numbers.

Mr. Riely: There are two more exhibits—two pages to go in the book.

Chairman Catterall: (To Reporter) You will have to number them just the way he has them there.

Identify the one that is going to be part of the record.

Mr. Pasco: That is the record. It is written on it (Indicating official record.)

Mr. Riely: There are two more exhibits and now if your Honors please, we will distribute copies to your Honors.

Chairman Catterall: They will be received.

As to the cross examination of these witnesses the defense counsel will notify you who they want here for cross examination.

Mr. Riely: Yes. I was in hopes that we would have some order in that so we would not have to have all the witnesses here at the same time.

Chairman Catterall: Right. And you can have pre-trial conferences between now and then.

Mr. Riely: I am a little afraid of pre-trial con-
page 36 } ferences, your Honor.

Chairman Catterall: You will agree in writing—

Mr. Shannon: Maybe Mr. Riely ought to come to the next pre-trial conference.

Mr. Riely: I wish you would have arranged it on the day when I could have been there.

I believe that is all we have.

Chairman Catterall: How about those little letters and things. Are you going to distribute those too?

Mr. Riely: Yes, I have them here.

Chairman Catterall: I think maybe you had better distribute those as well as these big ones. There might be some people here who would like to have them.

Mr. Riely: I propose to do that.

Chairman Catterall: You are going to do it after we recess?

Mr. Riely: Well, I thought we would do it after we adjourned.

Chairman Catterall: Is there anything more that we need to do today?

page 37 } Mr. Epps: I think—may it please the Commission—that I should make a statement as to those parties whom I actually represent. As you know, the defendants are the cities, counties and towns in which there are railroad properties, even though some of them are not served by the Norfolk and Western.

Chairman Catterall: They all have an interest in this case, because this is a test case.

Mr. Epps: But I must say, of course, there are some counties which are not served by railroads and I do not represent those. There are some cities whose—who are not participating and I will, with the Commission's permission, file a list of those cities and towns which I do represent so it will appear as to which of the defendants that I represent.

Chairman Catterall: In just this case or in all the cases?

Mr. Epps: Well, I am employed for this case, Sir.

Chairman Catterall: But the others are interested.

Mr. Epps: Yes, Sir, and they are named by—Mr. Riely has pointed out that they are named by the order bringing this case on as parties in interest and hence, I think, even

page 38 } though they are not named as defendants in the application and I have discussed this with these gentlemen and they have indicated that they thought a statement like this for the record, together with a list of the various localities, would suffice.

Chairman Catterall: Well, you must file that with the record.

Mr. Epps: I will file that with the record, if that is acceptable.

Mr. Riely: That is entirely acceptable.

Chairman Catterall: Head it "Notice of Appearance."

Mr. Epps: That, as of right now, is not complete. I will file it as quickly as I can and as it becomes complete, I will—

Mr. Carter: Add to it.

Mr. Epps:—add to it. Supplement the record.

Chairman Catterall: Right. Anything else?

Mr. Shannon: Your Honors, I think before we adjourn

or before we postpone this further hearing until April 15, I think we ought to have it definitely understood in the record that this is a test case and that the other
page 39 } fourteen odd applications that were filed by the railroads are being held in abeyance pending the decision in this case.

Mr. Pasco: The order so provides.

Mr. Shannon: I just wanted to put that in the record, so there would be no misunderstanding.

Mr. Riely: It is already in the record, in the order.

Mr. Pasco: You cannot get it any better than that.

Chairman Catterall: Well, that is understood and stipulated to, and there can be no misunderstanding about that.

Are there any other misunderstandings to clear up? If not, this case will be continued until April 15.

Mr. Shannon: April 15.

Chairman Catterall: At 10:00 A. M. I believe that entire week is set aside.

Mr. Pasco: Through Wednesday of the following week.

Chairman Catterall: Through Wednesday of the following week.

page 40 } Mr. Shannon: Yes, Sir, your Honor. We have April 15, 16, 17, 18, 21, 22 and 23 reserved for this case.

Chairman Catterall: Well, I hope we can finish the testimony, at least, during this period.

The Commission will now rise.

page 41 } COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

At Richmond, March 17, 1969

Application Of — Case No. 18629

Norfolk and Western Railway Company

For review and correction of the assessment for taxation of its property subject to local taxation for the year 1968 and for the right to recover from local authorities excess taxes paid.

On November 13, 1968, came the Norfolk and Western Railway Company, by counsel, and filed its application for review

and correction of the assessment for taxation of its property subject to local taxation for the year 1968 and for the right to recover from local authorities excess taxes paid, such application being verified by affidavit.

Investigation of the issues involved in this proceeding is now pending, a hearing having been held for presentation of the applicant's testimony on March 10, 1969, with a subsequent hearing to be held commencing on April 15, 1969 for presentation of all testimony in support of the Commission's assessment of applicant's property for *ad valorem* taxation and for cross-examination of such witnesses as may be requested to appear on said date, and

It Appearing, That for the Commission's staff and the intervening supporting parties representing numerous cities, towns and counties in the Commonwealth of Virginia properly to prepare testimony concerning the value and physical condition of applicant's roadway, track, signal and

page 42 } other properties in the Commonwealth of Virginia, it is necessary that representatives of both the Commission and the intervening cities, towns and counties be given access to such of applicant's track maps, track charts, valuation documents and other books and records pertaining to applicant's lines of railroad in Virginia as may be requested and be permitted to make a physical inspection of all or such portions of applicant's lines of railroad in Virginia as may be deemed necessary:

It Is Ordered, That Norfolk and Western Railway Company make available to the three representatives of the Commission and the intervening cities, towns and counties at its offices in Roanoke, Virginia on March 21, 1969 all track maps, track charts, valuation maps and such other documents pertaining to Norfolk and Western Railway Company's roadway, track, signals and other properties in the Commonwealth of Virginia as may be requested by all or any one of the Commission's and Intervenor's representatives.

It Is Further Ordered, That commencing on the morning of March 24, 1969 Norfolk and Western Railway Company permit said representatives to inspect all or such portions of its lines of railroad in Virginia, including its signal and communication properties, as in their judgment shall be deemed necessary, and make available to said representatives on March 24, 1969 for such time as may be re-

page 43 } quired to complete said inspection a Hy-rail car together with driver and such operating personnel as is necessary to accompany the Commission's representatives in inspecting the applicant's lines of railroad in Virginia.

It Is Further Ordered, That attested copies of this Order be mailed to each counsel of record in this proceeding.

A True Copy

Teste: William C. Young
Clerk of State Corporation Commission.

page 44 } April 15, 1969

10:00 A. M.

The Commission resumes the hearing in Case No. 18629.

Chairman Catterall: I am sorry to announce that Judge Dillon had to go to the hospital for a major operation, so he will not be able to sit in this case.

Mr. Riely: May it please the Commission, I should like to tender at this time a small amount of additional testimony by the witness Russell D. Tipton and one exhibit. This testimony was prepared last evening and most of it this morning, and I am sorry it has not been available until today; and I placed the copies on the Commission's desk.

Chairman Catterall: This will be treated as if read into the record, and when it comes to making up this enormous record, the Reporter will not copy these into the record; but these documents will be treated as the record. The only thing that the Reporter will type will be the cross ex-
page 45 } amination.

Mr. Riely: That is going to be an interesting problem in pagination, your Honor.

Chairman Catterall: The pagination will be done with a rubber stamp, the kind that moves one, two, three, four—and that will be put on the bottom of the pages, so that you can refer to them.

Mr. Riely: Perhaps the Reporter and I should have some conferences, so that we can, all of us get a record that looks alike.

Chairman Catterall: You will all get exactly the same record. Well, you can bring in your copy of the record and it can be paginated with this rubber machine.

Mr. Riely: I feel sure we can work this out.

Chairman Catterall: We tried to get a team of reporters for this, but we could not get them. I mean Colonel Pasco tried.

Mr. Riely: We made some effort in this.

Chairman Catterall: This is quite a job. We would like to have the record out before Christmas.

Mr. Riely: I would hope so. Otherwise, these cases will pile up forever.

page 46 } If it please the Commission, I should like again to renew my request at this time that we be permitted to call Mr. Younger to the stand.

Mr. Shannon: And I will renew my objection, Sir.

Your Honors, I have one or two preliminary matters that I would like to put before the Commission before we get on with our cross examination.

In accordance with the understanding that we reached with Counsel for the Applicants at our prehearing conference on February 7 and subsequently thereto as covered in my letter of February 26 to Mr. Pasco, we have prepared the Commission's witnesses' case and testimony in canned form, which has been distributed to all counsel this morning. I will have three witnesses who will testify in behalf of the Commission, and I believe the cities and towns, Mr. Epps will cover their testimony that they propose to present.

I would like at this time to ask the Commission if it could take official notice of the Annual Reports of the Norfolk and Western Railway Company that have been filed with this Commission for each year ending December 31,

page 47 } 1926, through the latest period.

Chairman Catterall: We do that automatically because they are available to everybody.

Mr. Shannon: Well, it would be voluminous to send all of those up to the Court of Appeals, and I would like further to ask permission that any pertinent parts of those reports that we would be able to photostat it and put it in the record as if we had submitted it here.

Chairman Catterall: They alone will be included in the record—

Mr. Shannon: That is correct, Sir.

Chairman Catterall:—numbered as an exhibit and both sides will pick out whatever they desire.

Mr. Shannon: The next preliminary matter I would like to offer at this time as exhibits copies of the Norfolk and Western's 1967, 1966, 1965, 1964, and 1963 Annual Reports. I do not have sufficient copies to distribute to everyone.

Mr. Riely: I think we could find copies if we looked hard enough.

page 48 } Chairman Catterall: The question of numbering these exhibits had better be considered at some length at the moment.

Mr. Shannon: Well, your Honors, we have—

Chairman Catterall: Each of the canned testimony people

have referred to their own exhibits with blanks, as I understand it.

Mr. Riely: No, your Honor, I think we have done it in ours with Exhibit No. 1 with the initials of the witness.

Chairman Catterall: Oh, I see, yes. "Counsel introduces Exhibit No. 2-RDT."

Mr. Riely: That is right.

Chairman Catterall: So, in this case we will not number exhibits one, two, and three except those that are offered now. What is the last exhibit?

Bailiff: The next exhibit, Sir, will be eleven.

Chairman Catterall: All right. These that have just been handed in will be received as Exhibit Nos. 11, 12, 13, 14, 15, 16 and so on; and all of the exhibits referred to
page 49 } in the canned testimony will be referred to as they are referred to in the canned testimony.

Mr. Shannon: Your Honors, in our canned testimony as far as the Commission's witnesses are concerned, we have identified each exhibit by symbol. For instance, Mr. Younger's testimony bears the symbol LBY-ABC or maybe a number, so that it can be readily identified.

Chairman Catterall: They will be so identified in the testimony and in the record.

Mr. Shannon: That is correct, Sir.

Mr. Riely: That is entirely agreeable.

Mr. Shannon: Your Honor, I have a preliminary statement I would like to make, but I would defer making it until such time as our witnesses are presented for cross examination.

I think in the keeping with the logical order of the proceeding, if Mr. Riely agrees, the purpose of our hearing today and the balance of this week or as long as it requires to cross examine Applicant's witnesses; and when we conclude that, then I will make a statement as to what our case
page 50 } is, what the Commission's case is.

Chairman Catterall: That is a good idea because then it will be easier to remember what you say.

Mr. Riely: I judge the Commission will put on its case before the Interveners.

Chairman Catterall: No, we are going to cross examine the—

Mr. Riely: Cross examine the Applicant's witnesses?

Chairman Catterall:—Applicant's witnesses first.

Mr. Riely: And then who will come next?

Mr. Shannon: The Commission will go first.

Mr. Riely: All right, the Commission will go first.

Mr. Shannon: Mr. Younger will be the third witness. We have two preliminary witnesses, and then Mr. Younger will be

the third witness; and then I assume that the Interveners will put in their testimony.

Chairman Catterall: That will be proper procedure.

Mr. Riely: Mr. Strouse, will you come around, page 51 } please.

Mr. Epps: Before Mr. Strouse comes around for cross examination, may I make a statement.

Mr. Riely: Please. I beg your pardon.

Mr. Epps: Counsel for the counties, cities and towns has prepared in canned form as stipulated and ordered at the pre-trial conference the testimony of our five witnesses, Messrs. Howland, McCarthy, Priest, Foster, and Dunn. Copies of the canned testimony have been presented to Counsel beginning last week with Mr. Priest and Mr. Foster, last week and Monday or midday Monday, Dunn; and we have given copies to Counsel as they have become available.

We have filed with the Reporter the copies and we have copies for the Court, and I would think that the Court would like their copies when we come to our case; but if the Court would like to have the copies now, they are available. What does the—

Chairman Catterall: Keep them until they get ready.

Mr. Epps: I thought that was what the Court page 52 } would like.

One word to Counsel, we had some typographical changes, not of substance, which came into Mr. Priest's testimony about five o'clock yesterday afternoon. We labored and got those done, but, of course, we could not get them to you folks because they were not finished until ten-thirty.

Mr. Riely: They are in the books?

Mr. Epps: They are in the books, but I caution you if you use Counsel's copy, they won't be identical; but there is no change in substance.

Mr. Riely: Right.

Mr. Epps: Thank you, Sir.

Mr. Riely: Now, Mr. Strouse.

Chairman Catterall: Mr. Strouse.

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* * * * *

TESTIMONY OF MELVIN J. STROUSE ON DIRECT EXAMINATION

Q. Please state your name and address.

Melvin J. Strouse

A. Melvin J. Strouse. My address is Roanoke, Virginia.

Q. Please state the name of your employer and your title in your present position.

A. I am Director—State and Local Taxes for the Norfolk and Western Railway Company.

Q. Please describe your educational background, your professional qualifications, and your working experience.

A. I am a 1951 graduate of Adelbert College of Case Western Reserve University with a Bachelor of Arts Degree and a 1954 graduate of the School of Law of that

page 54 } University with a degree of Juris Doctor. I am a member of the Bars of Ohio, the United States Supreme Court, and the Federal District Court for the Northeastern District of Ohio. During the years 1955 and 1956, I served as a Legal Officer in the United States Air Force. In 1957 I became an Attorney for The New York, Chicago and St. Louis Railroad Company. In 1962 I became Land and Tax Attorney for that Company. On October 16, 1964 that Company was merged into the Norfolk and Western Railway Company, at which time I was appointed Manager Property Taxes and Real Estate of the Lake Region of the Norfolk and Western. Subsequently, I was appointed System Manager Property Taxes, General Manager Property Taxes, and finally to my present position as Director-State and Local Taxes.

Q. During your years with the railroads, Mr. Strouse, what have been your duties and responsibilities relating to *ad valorem* taxes?

A. Since 1962 I have been responsible for *ad valorem* tax matters in the various states in which the companies operate. At present, the Norfolk and Western operates in 14 states and Ontario.

page 55 } Q. Then you have been in charge of the preparation and filing of the Norfolk and Western's Annual Tax Report of Railroad Companies to the State Corporation Commission of Virginia?

A. Yes, beginning with that for the year 1966.

Q. In your present capacity, Mr. Strouse, have you familiarized yourself with the Norfolk and Western's Virginia Reports for past years, as well as those for the years for which you were responsible?

A. Yes, I have.

Q. Have you determined for what years prior to 1968 the State Corporation Commission has followed a consistent practice in the valuation of the tracks of the Norfolk and Western?

Melvin J. Strouse

A. Yes. The Commission followed a consistent valuation practice from 1926 through 1967.

Q. Can you describe the method of assessment which was established in 1926?

A. It is not clear to me how the 1926 values, which were used until 1968, were determined. In a letter from Judge Epes of the Commission to Mr. W. L. Stanley of the Seaboard Airline Railway Company dated September 17, 1927, which has been introduced as an exhibit through Mr. page 56 } Younger, Commissioner Epes stated that in fixing these values, the Commission "used as one of the facts indicative of the actual value of these properties and as a check upon the maximum limit thereof the estimated cost of reproduction new of these properties less depreciation as ascertained by the Engineering Section of the Bureau of Valuation of the Interstate Commerce Commission."

Commissioner Epes further stated that the Commission had taken the estimates of the Engineering Section of the Bureau of Valuation (as of June 30, 1916 for the Norfolk and Western) and added thereto a composite percentage of 30% to cover net increase in value of the property inventoried due to increased cost of labor and material, "after allowing for depreciation accrued since valuation date not counter-balanced by the actual maintenance, repairs and replacements applied by the railroad company, charged to operating expense." To these ICC estimates increased by 30%, the Commission added the cost of additions and betterments charged to capital since the valuation date (1915-1918 as fixed by the ICC) less a 20% allowance for depreciation. Commissioner Epes concluded by stating that, after making estimates according to this method, these estimates page 57 } were used as a maximum limit but that the Commission "has not accepted such estimates as value and has used all sources of information available to it in deducing the actual values assigned to these properties."

Q. What did the Commission do with respect to the Norfolk and Western's track values?

A. The Commission then established various values per mile for the different categories of track, such as main line, branch line, single track, double track, yard track, and so forth, for the year 1926.

Q. Have you reviewed the Norfolk and Western's Assessment for the years 1926 through 1967?

Melvin J. Strouse

A. Yes, I have.

Q. Did the track values remain constant for those years?

A. Yes, the did. They were substantially the same for each of the years 1926 through 1967. There was no significant change at all in the important category of single main line trackage. In the other categories there were relatively minor changes which were of no real overall significance.

page 58 } Q. Was the same method used in each of those years for determining the full value of the Norfolk and Western tracks?

A. Yes, it was.

Q. Was a new method adopted in 1968?

A. It certainly was.

Q. Did you receive a letter from the Commission dated October 3, 1967, asking that a representative of the Norfolk and Western meet at the office of the Commission on October 18, 1967, with regard to the 1968 assessment of track values?

A. Yes, I did.

Q. Has a copy of that letter been introduced as an exhibit through Mr. Younger?

A. Yes, it has.

Q. Did you attent that meeting of October 18, 1967?

A. Yes, I did.

Q. At that meeting were you requested to supply any information to the Commission?

A. Yes.

Q. What information was requested?

page 59 } A. I was asked to supply the Commission with the actual cost of the Norfolk and Western's trackage in place in Virginia as of the end of 1966.

Q. Did you supply that information?

A. Yes. I wrote a letter dated January 9, 1968, supplying to the best of my ability the information requested by the Commission.

Q. Has that letter been introduced through Mr. Younger?

A. Yes, it has.

Q. What happened next?

A. I received a letter from Mr. Younger dated February 6, 1968.

Q. Has that letter been introduced through Mr. Younger as an exhibit in this case?

A. Yes, it has.

Q. What was the purpose of this letter?

A. It specified values for the various categories of trackage and requested the Norfolk and Western to use these

values in its report to the State Corporation Commission for 1968.

Q. Was there similar correspondence between the Commission and other railroads?

page 60 } A. Yes, although most of the railroads, as I understand it, did not submit original cost figures for trackage.

Q. Did you file the Norfolk and Western's 1968 Return in compliance with Mr. Younger's request?

A. No.

Q. Why not?

A. I did not feel that the values set forth in Mr. Younger's letter represented the fair market value of the property as called for by the laws of Virginia. Railroad property in Virginia is to be assessed at its fair market value exclusive of any franchise value. It was my conclusion that depreciated cost, as used by the State Corporation Commission, was not a proper method for determining the fair market value of railroad tracks and that, even if it were proper, the depreciation allowed should have been at least 50% rather than 20% as allowed by the Commission.

Q. What was the basis for the figures used in submitting the Norfolk and Western report?

A. The figures which I submitted were based on an appraisal which we had made by Mr. William E. Kelly, an Account Executive with Luria Bros. & Co., Inc., a corporation engaged in the business of buying and selling rail-

page 61 } road used track materials. Mr. Kelly is thoroughly familiar with the current market values of railroad used track materials and was able to tell us how much we could sell our Virginia tracks for exclusive of any franchise value. Mr. Kelly's appraisal was made very hastily in order to meet the filing deadline for our report to the Commission; and it has since been supplemented by a thorough and exhaustive appraisal by DeLeuw, Cather and Associates, a firm of consulting engineers.

Q. Will Mr. Kelly testify in this case?

A. Yes, Mr. Kelly will testify in this case and will submit the appraisal prepared by him which was the basis for the report made by the Company to the Commission for 1968.

Q. Mr. Strouse, do you know on what basis the other railroads reported their trackage figures to the Commission in 1968?

A. I have been advised that the other railroads based their returns on the Kelly appraisal.

Melvin J. Strouse

Q. The 1968 assessment made by the Commission was not based on the figures for track valuation shown in your report, was it?

A. No. The assessment was based on the figures contained in Mr. Younger's letter to the Norfolk and West-

page 62 } ern dated February 6, 1968.

Q. How did the assessment figures for 1968 relate to the 1967 assessment for similar items?

A. We determined that, before the application of §58-512.1 of the Code, the 1968 assessment was based on full values approximately 55% higher than the 1967 full values.

Q. Did you receive a letter from the State Corporation Commission dated May 14, 1968, relating to the signal equipment?

A. Yes, I did.

Q. Has that letter been introduced as an exhibit through Mr. Younger?

A. Yes, it has.

Q. Did the Norfolk and Western reply to that letter?

A. Yes, it replied to that letter by a letter dated June 11, 1968, which was signed by Mr. E. L. Butler, my assistant director. A copy of the June 11 letter has also been introduced through Mr. Younger.

Q. In the June 11 letter, did the Company give to the Commission its best estimate of the actual cost of the Norfolk and Western signal, interlocker and car retarder equipment?

A. Yes it did.

page 63 } Q. Did the Company's report to the Commission as to the value of this equipment use as a basis the information contained in the letter to the Commission of June 11, 1968?

A. Yes. The report valued this equipment at approximately 50% of actual cost after excluding the cost of crossing signals designed for public protection.

Q. Was this in accordance with the practice in prior years?

A. Yes, it was. We made no change in our procedure in reporting.

Q. Did the Commission assess this equipment on the basis of your report?

A. No, it did not. The full value used in making the assessment was 80% of original cost including the investment in public crossing signals. This method of assessment was in sharp contrast to the method previously used by the Commission.

Q. What happened after you received the assessment?

Melvin J. Strouse

A. All of the taxes paid to the various Virginia localities by the Norfolk and Western for the year 1968 were paid under protest. Within the time permitted by the statute, this proceeding was instituted.

page 64 } Q. Thank you, Mr. Strouse.

A. Thank you.

page 65 } I hereby certify that the answers given to the foregoing questions are true and correct to the best of my knowledge and belief.

Melvin J. Strouse

Subscribed and sworn to before me this 8th day of March, 1969.

R. T. Anderson

Notary Public

My commission expires:
November 3, 1969.

page 66 } Chairman Catterall: Are you going to cross examine Mr. Strouse?

Mr. Shannon: Yes, I would like to.

Mr. Riely: Mr. Strouse is submitted for cross examination.

page 67 } CROSS EXAMINATION

By Mr. Shannon:

Q. You are the same Mr. Melvin J. Strouse that submitted this verified statement in this proceeding on March 15, are you not?

A. I am not sure of the date, but it is my statement. I thought it was March 10.

Q. March 10, that is correct.

Mr. Strouse, in your statement on your direct testimony you state that since 1962 you have been responsible for the *ad valorem* tax matters in various states in which the Company has operated. Would you please explain what you mean by responsible for *ad valorem* tax matters?

A. In 1962, I was working for the Nickel Plate Railroad, and I had the responsibility for preparation of *ad valorem* tax reports and paying of *ad valorem* taxes and negotiation of the assessments on the property.

Mr. Riely: Mr. Strouse, if you will face the Commission, I believe the Commission could hear you better.

Melvin J. Strouse

A. All right, Sir.

In 1964, the Nickel Plate Railroad was merged into the Norfolk and Western Railway. I was then assigned the responsibility for *ad valorem* tax matters on the Lake Region of the Norfolk and Western Railway Company. In

page 68 } 1965, I was transferred to Roanoke, Virginia, and placed in charge of *ad valorem* tax matters and certain other state and local tax matters on the entire Norfolk and Western Railway System.

My duties were similar to those I had on the Nickel Plate.

Mr. Shannon:

Q. Well, do you supervise the preparation and filing of the tax reports which are filed with the various states in which the N&W operates?

A. Yes, Sir.

Q. Are your duties confined solely to tax matters, Mr. Strouse?

A. Yes, Sir.

Q. Was the Petition filed with this Commission in November of 1968 for a review and correction of the assessment, was that filed on your recommendation?

A. Yes, Sir, it was.

Q. Now, of the fourteen states in the United States in which Norfolk and Western operates, which states assess Norfolk and Western's property, their roadway and track property on the basis of scrap value?

page 69 } A. None that I know of.

Q. Mr. Strouse, Norfolk and Western is not planning to liquidate and go out of business, is it?

A. Not that I know of.

Q. Isn't the Norfolk and Western a very strong railroad financially?

A. Norfolk and Western is managing to make a profit each year.

Q. Do you have any idea what the net earnings were last year, 1967?

A. Not without looking at the income statement for the year.

Q. All right, Sir. I hand you a copy of this; that is the "1967 Annual Report to Stockholders" that I handed to Mr. Strouse.

A. I have the income statement. What figure do you want?

Q. The net income in 1967.

Melvin J. Strouse

A. The net income shown here is seventy-two million six hundred seven thousand three dollars for 1967.

Q. In fact, Mr. Strouse, the Norfolk and Western is pushing rapidly toward a merger with the Chesapeake and page 70 } Ohio, isn't it?

A. Yes, Sir.

Q. I believe you stated in your verified testimony that you have been in charge of the preparation and filing of N&W's Annual Tax Reports to the State Corporation Commission. You mentioned the year 1966, is that correct?

A. That is correct.

Q. When you say in charge of the preparation and filing of the Tax Reports, what do you mean? What does that entail?

A. The report is prepared information assembled by people who work for me in the Taxation and Real Estate Department in the Norfolk and Western Railway Company.

Q. Then you review the final report before it is sworn to and filed with the Commission?

A. Generally, yes, not in complete detail.

Q. Who verifies that report or subscribes on the oath section of the report, what officer?

A. Normally, that is done by the Vice President of Taxation and Real Estate.

Q. Now, have you examined the various tax reports filed with this Commission by the N&W each page 71 } year from 1926 through 1967?

A. I have looked at all of them. I believe I was not able to find the tax report for one or two earlier years; but with those exceptions, I have looked at the tax reports filed since 1926 to date.

Q. Isn't it a fact then that those reports that you examined for each of the years, 1926 through 1967, that the N&W filed sworn tax reports each year with this Commission?

A. I believe that is correct. I was not looking for that specifically.

Q. Now, you testified that for the years prior to 1968 the State Corporation Commission followed a consistent practice in the evaluation of the tracks of N&W. Would you please explain what you mean by "consistent practice"?

A. In 1926, certain values per mile were established for the various categories of track of the Norfolk and Western Railway Company; and with certain minor changes, these same values were used through 1967.

Q. Well, then, do I understand, Mr. Strouse, that

page 72 } the per mile track values of the Norfolk and Western's line in Virginia remained generally unchanged during the period 1926 through 1967?

A. That is correct.

Q. Now, isn't it a fact, Mr. Strouse, that during the period 1926 to 1967 costs have generally increased?

A. That is my understanding.

Q. Don't you know from your own experience?

A. My costs have increased.

Q. Yes, Sir. Isn't it a fact that costs of material, such as ties, rails, track materials and ballast have increased since 1926 or during the period we are talking about—1926 to 1967?

A. I understand that is a correct statement.

Q. And isn't it a fact that maintenance and operating costs similarly have increased during this period?

A. I do not know, Mr. Shannon. I know that we have certain economics in maintaining our track and I would suspect that the number of man hours required to do maintenance jobs are less now than they were forty years ago.

Q. Do you know anything about freight rates?

A. No, I do not.

page 73 } Q. But you do know that before freight rates are increased, they have to—the railway or railroad company has to obtain permission from the Interstate Commerce Commission to increase interstate rates and from this Commission to increase intrastate rates, isn't that right?

A. That is my understanding.

Q. Have you ever prepared or anyone under your supervision prepared statistics or developed information for use in a general freight rate increase case?

A. Not that I know of.

Q. Isn't it a fact, Mr. Strouse, that both this Commission and the Interstate Commerce Commission have granted the Virginia railroads I'll say at least a dozen general freight rate increases since 1946?

A. I do not know how many were granted.

Q. But you know there were some granted.

A. Yes, Sir.

Q. And wasn't part of the justification for those freight rates which was presented to this Commission as well as to the Interstate Commerce Commission the increased costs the railroads incurred for wages and materials?

A. I have no way of knowing what was pre-

page 74 } sented to the Commission in the justification of this rate increase.

Q. But you do know they have to justify these rate increases?

A. I assume they did.

Q. Have wages and salaries increased during the period 1926 through 1967?

A. Yes, they have.

Q. And from time to time isn't the railroad called upon as a consequence of its contracts with the various brotherhoods to pay periodic cost of living increases?

A. Yes.

Q. And of course similarly the official family—they get corresponding increases, too, is that correct?

A. Usually.

Q. Which ups your total cost of operating?

A. That is correct.

Q. Do you have any idea, Mr. Strouse, what the percentage increase in cost in 1967 was, over 1926?

A. Cost of what?

Q. The cost of materials, cost of wages, the cost index generally.

A. No, the only indicator I would have would page 75 } be the price indices put out by the ICC, which we used in preparing certain testimony in this case.

Q. Do you have that available?

A. Yes, I do.

Q. But without—I won't make you refer to it specifically. It is a recognized fact, is it not, that costs have gone up?

A. Yes.

Q. All right, Sir. Now, Mr. Strouse in your direct testimony you selected certain quotations from Judge Epes' September 17, 1927 letter, I believe, to Mr. W. L. Stanley, who was then vice president of what was then the Seaboard Airline Railroad, didn't you?

A. Yes, I did.

Q. Then I take it that you are familiar with the entire content of Judge Epes' letter, are you not?

A. I have read the entire letter several times.

Q. Isn't it a fact that according to Judge Epes' letter, the State Corporation Commission relied to a great extent on the evaluation of railroads operating in Virginia made by the Engineering Section of the Interstate Commerce Commission, Bureau of Evaluation?

page 76 } A. I have not been able to determine exactly

how these values were determined in 1926, but I would gather from Judge Epes' letter that these cost figures, this original engineering inventory, were given substantial consideration in coming up with the values.

Q. You mean the inventory made by the ICC's Bureau of Valuation?

A. That is correct.

Q. Now, isn't it also a fact—do you have Judge Epes' letter?

A. I believe so.

Q. It might help a little bit if you would get it out and have it before you, here, in referring to it. Isn't it also a fact that on page four of Judge Epes' letter the State Corporation Commission, as it was composed at that time, recognized that estimates of reproduction costs new and reproduction new costs, less depreciation, made by the Engineering Section of the ICC's Bureau of Valuation were based on normal prewar prices of labor and material as of June 30, 1914. I refer you specifically to paragraph eight, there, right at the top of the page.

A. Thank you.

page 77 } Note: Witness reading above referred to letter.

A. He seems to say the same thing you just said.

Q. All right, Sir. Now, continue on page four, paragraph eight of Judge Epes' letter, which I believe has been identified in this record as Exhibit No. 3. Didn't Judge Epes also recognize that in 1927 the prices of labor and material, to use his words, "were much higher" than prices in 1914?

A. Yes, he said that.

Q. And for that reason, didn't Judge Epes state that the Commission added thereto a composite percentage of thirty per cent to care for the net increase in value of the property inventoried which came about as a result of the increased cost of labor and materials in the ensuing years?

A. He says that he did that after allowing for depreciation accrued since the evaluation.

Q. In other words, he did that to bring the 1926 evaluation up to the present level wages and price costs.

A. That is my understanding.

page 78 } Q. Didn't Judge Epes further state that this thirty per cent took into account the depreciation accrued since the evaluation date, not counter bal-

anced by the actual maintenance repairs and replacements applied by the railroads charged to operating expenses?

A. That is what he said.

Q. So he did take into account the fact that railroads at that time were maintaining their lines and the money spent into that maintenance was a factor that he considered, was it not?

A. I would gather from his language that he considered maintenance, repairs and replacements. I have not seen any calculations made under this letter and I really have no idea.

Q. But you take it at face value, what he said in there, is that correct?

A. Well, I have no reason to disbelieve what Judge Epes put in his letter and the letter pretty much speaks for itself to the extent that I can understand it. I cannot say what Judge Epes had in mind when he wrote this or exactly what he did. All I know is what the letter says.

Q. But you did introduce this into the record, did you not?

A. Yes, I did.

page 79 } Q. Now, this thirty per cent about which we are talking was added then to allow for the net increase in the value of property inventoried since—what year was it, do you recall what year?

Mr. Riely: If it please the Commission—

Mr. Shannon: 1914. I believe.

Mr. Riely: —I have no objection to this cross examination, but the witness and the Counsel are merely reading the letter back and forth to each other and the letter speaks for itself.

Mr. Shannon: Yes, Your Honors, I am just—he put the letter in. I wanted to test his knowledge about it and I am leading up to a point, here.

Mr. Riely: Mr. Strouse did not put the letter in. The letter was put in as one of the ten exhibits that I suggested would be put in when I examined Mr. Younger. I have no objection to this examination, except it seems to me it is a waste of time.

Mr. Shannon: Your Honors, Mr. Strouse, in his direct testimony, goes into Judge Epes' letter in right considerable detail.

page 80 } Chairman Catterall: I think this is all right.

Mr. Shannon:

Q. Then the thirty per cent that Judge Epes took into ac-

count to allow for net increase in the value of property since 1914, I believe he said in the letter, that would cover a period of about twelve years, would it not? 1914 to 1926, approximately?

A. Yes.

Q. And if my mathematics are correct, that would be about two and a half per cent a year, would it not?

A. Approximately.

Q. Then, applying two and a half per cent for each year, 1926 to 1968, you would arrive at a composite percentage of around one hundred five per cent to care for net increase in value since 1926 to date, would you not?

A. If you multiply two and a half per cent times the number of years which has elapsed since 1926, you will come up with about one hundred five, yes, Sir.

Q. Yes. Mr. Strouse, let's get a little more specific. Do you know what the Norfolk and Western average cost of a tie was, say, in 1928?

A. No, I do not know.

page 81 } Q. Have you made any endeavor to find out or ascertain that information?

A. No, I have not.

Q. If I tell you that according to the Norfolk and Western's annual operating report for the year ended December 31, 1928, which I have here in front of me and which was filed with this Commission, and it states that the average cost per tie was one dollar and sixty cents, will you accept that figure?

A. I have no way of knowing whether that is the correct figure, or not. I have no reason to doubt that it is correct.

Q. All right.

A. I do not prepare the report you refer to and I have not seen the figures.

Q. Well, Mr. Strouse, I will refer you to the annual report of the Norfolk and Western to this Commission for the year ended December 31, 1928 and I am referring specifically to Schedule nine thirteen, which is entitled "Ties Laid in Replacement within the State," page nine hundred, and I refer you to the class of ties, the total number of ties applied, the average cost.

page 82 } Do you want to see this, Mr. Riely?

Mr. Riely: Yes, please.

Mr. Shannon: Gladly. I would like for you to.

Melvin J. Strouse

Mr. Shannon:

Q. Now the ties—they show two prices there. They show four hundred ninety-eight thousand, six hundred eighty-five ties put down, the average cost of which was one dollar and sixty-eight cents. Then there were fifty-eight thousand, four hundred twenty-six ties laid which were untreated, apparently the average cost of which was seventy-five cents. Now, if I were to tell you that the average was around one dollar and sixty cents, which is a weighted average, would you accept that?

A. I have no way of knowing what the figure was. You have shown me what purports to be the report to the State Corporation Commission of the Norfolk and Western Railway Company for the year ended December 31, 1928—

Q. Yes.

A. —And then on page nine hundred under cross ties, average cost per tie, Column C, first line, which is identified as "T" shows four hundred ninety-eight thousand, six hundred eighty-five the total number of ties applied,
page 83 } the average cost per tie, one dollar and sixty-eight cents. The next line, identified as "U", shows fifty-eight thousand, four hundred twenty-six the total number of ties applied, which shows the average cost per tie as seventy-five cents.

Mr. Shannon: So you get a weighted average of around a dollar and sixty-cents?

A. I do not know.

Q. All right. Well, it would be something less than a dollar and sixty-eight cents, which was the highest price of ties they put in.

A. Yes.

Q. All right. Do you know what the Norfolk and Western's average cost per tie put in its railroad in 1968 or 1967 was?

A. No, I do not.

Q. If I tell you that according to the Norfolk and Western's annual operating report for the year ended December 31, 1967 the railway company was paying an average price of five dollars and eleven cents for cross ties, would you accept that figure?

A. I have no basis for accepting or rejecting it. I just do not know.

page 84 } Q. All right. Let me show you again. Let me refer you, Mr. Riely, (Mr. Riely crosses Courtroom

to look over witness' shoulder,) to the annual report of the Norfolk and Western Railway Company to the State Corporation Commission for the year ended December 31, 1967, and I am referring specifically to Schedule five thirteen on page five hundred four and the title of this schedule is "Ties Laid in Replacement" and they show—would you read those figures right there? (indicating) You may look at it. It is a sworn report.

A. I am looking at what purports to be an annual report of the Norfolk and Western Railway Company to the State Corporation Commission, Commonwealth of Virginia, for the year ended December 31, 1967.

Chairman Catterall: Why do you say that it "purports to be?"

Mr. Shannon: I was going to ask him about that. Look back here at the—

A. I have never seen this report before and I assume that it is the report.

Chairman Catterall: It is the report. I take it this cross examination is to show the amount of study that this witness made in filing the evaluation report, isn't that

page 85 } right?

Mr. Shannon: That is part of it, your Honor. Yes, Sir.

Chairman Catterall: Of course he professes a great deal of ignorance and I don't know whether you are trying to prove ignorance or knowledge.

Mr. Riely: I don't know what he is trying to prove, either, your Honor.

Chairman Catterall: Go right ahead. We will find out.

A. On Page five hundred four, Schedule five thirteen, line one, shows "Class of Ties, T" total number of ties applied, three hundred seventy-eight thousand, eight hundred seventy-six; average cost per tie, five dollars and fourteen cents. Next line again identified as "Class of Ties, T" total number of ties applied two thousand two hundred thirty-four; average cost per tie, seventy cents.

Q. So then the average cost of ties would be something less than five dollars and fourteen cents, would it not, laid in 1967?

A. Yes.

Q. Now, comparing the figures I have just given

page 86 } you, that would show an increase of about three

times 1967 over 1926 for cross ties. In other words, let me state it this way: cross ties put in the railroad in 1926 as compared with cross ties put in the railroad in 1967—the 1967 ties cost approximately three times as much as the 1926 ties.

A. According to those figures you have just shown me.

Q. Yes. Now, let's repeat the same procedure for ascertaining the cost of rail laid in the Norfolk and Western's running tracks in 1926, as compared with the average cost per ton of rail laid in its running tracks in 1967. Again, if I show you the annual report—

Chairman Catterall: I believe Counsel could agree on these figures, because the witness says he knows nothing about them.

Mr. Shannon: All right. If Mr. Riely will agree, I will go on to something else.

Mr. Riely: The only thing I agree to is you said you wanted to put in excerpts of the annual reports and that was agreed to.

Chairman Catterall: I believe the witness, in making his evaluation, has not studied the figures you are
page 87 } calling to his attention, is that right?

A. That is right.

Mr. Shannon: That is correct, your Honor.

Chairman Catterall: I believe that point is fully established.

Mr. Shannon: All right. I will proceed then.

Chairman Catterall: Am I correct in assuming you just took last year's figures every year and went ahead with that?

A. Your Honor, as I understand the procedure from 1926 through 1967 we used substantially the same values each year and changed them only when a member of the staff of the Commission instructed us to change them.

Chairman Catterall: I see. I think that is clear enough.

Mr. Shannon: All right, Sir. Your Honor, what I will do—I will refer to these pages that I was going to—I was going to ask him the same questions with respect to the increased cost per ton. The average cost increase per ton with respect to rails laid in the running tracks in 1926 as compared with the cost of the rail laid in the N&W's running
page 88 } tracks in 1967, there again it would show a substantial increase.

Melvin J. Strouse

Chairman Catterall: You can state for the record what it shows from those documents that were taken in.

Mr. Shannon: Those documents that I have and asked the witness, it showed in 1928 the average price per ton for running track was thirty-eight dollars and sixty-five cents and that it increased to a hundred seven dollars and seventy-four cents per ton average price, as of December 31, 1967.

Q. Now let us continue on your direct statement, Mr. Strouse. At the top of page five of your testimony, you again quote from Judge Epes' letter. You state there, so that the record will be clear, but the Commission "has not accepted such estimates as value and has used all sources of information available to it in deducing the actual values assigned to these properties." That is correct, isn't it?

A. Yes, it is.

Q. Didn't Judge Epes actually state that the Commission accepted reproduction cost new less depreciation as the figure which the actual value of the property

page 89 } should not exceed?

A. I believe that is correct. If you wish, I can find the exact language.

Q. I am sure the letter speaks for itself. I just wanted to —now, let me ask you this. Did Judge Epes specifically mention the Norfolk and Western Railway in his letter?

A. Not that I recall.

Q. Do you recall whether Judge Epes included anything in his evaluation for general overhead and interest during construction?

A. I do not recall.

Q. Now, on page five, continuing with your direct statement, you state that you reviewed the Norfolk and Western assessments for the years 1926 through 1967. Isn't it a fact that the so-called 1926 track values were reported by the N&W to this Commission in its annual sworn tax reports during each of the years 1927 through 1967?

A. Yes, with certain minor changes authorized by the Commission.

Q. But the fact of the matter was that those values that were set forth in there were contained in a sworn statement filed with this Commission, is that correct?

page 90 } A. That is correct.

Q. And isn't it a fact, Mr. Strouse, that the Norfolk and Western took no affirmative action to have this Commission review and correct the assessment for taxation

of its property, subject to local taxation during the forty-two year period, 1926 through 1968—to 1968?

A. I am personally familiar only with the period beginning about 1966.

Q. So you really don't have any knowledge about this, prior to 1966.

A. That is correct.

Q. That is the period that you were with the Nickel Plate, I believe.

A. Yes.

Q. Until the merger.

A. Yes, Sir.

Q. Now, let me ask you this, Mr. Strouse. Why, after forty-two years of reporting substantially the same values of Norfolk and Western's road and track structures in Virginia to this Commission, did you conclude that the values you have been reporting all these years were erroneous and the correct value of the property should be the net scrap or

page 91 } liquidating value.

A. Again, I cannot speak for the thinking or the policies prior to 1966, but the reason for the present changes was that for the year 1968 we were instructed by Mr. Younger at the State Corporation Commission to use values—track values—substantially higher than those that have been used. This meant a substantial increase in taxes paid. We then undertook to investigate what would be a proper value for those tracks. As a result of our investigation, we determined that the values suggested by Mr. Younger were too high and that in fact, the values we have been using for forty years were too high and we reduced them accordingly.

Q. You feel that the proper values of the track is scrap value?

A. Not the scrap value, Mr. Shannon, the salvage and liquidating value.

Q. And by salvage and liquidating value, what do you mean?

A. I mean the price at which, assuming we were no longer going to operate a railroad, we could sell these materials to somebody else.

page 92 } Q. And wouldn't that include the net cost after paying out the cost of your labor for removing the ties, the rails and the other track materials?

A. Yes, that is correct.

Q. Now, in coming to this conclusion, do you mean to state or to say that the Norfolk and Western's track, road and

track structures are poorly maintained and are not suitable for handling large and heavy equipment which is moving over the railroads in this modern age?

A. No, I did not mean that.

Q. Isn't it a fact that the Norfolk and Western is a well-maintained railroad?

A. I have nothing to do with the maintenance of the railroad and I have no way of knowing how a railroad is maintained.

Chairman Catterall: How does it compare with the Nickel Plate?

A. Again, your Honor, I have no way of comparing this. It is under the jurisdiction of the Engineering Department and they would be the ones to answer questions like this.

Chairman Catterall: Why is the Nickel Plate
page 93 } called the Nickel Plate?

A. Your Honor, no one seems to be quite sure. Some newspaper reporter, I believe, came up with that nickname when the thing was being built and it stuck.

Chairman Catterall: The nickname was because it was such an expensive road to build, wasn't it? They would call it the chromium plate now, if they called it the Nickel Plate then.

Mr. Shannon:

Q. Mr. Strouse, did anything happen between 1967 and 1968 to cause the Norfolk and Western Road and track structures in Virginia to depreciate from the ninety-one million, six hundred forty-four thousand, seven hundred ten dollars reported in 1967 to twenty-eight million, one hundred fifty-five thousand, six hundred sixty dollars full value reported in 1968?

A. It would be my opinion that the fair market value of our track in Virginia in 1968 was not substantially different from the fair market value in 1967 or 1966.

Q. Do you mean the fair market value reported in each of these sworn tax reports is substantially the same?
page 94 } A. Yes

Q. You do not know for a fact what these figures were?

A. The figures we reported for the purpose of 1968 were based upon studies we made, the figures reported for 1967 were values that—we were directed by the State Corporation Commission to include in the report.

Q. When were you directed by the State Corporation Commission to include these 1967 values?

Melvin J. Strouse

A. The values were established in 1926 and the understanding that the procedure—and the understanding with the Commission was that these values were to be used until some different values were authorized.

Q. And the Norfolk and Western used them for forty-two years?

A. Approximately.

Q. Mr. Strouse, do you report the fair market value of your track, your roadway property, in Illinois?

A. We report not as such, no, we report various statistics to the State which are used to determine a fair market value. We do not, by ourselves, determine the fair market value of the property.

page 95 } Q. Does Illinois appraise your property on the net salvage worth of ties, rails and other track materials?

A. No.

Q. In fact, they use the unit method, don't they?

A. That is correct.

Q. Then, it is a fact, is it not, Mr. Strouse, that the law in Illinois pertaining to the determination of fair market value of rail carriers, tracks, road property and structures is entirely different from that in Virginia.

A. I am not sure I know what you mean by entirely different.

Both states, I believe, provide for the determination of the fair market values of the property. Illinois does not have provision in its law, that I know of but from that fair market value you are to exclude franchise value.

Q. Does Illinois require you to report your track and road properties, including your cuts, fills, tunnels and excavations separately, as Virginia does?

A. Only to the extent that we do report our investments by accounts to the State of Illinois.

page 96 } Q. Do you report by the state book investments, say for Account One, Engineering; Account Two, Account Three, Grading? Do you report that separately?

A. Yes.

Q. Now, Mr. Strouse, on page eight of your direct testimony you state that the Norfolk and Western's 1968—that you did not file the Norfolk and Western 1968 tax returns with the Virginia Commission here, in compliance with Mr. Younger's request, since it was your conclusion that the depreciated cost as used by the Virginia Commission was not

a proper method for determining the fair market value of the railroad tracks and that even if it were, the depreciation allowed should have been at least fifty per cent. Did you make that statement? I paraphrased it.

A. Yes, I did.

Q. On what did you base your statement that the depreciation should be fifty per cent?

A. As a non-accountant, it seemed only logical to me that this type of asset with the number of years it had been in existence and maintenance practices, I assumed on the rail roads that fifty per cent would be approximately correct, but we consulted with accountants in the—experts in the company and specifically we retained the firm of Has-
page 97 } kins and Sells, Mr. Russell D. Tipton, who advised us on this matter.

Q. They are accountants, aren't they?

A. That is correct.

Q. They are not traffic and consulting engineers, they are Certified Public Accountants?

A. These people were accountants, yes.

Q. Did you conduct a physical inspection of the Norfolk and Western roadway and track properties in Virginia, you, personally?

A. Personally, no.

Q. Have you ever inspected N&W's roadway and track property in Virginia?

A. Only small segments of it.

Q. By small segments, what do you mean?

A. A few miles.

Q. Was that a personal observation from a Hy-rail car or from walking the track?

A. Both.

Q. Both.

Commissioner Hooker: What sections of the railroads were those two miles inspected?

A. I went along with representatives of De-
page 98 } Leuw, Cather and Associates, your Honor, and examined the short stretch of our railroad near Roanoke.

Commissioner Hooker: Near Roanoke City.

A. Yes, Sir.

Commissioner Hooker: Within the city?

A. No, Sir, it was outside the city. I cannot be more precise, I am sorry.

Commissioner Hooker: None of the two miles were within the city?

A. No, Sir, not that I recall.

Commissioner Hooker: All right.

Mr. Shannon:

Q. Have you ever had any experience in assessing property?

A. No, not that I recall.

Q. Then, it would follow that you have never made an assessment of railroad property, is that correct?

A. That is correct.

Q. So you rely completely on others for the fair cash values of the N&W's property?

A. No, that is not completely correct. It is my job to negotiate with assessors the value of our property and
page 99 } as such, I am familiar with the assessment practices that are used.

Q. But you do not—

A. I do not work for a taxing body and as such, have never placed an assessment on property.

Q. Your responsibility is merely to prepare the reports—the tax reports—that are filed with the several states, to supervise the preparation of them. You don't actually do the preparation yourself?

A. On occasion I prepare some parts myself. I supervise others or supervise people who do. That is a part of our duties.

Q. Now, on pages eight and nine of your testimony, you state that Mr. Kelly, I believe, an official of Luria Brothers and Company, Incorporated, a corporation engaged in the business of buying and selling used track materials, made an appraisal of Norfolk and Western's track property in Virginia, did you not?

A. That is correct.

Q. Then, let me ask you this, Mr. Strouse. Is the Norfolk and Western ready, willing and able to sell its tracks in Virginia to Luria Brothers, or to any other
page 100 } junk dealer?

A. Not that I know of. Not in total.

Q. Your testimony further advises, on page nine—on page nine you state that you have been advised that other railroads base their tax rates—I assume you mean fair value rates—their fair value rates on Mr. Kelly's appraisal, did you not?

Melvin J. Strouse

A. Where are you reading, Mr. Shannon?
Q. Page nine.
A. I don't see it on page nine.

Mr. Riely: I don't see it either, if it please the Commission.

Mr. Shannon:
Q. "I have been advised that when they base their returns, and I guess—"
A. What page are you on?
Q. Page nine. I will read you the question, so there won't be any mistake about it.

"Mr. Strouse, do you know on what basis the other rail roads reported their trackage figures to the Commission in 1968?"

page 101 } "A. I have been advised that the other rail roads base their returns on the Kelly appaisal."

Now, who gave you this advice?
A. After we had the Norfolk and Western—had determined the results of Mr. Kelly's appraisal of our property, we relayed that information to representatives of other railroads and told them, generally, the relationship of Mr. Kelly's appraisal to values we had been using and I told them generally the results that he came up with and I understood that in talking with various other railroad representatives, that they considered this in the value they determined in reporting to the Commission in 1968.
Q. Now, what other railroads used the Kelly figures specifically, can you name them?
A. I cannot be specific because I have not seen the reports, but I would suspect that it would be the overwhelming majority of those railroads that filed an application for review of their 1968 assessments in Virginia.
Q. Well, then, did Mr. Kelly make an appraisal of each of the railroads in Virginia to determine the net salvage value of the rails, tracks, ties, et cetera which were to be reported in the annual tax report for this Commission by those railroads?

page 102 } A. As far as I know, Mr. Kelly examined only our railroad in Virginia.

Q. And so the conclusions he reached with reference to the N&W were relied upon by other railroads, is that correct?
A. I understand that is correct.

Q. All right. Were you asked by Mr. Younger, the Director of the Commission's Public Utility Taxation Division, to furnish the original cost of the Norfolk and Western line of railroad now in place in Virginia?

A. Yes, at a meeting of all railroads, he requested, I believe, almost all railroad representatives to give him that figure.

Q. Did you furnish him that information?

A. Yes, I did.

Q. Did you include in the original cost figures initially furnished Mr. Younger, the value of grading which is identified under ICC primary account number three, that is the value of grading for Norfolk and Western's property in Virginia?

A. No, I did not.

Q. Why not?

page 103 } A. Mr. Younger had asked for the original cost of our tracks in Virginia and we did not consider this a part of the tracks. I was aware, too, that it had been a long-standing practice of this Commission to include the value of the grading to the extent that there is any along with the land values. It seemed to us that its very difficult to value grading apart from land, or land apart from grading, and we thought sure that the Commission did not want to assess us twice on the same value, and so we did not include this.

Q. Are you familiar with the ICC's uniform system of accounts for railroads, Mr. Strouse?

A. I have occasionally referred to it. I am thoroughly—I am not thoroughly familiar with it.

Q. Under the ICC's uniform system of accounts, under the primary property accounts, what is account two?

A. Land.

Q. Land. Land for transportation purposes, isn't it?

A. Yes, Sir.

Q. All right. Now, what is account three?

A. The name of the account is grading.

page 104 } Q. So the ICC recognizes the distinction between grading and land for transportation purposes, does it not?

A. For keeping books, yes.

Q. Isn't that the normal way you allocate your various expenses to property accounts, by keeping books under the system prescribed by the ICC?

A. Yes. We are required by the ICC to keep our books the way they prescribe.

Q. You don't have any latitude? You have to follow the ICC's accounting procedures?

A. That is correct.

Q. Were you subsequently asked to furnish the original cost of grading in Virginia?

A. Yes.

Q. Did you do so?

A. Yes.

Q. And what amount did you furnish Mr. Younger in your July 8 letter? What amount did you furnish for grading in that letter? I can save you some time. I hand you a letter which purports to be a letter from Mr. Melvin J. Strouse dated July 8, 1968 to Mr. Lee B. Younger.

page 105 } Mr. Riely: May I see it Mr. Shannon, please.
Mr. Shannon: You may, Mr. Riely. Gladly.
Mr. Riely: Thank you, Sir.

Note: Mr. Riely examines above mentioned letter and returns same to Mr. Shannon.

Mr. Shannon:

Q. What amount did you furnish Mr. Younger in your July 8, 1968 letter?

A. Forty-five million, eight hundred forty-three thousand, seven hundred dollars.

Q. All right. Was any cost for engineering included in that figure you have just given?

A. If you mean any of the—

Q. Account one—cost for engineering.

A. No, there was not.

Q. Now, Mr. Strouse, are you aware of the fact that Mr. H. J. Brinner, whom I believe is the controller of the Norfolk and Western, furnished Mr. Younger with a copy of Schedule Six Eleven, which has been identified in this record in the red book there (indicating) as Exhibit LBY-M showing Norfolk and Western's investment in grading in Virginia as of January 1, 1967 as forty-nine million, seven hundred eighty-
page 106 } three thousand, three hundred ninety-four dollars. Here it is. Do you have that before you?

A. That is for what year, Mr. Shannon?

Q. This is the balance sheet at the beginning of the year, 1967.

A. I do not have that paper in front of me—

Q. Well, here is—

A. I have one for the end of 1966.

Q. That is right. Now, wouldn't that be the same?

A. Not necessarily, Mr. Shannon. I do not believe these figures were—

Q. It will be one day's difference.

A. I believe these reports were sent in in normal chronological order, normal spacing, and in the case of accounting and investments account, there is a considerable lag in these figures and adjustments are often made for a year or two afterwards.

Mr. Shannon: Mr. Riely, I would like to show you this letter from Mr. Brinner.

Mr. Riely: I would like very much to see it.

Note: Letter examined by Mr. Riely and returned to Mr. Shannon.

page 107 } Mr. Riely: Thank you.

Mr. Shannon:

Q. I will show it to you, there, that is, Mr. Brinner's letter on the bottom and there is Schedule Six Eleven on top.

There is a difference, then, between the figures shown on Schedule Six Eleven and that figure you furnished Mr. Younger in your July 8, 1968 letter.

A. That is correct.

Q. How do you account for this difference between the forty-five million, eight hundred forty-three thousand, seven hundred dollar figure furnished by you and the forty-nine million, seven hundred eighty-three thousand, three hundred ninety-four dollars set out in Schedule Six Eleven furnished by Mr. Brinner.

A. As I previously indicated, these figures—adjustment figures—do not become final normally for a year or for two years after the close of the year. The figures will vary depending upon when they are obtained. Generally, the figures were correct as of the time they are filed, as far as the books show.

Q. Which figures are correct here? Mr. Brin-
page 108 } ner's figures?

A. I should say Mr. Brinner's figure is correct because according to this letter it was submitted rather recently. In addition, account three, while it has the short caption of grading, includes certain elements of investments which you would not normally consider as grading.

Q. Such as?

A. Such as retaining walls and things like that I believe you have a copy of the ICC uniform system of accounts that lists quite a few.

Q. Yes, I do.

A. That is things other than cuts and fills.

Q. That has been put in the record, Mr. Strouse, as Exhibit EPJ 1.

Mr. Riely: Excuse me. Who is EPJ?

Mr. Shannon: EPJ is—

Mr. Pasco: Johnson,

Mr. Shannon: E. P. Johnson.

Mr. Riely: I am not familiar yet with all of these gentlemen.

Mr. Shannon:

page 109 } Q. Mr. Strouse, continuing now on page ten of your testimony, you state that before the application of code section 58-512.1 the 1968 assessment was presented on full values of approximately fifty-five per cent higher than the 1967 values. Now, my question is what was the per cent increase in the 1968 assessed value over the 1967 assessed value for road and track structures in Virginia. It actually wasn't fifty-five per cent, was it?

A. No, it was not.

Q. It was somewhat lower, was it not?

A. Yes, substantially lower.

Q. And that comes about as the result of that section of the code that you referred to there as 58-512.1, a portion of the value being put on the true local ratio, is that correct?

A. That is correct.

page 110 } Q. Now, Mr. Strouse, before I conclude from your testimony, I would like to ask you a few questions regarding the value of Norfolk and Western's signal equipment reported to this Commission for *ad valorem* taxation. You stated that the reported value of this equipment is approximately fifty per cent of the actual cost after excluding the cost of crossing signals designed for public protection. How did you arrive at this fifty-per cent figure?

A. This is the percentage that I have been informed has been used for a great many years by the Commission.

Q. By which Commission?

A. The State Corporation Commission of the Commonwealth of Virginia.

Melvin J. Strouse

Q. They gave you fifty per cent so you just carried on their depreciated figure on that, is that correct?

A. We used the same basis for reporting that we had for many, many years.

Q. Now, how many miles of centralized traffic control does the Norfolk and Western operate in Virginia?

A. I do not know.

Q. You have no idea.

A. No.

Q. Then you would have no idea as to the cost of a mile of CTC or centralized traffic control line, would you?

A. I have no idea.

Q. Now I noticed that you excluded the cost of signals designed for public protection and I assume you mean there grade crossing protective devices. Is that correct?

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A. That is correct.

Q. Why were such signals excluded?

A. Again, this had been the long standing practice and arrangement with the Commission to leave these out.

Q. Well, don't you—isn't it a fact that the railway company derives a substantial benefit from having these devices at grade crossings on its line?

A. I am not familiar with the operational end of our railroad, but I would assume that the main reason these devices are there, mainly because we are required to put them there and they are there for the protection of the public.

Q. Well, now isn't it a fact—you're a lawyer, Mr. Strouse. Isn't that correct?

A. Yes.

Q. But isn't it a fact that the N&W would tend to derive a benefit from such protective devices, since they tend to reduce accidents and thereby cut down your verdicts for personal injury and death by wrongful acts? Wouldn't that be a benefit to the railway company?

A. To the extent that these signal devices would prevent someone who is judgment proof from damaging our property for which we couldn't collect, there might be some benefit.

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Q. Well, I am talking about to the extent that one of your locomotives cruising along at a road crossing and hits a carload of people and gave no warning and you have a lawsuit on your hands and there was a big verdict entered against the railway company. Certainly it would be to the

advantage of the railway to have a device there that would prevent such an occurrence from happening, would it not?

A. I am not aware that our trains have, or our engineers have failed to give signals or otherwise obeyed the law at the crossings.

Q. And the N&W never has any accidents at grade crossings—is this what you are saying?

A. No, I am not saying that.

Q. Mr. Strouse, will you please tell me how you arrived at the original cost in each account for road and track properties in Virginia which you furnished Mr. Younger.

A. This was—I furnished them when, Mr. Shannon?

Q. It was the letter that has been identified in here, I believe, Exhibit No. 5. I think it was supplemented

page 113 } at the outset of this proceeding and it was schedule one and schedule two. Did you have anything to do with the preparation of those original cost figures or would Mr. Tipton be the proper man to go into all that?

A. Mr. Tipton has additional testimony which was just put in this morning and has gone in some detail into all of that supplemental information. He would be the one to answer in detail.

Q. Well, now, you did furnish this information to Mr. Younger, did you not?

A. I transmitted it. I believe it was just to the Commission. I am not sure it was to Mr. Younger. It was written to the attention of the Honorable Ralph T. Catterall.

Q. I see.

A. The information on schedule one was from our accounting department.

Q. Did you have anything to do with the preparation of that?

A. The information which we received was put on the statement, which was referred to as schedule one—revised schedule one. It was typed in our department.

page 114 } Q. How about schedule two?

A. Yes, some of the work—some of the computations going into schedule two were done in the taxation and real estate department.

Q. Can you explain to us how you arrived at your original cost, say, for ties?

A. Yes, Sir.

Q. All right.

A. Again, Mr. Tipton has gone into some detail on this, but I will try to answer your question. In the case of the account

eight, ties shown on revised schedule two, we took the amount of investment which was shown in the engineering reports prepared by the Interstate Commerce Commission as of June 1916. This investment stated the 1910-1914 prices. To that we added the net changes from ICC form BV-588 for each year subsequent to that, up through the end of 1966. For each year using price indices prepared by the Interstate Commerce Commission, we trended these net additions each year back to 1910-1914 prices. Then after we had all the property at 1910 to 1914 prices, we trended this figure up to a year, which would be midpoint in the life of the asset.

page 115 } In other words, to a point which would reflect the average year in which all this material was installed. In the case of ties, we used an average service life of thirty-two years, and thus trended it to 1950.

Q. You used an average service life for ties of thirty-two years?

A. Yes, Sir.

Q. And you—now I want to get this clear. You trended that up to a mid-point in the average service life, is that correct?

A. That is right. We subtracted—

Q. That would be using how many years—that would be sixteen years.

A. We subtracted sixteen years from 1966 and got 1950 and thus used the price figure from the ICC for 1950 and trended the figure we had for account eight to that year.

Q. All right. Now, explain the procedure for rails.

A. It was exactly the same procedure.

Q. What service life did you use for rails?

A. Thirty-seven years.

page 116 } Q. Thirty-seven years. How about other track material?

A. Same procedure. Service life of twenty-three years.

Q. Ballast?

A. Same procedure. Service life fifty-three years.

Q. What about track laying and surfacing. How did you treat that?

A. Same procedure. Service life thirty-five years.

Q. How did you arrive at your account one—engineering?

A. For these accounts or for all of the accounts?

Q. Well, now, that is my next question. Did you pro-rate or did you assign a portion of the engineering expense to each accounts five, six, eight, nine, ten, and so forth?

A. Yes. In the case of accounts eight through twelve, we

were informed by our accounting department that the total investment in engineering in the 1916 inventory was four per cent of the total investment in the balance of the
page 117 } road account, excluding certain accounts which do not have any engineering connected with them, so to get the engineering attributable to accounts eight through twelve, we took four per cent of the total original cost we had calculated for those accounts. In the case of the accounts five, six and thirteen, we determined on our present investment as of the end of the 1966—that the engineering—the amount of the investment in the engineering account was three point one seven zero four per cent of the total investment in the road accounts, again excluding those accounts which do not have any engineering related to them. So to get the amount of engineering attributable to five, six and thirteen, we took three point one seven zero four and the amount which was shown on the books of the companies of those accounts.

Q. Now, you say you used an age, I believe, of thirty-two years for cross ties and what was your figure for rail?

A. Thirty-seven.

Q. Thirty-seven. And wasn't it twenty-two years for other track material?

A. Twenty-three.

page 118 } Q. Twenty-three. How was this age determined, Mr. Strouse?

A. The railroads in the United States prepared a few years back a study with the Treasury Department, relating the depreciation and accounting, on accounts eight through twelve. This study—as a result of this study which Mr. Tipton refers to at some length in his testimony, these lives were developed.

Q. Does the ICC accept a thirty-two year average life for ties?

A. I do not know what the ICC uses.

Q. Are you familiar with the ICC's report from finance docket number two one five one zero, Norfolk and Western Railway Company and New York, Chicago and St. Louis Railroad Company decided June 9, 1967, which I think is generally referred to as an inclusion case involving the Delaware and Hudson and Boston and Maine?

A. No, I am not.

Q. You are not familiar with that?

A. No, Sir.

Q. Well, you have no way of knowing, and if I were to tell you that in this report the Interstate Commerce
page 119 } Commission concluded that the record—

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Mr. Riely: He said he is not familiar with it, your Honors. I suggest that this ought to be the end of the examination about this report.

Chairman Catterall: I guess you will have to examine somebody else, or else just read the report.

Mr. Riely: The Commission can read the report.

Mr. Shannon: Well, we will get to that. We will ask the next witness.

Q. All right. Now, how did you determine your average age of twenty-three years for other track materials?

A. This life was established by this Railroad-Treasury Department study that Mr. Tipton has referred to.

Q. The Treasury Department study—that is for the Internal Revenue tax purposes, is it not?

A. That is my understanding.

Q. And as far as you know, these average lives that you have given here of thirty-two, thirty-seven and twenty-three years have never been adopted by the Interstate Commerce Commission for accounting purposes?

A. I have no knowledge of that.

page 120 } Q. Now, Mr. Strouse, all other accounts that are listed in your schedule two which you were just testifying about—are they on original cost except your land and your roadway and track?

A. These schedules do not have any land in them.

Q. No land—that is right. They have no grading either, do they?

A. That is correct. Schedule two, accounts eight through twelve, the original cost was determined as I described. For the other accounts they were figures taken off the books of our company.

Q. Well, do the figures that you have just described here on schedule two—do they include any amounts for overhead?

A. I am not completely familiar with the technical meaning of the term. All I can tell you is that these are the figures that are shown on the books of the company.

Q. Shown on the books, and the books of course are kept in accordance with the ICC's uniform system of accounts for railroads?

A. That is right. These figures were obtained from the accounting department and are kept under the supervision of our controller.

page 121 } Q. Well, now, I believe I have got a notation here on my schedule by ties, 1950, which indicates

the average age—how was 1950—why was that selected or how did you go about selecting that for the age of the ties?

A. As I indicated, the study by the Treasury Department developed a life for ties of thirty-two years. This was checked with our chief engineer and made sure that this met with his approval, since that was a nationwide average and not specifically for the Norfolk and Western and he has expressed an opinion that there is no reason to assume that our lives would be any different from this. Half of thirty-two is sixteen. We subtracted sixteen from 1966 and got 1950.

Q. Then you would have the same basic answer for your 1947 life of rails—1954 average life of other track material, is that correct?

A. That is correct.

Q. It was based on this Treasury Department study?

A. That is correct.

Q. Now, none of the items shown here on schedule two are listed at their scrap or net salvage value, are they?

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A. No, that is not what Mr. Younger asked for.

Q. Now you stated that the overall depreciated condition of the Norfolk and Western roadway and track structure is fifty per cent. How did you arrive at that?

A. Are you talking now just about accounts eight through twelve, Mr. Shannon?

Q. Yes. The depreciated condition here—that is the way you set it up, isn't that right?

A. Well, fifty per cent was used on accounts eight through twelve, but it was not used on the other accounts.

Q. How do you determine the fifty per cent used on those accounts?

A. I believe I answered this before to the effect that a normal layman's approach to the problem, this would seem logical, but we did not rely on that. We employed Mr. Tipton of Haskins and Sells to advise us on this because of his experience, particularly with this Treasury study and we relied on his advice and the advice of accounting experts. This would be a normal depreciation reserve which you could expect, had we kept these accounts on that type of basis of original cost and a separate reserve for depreciation.

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Q. Mr. Strouse, are you familiar with the ICC's evaluation of N&W's property and evaluation docket number three four three identified in the record as Exhibit No. BEG 3 and it

is reported in the evaluation report, volume twenty-six on page two fifty-five which has to do with the ICC's evaluation of N&W's property which was made back in the twenties and I think the report was issued in 1929. Are you familiar with that?

A. No.

Q. You are not. All right, I do not believe I have any more questions of this witness.

Chairman Catterall: The Commission will recess for ten minutes.

12:28 P. M. The Commission resumes its session.

Chairman *Catteral*: Any re-direct?

Mr. Epps: May I cross examine him?

Chairman Catterall: Oh, you want to cross

page 124 } examine him?

Mr. Epps: Yes, Sir.

Chairman Catterall: Are we going to have two people cross examining the same witness?

Mr. Epps: I don't think that our interests are identical.

Mr. Carter: There are two different groups, your Honor.

Chairman Catterall: I see. You may cross examine.

Mr. Epps: I had lots of the questions that have already been asked and I have endeavored to strike out any duplications. If I should let some creep in, I know the Court will stop me.

Chairman Catterall: I will stop you.

Mr. Epps: Yes, Sir.

CROSS EXAMINATION

By Mr. Epps:

Q. Mr. Strouse, I believe you testified that on the cross examination by Mr. Shannon that the railroad left out of its report signals having to do with the crossings. Is that correct?

A. That is correct.

page 125 } Q. You're a lawyer, aren't you?

A. Yes.

Q. Don't you know that the law says that that report shall include crossing signals.

A. No, I am not familiar with any specific provision of the law that says that.

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Chairman Catterall: Do you mean you make out all these reports and never read the applicable statutes?

A. Your Honor, we generally try and follow the dictates of the State Corporation Commission and go along with their interpretation of the law whenever possible.

Chairman Catterall: Your answer is yes?

A. We look at the provisions of the law when it seems appropriate. Sometimes in the rush of trying to do a lot of work, we do not check everything.

Chairman Catterall: Your answer is still yes?

A. Yes.

Chairman Catterall: Go ahead. Excuse me for interrupting.

Mr. Epps:

page 126 } Q. I refer you to section 58-524 of the code of Virginia which is the section that says "Annual property report required." That is the report that you made and filed under your supervision, I take it.

A. Yes, Sir.

Q. Sub-section one reads, after first saying the report shall classify such property under the following heads, sub-section one says this: "Right of way terminal and yard lines road bed and trackage or canal beds, bridges, trestles and tunnels and all signals, track and crossing." I understand your company has completely ignored that provision of the law. Is that correct?

A. No, Sir, I wouldn't say we have ignored it.

Q. You didn't—

A. In view of the fact that the Commission's practice over here has been that the value of this property or the cost of this property not be included in the report, it would seem to indicate to me that someone in the Commission had determined that there is no fair market value to the railroad for these signals and we generally will not resist an interpretation like that when it saves us tax money.

page 127 } Q. I wouldn't quarrel with you on that, but do you have any reference to a determination or anything in writing in this regard?

A. No, I do not.

Q. I believe you further said that you left out all grading, is that correct?

A. I left out of what, Sir?

Q. You did not report the account that includes grading to the State Corporation Commission in 1967.

Melvin J. Strouse

A. I am not sure I understand what you mean. Do you mean reported in the tax report?

Q. That is correct.

A. Well, it is my recollection that there is no specific place in there for reporting, the value of the grading is included in our land values which are in the report and of course the tracks are reported in a separate class. I know of no specific place in which you could report the grading.

Q. Well, and I think you said that Haskins and Sells filed it—helped you prepare the schedules in Exhibit No. 5. The grading was omitted there—did you not?

A. That is correct, Sir.

page 128 } Q. All right, Sir. Now, I asked you if the state law does not require you, in reporting this or—and does not require the Commission in assessing—making evaluations—to include the grading.

A. In making the assessments, the law, I believe, talks in terms of cuts and fills. The Commission, as I understand it, is valuing, assessing, and we are paying taxes on the property which would be covered by the investment in account three through our land evaluations.

Q. Well, now, section 58-532 specifically requires that the evaluation of this property—not land—the evaluation of the property we are talking about here shall include cuts, doesn't it?

A. Yes.

Q. And fills?

A. Yes.

Q. Excavations?

A. I believe that is correct.

Q. But yet you did not include those values in your report. And you did not—your auditors and you when you prepared schedules one, two and three—did not include these values.

A. The fair market value of the things you

page 129 } have just mentioned are included in the land values which are in our tax reports. In the case of schedule two, which was a specific request from Mr. Younger, we sent him the information we thought he had asked for.

Q. And then you subsequently sent the grading on request.

A. When he asked for it—the investment in grading—we sent it to him.

Q. Right, and yet in this Exhibit No. 5, schedule two, which was the basis for the evaluation, I believe, showing a hundred seventy-seven million dollars, we now find out that somehow

or another ten million dollars got left out of that. Is that right?

A. If you are talking about the original cost undepreciated—

Q. No, Sir, I am talking about schedule two.

A. Just a minute. Schedule two—the difference between the total depreciated cost shown on schedule two as originally submitted in the revised one is approximately five million dollars.

Q. Will you refer, please, to the original cost
page 130 ⟩ column on the first schedule two and the original
cost column of the second schedule two and wasn't there—won't you tell us there is approximately ten million dollars omitted on the original cost column?

A. Yes.

Q. On the first schedule two.

A. Yes, the difference between the original cost before depreciation was approximately ten million dollars.

Q. Correct. And will you tell me briefly how it came about that this ten million dollars was omitted?

A. Yes, I will try to, Mr. Epps. Again, Mr. Tipton has gone into this in some detail in his testimony.

Q. We will ask him, too.

A. —but when this was originally prepared, it was done in considerable haste, in order to get the information to the Commission and in order that we have some basis, we thought, for values for our tax reports and there were certain errors made. One thing, we started with the original
inventory in 1916. The people working with it
page 131 ⟩ at *at* the time were under the impression that
that was at 1916 prices and thus trended it back to 1910 and 1914 prices. In reviewing this, the latter part of last month, we found out it was in error and we corrected it. There should not have been this trending. In connection with the net changes throughout the years, there had been certain special work in the—I understand in the State of Virginia which was carried on special schedules and had been overlooked, so there were a few figures overlooked, simply clerical errors in taking them off the record. There were—have been certain accounting adjustments which the Interstate Commerce Commission ordered to be made a number of years back, which the people working the study made and subsequently discovered that the figures they were working with already had the adjustments in them and the adjustments should not have been made.

In addition, when we reviewed these as I explained before, there were certain—there was a certain lag in the accounting on these investment accounts, and it is often perhaps two years before the figures finally get to the point where they will not change any more. So when we found these errors and reworked the study, we picked
page 132 } up certain lags in accounting which just could not have been caught at the time the original study was made.

Q. I see. Then that is—there are three omissions, as I see it then. The crossing signals, the grading and the ten million dollars. Would you be good enough to tell me if I am correct in thinking from your answers to the way that schedule two, the first column or original cost column was prepared—is that when you trended figures forward from 1910—1914 base figure of which you get them back there—I think I understand it. Then when you trended them forward, you deducted from today's date, 1967, say, what you considered to be half the life cycle of the particular property you were trending. Is this correct?

A. That is correct.

Q. So that your multiplier for ties, let's say, was 1950 multipliers, is that correct?

A. That is correct.

Q. What is the 1950 multiplier?

A. Two ninety-one.

Q. What is the 1967 multiplier?

A. I don't have that. The most recent I have
page 133 } is in 1966.

Q. Would you give me that?

A. Yes, Sir. I have here indicated that the multiplier for account eight would be four nineteen.

Q. Now, the reason for this, as I understand it, was that you assumed that ties in there in 1968 or the end of 1967—we won't quibble about the arithmetic—have depreciated. Is that right?

A. No, Sir. This had nothing to do with depreciation. The study was made as of the end of 1966. We were asked to try to estimate for the Commission as best we could the amount that would have been reflected in our undepreciated figures shown on our books, had we maintained our accounts on a ratable depreciation basis—that is, we would have put the investment in the investment accounts and kept a separate depreciation which is not the way they are kept. So taking half the life of the assets was simply a way of de-

termining that on the average the investment in that account—say account eighty—on the average the materials had been—would have been put in in 1950 and therefore, the average price which would have been reflected on our books would have been the 1950 price. Obviously, some of it would have been put in the 1966, some of it thirty-two years ago, but on the average it was 1950.

page 134

Q. You are assuming the life cycle of thirty-two years?

A. We did not assume it. It was developed in this Treasury study.

Q. All right, you were taking it and using it, is that correct?

A. That is correct.

Q. You were using thirty-two years and you were backing up sixteen years under the further use or assumption that that is the average age of the tie in the system, is that correct, based on the average life cycle?

A. That is correct.

Q. So that you are assuming that in 1950 half of your ties were older than 1950 and half were newer than 1950. Is that correct?

A. That is correct.

Q. Which takes into account the use of life cycles of the ties, doesn't it?

A. Yes.

Q. And yet you turn around and accrue another fifty per cent depreciation against it, don't you, in your schedule two?

page 135

A. Yes, in determining at the request of the Commission what the original cost of the property would have been under a different accounting method, determining the average age at which the money was spent now has nothing whatsoever to do with depreciation involved and we then calculated what would have been the depreciation.

Q. Now, if you had trended these ties to 1967, you would have used the 1967 multiplier, is that correct?

A. Yes.

Q. What I have examined you on—taking account eight, for example, but the same principles would apply to eight, nine, ten, eleven and twelve with different dates, isn't that correct?

A. That is correct.

Q. Different life cycles, but going to the mid-point each time.

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A. Yes, Sir, the procedure was exactly the same.

Q. And in each case, you took fifty per cent depreciation or you claimed fifty per cent depreciation on schedule two?

A. That is correct.

Q. Mr. Shannon has inquired of you as to the difference in price levels in 1926 versus 1967 and you and he have had some agreements on this. Wouldn't the cost of reproducing the Norfolk and Western Railway be substantially higher in 1967 than it was in 1926?

page 136 } A. I would expect it to be, yes.

Q. Have you had experience in obtaining any cost of reproduction new figures of the Norfolk and Western in the past few years?

A. We have in the past few years developed some cost and reproduction figures for other states—not for Virginia.

Q. Do you have those?

A. I do not have them with me now.

Q. Are you familiar with them?

A. I cannot recall the precise figures, but I—

Q. Or part figures?

A. You are talking about a system figure or a particular state.

Q. Well, I'll take system and state.

A. I wouldn't want to speculate on figures. I can get familiar—

Q. Well, can you find out and let me know this afternoon or tomorrow morning?

Mr. Riely: If it please the Commission, I suggest that reproduction cost new figures for property in other states has nothing to do with the value of the property

page 137 } in Virginia and I object—

Mr. Epps: If it please the Commission, if he can give us the system wide and can give us the other states, we can find out about Virginia.

Mr. Riely: But he—you cannot do it by subtraction. He hasn't said that he has got it all for all of the other states.

Mr. Epps: Mr. Riely, I didn't say I was going to subtract it. You said it.

Mr. Riely: Well, I suggest what this is in other states is not relevant to this proceeding.

Chairman Catterall: Are you going back to the Epes letter which says that that will be the absolute ceiling above which nothing can go?

Mr. Epps: Safety valve. Yes, Sir.

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Chairman Catterall: And is there any question about whether that ceiling would be much higher?

Mr. Riely: He has already testified that it would be higher.

Chairman Catterall: I mean it would be much higher than the present assessment.

Mr. Epps: I do not think he has.

page 138 } Chairman Catterall: But it is not based on reproduction cost now?

Mr. Epps: No, Sir, it is not.

Chairman Catterall: And you want to show that that would be very much higher?

Mr. Epps: Yes, Sir.

Chairman Catterall: And the witness admits that it would be very much higher.

Mr. Epps: He hasn't said it yet. I will ask him.

Chairman Catterall: I thought he just admitted it.

Mr. Carter: Ask him now.

Mr. Epps: Let me ask him, Judge.

Chairman Catterall: All right. Ask him to admit it.

Mr. Epps:

Q. All right, is it not a fact that the reproduction cost new of the Norfolk and Western properties in Virginia would be substantially higher than the figures on which the Commission has based its assessment?

A. I do not know the cost of reproduction

page 139 } figures in Virginia, but it is generally true that the cost of reproduction new is substantially higher than investment.

Q. Do you have or happen to know what the cost of reproduction new was in 1926?

A. No, Sir, I do not.

Q. Could we, for the record, state it from the evaluation report at this point, so we can get it in the record. I refer the Commission to—

Mr. Riely: I would like to see it first.

Mr. Epps: Oh, yes.

Mr. Shannon: It is in this red book (indicating.)

Mr. Epps:—but I would refer Counsel to the evaluation report, which is Boyd E. Garrett, Exhibit No. BEG 3, and I think the page is two ninety-eight.

May I show it to the witness to save time, Mr. Riely?

Mr. Riely: Sure. Go ahead, please.

Mr. Epps: May I inquire or do you want me to wait?

Mr. Riely: No, please, go ahead.
Mr. Epps: I was waiting for Counsel.
Mr. Riely: I beg your pardon.

page 140 } Mr. Epps:

Q. To get it in the record—and I am not assuming that you have familiarity with it because I think you said you did not, but I want to get it in the record at this point.

If you would look at the page two ninety-eight which is on the evaluation report of the ICC filed in 1925 and decided in 1929, the total reproduction cost new, the very bottom figure, is what?

A. The figure shown here is one hundred one million, one hundred sixteen thousand, seven hundred fifty-five dollars.

Q. And the reproduction cost new as of that date is shown as what?

A. That was the figure I just gave you.

Q. Excuse me. Less depreciation?

A. Oh, yes.

Q. The next column.

A. Eighty six million, six hundred seventy-three thousand, two hundred forty-three dollars.

Q. Your work is in taxes. If you would look at those two figures, you would see that the depreciation
page 141 } figure there is something less than fifteen per cent, is that correct?

A. The depreciated figure appears to be about eighty-five per cent of the new figure, yes.

Q. All right. We are saying the same thing. You and I agree. Mr. Shannon has asked you about certain overheads and I do want to ask additional questions, but I do want to refer to overhead. Are you familiar with what are called general overheads incurred when railroad and other utility property is constructed?

A. No, I am not.

Q. Excuse me. I am sorry. Will you give the witness back the BEG 3 (exhibit bound in red book being handed back to the witness.)

Would you examine page two ninety-eight again and is it not correct that there are in the first breakdown certain property accounts?

A. Yes, Sir, that is correct.

Q. And then there are certain overhead accounts?

A. You are referring to accounts—the organization ex-

penses, general officers and clerks, law, stationery, printing, taxes?

page 142 } Q. Yes. It starts with the seventies, doesn't it?

A. Yes.

Q. Seventy through seventy-seven or something like that? Seventy-one through—

A. Seventy-one, seventy-two, seventy-three, seventy-four, seventy-five, seventy-six and seventy-seven.

Q. Seventy-six and seventy-seven, right, and the aggregate figures which you gave include those overheads?

A. That is correct.

Q. Just for the record, you might give the subheads under reproduction cost new for the property account, please.

A. The first sub-total which is for accounts one and three to forty-seven, cost reproduction new ninety million, five hundred twelve thousand, five hundred nineteen dollars. Cost of reproduction less depreciation seventy-seven million, five hundred fifty-three thousand, six hundred dollars.

Q. Thank you, Sir, do you agree that—and this is a statement from the Virginia Supreme Court in evalu-

page 143 } ation case, "in any estimate of the cost of constructing or reproducing a property, the sum added to labor and material costs and to present value of land for such general overhead items it should be determined in the same general manner that labor and material costs are determined." That is from the Alexandria Water Company case 163 Va. 512.

A. It is very difficult in quick reading. I have not read that case yet—

Q. You are not familiar—

A. —and formed an opinion. I understand it is a rate case and not an evaluation for tax purposes.

Q. That is correct.

A. I am not generally familiar with these accounts that you have referred to—

Q. All right.

A. —because in no state that I know of are they used in determining evaluation for tax purposes for the railroad.

Q. All right. I see.

Mr. Epps: I am going to refer the witness to Exhibit LBY-L, page one.

page 144 } Mr. Epps: Yes, that is the reason I called it to your attention first.

Mr. Riely: May I find it first, please, Sir?

Mr. Riely: I have it.
Mr. Epps: Do you have it?
Mr. Riely: Yes.

Mr. Epps:
Q. This, for the record, is headed "Summary of Relative Cost for ICC Accounts One, Three, Five, Six, Eight, Nine, Ten, Eleven, Twelve and Thirteen," and they are the primary accounts that we are dealing with here today, aren't we?
A. I did not realize that account three was involved, but—
Q. Well, you and I have been discussing account three at some length.
A. Yes.
Q. Would you refer on this graph, please, to the year 19—

Mr. Riely: May it please the Commission, would Mr. Epps explain to me what this graph is, because I don't understand it and in the absence of understanding it, I do
page 145 } not think I am going to understand the testimony.
Chairman Catterall: I think the best way is for Mr. Epps to take a long, leading question embodying everything he wants to prove and then asking the witness to agree with him.
Mr. Epps: I would be happy to.
Mr. Riely: But I hope his question includes some explanation of this chart.

Mr. Epps:
Q. If you assume, Mr. Strouse, that the chart to which I am referring you is a summary of the relative cost for the accounts mentioned and a graph of the same for the years beginning in 1915 and progressing through 1967, I ask you if it is not a fact that in the year 1927 the relative index was approximately one hundred seventy and in 1967 that same index exceeds four hundred?

Mr. Riely: May it please the Commission, until we know what this relative cost index is, which has not been explained to me in the way that I can understand it, I object to this question.
Chairman Catterall: It looks like those Dow Jones things that you see in the newspaper.
page 146 } Mr. Riely: I suggest it might well be brought

out by witnesses who can explain this exhibit, before we ask Mr. Strouse, who has never seen it before—

Chairman Catterall: Yes, I agree with that. I don't think—

Mr. Epps: May I read the explanation to Counsel and to the witness?

Chairman Catterall: What can this witness add except to say that he has never heard of it before.

Mr. Epps: I think he can answer my question.

Chairman Catterall: You think he can?

Mr. Epps: Yes, Sir.

Chairman Catterall: All right. See if you can get an answer out of him.

Mr. Epps:

Q. Do you agree that the graph shows that—

Mr. Riely: I object to that, if your Honor please.

Chairman Catterall: If the graph shows that, do you agree that it does show that?

Mr. Riely: I object to the relevance of that question. The graph speaks for itself.

Chairman Catterall: I don't think you can
page 147 } cross examine this witness with that graph.

Mr. Riely: I don't believe that is proper cross examination, if your Honor please.

Chairman Catterall: The witness says he has never heard of it before.

Mr. Riely: He never saw the graph before.

Chairman Catterall: He knows the price of living has gone up since he has been living.

Mr. Epps: But may I ask—

Q. If I were to tell you that this graph was prepared from the same indices which you have described as using in your combination report from Haskins and Sells, would this enable you to answer my question?

A. First, I do not know what your question is going to be, so I don't know whether—

Q. It is the one I have already asked you.

A. You were inquiring as to whether this is a correct graph. The ICC price indices that were used in the study—I would have no way of knowing. I will take your word for it, subject to check.

Q. All right. Suppose you do take my word for it. Then could you answer the question that the indices

page 148 } show four hundred for 1967 and approximately a hundred and seventy for 1927?

A. If the graph is correct and if it means what I understand it to mean, yes. I believe I have already previously testified as to what the indices were and this seems to be in accordance with that.

Q. All right, Sir. In your experience as a lawyer and working for railroads, can you refer this Commission to any decision of a regulatory agency or appellate Court confronted with the evaluation of the property of any railroad or other utility property operated by a going concern and not confronted with the likelihood of liquidation which accrued the evaluation of such property for tax rate making, or any other purpose, as its salvage value?

A. First, let me say, Mr. Epps, aside from Virginia I know of no state that for tax purposes attempts to separate franchise value from the balance of the fair market value, so that the question just would not arise in any other state with which I am familiar.

Q. Then, I take it your answer is no.

A. I am not familiar with any Virginia case that has specifically dealt with the issue.

page 149 } Chairman Catterall: We can take judicial notice that if there were such a case that Mr. Riely would produce it.

Mr. Epps: I submit—I am not going to comment, Sir. I don't have to take judicial notice of it, do I, Sir?

Chairman Catterall: Nobody has ever heard of such a case.

Mr. Riely: I would be very pleased if you would—

Mr. Epps: If I could find it, I would give it to you.

Mr. Riely: I don't believe that.

Mr. Epps:

Q. What is the highest use to which this Norfolk and Western track property can be devoted?

A. The tracks, if you have a franchise to operate a railroad as we do, the highest and best use would be the use to which we are putting it.

Q. Well, let's say—

A. Without a franchise it would be to sell it to someone for reuse or for scrap, if it cannot be reused.

Q. Well, let's look at that a minute, Mr. Strouse. If the tracks are there and the engineering is there

page 150 } and the tunnels are there and the trestles are

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there and you have not got a franchise, it will still bear locomotives and coal cars and freight cars, won't it?

A. If we don't have a permit—

Q. I'm not talking about you—I am talking about the tracks.

A. Yes, Sir, you could run a train over it if you are permitted to do so without a franchise.

Q. Right. Right.

Chairman Catterall: You are not going to ask him what the Old Dominion got for its abandoned tracks are you?

Mr. Epps: I was thinking about that, but we will bring that up later. I am not considering—my question did not embrace, may it please the Commission—my question did not embrace an abandonment. My question embraced a track in being there ready for use which would bear locomotives, but let's assume the Norfolk and Western did not want to operate it. Maybe this Commission enjoined them. The point is that they—It will still bear locomotives, won't it and if anybody will use it and can use it, that is the

page 151 } highest and best use.

A. If anyone had a franchise to use it for that purpose, yes.

Q. And if anybody bought the road properties from the N&W for that purpose then they could see about their own franchise, is that right?

A. Well, the highest and best use of the property as a railroad is predicated upon the user having a franchise to use it for that purpose.

Q. Do you know what the Norfolk and Western paid for this franchise?

A. No, Sir, I know we pay the State of Virginia over two million dollars a year for the privilege in taxes. I don't know what the original filing fees are.

Q. Do you carry that two million dollars on your books?

A. It is not listed as an investment, no. It's certainly an expense which reduces our income.

Q. So is your salary.

A. Yes.

Q. Do you know what you do carry on the books for franchise costs?

page 152 } A. No, I do not know that we carry anything.

Q. I think this question is—part of this has

been asked, but do you know of any time in the past ten years that the Norfolk and Western has desired to sell its track property?

A. No.

Q. Twenty years?

A. No. You must understand, Mr. Epps, I have been connected with the N&W only for less than five years.

Q. I understand. How long have you been in the railroad business?

A. About twelve years.

Q. I will stop at twenty. I was going back further, but I mistook your appearance for nine. I apologize.

You, I believe, or your department instructed that an evaluation should be obtained—a fair value—and indicated the general concept of the willing seller not under compulsion and a willing buyer not under compulsion. How are railroads bought?

A. It is very seldom that railroads are bought and sold. Occasionally, it happens. They are sold, if you want to put it this way, piecemeal, whenever stock changes

page 153 } hands.

Q. Right. That is one way, buying—well, you can buy all of the stock if you can get hold of it and buy the railroad that way, is that right?

A. Yes, Sir.

Q. All right, Sir. Now, what are the other ways?

A. Generally speaking, railroads—

Q. Mergers, excuse me, would you accept merger as another way?

A. Oh, yes, some sort of merger or consolidation.

Q. Right. And the sale of assets—the purchase and sale of assets for security, do you know of any other ways than those three ways? I don't.

A. No, you can—we generally—we merge railroads into ours—we lease railroads and occasionally we buy stock interest in other companies.

Q. But it embraces generally the three methods we are talking about, doesn't it?

A. Yes.

Q. Of course you can lease a line, but that way it is not for sale, except for a term.

page 154 } A. It depends, I think, on how technical you are in the definition of your word, "sale". The merger, for instance, I would not consider as a sale, but—

Q. Well, all right, but I go back to you and to your de-

partment in asking that the fair market value be based on a willing seller and willing buyer and that is why I am using your term and not my term.

To your knowledge, has the Norfolk and Western at least in the last five or ten years, which embraces your knowledge, ever contemplated a merger or consolidation or sale of assets which would have involved the abandonment of your Virginia trackage, or as much as a third of it?

A. No.

Q. How did Mr. Caywood determine the franchise value of your railroad?

Mr. Riely: If it please the Commission, I think that question should be directed to Mr. Caywood.

Chairman Catterall: Yes, I think we have gone far beyond what this witness has testified to.

Mr. Epps: But I think this witness instructed Mr. Caywood and that is what I want to find out.

page 155 } A. I did not instruct Mr. Caywood.

Q. Did your department take part in the instruction of Mr. Caywood and send him a letter?

A. Yes, Sir.

Q. All right. May I inquire about that?

Mr. Riely: I suggest that what Mr. Caywood did is still again—it could properly be addressed to Mr. Caywood and not to Mr. Strouse.

Chairman Catterall: Did Mr. Strouse tell Mr. Caywood what to do?

Mr. Epps: Yes, Sir.

Chairman Catterall: You told him what to do?

A. No, Sir.

Mr. Epps:

Q. Didn't your department give him a letter of instruction?

A. Yes, Sir.

Mr. Epps: That is what I want to ask him about.

Chairman Catterall: You want to know about the letter of instruction from this witness to the other witness.

Mr. Riely: Not from this witness, but it is

page 156 } already in evidence.

Mr. Epps: It is in evidence from this man's

department to Mr. Caywood. There is a letter of instruction telling him what they want him to do.

Chairman Catterall: Well, let's see what the witness says. If he says he doesn't know, it will save a lot of time.

Mr. Riely: I judge the Commission has ruled that Mr. Strouse may be examined with regard to this letter.

Chairman Catterall: That is what I think I ruled. Have you got the letter?

Mr. Epps:

Q. Will you turn to the letter of instruction.

A. I have a copy of the letter.

Q. Will you give me the number of it?

Mr. Riely: Exhibit No. JAC. 1.

Mr. Epps: Thank you.

Mr. Riely: Does the Commission have copies?

Commissioner Hooker: What page is it?

Mr. Riely: If you will give it to me, Judge, I will find it for you.

Commissioner Hooker: Thank you.

page 157 } Chairman Catterall: Go ahead.

Mr. Epps:

Q. I refer you to the bottom of the first page, in the last paragraph, "the values so determined shall be the fair market value of the property exclusive of any franchise value." Do you follow me there?

A. Yes, Sir.

Q. And continuing, "the franchise value to be excluded includes the value of the charter of privilege of doing business, that is, the value of the privilege of serving the particular community being served, the value of being first in possession of the particular location, the good will of the business already established and the patronage already secured, the value of all existing contracts and all those values which are usually comprehended in the term 'going concern' value. Only the 'barebones' value of the property should be included in the appraisal." Then, that is the end of the letter.

Now, did you ascribe a dollar amount to that value in your instructions to Mr. Caywood?

A. No, Sir.

Q. You say you do not know how much the

page 158 } Norfolk and Western paid for its charter.

A. That is right. I know simply how much we pay each year to keep it.

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Q. Right, but you did not tell Mr. Caywood what you paid for it.
A. I did not, no.
Q. And this letter doesn't.
A. No.

Chairman Catterall: The letter says "exclude the 'going concern' value," regardless of what the 'going concern' value might contain and it ends up with the 'barebones' value which seems to be the peculiar law of Virginia, which no other state has.
Mr. Epps: Yes, Sir.

Q. Does your railroad have any exclusive franchises in any areas in Virginia in which it serves localities, cities?
A. I am not familiar with the nature of our franchise, but generally by the nature of the railroad industry, you cannot move your tracks around—you tend to have a monopoly on certain areas you service.
page 159 } Q. Well, but I'm talking about the specific franchises granted you by municipalities.
A. I would doubt that we have any franchises that are so worded that includes a guarantee that no one will ever come along and will give someone else a franchise.
Q. Does your railroad ever pay for any franchises from any localities?
A. I have not been involved in the obtaining of franchises. I have not seen any of them, so I have no—anything I would say on this subject would be pure speculation.
Q. But you don't know of any value on any of your books for them?
A. Oh, no.
Q. They are not on your balance sheet, are they?
A. Our balance sheet is not intended to reflect fair market value. It is simply accounting.
Q. Did you give a dollar figure to Mr. Caywood—you or anyone in your department—for the goodwill of the business already established?
A. I did not and I do not know of anyone in the department.
page 160 } Q. To your knowledge, no one did.
A. To my knowledge, no one did.
Q. How about for patronage already secured, same answer?
A. I do not know either. Mr. Caywood could tell you.

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Q. But you didn't give him one?
A. No, Sir.
Q. Now, tell me about the value of all existing contracts. Did you give him a list of all of your existing contracts?
A. No, Sir.
Q. Do you have a list of all of your existing contracts?
A. I do not, no.
Q. Could you let us have a breakdown listing all of the contracts referred to in your instructions to Mr. Caywood and the values ascribed to those contracts?

Mr. Riely: I object to that, your Honor. A list of all the contracts which the Norfolk and Western—
Chairman Catterall: He is just saying that. He didn't have any contracts in mind.
page 161 } Mr. Riely: This language, as the Commission well knows, is quoted from a decision of this Commission.
Chairman Catterall: Yes.
Mr. Riely: The interstate railroad case in 1942—and I am trying to get the book to read it—
Mr. Epps: Well, may it please the Commission I know that, too, but I don't know that Mr. Caywood knows it and that is the commission that Mr. Caywood had, and I want to know if they gave him anything from which he could determine the franchise.
Chairman Catterall: No, of course they did not and couldn't.
Mr. Epps: Well, I think that is obvious at this point. I think this witness—
Chairman Catterall: Don't try to tell him that the Virginia law is the "barebones" value that we assess and that the state has this very large gross receipts tax to take care of what the "barebones" doesn't take care of. In other states you value the whole thing—"going concern" and all—and then split it down. Isn't that the way you do it in other states?
page 162 } A. That is correct, your Honor.
Chairman Catterall: And Virginia is unique in this respect?
A. Yes, Sir.
Mr. Epps: Judge, just let me ask him a final question to close the chapter on this letter.
Chairman Catterall: All right.

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Mr. Epps:

Q. The same answer would be to quote all those values which are usually comprehended in "going concern" values, is that right?

A. That is correct.

Q. What are those values?

A. I do not know. This language seems to be a catchall which would include anything that has not been specifically enumerated in the earlier language.

Q. Sort of an et cetera.

A. And I am not an expert on "going concern" values.

Q. Can you list any of those values? Do you know any of them?

Mr. Riely: Excuse me. Will you repeat the
page 163 } question?

Chairman Catterall: No, he doesn't know them and his answer is he doesn't know and that is the end of the question.

Mr. Epps: All right, Sir.

Q. Do you, in your experience in the railroad law know of any case within the past twenty years in which any regulatory agency or Court has assigned a franchise value including all the elements that we have gone over—a figure representing as much as twenty per cent of the total value of the railroad?

Mr. Riely: Is Mr. Epps asking Mr. Strouse—

Chairman Catterall: It is a purely legal question and his answer is he doesn't know.

Mr. Epps: All right, Sir.

Chairman Catterall: Next question.

Mr. Epps: Let the record show that he doesn't know.

Mr. Riely: I really object to the record showing that he does not know, because I don't think it is a proper question.

I think Mr. Epps ought to do his own legal re-
page 164 } search.

Chairman Catterall: I think so, too.

Mr. Epps:

Q. Am I correct in understanding the position of the Applicant is that this Commission must determine franchise value in this proceeding?

Mr. Riely: If it please the Commission, again, that is a legal question. That is not asking him—

Chairman Catterall: I think we ought not to ask legal questions of any of the witnesses—legal or non-legal. You can ask accounting questions of accounting witness, but not legal questions of legal witnesses.

Mr. Epps: May it please the Court, he indicated that he worked on the application and he testified that they cannot operate this railroad without a franchise. Can't I ask him whether he considers it a part of this proceeding that this Commission has got to determine the franchise value?

Chairman Catterall: That is not for him to determine.

Mr. Riely: That is not for him to determine.

Mr. Epps: He can't say that that is the
page 165 } position of the Norfolk and Western?

Mr. Riely: No, and he is not here to state the position of the Norfolk and Western.

Chairman Catterall: No, Mr. Riely can make any legal points he wants to make.

Mr. Riely: I can make the legal point and I think I am authorized to state the position of the Applicant, but so far as I know, Mr. Strouse has never had any power of attorney given him by the Norfolk and Western to state its position.

Chairman Catterall: I think we are going too far with this witness. He puts the figures together and I suppose he had legal advice to do it.

Mr. Epps:

Q. I believe you testified, although I am not sure—I am just trying to repeat—I want to be sure that your company does not maintain a depreciation reserve for accounts eight through twelve or that part of five which is under the so-called betterment replacement accounting, is that correct?

A. I do not recall whether I testified on that as to ac-
counts. Mr. Tipton can perhaps answer you
page 166 } more specifically. I do know that on accounts
eight through twelve there is no depreciation reserve kept.

Q. Correct. Now are you familiar with the ICC docket three two one five three reported in 309 ICC 289 entitled, "Uniform System of Accounts for Railroad Companies Betterment Depreciation Accounting Railroads," dealing with the proposal that the depreciation accounting be instituted by the railroads for other property.

Mr. Riely: If Mr. Strouse is familiar with it, I am not. Will you identify it for me?

Mr. Shannon: EPJ-3, Mr. Riely.

Chairman Catterall: Don't you think that these are things that ought to be put in by a witness, instead of on cross examination?

Mr. Epps: Judge, I want to find out if he is familiar with it. The accounts are under his office if he knows about the—

Mr. Riely: If it please the Commission, the accounts are not under his office. He has testified that he is the tax man. He is not the accounting man.

Mr. Epps: He works with the accounts and if he knows about it—

page 167 } Chairman Catterall: Only the tax accounts.

Mr. Riely: He is only a tax man, a very excellent tax man.

Mr. Epps:

Q. Are you familiar with it?

A. No, Sir.

Q. Did you know what the Norfolk and Western's position in that case was? If you don't, I certainly don't want to presume.

A. No, I do not.

Mr. Epps: All right.

12:30 P. M. Chairman Catterall: The Commission will recess until two o'clock and you can put your heads together during the recess.

Mr. Epps: What time, Sir?

Chairman Catterall: Two o'clock.

page 168 } AFTERNOON SESSION
April 15, 1969

* * * * *

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Judge Catterall: Let the record show that we have a new reporter. Mrs. Simpkins was taken suddenly ill at the lunch hour and has been rushed to the hospital.

MELVIN J. STROUSE, the witness on the stand at the noon recess, resumed, and testified further in behalf of the applicant, as follows:

CROSS-EXAMINATION

By Mr. Epps:

Q. Mr. Strouse, was it your testimony—and this is a question because I didn't hear properly, I am not trying to test you or ask you the same question—but was it your testimony that you said this property had a salvage value and it also had an assembled value?

A. I don't recall saying that. I believe my position was that the company's position is that the property has a fair market value with franchise included, in which the highest and best use would be to put it running a railroad. Without the franchise value, its highest and best use would be salvage.

page 170 } Q. Does it not also have a value assembled and in place?

A. It would have a value assembled in place. The only one I know of would be to run a railroad on it, which you could not do without a franchise.

Q. But assembled and in place, it would bear locomotives and freight cars?

A. Yes, sir.

Q. And could be sold as such, if there were a buyer willing to buy?

A. Its value to a prospective purchaser in place, to be left in place, would depend on the purchaser having a franchise to operate a railroad.

Q. Well, it would depend on his being willing to buy; isn't that right?

A. My answer assumed this was a prudent, well-informed buyer.

Mr. Riely: May it please the Commission, I, again, suggest that we are really having legal arguments between the witness and counsel.

Chairman Catterall: I wish you would not ask legal questions of the witness.

Mr. Riely: Both are very competent to argue.

Mr. Epps: I saw nothing legal about it. I

page 171 } think it was a question of fact.

Chairman Catterall: Off the record.

Melvin J. Strouse

(Discussion off the record.)

Mr. Epps: That is all I have, sir.
Chairman Catterall: Any redirect?
Mr. Riely: I shall be very brief, if Your Honor please.

REDIRECT EXAMINATION

By Mr. Riely:
Q. Did I understand you to say, Mr. Strouse, that you hadn't read these statutes under which these taxes are levied?
A. I didn't mean to give that impression. I have read them.
Q. You have read them. And I judge you have read them more than once?
A. Yes, sir, quite frequently, of recent date.
Q. I should now like to show you a copy of a document that has been introduced as Exhibit 7, and ask you whether you can identify it.
A. Yes, sir. This is the annual tax report of the Norfolk &Western for the State Corporation Commission page 172 } of Virginia for the year 1968.
Q. This is the sworn testimony, to which reference has been made by counsel this morning; is that not true?
A. Yes, it is.
Q. Is there any place in there that you can find where a separate entry appears for the value or cost of grading is requested?
A. There is no such place.
Q. There are values for trackage, are there not?
A. Yes, there are.
Q. And there are also values for land, are there not?
A. Yes.
Q. But there is no separate request for the valuation of grading?
A. That is correct.
Q. Mr. Strouse, did you tell the Commission the amount of the franchise tax Norfolk & Western paid in '68?
A. I believe I mentioned that it was in excess of $2,000,000. It is exactly $2,025,010.
Q. That was for the year 1968; is that correct?
A. Yes, sir.
Q. Am I correct in understanding you to say that you know of no state which assesses railroad prop-

page 173 } erty for taxation the way Virginia does, no state in which the Norfolk & Western operates?

A. That is correct.

Q. Is there any state that separates franchise value, based on gross receipts in this manner, from the value of the tangible personal property?

A. I know of none.

Mr. Riely: I have no further questions.

Chairman Catterall: You may stand aside, sir.

(Witness stood aside.)

page 174 } JAMES A. CAYWOOD, called as a witness in behalf of the applicant, and being first duly sworn, testified, as follows:

DIRECT EXAMINATION

By Mr. Riely:

Q. Mr. Caywood, you are the James A. Caywood whose testimony has been filed on behalf of the Norfolk & Western in this case?

A. Yes, sir.

Q. And that testimony consists of 89 pages, page 175 } and exhibits numbered Exhibit 1-JAC through Exhibit 40-JAC; is that correct?

A. That is correct, sir.

Q. And, to the best of your knowledge and belief, the answers that you have given in this testimony are correct?

A. Yes, sir.

Mr. Riely: May it please the Commission, I ask that Mr. Caywood's testimony be received and his exhibits be admitted to evidence. Mr. Caywood is ready for cross-examination.

Chairman Catterall: They are received, under the understanding that we have all reached, and you may now cross-examine.

(The testimony of the witness Caywood and Exhibits numbered 1-JAC through 40-JAC were filed in behalf of the applicant.)

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* * * * *

James A. Caywood

TESTIMONY OF JAMES A. CAYWOOD ON DIRECT EXAMINATION

Q. State your name and address, please.

A. James A. Caywood; Potomac, Maryland.

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

A. I am Senior Vice President of DeLeuw, Cather & Company.

Q. In what type of work is DeLeuw, Cather engaged?

A. DeLeuw, Cather is an engineering firm. The company has been involved in all aspects of transportation engineering.

Q. Please state your educational and professional experience.

page 177 } A. I received a B.S. in Civil Engineering in 1944 from the University of Kentucky. During the period 1944 to 1946, I was a navigator in the U. S. Navy, holding the rank of Lieutenant J. G.

During the period 1946 to 1947, I was Assistant Engineer and Senior Instrument Man for the Louisville & Nashville Railroad. I worked on a locating party in eastern Kentucky on a line extension project.

During the period 1947 to 1957, I worked as Assistant Engineer, Western Region Engineering Corps, at Cincinnati, Ohio for the Baltimore and Ohio Railroad; then as Assistant Division Engineer—Monongah Division, and finally as Division Engineer—Ohio and Baltimore Divisions.

During the period 1957 to 1961, I was Engineer, Maintenance of Way, for the Baltimore and Ohio. I was in charge of regional engineering and maintenance-of-way activities of the Baltimore and Ohio Railroad. I organized, planned operations and supervised construction of new transportation yard facilities at Cumberland, Maryland and a major line relocation project—Flatwoods, West Virginia to Gillespie, West Virginia. During the period 1960-61, I was

page 178 } Assistant Chief Engineer for the Baltimore and Ohio Railroad. I instituted a system-wide continuous welded rail program and set up a system rail welding plant at Cumberland, Maryland with capacity to weld 350 track miles annually.

During the period 1961-64, I was General Manager of Engineering Planning for the Chesapeake and Ohio-Baltimore and Ohio Railroads and Chief Engineer of the B&O. I was in charge of studies involving the coordination and consolidation of all engineering activities of the affiliated railroads,

including plant capacity and adjustment studies to meet present-day and future traffic requirements, labor and material requirements for efficient maintenance, development of new material standards and usage predicated on economic as well as engineering values. I instituted studies and led development of new 122.53-pound rail section for joint use of C&O-B&O, and new uniform tie spacing and sizing, resulting in annual operating savings of $3.1 million for the combined system. I made organizational studies and completed plans for the consolidation of the combined engineering departments of C&O-B&O, involving 1,130 professional,
page 179 } technical, supervisory, clerical and administrative personnel. I developed engineering coordination reports for the combined C&O-B&O system, design 1 to result in savings of $189 million over a 10-year period.

As Chief Engineer of the B&O, I was in charge of the administration and operation of the Engineering Department of this 11,000 track-mile system and its 4,000 engineering, construction and maintenance-of-way personnel. I planned and administered annual roadway capital improvement budgets, ranging between $15 and $25 million annually. I planned and administered annual operating budgets for maintenance-of-way, ranging from $40 to $50 million annually. I introduced new techniques of section gang organization and equipment utilization for maintenance-of-way, resulting in a $4 million annual payroll savings, while doubling material replacements. I initiated and led a material clean up and inventory program, resulting in a $2 million deferment of purchases for new materials. I was in charge of the design and installation of a major clearance improvement program involving reconstruction, alteration, and new construction of 46 major structures, including 18 tunnels.

During the period 1964-65, I was President
page 180 } and a Director of Royce Kershaw Company, Inc., a firm engaged in railroad contracting.

Since joining DeLeuw, Cather in 1965 I have been working on a high speed test track study for General American Transportation Company. I am Project Manager for the design of the Washington, D.C. rail rapid transit system.

I am a licensed professional engineer in the states of Maryland, Kentucky, Alabama and the District of Columbia. I am a member of the following organizations:

National Society of Professional Engineers
Kentucky Society of Professional Engineers

James A. Caywood

District of Columbia Society of Professional Engineers
American Railway Engineering Association
American Railway Bridge and Building Association
Roadmasters and Maintenance of Way Association
American Management Association
American Society of Professional Engineers

Q. What is your connection with this Petition for Review and Correction?

A. In the Spring of 1968, DeLeuw, Cather was engaged by Norfolk and Western Railway Company to make an appraisal of the roadway items of Norfolk and Western in the State of Virginia.

page 181 } Q. What were your instructions for making this appraisal?

A. DeLeuw, Cather was asked to determine for the Norfolk and Western Railway Company for its main line or lines and for each branch line, for single and, where existing, double, triple and quadruple track and for side track, the average value per mile in the State of Virginia of its track, track appurtenances and track structures, including cuts, fills, track surfacing, excavation, ballast, bridges, trestles and tunnels, but not including right-of-way lands and buildings or structures thereon other than track structures. We were instructed that the value to be so determined should be the fair market value.

We were instructed that fair market value is defined as the price which property will bring when it is offered for sale by one who desires, but is not obligated to sell it and is bought by one who is under no necessity of having it.

We were instructed that the value so determined should be the fair market value of the property, exclusive of any franchise value. We were instructed that the franchise value includes the value of the charter or the privilege of doing business, that is, the value of the privilege of

page 182 } serving the particular community being served, the value of being first in possession in 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. We were instructed that only the "bare bones" of the property should be included in the appraisal.

[Counsel will introduce Exhibit 1-JAC (Letter of May 29, 1968, James E. Carr to James A. Caywood)]

James A. Caywood

Q. In addition to determining the fair market value of Norfolk and Western's track, track appurtenances and track structures, were you requested to make any other determinations with regard to this property?

A. Yes, by oral request we were asked to examine this same property and determine its condition, expressed as a percentage of new condition.

Q. Were you told why this approach was requested?

A. Yes. Mr. D. L. Kiley, Assistant Vice President—Taxation, of Norfolk and Western told us that the State Corporation Commission was basing its 1968 as-
page 183 } sessment of this property on original cost less a 20% allowance for depreciation. Mr. Kiley wanted us to determine whether a 20% allowance accurately reflects the actual physical depreciation of the Norfolk and Western's track and track structure in Virginia.

Q. So your valuation appraisal of the Norfolk and Western track and track structure was to involve two separate approaches: (1) determining a fair market value of the property; and (2) determining the condition of the property, expressed as a percentage of new?

A. That is correct.

Q. Did you in fact undertake such an appraisal of Norfolk and Western property in the State of Virginia?

A. Yes.

Q. Would you briefly summarize the findings of that appraisal?

A. The total fair market value for Norfolk and Western trackage in the State of Virginia is $33,248,754, exclusive of signals, interlockers and car retarders. In a separate study, we determined that the fair market value of signals, interlockers and car retarders is $1,600,478. The actual physical condition of this property, expressed as a percentage of new, is 48%.

page 184 } Q. In other words, you found the property to be 52% depreciated?

A. That is correct.

Q. During what period of time was the field work on this appraisal conducted?

A. We began the field work on June 3, 1968 and completed it on October 10, 1968.

Q. This does not include the office work?

A. No, compilation and correlation of the field appraisal data took over two months.

Q. How many man-hours were devoted to this project by engineering personnel?

A. Over 3,000 man-hours.

Q. How many man-hours were put in by office personnel?

A. Over 500 man-hours.

Q. Let's first discuss the determination of fair market value and then I will ask you about your determination of the "condition percent" for this property. Would you summarize the findings of your appraisal as they relate to determination of fair market value?

page 185 } A. We determined an average fair market value per mile. For main line track, the average fair market value per mile for single track is $13,962; for double track—$28,914; for triple track—$36,096; and for yard track and sidings—$9,778. The respective average fair market values per mile for the branch lines varied widely.

[Counsel will introduce Exhibit 2-JAC (Average Fair Market Value Per Mile)]

This exhibit shows the subdivisions of track that are used by Norfolk and Western in its report to the State Corporation Commission. The first entry, "Main Line," is a composite average of field appraisals of the main line of the several Norfolk and Western divisions from Norfolk to the West Virginia state line. Although some lines are less than one mile long, a hypothetical value per mile is shown. The total value of the line and the length of track involved are shown in parentheses.

Q. Did you determine the total fair market value of the lines of the Norfolk and Western in the State of Virginia?

A. Yes. By multiplying the average value per mile times the mileage of each line, we determined a total fair market value of each line listed in Exhibit 2-JAC.

page 186 } [Counsel will introduce Exhibit 3-JAC (Total Fair Market Value of Track) and Exhibit 4-JAC (Miles of Track in Virginia)]

[Counsel will introduce Exhibit 5-JAC (Quantities of Marketable Material Producing a Net Value)]

The lines of track in each category used in arriving at the total values listed in Exhibit 3-JAC are shown in Exhibit 4-JAC. These two exhibits include main line and branch lines. Mileages were taken from the Annual Tax Report of Railroad Companies (Report of Norfolk and Western Rail-

way Company) to the State Corporation Commission of Virginia for the year 1967.

Q. In making this appraisal, did you determine the total quantities of marketable material from all Norfolk and Western tracks in Virginia?

A. Yes. Total quantities of marketable material from all Norfolk and Western tracks in Virginia are summarized in Exhibit 5-JAC.

[Counsel will introduce Exhibit 5-JAC (Quantities of Marketable Material Producing a Net Value)]

Q. Did you determine a total fair market value of Norfolk and Western trackage in Virginia by Interstate Commerce Commission accounts?

page 187 } A. Yes. Total fair market value of Norfolk and Western trackage in Virginia is summarized in Exhibit 6-JAC by Interstate Commerce Commission accounts. A separate breakdown by single, double, triple and side tracks for individual lines is listed on pages following the summary table in Exhibit 6-JAC.

[Counsel will introduce Exhibit 6-JAC (Fair Market Value Per ICC Account)]

Q. Would you state the total fair market value determined for Norfolk and Western trackage in the State of Virginia?

A. $33,248,754. This figure is shown in both Exhibits 2-JAC and 6-JAC.

Q. What was your over-all approach for determination of fair market value?

A. The valuation of roadway items in the State of Virginia for the Norfolk and Western Railway Company was made to establish a fair market value, exclusive of any franchise value, as I stated earlier. As no "going concern" value was to be included in the appraisal, the value is the market value of the roadway components. We examined

page 188 } the roadway components in terms of Interstate Commerce Commission accounts.

Q. Did you determine any value for ICC Account 1—Engineering?

A. The major part of this account represents payroll and expense of engineers and assistants engaged in the survey and construction of the railway lines. It cannot be sold; therefore, it has no market value.

James A. Caywood

Q. Did you determine a value for ICC Account 3—Grading?

A. The major part of this account represents the costs of clearing and grading the roadway to establish a track roadbed on which track could be constructed to acceptable tolerances for gradient and curvature. Grading may have altered the value of the land; however, grading could not be separated from the land and sold. Therefore, in the absence of a "going concern" value, grading has no market value.

Q. Did you determine a fair market value for ICC Account 5—Tunnels and Subways?

A. Some of the tunnels on the Norfolk and Western are mined through solid rock with no tunnel lining. These tunnels have no marketable components. Other tunnels page 189 } have reinforced concrete or brick lining which is not salvageable. There is no market value for such a tunnel unless it has an "in place" use. One such use for tunnels might be as a passage for highways. However, a highway need for any Norfolk and Western tunnel at its existing location is unlikely. Railway tunnels are usually built because of limitations on grading that are not controlling in highway construction. The Norfolk and Western standard single track tunnel, which is 17′ to 19′8″ wide, is too narrow for modern highway use. Thirty-four of the 37 Norfolk and Western tunnels in Virginia are single track tunnels. The greater width of the four double track tunnels would be sufficient for a secondary road. However, it is unlikely that there would ever be a need for them for highway purposes.

Q. Could tunnels be used for any other purpose?

A. With alterations, the tunnels might be used for storage. The cost of sealing the tunnels, installing flooring and repairing roofs and walls is high, and the tunnels are not readily accessible. Consequently, their marketability for such use is minimal Because of their remote page 190 } locations, it is doubtful if the tunnels could be sold even for civil defense purposes. No asset value could be assigned to the Norfolk and Western's tunnels. If it became necessary to seal unused tunnels, they would be a liability. Therefore, we determined a fair market value of zero for items in ICC Account 5—Tunnels and Subways.

[Counsel will introduce Exhibit 7-JAC (N&W Standard Single Track Tunnel Portal)]

James A. Caywood

Q. Did you determine a fair market value for ICC Account 6—Bridges, Trestles and Culverts?

A. Bridges are usually designed and built to fit local conditions. There would be little market for Norfolk and Western's bridges, therefore, as units for transfer to a new location. In order to sell the components of the steel bridges, there would have to be a market for girders and beams of the available shapes, sizes and designs. Even then, the components probably would have to be refabricated to fit a new location. The cost of such work would ordinarily
page 191 } make the used components non-competitive with new material. It is unlikely that a dealer would purchase girders, beams, trusses, etc., at greater than scrap value to store them in inventory with the expectation of later selling them at a profit. Therefore, we used scrap value in arriving at fair market value for bridges. A price of $22.85 per gross ton for scrap structural steel delivered to scrap yards was used. This was a 1968 price tendered to the Norfolk and Western for this type of scrap.

Estimates were made of the cost of removing each bridge that contained salvageable components. In all cases the market value of the salvage was estimated to be less than the cost of removal. A total salvage value of $1.7 million was determined for the Norfolk and Western's 866 bridges in Virginia as compared with an estimated cost of removal of $5.1 million. This left a debit of $3.4 million. No estimates were made for removal of concrete structures or culverts as no usable salvage was anticipated from them. Their removal would increase the negative value of bridges, trestles and culverts if the Railroad were required to move
page 192 } them from the property. That bridges, trestles and culverts cannot be removed profitably is attested to by the many structures left in place in prior abandonments of railways (including the Norfolk and Western) and highways. No market value was attributed to these items.

Q. To summarize to this point, you found the "bare bones" value of engineering, grading, tunnels and subways, and bridges, trestles and culverts to be zero?

A. That is right. While these items may have some "going concern" value to an operating railroad, they have no market value exclusive of franchise value.

Q. Mr. Caywood, in order that the subsequent testimony and evidence in this case may be as clear as possible to all concerned, will you please describe and illustrate the typical method of track construction?

James A. Caywood

A. Yes. A basic piece of track consists of two parallel bands of steel rails. In each band, the rails are fastened together at their abutting ends by means of steel bolts through steel joint bars. The rails are attached to steel tie plates by steel spikes which serve the double purpose of holding the rail firmly against the tie plate and securely
page 193 } affixing the tie plate, in turn, to the wood tie. On most main track and certain other track subject to heavy duty, steel rail anchors clamp to the underside of the base of the rail flush with an adjoining tie to prevent the rail from "creeping" or sliding lengthwise in the tie plate.

[Counsel will introduce Exhibit 8-JAC (Diagram of Track Structure)]

Except on certain bridges and trestles, the ties are embedded in a layer of top-ballast, consisting of stone, slag, cinders, or some similar substance. This top-ballast rests on a layer of sub-ballast, consisting of sand, finely-crushed stone or cinders, gravel, etc. The sub-ballast, in turn, rests on the roadbed, which is usually graded earth. The graded earth is a route or path for the track, and in most places has been brought to its present state by the leveling, packing, and smoothing of either filled or excavated land.

Q. What about ICC Account 8—Ties. What is included in this account?

A. Cross, switch and bridge ties are included in this account.

page 194 } Q. What is the market for secondhand ties?

A. Short-line railroads, some industries and occasionally a larger railroad will buy secondhand ties. It is questionable if there would be a ready market for all of the 2.4 million cross ties considered reusable of the approximately 8.4 million cross ties in Norfolk and Western tracks in Virginia.

Q. Assuming there would be a market, what price would ties bring?

A. We used a price of $2 per tie f.o.b. in cars on the Norfolk and Western. This was the top price to be expected from a broker in used ties.

Q. What was your source of information for this figure?

A. We checked this figure with Mr. Fred Mewhinney, President of Gillis & Company of Louisville, Kentucky. Gillis deals extensively in used ties. We also consulted Mr. Me-

whinney with regard to standards for grading ties as marketable or nonmarketable.

Q. Wouldn't a broker have to sell the ties at a higher price to cover selling expense and profit?

page 195 } A. Yes, and the cost to Norfolk and Western of recovering the ties would have to be deducted from the selling price of $2 per tie to arrive at net market value. We estimated a twelve-man gang could recover approximately 900 cross ties a day from a single track line at a cost of 81 cents per tie. This is based on Norfolk and Western track labor rates.

[Counsel will introduce Exhibit 9-JAC (Estimated Cost to Recover Cross Ties)]

The procedure assumed in arriving at this cost is to remove and stack for loading into railroad cars all marketable cross ties. Nonsaleable cross ties would be left in the track. During the operation of a work train, the ties to be sold would be picked up. All reusable ties would be loaded in gondolas for delivery by rail.

Q. Would the average cost of removal be lower for double track and for side track and yards?

A. Yes. Because of better concentration, the average cost of recovering ties from double track was estimated to be 75% of that for single track, or 61¢ per tie. The estimated cost for side tracks and yards was 70% of that for single track, or 57¢ per tie.

page 196 } Q. What then did you estimate the net value of marketable ties to Norfolk and Western to be?

A. The estimated net value of marketable ties to Norfolk and Western would be $1.19 for single main track, $1.39 for double main track and $1.43 for side track.

Q. How did you determine the number of marketable ties?

A. The number of marketable cross ties was estimated from a condition percentage assigned to ties during our field appraisals. All ties given a condition rating of 70% of new or better were considered reusable. A portion of the ties rated at 60% to 70% of new would be reusable. The remaining life of a cross tie removed from its original location and reused elsewhere is reduced through damage in handling, drying out during shipment and respiking. Including labor of installation, the user's cost in place of a secondhand tie is more than half of that of a new tie. Therefore, it is not

economical to reuse ties with a condition rating of 50% of new or lower. The percentage of the sample ties on each line rated six or above in the zero to ten rating system was determined. This total was reduced by 5% to allow

page 197 } for marginal ties that would not be marketable.

The average number of cross ties per mile for each line was estimated by deducting from 5,280 feet the average length of trackage on switch ties and bridge ties per mile for each line and dividing this footage by the tie spacing.

The percentage of marketable ties for each line times the average number of cross ties per mile for each line gave the average number of marketable cross ties per mile for each main and branch line of the Norfolk and Western in Virginia.

The percentage of marketable cross ties in sidings and yards was estimated from over-all observations and ratings. The number of cross ties per mile of side track was determined in a manner similar to that for main track.

The total number of main or side track turnouts in each line was divided by the track mileage to arrive at an average number of turnouts per mile of main or side track.

Q. What is a turnout?

A. A turnout is an arrangement of a switch

page 198 } and a frog with closure rails, by means of which rolling stock may be diverted from one track to another. A switch consists of a pair of switch rails, one or more rods to hold the switch points in alignment with each other and switch plates to support the switch rails, and, in conjunction with rail braces, to maintain the correct position of stock rails, i.e., running rails against which the switch rail operates. A frog is a track structure used at the intersection of two running rails to provide support for wheels and passageways for their flanges, thus permitting wheels on either rail to cross the other. Switch points are rails tapering from standard width at one end to a point at the other end. Moving a lever on a switch stand shifts the position of switch points from one side to the other. Guard rail is laid parallel with the running rails to hold wheels in correct alignment to prevent their flanges from striking the switch point and derailing. Rail braces reinforce standard rails and switch points at the point they join.

Q. How did you determine the quantity of marketable switch ties?

A. A system average length of trackage on switch ties per

main or side track turnout was estimated on the basis of the total length on switch ties divided by the
page 199 } total number of turnouts. The average figures— 117.55 feet for each fork of main track turnouts and 98.19 feet for each fork of side track turnouts—were deducted for each turnout on all lines in estimating average footage per mile occupied by cross ties.

The average footage of switch ties per main or side track turnout was determined, similarly, by dividing thousands of feet board measure (MBM) of switch ties by total number of turnouts. These averages were 4.155 MBM per main track turnout and 3.426 MBM per side track turnout. The average number of turnouts per mile times these figures gave average MBM of switch ties per mile for each line. The percentage of reusable switch ties for each line usually ranged from one-half to two-thirds of the condition percentage assigned during the field appraisal. A value in this range adjusted through field observations was used to estimate the average MBM of marketable switch timber per mile for each line.

The average cost of recovery of switch ties would be about twice that for side track cross ties. Based on an average switch tie length of 12 feet, the cost of recovery
page 200 } would be about $18 per MBM. Based on a value of $60 per MBM of switch timber f.o.b. in railroad cars on the Norfolk and Western, the net value to the Norfolk and Western after cost of recovery would be $42 per MBM.

Q. What was the procedure for bridge ties?

A. Bridge ties are framed to fit a particular bridge. They are notched or dapped according to the width of the girders or stringers on which they rest on steel bridges. Also they are framed to provide the track super elevation required on individual bridges on curves. Generally, they would not be reusable as bridge ties for another structure without alteration at considerable expense. Even then, it is questionable if there would be a market for many of the bridge ties on the Norfolk and Western that would be fit for reuse. An estimated cost of recovery of $50 per MBM for bridge ties plus transportation and selling expense would offset the approximately $75 per MBM that bridge timbers might bring if delivered to the user. Therefore, there is no market value for bridge ties.

page 201 } Q. What did you determine the total fair market value of ties to be?

A. $3,488,878.

James A. Caywood

Q. This information is in Exhibit 6-JAC?

A. Yes.

Q. In determining a fair market value for ICC Account 9—Rail, what markets did you consider?

A. There are three potential markets for used rail.

First, good secondhand rail can be sold to be relaid by other railroads or industries. A railroad selling this type of rail to a dealer could expect an average of about $78.50 per gross ton, at 1968 prices, for the rail f.o.b. loaded in cars. Usual limits of wear for rail to be saleable for relay are a maximum of 3/16″ loss of height and 1/8″ curve wear or overflow. Rail not control cooled during manufacture is generally not acceptable for sale as relay rail.

Second, rail for rerolling into bars and shapes can be sold to rolling mills at higher than scrap prices. The 1968 price for this type of rail sold by the Norfolk and page 202 } Western was $41 per gross ton. Rail cannot be sold as rerolled rail if it is bent, twisted, has thin or broken flanges, shows excessive flow of metal, or has other defects making it unsuitable for rerolling.

Third, rail not meeting the requirements for relay or reroll can be sold as scrap. In 1968 Norfolk and Western received $29.50 per gross ton for scrap rail. Rail measurements and rail contours which we took during the field appraisal of each main or branch line were reviewed to determine the percentage of rail that would fall into each of the three classifications.

[Counsel will introduce Exhibit 10-JAC (Typical Rail Contours)]

Exhibit 10-JAC shows some typical rail contours representing the three classifications. The percentage for side tracks was estimated from observations.

Q. How did you determine the weight of rail?

A. The average footage per mile occupied by switch points and frogs was deducted to arrive at an average footage of rail per mile for each line. This footage was converted to average gross tons of rail per mile for each line. A composite average weight of rail was used in these page 203 } calculations based on the quantities of weights of rail in each line. An average weight of 131 pounds per yard was used for main track. The composite weight of rail for separate branch lines was determined from Norfolk and Western's records of weights of rail in

each branch line. The mean nominal weight of rail in Norfolk and Western's branch lines in Virginia is about 123 pounds per yard. A composite average weight of side track and yard track was determined from Norfolk and Western's records. This mean weight was used where large concentrations of mixed weight rail exist in yards. The mean weight was adjusted for side tracks on branch lines from field observations. The mean weight of rail in Norfolk and Western's side tracks and yards in Virginia was estimated to be 119 pounds per yard.

A planimeter was used on a portion of the rail contours which we recorded to determine the average loss of rail section for rail classified as relay, reroll or scrap. The average loss was found to be 1.5% for relay, 3% for reroll and 5% for scrap. The average tonnages per mile of each classification of rail were reduced accordingly.

page 204 } Q. How did you use these quantities to determine the fair market value of Norfolk and Western's rail?

A. These quantities times the sale price for the three classifications of rail less the cost of recovery were used in estimating the average fair market value of rail per mile for each line.

Q. How did you determine the cost of recovery of rail?

A. It was estimated that 18 men could recover approximately 6,000 track feet of 131 pound rail per day from a single track line at an estimated cost of $0.228 per track foot, or $6.61 per gross ton.

[Counsel will introduce Exhibit 11-JAC (Estimated Cost to Recover Rail)]

Exhibit 11-JAC shows the labor and equipment costs which we used to develop these recovery costs. The procedure on which this estimate was based for recovery of rail from single track is to disconnect strings of rail and pull them by tractor to a point where the individual rails could be disconnected and loaded by crane into railroad cars. As in the case of cross tie recovery, the cost of rail recovery in multiple track territory would be lower. The av-

page 205 } erage cost to recover rail from double track was estimated to be 75% of that for single track, or $4.60 per gross ton. The cost for side tracks and yards was estimated to be 70% of that for single track, or $4.30 per gross ton.

James A. Caywood

Q. Did you then determine a net market value per gross ton of rail?

A. Yes. Deducting these costs of recovery from the sale prices for the three classifications of rail gives estimated net market value to the Norfolk and Western per gross ton of rail as follows: Net market value per gross ton for single main track is $72.34 for relay rail, $34.84 for reroll rail, and $23.34 for scrap rail. The net market value per gross ton for double main track is $73.90 for relay rail, $36.40 for reroll rail, and $24.90 for scrap rail. The net market value per gross ton for yard and side track is $74.20 for relay rail, $36.70 for reroll rail, and $25.20 for scrap rail.

The cost per ton to recover rail lighter than 131 pounds per yard for relay might be a little higher than the cost to recover 131 pound jointed rail. The cost of recovering continuous welded rail would probably be even higher. These would lower the net market value to Norfolk and
page 206 } Western somewhat. As 130, 131 and 132 pound jointed rail represents a major portion of Norfolk and Western rail in Virginia, however, the effect on over-all averages would be slight.

Q. Following this procedure, what did you determine to be the fair market value of Norfolk and Western's rail in the State of Virginia?

A. $22,946,916.

Q. Did you have any way of checking your procedures in determining the value of rail?

A. Yes. We consulted Mr. William E. Kelly of Luria Brothers & Co., Inc. Luria Brothers is one of the largest dealers in used rail in the country. We consulted Mr. Kelly with regard to standards for classification of rail as relay, reroll or scrap and costs of recovery of rail.

Q. Please tell us what type of property is carried in ICC Account 10—Other Track Material?

A. A major portion of this account consists of track accessories such as joint bars, tie plates, bolts,
page 207 } nut locks, spikes and rail anchors.

Q. How did you go about determining the tonnage of this material in Virginia?

A. The number of such items is fairly constant per unit of length of track. However, the tonnage of these items varies with the weight of rail and spacing of the ties. Tonnage also depends on the type of accessories involved: four-hole or six-hole joint bars, single shoulder or double shoulder tie plates, etc. (A joint bar is a steel member, commonly

used in pairs for the purpose of joining rail ends together, and holding them in position. A tie plate is a plate interposed between a rail or other track structure and a tie.)

The predominant situation in Virginia was observed to be: six-hole joint bars; 8″ x 13-1/2″ double shoulder tie plates; 4 spikes per tie plate; and ten rail anchors per 39-foot section of rail. This standard was used to estimate gross tons of accessories per mile of main track at various tie spacings. As other variables tended to offset each other, these tonnages were used in our appraisal for heavy rail. At 22 ties per 39-foot rail, tie spacing of 21.3″ yields 88.6 gross tons per mile of accessories, and at 22 1/2 ties per section, spacing of 20.8″ yields 90.1 gross tons

page 208 } per mile of accessories. At 23 ties per 39-foot rail section, tie spacing of 20.4″ yields 91.7 gross tons per mile of accessories, and at 23 1/2 ties per section, spacing of 19.9″ yields 93.2 gross tons per mile of accessories. At 24 ties per 39-foot rail, tie spacings of 19.5″ yields 94.7 gross tons per mile of accessories. Norfolk and Western records indicate that the over-all average weight of accessories in Virginia is 91.5 gross tons per mile.

Q. Did you calculate gross tons of accessories per mile of side track?

A. Yes. Based on an average tie spacing of 23.4″ (20 ties per 39-foot rail), the calculated gross tons of accessories per mile of side track is 74.9 gross tons where the weight of rail is 131 pounds per yard and 43.0 gross tons of accessories where the weight of rail is 100 pounds per yard.

Norfolk and Western records show that accessories weigh 56.8 gross tons per mile of side track in Virginia. The average tonnage per mile which we used for the various lines was based on the composite average weight of rail on the line. This tonnage per mile was determined

page 209 } by interpolation between the above figures for 100 pound and 131 pound rail. The tonnages were then reduced for the average footage per mile of each line occupied by switch points and frogs for which other types of accessories are used.

Q. How did you determine prices to be applied to these tonnages?

A. As in the case of rail, accessories sold for reuse would bring a higher price than they would if sold for scrap. The number of joint bars and tie plates that could be sold for reuse would probably be related to the amount of relay rail recovered. The sale price would be comparable to that for

relay rail, which would be about $78.50 per gross ton. It is questionable if used spikes, bolts, nut locks and rail anchors could be sold except at scrap prices. Also, joint bars and tie plates in excess of quantities needed to install the relay rail would probably be sold at scrap prices. Recent scrap prices per gross ton received by Norfolk and Western for these types of accessories were $34.61 per gross ton of joint bars; $37.00 per gross ton of tie plates; and $38.50 per gross ton of spikes, bolts, etc. For Norfolk
page 210 } and Western tracks in Virginia, the average breakdown of the total weights of these track accessories was as follows: joint bars—16.6%; tie plates—68.0%; spikes, bolts, etc.—15.4%.

Applying these percentages against relay and scrap prices gave a composite price of $72.34 per gross ton for accessories recovered with relay rail and a price of $36.84 per gross ton for accessories recovered with reroll and scrap rail. These prices, less the cost of recovery, represent the fair market value of accessories to Norfolk and Western.

Q. How did you determine the cost of recovery for OTM?

A. We estimated that 16 men could recover approximately 3,000 track feet of single main track accessories per day at an estimated cost of 34¢ per track foot, or $19.70 per gross ton.

[Counsel will introduce Exhibit 12-JAC (Estimated Cost to Recover Other Track Material)]

The procedure assumed in arriving at these costs for single track is to use a crane equipped with a magnet to load the accessories into trucks for transporting to a
page 211 } point where another crane with magnet would transfer the accessories into railroad cars. A work train would pull loaded cars and spot empty cars as work progressed.

The availability of adjacent tracks would permit accessories from yards and sidings to be loaded directly into railroad cars. The additional work train cost would offset the saving in trucks and drivers used in recovering accessories from single track facilities. However, accessories would be recovered from more track per day. We estimated that cost per ton to recover side and yard track accessories would be 70% of that for single main tracks, or $13.78 per gross ton.

The accessories from one track of double main track could

be recovered in the same manner as for yard track. Accessories from the remaining track, however, would be recovered at the higher cost for single track. A composite cost of $16.87 per gross ton was estimated for recovering all accessories from double track.

Q. After deducting these costs from the composite sales price of accessories recovered from relay and scrap rail, what did you determine the net market value to Norfolk and Western per gross ton to be?

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A. The net market value per gross ton for relay—other track material would be $52.64 for single main track, $55.47 for double main track, and $58.56 for yard and side track. The net market value per gross ton for scrap—other track material would be $17.14 for single main track, $19.97 for double main track, and $23.06 for yard and side track.

Q. There is other material in ICC Account 10 also, isn't there?

A. Yes. Another large part of Account 10 consists of special track work material such as switch points, frogs, guardrail, rail braces, switch rods and switch stands that are used in turnouts. Norfolk and Western has over 5,000 turnouts in Virginia. Probably only a very small portion of material from these turnouts could be sold at other than scrap prices. This would be due both to the undesirability of using worn material in special track work and to the incompatibility of special track work on various railroads. This would be particularly true of Norfolk and Western frogs and switch points where special drilling is used between bolt holes. We used a scrap price of $19.50 per gross ton in making our calculations. This was the figure received in 1967 by Norfolk and Western for scrap switch material. Turnout material would be dismantled at the same time as the remainder of the trackage. It might cost more per track foot to recover special track work material than other types of track. Because of the concentration of weight, however, the cost per ton would be about the same as for track accessories.

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Q. What did you determine the net market value per gross ton of special track work material to be?

A. The net market value per gross ton for special track work material was determined to be zero for single main track, $2.63 for double main track, and $5.72 for yard and side track.

An analysis was made of the quantities of various sizes

of main track turnouts to arrive at an average total weight, less rail weight, of 4.20 gross tons per turnout. We used this tonnage throughout for turnouts in heavy rail
page 214 } (130 pounds per yard and up) main lines. An average weight of 3.44 gross tons was used for 100 pound main track turnouts. These are on branch lines and represent less than 10% of main track turnouts.

For side and yard track turnouts, we used a composite weight of 3.68 tons per turnout based on all sizes and weights. Over 70% of the turnouts in side and yard tracks of Norfolk and Western in Virginia are constructed of heavy rail. These tonnages times the average number of turnouts per mile for each line gave the tonnage of turnout material used in arriving at the average fair market value per mile for each line.

The over-all average number of turnouts on the Norfolk and Western in Virginia is about one per mile of main line, 1.75 per mile of branch line and 3.25 per mile of siding and yard track.

Q. Is there material in ICC Account 10 other than track accessories and special track work material?

A. Yes. The remainder of Account 10 consists of material from track appurtenances such as bridge guardrails, derails, switch heaters, rail oilers, bumping posts, and
page 215 } wheel stops. A derail is a track structure for derailing rolling stock in case of emergency. A switch heater is a device for keeping switch points clear and moveable in severe cold weather conditions. A rail oiler is a storage unit for lubricant and an apparatus which is activated by the wheels passing over it. Grease is thereby applied to passing wheel flanges which carry it to high rails in curves, switch points and other points of the track structure subject to intense wheel flange wear. Bumping posts and wheel stops are devices placed at the open end of track to stop rolling stock from rolling off the end of the track. Most of the bridge guardrail is installed in main tracks, while most of the other material is installed in side tracks. These types of items are scattered throughout the property. We obtained the total quantities of material from Norfolk and Western records. As it is doubtful if very much of this material would sell above scrap prices, these quantities were converted to weights. We prorated the total weight of guard-
rail to the various lines based on the footage
page 216 } of each line occupied by bridges and tunnels where guardrail is used. We then reduced this to

average tonnage per mile for each line. To this was added an average weight per mile of the other appurtenances. We found the system average weight of track appurtenances per mile, exclusive of guardrail, to be less than 0.10 gross tons for main track and less than one gross ton for side track. The cost per gross ton to recover the miscellaneous track appurtenances would vary considerably by type and distribution. Since bridge guardrail makes up most of the tonnage, however, the net value would be approximately that of scrap rail. We used $23.50 per gross ton, the same price we used for scrap rail.

Q. Would you summarize your findings as to the fair market value of Norfolk and Western's Other Track Material in the State of Virginia?

A. We determined that in the State of Virginia Norfolk and Western has 53,703 gross tons of relay accessories, 165,390 gross tons of scrap accessories, 23,564 gross tons of switch scrap and 11,813 gross tons of miscellaneous scrap.

page 217 ⟩ We determined the fair market value of this material is $6,812,960.

Q. Did you determine any fair market value for Norfolk and Western property in ICC Account 11—Ballast?

A. The market value of used railroad ballast is zero. This is apparent from the fact that most ballast has been left in place in past track removals.

The cinders used as ballast under most yard and side tracks of Norfolk and Western in Virginia are old and have disintegrated to fine particles and dust. This type of ballast would not be suitable for reuse. Even the reusable types of ballast, such as crushed stone found in main tracks would be too fouled with coal dust and dirt to be reused as ballast unless cleaned.

The uncleaned ballast might be suitable for a lower class use, such as for surfacing semi-improved roads. However, railroad ballast is usually spread over too long an area for large quantities to be recovered without hauling it considerable distances, making it uneconomical to recover.

Q. Did you estimate a cost to load ballast from a railway roadbed?

A. Yes. We estimated that use of an elevating loader with

page 218 ⟩ operator would cost $26 per hour and that use of a dump truck with driver would cost $12 per hour. The capacity of the loader is 15 truckloads per hour and an average truckload would be 10 cubic

yards. On these assumptions, we determined that the cost to load was approximately 25¢ per cubic yard. At an average speed of 20 miles per hour, the round trip cost to haul ballast would range from $1.20 per cubic yard for a distance of 20 miles round trip to $4.80 per cubic yard for a distance of 80 miles round trip. Such costs would usually make recovered ballast noncompetitive with concentrated sources of roadway material more conveniently located to where material is needed.

[Counsel will introduce Exhibit 13-JAC (American Railway Engineering Association Bulletin No. 615, page 76)]

This exhibit shows that a recent study by the American Railway Engineering Association Committee 16 on Economics of Railway Location and Operation revealed an average cost of ballast from many sources to be $1.70 per cubic yard. It would cost more than this to load and haul most recovered ballast to a cleaning plant. It is doubtful if any ballast could be priced competitively, consider-
page 219 } ing the cost of cleaning it and delivering it to a purchaser. Most railway companies have sources of ballast on their lines. The ballast from the local sources can be hauled in railroad cars at comparatively low out-of-pocket cost to locations where needed. Rail freight rates to deliver ballast from an offline cleaning plant usually would be higher.

Q. Then you could attribute no market value to ICC Account 11—Ballast?

A. That is correct.

Q. What were your findings with regard to ICC Account 12-Track Laying and Surfacing?

A. This account includes the cost of distributing, laying and adjusting ties, rail and other track material used in the construction of tracks not previously ballasted. It cannot be sold; therefore, it would have no market value.

Q. Did you find that Norfolk and Western property in ICC Account 13-Fences, Snowsheds and Signs has any fair market value?

A. We doubt that a market could be found for used right-of-way fence material. Even if there were a
page 220 } market, most right-of-way fence could not be recovered economically. Furthermore, the material could not be sold competitively. We did not observe any snowsheds along Norfolk and Western tracks in Virginia.

James A. Caywood

There would be no reuse value to most railroad signs as standards for signs vary considerably among railroads. Many signs, such as milepost markers, are functional only at their existing locations. There would be no scrap value to the concrete milepost signs or wooden crossing signs used on Norfolk and Western property in Virginia. Other signs are so scattered that cost of recovery would exceed any likely scrap value.

Therefore, we attributed no market value to fences, snowsheds and signs.

Q. Does that cover all the items of property of the track, track structure and track appurtenances, other than signal equipment, of Norfolk and Western in the State of Virginia?

A. Yes.

Q. Would you summarize your opinion as to fair market value of this property?

page 221 } A. In my opinion the total fair market value of this property is $33,248,754. It is my opinion that the average fair market value is $13,962 per mile for single track main line, $28,914 per mile for double track main line, $36,096 per mile for triple track main line, and $9,778 per mile for yard track and sidings. In my opinion, the fair market value per mile of the various branch lines is correctly set forth in Exhibit 2-JAC.

Q. This does not include signal equipment, does it?

A. No. Signal equipment was considered separately.

Q. Now that we have your testimony as to your opinion of the fair market value of this property, would you briefly summarize your procedures used for determining the actual depreciated condition of this property?

A. As I stated earlier, it is my opinion that the condition of the property in ICC Accounts 1, 5, 6, 8, 9, 10, 11, 12, and 13 is 48% of new, or stated another way, this property is 52% depreciated. We made this determination of physical condition from field observations, evaluation of maintenance practices and field measurements. Automobiles

page 222 } with flanged wheels operating on the railroad rails were used for inspection of the track. General track conditions were observed while traveling over the main and branch lines. An average of two stops per mile was made to note the precise condition of track components and to record the information. One stop was made at each numbered milepost and one about midway between the mileposts. This procedure assured a broad sampling of the condition of each line and permitted us to appraise the average condition of track components.

James A. Caywood

Q. Averaging two stops per mile, how many total inspection stops did you make?

A. Over 3,000.

Q. More specifically, what were your procedures for determination of the condition of rail as a percentage of new?

A. On main and branch lines the track alignment was recorded for each inspection stop. We obtained this information from Norfolk and Western's track charts. The nominal weight of rail and year the rail was rolled were determined from rail markings and recorded. Where actual conditions differed from track chart information, page 223 } the rail had been replaced. This gave an indication of rail life on curves. In main line territories, a rail contour machine was used to reproduce on paper cards a cross-sectional diagram of the head of the rail.

Q. Examples of rail contours are shown in Exhibit 10-JAC?

A. That is right.

[Counsel will introduce Exhibit 14-JAC (Contour Machine to Trace Rail Head)]

Where rail had been new when originally laid, representative rail contours were taken for the various ages of rail and track curvatures encountered. Loss of rail section was measured from the reproduced rail contours.

Q. This procedure was used to measure rail wear, is that correct?

A. Yes. Norfolk and Western has standards for limit of rail wear.

[Counsel will introduce Exhibits 15-JAC and 16-JAC (Norfolk and Western Limit of Rail Wear and Gauge for Measuring 130 Pound and 131 Pound Rail)]

These limits of wear are for physically sound rails. A notation on the standards requires immediate re- page 224 } moval of rail showing evidence of failure before these limits are reached. Also, rails with battered ends, rough surface, excessive flow of metal, etc., may be removed earlier.

Q. In other words, rail wear is not the only factor in rail life?

A. That's right. Permissible rail wear is a factor in rail

life only for rail laid on curves above 4°. Abrasion usually does not become the limiting factor until curvature exceeds about 7°. Generally, rail life is limited by the other factors I mentioned such as rough surface, excessive flow of metal, etc., that vary with traffic.

[Counsel will introduce Exhibit 17-JAC (Rail Defects)]

You can see In Exhibit 17-JAC some very badly corrugated rail on the low side of the track ready to be changed. This rail rolled in 1956 has a loss of height of only 1/16 of an inch. Also in Exhibit 17-JAC you see rail with excessive flow of metal and rail with surface defects that reduce life.

page 225 } In none of these cases is vertical headwear near the condemning limit. Exhibit 17-JAC also contains illustrations and technical definitions to which I refer.

Q. Then it is correct to say that rail on tangent (straight) track must be replaced before it has been worn down by abrasion to any considerable degree?

A. That is usually the case. In 1957 the engineering division of the Association of American Railroads conducted a study to determine the amount of metal worn from the top of rail during its life on main line tangent track.

[Counsel will introduce Exhibit 18-JAC (American Railway Engineering Association Proceedings, Volume 60, page 971)]

This study indicates that total headwear varies from 0.100″ to 0.140″ with total traffic *carying* from 150 to 500 million gross tons. Norfolk and Western contributed to this study. The 19 measurements furnished by Norfolk and Western varied from 0.065″ to 0.128″ of headwear. These measurements were low because of Norfolk and Western's practice

page 226 } of removing rail from its first location in tangent track in order to have good secondhand rails for replacing rail worn out on curves, engine-burned rails, etc. During our examination, however, it was an exception to find any rail in tangent track with vertical headwear exceeding 0.125″ unless it was rail relaid from curves. Also, it was an exception to find any rails on curves with vertical headwear exceeding 0.25″. When these conditions were found, it was obvious to us that there was very little remaining life in the rail.

Q. Are there any standards for anticipating rail life for various traffic density situations?

James A. Caywood

A. The American Railway Engineering Association has sanctioned a formula based on railway industry averages determined from past experience.

[Counsel will introduce Exhibit 19-JAC (American Railway Engineering Association Manual, p. 16-1-13)]

Q. And Exhibit 19-JAC also shows what percentage of rail life for tangent track can be anticipated on curves?

A. Yes.

page 227 } Q. Did you use these relationships as a basis for establishing the percent condition of rail?

A. Yes. An analysis was made of rail wear and rail curve patching information which we obtained in our survey for sections of new rail territory where the approximate total tonnage carried could be determined. We developed an empirical table whereby a percent condition could be assigned to rail based on wear. Our table provided for grading rail from 100% (new) condition down to 1% (imminent replacement) condition.

[Counsel will introduce Exhibit 20-JAC (Percent Rail Condition Based on Wear)]

Q. How did you determine the validity of this table?

A. By establishing percent conditions for existing rail, for tangents and curves in general agreement with antici- based on wear, that would project a total life of the rail pated life by the American Railway Engineering Association formula in Exhibit 19-JAC. This table was then used as a guide for assigning a physical percent condition to other rail based on wear.

page 228 } Q. What other factors affect the anticipated rail life?

A. Conditions of track maintenance standards and characteristics of traffic are important. The life of individual rails often is shortened by defects not related directly to wear or tonnage.

[Counsel will introduce Exhibit 21-JAC (Description of Rail Failures)]

Norfolk and Western operates a Sperry Rail Service Rail Detector car over its main line and heavy branch lines to find by electric and electronic means certain of these de-

fective rails that cannot be detected by visual inspection. Norfolk and Western replaces these defective rails when found.

[Counsel will introduce Exhibit 22-JAC (Defective Rails Found by Sperry Rail Service)]

Exhibit 22-JAC shows the results of tests of tracks in Virginia for the past several years.

[Counsel will introduce Exhibit 23-JAC]

The steady increase in the number of these rails found, as plotted on Exhibit 23-JAC, is indicative of a page 229 } lessened rail value on the Norfolk and Western.

Q. What causes these defects?

A. In some cases these defects are due to progressive fatigue in old rail. Such is the case on the Norfolk and Western's Shenandoah District north of Roanoke where about one-third of the rail was laid in 1933, 1934 and 1935. This rail was produced before steel rolling mills started to control the cooling rate of rail to reduce internal defects. At that time the cooling of rails hot from the rolls resulted in shatter cracks which can develop into fissures similar to those shown on Exhibit 21-JAC. Over 85% of the defective rails found by the Sperry Detector car on the Shenandoah District have occurred in this old rail. The average head loss of this rail is less that 1/16th inch. Tangent rail with this wear would be rated at 50% in accordance with Exhibit 20-JAC. Projecting the increased rate of defective rail found, however, indicates a far lower percent condition.

Q. Are there other causes of rail defects?

A. In other cases the increase appears to be page 230 } due to heavier traffic. There has been a significant increase in the number of defective rails detected on former Virginian Railway trackage between Glen Lyn and Abilene. This line carries most of the eastbound coal tonnage on the Norfolk and Western. Many of the rail failures in this territory are detail fractures. Detail fractures are associated with shelly rail (shell-like chipping of rail surface) and other defects caused by the plastic flow of metal as a result of heavy wheel loads. Some of the shelly rail noted on this line occurs in ten-year old control-cooled rail with as little as 1/16 inch headwear and 1/4 inch gauge wear.

James A. Caywood

Q. In other words, the percent condition which assigned to rail was based not only on the loss of section due to wear, but also on your judgement when justified by other factors?

A. That's correct.

Q. What did you determine the over-all condition percent of rail in the State of Virginia to be?

A. 40% for main track and 27% for side track.

page 231 } Q. In other words, you determined that the rail in Norfolk and Western's main track is 60% physically depreciated?

A. Yes.

Q. How was this over-all condition determined?

A. We determined a condition rating for individual lines and weighted the condition ratings based on relative length of the lines.

[Counsel will introduce Exhibit 24-JAC (Condition Rating)]

Q. Did you follow this same procedure for determining an over-all condition rating for the other components of the track structure and track appurtenances?

A. Yes. Exhibits 24-JAC shows the condition of each of these elements for each line and also shows the composite weighted condition rating for each element.

Q. What percent condition rating did you assign to ballast?

A. Forty-three percent for ballast in main track and 37% for ballast in side track.

Q. What procedure did you use for rating bal-

page 232 } last?

A. The appraisal of ballast in main and side tracks was based on the ballast sections as applicable to the class of track and kind of ballast used.

[Counsel will introduce Exhibit 25-JAC (Norfolk and Western Standard Ballast Sections)]

Exhibit 25-JAC shows the Norfolk and Western standard ballast sections. These standards were adopted in 1965 and are not representative of the original ballast section of most of the trackage which we inspected.

[Counsel will introduce Exhibit 26-JAC (Ballast Sections)]

In Exhibit 26-JAC, you can see ballast given a 90% condition rating even though this ballast section does not conform to current standards. We related the percent condition assigned to how well the existing ballast conformed to earlier ballast construction sections. Over the years, effective ballast may be lost by working down into the sub-grade or by erosion from the shoulders. Also shown in Exhibit 26-JAC is ballast that has a lower percent condition than new because of being scant and another ballast section

page 233 } rated low because of little depth between the bottom of the ties and the sub-grade.

Q. How do you determine the effectiveness of ballast?

A. The effectiveness of ballast is governed as much by cleanliness as it is by conformity to an original ballast section. An important function of ballast is to provide immediate drainage for the track structure. Good ballast permits rapid runoff of surface water. There must be voids between ballast particles to allow drainage.

[Counsel will introduce Exhibit 27-JAC (Norfolk and Western Specifications for Prepared Stone, Slag and Gravel Ballast)]

You can see that Norfolk and Western's specifications for ballast as shown in Exhibit 27-JAC require original ballast to have such voids.

Q. What causes deterioration of ballast?

A. Ballast pulverizes due to the abrasion of adjacent particles under repeated traffic loadings. These fine particles choke the voids and impede drainage. Fine particles, such as sand and coal dust from the shifting of lading

page 234 } from cars may obstruct ballast drainage also. The ballast then stays wet, becomes muddy, "pumps" excessively under traffic, i.e., is expelled from the sides and ends of ties, and the ballast no longer functions properly in holding track surface. When ballast gets too dirty, it must be removed and replaced.

[Counsel will introduce Exhibit 28-JAC (Foul Ballast Removal)]

Exhibit 28-JAC shows locations on the Norfolk and Western where fould ballast was being removed.

Q. Were your ratings for ballast derived solely from visual observation of surface appearance?

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A. No. Surface appearance of ballast can be deceptive in that fine particles, such as dirt, engine sand, and other foreign matter settle into the ballast from train vibrations and washing action of rain. Ballast may appear clean although underlying ballast may be very dirty and fouled.

[Counsel will introduce Exhibit 29-JAC (Foul Ballast)]

page 235 } Exhibit 29-JAC shows foul ballast exposed during cross tie renewal. Also shown in Exhibit 29-JAC is vegetation growth indicating an underlying dirty, foul condition. During our survey, where foul ballast was suspected, we removed the top layers of ballast and examined underlying layers.

We made notations on ballast conditions in comparison with a full section of clean ballast and then assigned a percentage condition.

[Counsel will introduce Exhibit 30-JAC (Examples of Ballast Appraisals)]

Exhibit 30-JAC shows examples of notations of condition percentages which we assigned to various ballast sections with differing degrees of cleanliness.

Q. Did you confirm the validity of the relative percent conditions which you assigned to ballast based on visual appraisal?

A. Yes. Some samples were given a sieve analysis by a testing laboratory. This analysis determined the gradations of the existing ballast for comparison with Norfolk and Western specifications for new ballast. We took

page 236 } samples from locations that had received ballast ratings of 80%, 60%, 40%, and 20% during our inspection tours.

[Counsel will introduce Exhibit 31-JAC (Locations Where Ballast Samples Were Taken and Method of Sampling Ballast at Each of Four Locations)]

[Counsel will introduce Exhibit 32-JAC (Froehling and Robertson, Inc., Lab Report on Ballast, Gradations)]

Exhibit 31-JAC shows the location from which we obtained samples and the method we used in sampling.

All locations which we sampled had originally been bal-

lasted with the same type of crushed stone ballast. Norfolk and Western specifications establish the following size limits for new ballast of this type:

Size of Square Opening	Percentage (by Weight) Passing Each Sieve
2″	100
1½″	90-100
1″	20- 55
¾″	0- 15
⅜″	0- 5

Under these specifications, acceptable ballast should have a minimum size of 3/4″. This would be desirable from a drainage standpoint. From the practical standpoint, in obtaining crushed stone ballast, however, smaller
page 237 } gradations of up to 15% by weight are permitted. Of this, as much as 5% can be smaller than 3/8″.

Exhibit 32-JAC gives the results of the laboratory sieve analysis of the four samples made by Froehling and Robertson, Inc., inspection engineers.

[Counsel will introduce Exhibit 33-JAC (Laboratory Analysis of Ballast Samples)]

The results of the laboratory analysis are plotted on Exhibit 33-JAC for comparison with Norfolk and Western specifications for new crushed stone ballast. Norfolk and Western specifications conform to the American Railway Engineering Association grading requirements for size Number 4 crushed stone prepared ballast with nominal size of 1-1/2″-3/4″.

Q. Will you interpret this chart in Exhibit 33-JAC, please?

A. Sample No. 1, rated 80%, was the only sample having less material than specified pass through any sieve. This occurred on both the 2″ and 1-1/2″ sieves, indicating there were some particles larger than the nominal size of the ballast.

page 238 } All samples were well within the limits for the 1″ size sieve; the samples rated 20% and 40% had a greater percentage of ballast pass through this sieve, however, than did samples rated 60% and 80%.

An increasing amount of material passed through the

3/4″ sieve by progressively lower rated samples. Ballast passing this sieve was below the nominal size of the ballast being tested. Sample No. 4, rated 20% had more material pass through this sieve than permissible for new ballast. Sample No. 3, rated 40%, was within 6% of the permissible limit. Sample No. 4 had about 2-1/2 times as much material pass through the 3/8″ sieve as is permissible for new ballast. Sample No. 3 was 4% below the permissible limit. Sample No. 2, rated 60%, was 10% below the permissible limit. Sample No. 1, however, had less than one-half the amount of material pass through the 3/8″ sieve as is permissible for new ballast.

This standard sieve analysis revealed the ballast assigned lower percent conditions in our appraisal was nearer to non-acceptable gradation limits for new ballast than was the ballast assigned higher percent conditions.

page 239 } Although not specified in Norfolk and Western grading requirements for crushed stone, an additional screening of the material passing through the 3/8″ sieve was made with a No. 4 sieve (3/16″ square openings). This was done to determine the amount of pulverized material and extraneous matter present. For Sample No. 1, which received a visual rating of 80%, 1.2% (by weight) of the material tested passed through a No. 4 sieve. For Sample No. 2, rated at 60%, 2.6% passed through the No. 4 sieve. For Sample No. 3, rated 40%, 3.6% passed through the No. 4 sieve. For Sample No. 4, rated at 20%, 9.5% passed through the No. 4 sieve.

Fine particles tend to fill the voids in ballast and eventually to block drainage. The increased amount of dirt in the ballast samples related to the condition ratings which we gave ballast in our field appraisals.

Based on the results of the sieve analysis, it would appear that Sample No. 3, rated 40%, was in almost as good condition as Sample No. 2, rated 60%. As I said earlier, however, the condition rating was also affected by ade-

page 240 } quacy of the ballast cross section. Sample No. 3's rating was lower since it came from a scant section, whereas Sample No. 2 was from a fairly full section.

Q. To review, you assigned a 43% condition rating for ballast in main track and a 37% condition rating for ballast in side track?

A. That is correct.

Q. What percentage condition rating did you find exists for Norfolk and Western ties in the State of Virginia?

A. Fifty percent from main track and 35% for ties in side track.

Q. What procedures did you use for assigning a percent condition to ties?

A. The percent condition of cross ties at each main track inspection stop which we made was judged by grading the condition of ten ties in a row, starting opposite a milepost or telephone pole. Each tie was graded from 0 to 10 as an indication of the relative service life left in the tie. A tie was graded 0 if its useful life was gone. Such a tie was neither carrying weight nor holding rails to the page 241 } proper gauge. We graded a practically new tie at 10. We graded ties at 1 through 9 according to their condition between almost worn out and almost new.

[Counsel will introduce Exhibit 34-JAC (Individual Cross Tie Ratings)]

Exhibit 34-JAC shows examples of ties rated from 0 to 10. Adding the ratings of the 10 individual ties indicated the percent condition of the group of ties at the inspection stop.

[Counsel will introduce Exhibit 35-JAC (Examples of Tie Appraisals)]

Exhibit 35-JAC shows examples of group tie ratings assigned during our field evaluation. Averaging the conditions of the inspection stops at half-mile intervals on each main line gave us the over-all percent condition of the cross ties on each line. We adjusted this condition by weighting in the average condition of switch ties and bridge ties for each line. Switch and bridge ties represent about 6% of the Norfolk and Western's track mileage in Virginia. We considered the over-all condition of sets of switch ties and bridge ties in assigning a percentage rating to the unit. page 242 } We also gave the cross ties in side tracks an over-all rating from observation of the entire trackage.

Q. Will you comment on the statistical sampling method used to arrive at the over-all condition for main track cross ties?

A. We based our findings on a systematic sampling of the condition of a portion of the ties. The accuracy of this method depends on the number of samples taken. For the chances to be 99 out of 100 that the average condition of

the ties sampled would be within 1% of the average condition of all ties on the territory, it would have been necessary to sample about 6,650 ties. For the chances to be 95 out of 100 that the accuracy would be within 5%, it would have been necessary to sample 154 ties.

[Counsel will introduce Exhibit 36-JAC (Sample Size for Estimating a Mean)]

Other sample sizes necessary for various confidence limits are shown in Exhibit 36-JAC. Since we sampled over 30,000 main track cross ties on the Norfolk and Western in Virginia, the accuracy of the over-all percent con-
page 243 } dition determined by our systematic sampling method should be within 1%. The accuracy for separate lines could be expected to vary with the length of the line. For a 100 mile line such as the Clinch Valley Line between Bluefield and Norton, the average condition of the ties sampled should be within 2% of the average condition of all cross ties on the line. For a shorter line such as the 23 mile Dismal Creek Branch, the accuracy should be within 4%. On the short spur lines up to about two miles in length, we found that the conditions usually were uniform throughout the length of the line. The likelihood was that a few observations would reflect over-all conditions. Therefore, the average cross tie conditions which we determined for each line should be deemed to be accurate to within 5% regardless of the length of the line.

Q. What condition percentage did you assign to other track material in the State of Virginia?

A. Forty-five percent for other track material in main track and 30% for other track material in side track.

Q. On what basis did you assign this rating?

page 244 } A. Rail accessories such as joint bars, tie plates, bolts, spikes, nut locks and rail anchors are usually changed when rail is changed. Therefore, we compared the relative condition of these track components with the condition of rail at the inspection locations. We made notations where the accessories had other than about the same percent condition as the rail.

[Counsel will introduce Exhibit 37-JAC (Varying Conditions of Other Track Material at the Same Location)]

Exhibit 37-JAC shows a location where tie plates were in better condition than the rail. We found that this some-

times occurred in track with heavy curvature where rail life would be low. Exhibit 37-JAC also shows a place where tie plates were in worse condition than the rail. This occurred where newer rail had been laid on existing tie plates. A third picture in Exhibit 37-JAC shows a location where the tie plates were in fair condition, but the joint bars were in poor condition. We found that the condition of different types of track accessories usually varied at the page 245 } same location only on branch lines or sidings and yard tracks maintained with secondhand material. We made an over-all condition appraisal of switch material at each location. We made notations when this condition varied from the general condition of the rail and other track material.

[Counsel will introduce Exhibit 38-JAC (Examples of Worn Switch Material)]

Exhibit 38/JAC shows samples of worn switch material that would downgrade the condition rating. The over-all percent condition rating which we gave to other track material for a main line, branch line or the related side tracks was determined by weighting the various conditions noted and arriving at an average.

Q. Did you determine a condition percent rating for track laying and surfacing?

A. Yes. We assigned a condition rating of 46% to main track and 32% to side track.

Q. On what did you base this determination?

A. Track laying and surfacing represents the labor in installing ties, rails and other track material, and in placing ballast. It was not a tangible item, therefore, page 246 } that we could observe. The benefit of the original track laying and surfacing labor costs would diminish, however, as the condition of the materials diminished. For instance, when the condition of a component of the track structure fell to zero and needed to be replaced, there would be no benefit in the original labor because new labor would be required to install the replacement material. Therefore, we felt that the average condition of ties, rails, other track material and ballast would be a proper condition rating to apply to track laying and surfacing. As the cost of installing the various components per unit of track length is not the same, it was necessary to take a weighted average of the condition percentages of the components. Based on

the study of maintenance-of-way costs by Committee 16 of the American Railway Engineering Association (shown in Exhibit 13-JAC, the components were weighted: ties, 40%; rails, 20%; other track material, 20%; and ballast, 20% in arriving at the percent condition of track laying and surfacing which we assigned.

Q. Did you determine a condition percent rating for fences, snowsheds and signs?

page 247 } A. Yes. We assigned a condition rating of 44% to fences, snowsheds and signs.

Q. What were your procedures in making this rating?

A. We observed the general condition of right-of-way fences while we traversed each railway line. When stops were made to examine other roadway components, we made notations of the percent condition of fences in our survey notes. We made spot observations and notations of the condition of signs. An over-all average percent condition was assigned to fences and signs for each line based on our judgment in reviewing separate notations and recalling general observations.

Q. Did you determine a condition percent rating for tunnels and subways?

A. Yes. We assigned a condition percent rating of 67% to tunnels and subways.

Q. How did you go about determining this condition percent rating?

A. We established a condition percentage for each of the 37 tunnels on the Norfolk and Western lines in

page 248 } Virginia by visual inspection. In Virginia, Norfolk and Western has 11 unlined rock bore tunnels, 17 concrete lined tunnels, 6 brick lined tunnels and 3 partially lined tunnels. In applying the condition percentages to unlined tunnels, we gave consideration to the extent or seriousness of defects, such as the magnitude of rock falls, dampness around the track structure, and dripping or running water from the roofs. We also considered the size and location of cracks in the linings of lined tunnels in applying a condition percentage. As a large part of the expense of constructing lined tunnels is in excavating the bore, a tunnel with poor lining could have above a median over-all condition value.

Q. Could you be a little more specific in the standards used for rating individual tunnels?

A. Good, dry, lined tunnels with but few small cracks and no indication of serious conditions were graded at 75% or better. We found 20 tunnels in this category.

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Lined tunnels with large cracks emitting running water; those with heavy seepage through the roofs or
page 249 } sidewalls; and those with spalling lining were graded at 50% to 75% condition. We found 13 tunnels in this category.

We limited our condition ratings of below 50% to tunnels where rockfalls were causing trouble, or where excessive dampness was causing track difficulties. Four tunnels were in this category.

Q. Did you determine a condition percent rating for bridges, trestles and culverts.

A. Yes. We assigned a condition percent rating of 77% to bridges, trestles and culverts?

Q. What procedure did you use for assigning this rating?

A. We made an on-sight inspection of each bridge and trestle and a spot inspection of culverts on each line. We inspected a total of 866 bridges and trestles, and many non-numbered culverts.

Q. What type of bridges does the Norfolk and Western have in Virginia?

A. Norfolk and Western bridges in Virginia are mostly steel spans with masonry abutments. However,
page 250 } there are some masonry arches, concrete slab bridges, reinforced concrete box structures, and a few timber trestles. Most of the timber trestle is used in approaches to steel girder center spans.

Q. What factors did you consider in assigning this condition percentage?

A. Deterioration of the components of each structure was the governing factor in assigning our ratings. We gave consideration to loss of steel due to corrosion, spalling of masonry due to weathering, and decay of timber due to age. Also, defects such as damage due to external causes, cracks in concrete and fractured bridge seats affected the condition rating.

Q. What was your specific method for rating each bridge, trestle or culvert?

A. For each component, such as abutments, piers, bridge seats, footwalks, and steel, we noted a relative grading of excellent, good to excellent, good, etc., during the inspection. Grades assigned, which represented condition as the percentage of new, were "excellent" for 90% to
page 251 } 100%, "good" for 70% to 80%, "fair" for 50% to 60%, and "poor" for 40% and below.

A notation of "good to excellent" or "good to fair" was

used for borderline cases. We weighted the condition of the various components and assigned an over-all condition to each structure.

Q. Was the rating given each structure based entirely on its appearance?

A. Yes, and this probably overstates the condition percentage of many of the structures. We did not attempt to grade for conditions not visible, such as progressive fatigue of components. Also, we did not downgrade any structure for obsolescence.

Q. Did you determine a condition percent rating for engineering?

A. Yes, we assigned a condition percent rating of 48% to engineering. As most of the expense charged to engineering is in the pay and expenses of engineering employees involved in original construction, it is not an item visible to inspection. The average percent condition of the tan-

page 252 } gible items of track and appurtenant structures was used as the condition of the engineering related to the accounts involved. We based this on the fact that engineering expense was involved in the cost of the components as well as in the whole of original construction.

Q. You stated earlier that you determined an over-all condition percent rating for the track structure and track appurtenances of Norfolk and Western in the State of Virginia. You stated that that over-all percent condition rating was 48%. Would you please state how this over-all condition percent rating was determined?

A. In our opinion, the composite average condition of track, track structures and track appurtenances, weighted for each component's proportionate share of the total depreciated investment of all items being averaged, gives a reasonable indication of over-all condition. As I indicated earlier, we determined a separate condition rating for each element of property, i.e., for each ICC account, in each line. Next we determined a composite condition rating for the "track accounts" (ICC Accounts 8, 9, 10, 11 and 12) for each line. This was done by weighting an average proportionate cost of each component of material and of track laying and surfacing in building new track of

page 253 } various types against the condition rating of the various track accounts. To determine an over-all or state-wide condition rating for the track accounts, the composite condition rating for these accounts,

for each line, was weighted according to the relative length of the various lines.

For the other accounts under consideration (with the exception of Engineering), we determined an over-all or state-wide condition rating by weighting the condition rating for each account for each line according to the relative total investment in the applicable account in the applicable valuation section against the total state-wide investment in the same account. (Mileage is not a satisfactory method for weighting the condition rating of bridges, tunnels, etc., because some long lines have very few of these structures while other relatively short lines have several structures.)

Once we had determined a composite state-wide condition rating for the track accounts and a state-wide condition rating for the remaining accounts, the over-all condition rating for the track structure and appurtenances was determined

page 254 } by weighting the state-wide condition rating of each account (the "track accounts" taken as a composite) according to the relative depreciated investment in the various accounts. (The Engineering Account received the same rating as the over-all rating because its condition is a direct function of the condition of the track structure and appurtenances as a whole.) The depreciated investment was supplied to us by Mr. D. L. Kiley of Norfolk and Western.

[Counsel will introduce Exhibit 39-JAC (Condition of Lines as Percentage of New)]

The over-all condition rating by components is shown in Exhibit 39-JAC.

Q. Mr. Caywood, you stated earlier that a separate appraisal was made to determine the fair market value of Norfolk and Western's signal equipment in service in the State of Virginia?

A. That is correct.

Q. Did you follow the same general procedures in valuing this property as you did in valuing the items of property about which you have previously testified?

A. Yes.

page 235 } Q. When was the field work done on signals?

A. Between the first week of September and mid-November, 1968.

Q. I think first you should tell us something about the type of equipment which is in question here.

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A. This is signalling equipment which is included in ICC Account 27. This account includes automatic block signals, traffic control systems, interlockings, highway-railroad grade crossing protection devices, car retarder and auxiliary equipment, and line-of-road detectors.

Q. What are automatic block signals?

A. These are an arrangement of electrical signals along the track which display various colored or position light aspects giving locomotive engineers information as to the occupancy of blocks or sections of track ahead. The signals are automatically activated by the shunting of track circuits by wheels of cars and engines. The purpose of the signals is to provide safe and flexible movement of trains.

Q. What is a traffic control system?

page 256 } A. This is a system of electrically controlled signals and power operated track switch mechanisms which are controlled from a central point, usually a distantly located dispatcher's office, which governs the movement of trains at passing sidings, junctions and on line of road. The indication of the signals informs the locomotive engineer of the route the train is to take and all movements are made without train orders or time table rights. For safety purposes the traffic control system is interconnected with and backed up by the automatic block signal system to which I previously referred.

Q. What are interlockings?

A. An interlocker is a local arrangement of signals and power or mechanically operated track switches at junctions, movable bridges and railroad grade crossings to provide a route and direct the movement of trains without danger or interference with other train movements. The arrangement can be controlled by a local operator, by remote control from a distant point, or automatically.

Q. Would you explain highway-railroad grade crossing protection?

page 257 } A. This is a system of automatically operated flashing red lights, with or without short arm gates, which are activated by the approach and the presence of trains at the crossing. The purpose of these devices is to warn drivers of highway vehicles of the approach of trains.

Q. Please describe car retarder and auxiliary equipment.

A. This type of equipment is used in classification yards to expedite the classification of cars and the makeup of trains. At such locations cars are shoved over a hump in the track and released either individually or in cuts

(groups) and roll by gravity to the appropriate classification track. The required retardation or braking is provided by power operated mechanisms which apply varying pressure to the sides of the car wheels. Power operated track switches divert the car or cut of cars to the proper yard track.

Q. Please tell us about line-of-road detectors.

A. As a part of the signal system, devices are provided at various locations to detect overheated journals on cars, loose wheels, dragging equipment and falling

page 258 } rocks in cuts. These detectors are either interconnected with the automatic block signal system in order to cause stop signals to be displayed when activated, or else they automatically transmit the information to a distant dispatcher's or operator's office where appropriate action can be taken.

Q. Would you go into a little more detail as to your method of making the appraisal of this equipment?

A. We first requested and were furnished scale plans showing the track and signal layout for all lines having signal equipment in Virginia. This information was furnished by the Manager of Signals and Communication for the Norfolk and Western in Roanoke. We also obtained operating department time tables to assist in determining specific territories where different types of signal systems are in service. We requested and were furnished experienced representatives of Norfolk and Western's Signal Department to accompany and guide us to locations where signal equipment was in service.

Q. What occurred when you reached a location where signal equipment was in service?

page 259 } A. At each location we visited we made an inspection and inventory of equipment and components.

Q. What did this inspection involve?

A. It involved a check of the equipment or component parts to determine approximate age, type, condition and whether or not the device or item of material would have any market value if removed from service.

Q. Did you visit every signal layout in the Commonwealth of Virginia?

A. No. We visited and inspected all of the large or special layouts which do not conform to any typical or standard track and signal arrangement. In cases where the installations were of a standard nature and there would have been a repetition of equipment or a typical pattern, we made

samplings at frequent locations to inspect and tabulate the component parts. On the basis of this sampling, we compiled typical lists and used these to tabulate items of equipment in similar units which were not visited. Combining the information which we secured from road inspections with the check of plans obtained from Norfolk and Western Signal Department, we tabulated all items of signal

page 260 } equipment considered to be of any saleable value.

Q. Once you had tabulated the quantities of marketable materials, how did you determine the fair market value of these items?

A. Much of the material involved has no market value. These items include concrete foundations, underground and aerial cables, track joint bonds, copper-coated steel line wire, pole line fittings, etc. The interlocking, traffic control and retarder control machines are custom made for specific track layout or application and with the exception of a few component parts would have no market value. As for the structures used to support signals and other equipment together with some of the instruments, most of this material is manufactured or assembled in Norfolk and Western shops and would not have a market value other than scrap.

Q. Is any of this equipment significantly obsolete?

A. Yes. For example, there are over 3,200 old alternating current relays in service in Virginia. Thousands of such relays are being thrown away by different rail-

page 261 } roads as modern equipment is installed. The general practice today is to use direct current apparatus in order that standby battery power can be utilized to insure continuity of service in the event of alternating current powerline failures.

Q. What considerations did you make in determining the fair market value?

A. In assigning a fair market value to these items, we considered type, age, condition, current usage in the industry, and costs of overhauling and testing. We determined that a considerable proportion of standard items of equipment or material would have no market value on account of deterioration. In making our decision as to fair market value of the various items, we depended on our best judgment.

Q. You also made a determination of the present condition of this equipment, expressed as a percentage of new, did you not?

A. That is correct. During our line-of-road inspection, we observed the various components of the sig-
page 262 } nal system to determine approximate age, condition, and probable extent of future reliable performance. We interviewed Norfolk and Western signal supervisors, maintainers and other Norfolk and Western signal personnel in order to obtain information as to wear and weak points in the signal system. Based on this information, we made an estimate of the average over-all physical depreciation of the system as a percent of new or original condition.

Q. What did you determine to be the fair market value of the Norfolk and Western's signal equipment in the Commonwealth of Virginia?

A. $1,600,478.

[Counsel will introduce Exhibit 40-JAC (Appraisal of Signal Equipment)]

Exhibit 40-JAC indicates the total fair market value which we determined and the fair market value per mile for the various divisions of the main line and various branch lines.

Q. What did you determine the over-all condition percent of this signal equipment to be?

page 263 } A. We determined the over-all condition percent of this equipment to be 65%. This determination is also reflected in Exhibit 40-JAC.

Q. To review your testimony, Mr. Caywood, in your opinion the fair market value of the Norfolk and Western track, track structures and track appurtenances, exclusive of signal equipment, in the State of Virginia is $33,248,754. Is that correct?

A. Yes.

Q. And this figure represents the fair market value exclusive of franchise value?

A. Yes.

Q. And the fair market value, exclusive of any franchise value, of Norfolk and Western's signal equipment in the State of Virginia is $1,600,478, in your opinion?

A. That is correct.

Q. And the "condition percent" of the property other than signals is 48%, expressed as percentage of new?

A. Yes.

Q. And the condition percent of signal equipment is 65%.

A. That is correct.

page 264 } Q. Thank you, Mr. Caywood.

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A. Thank you.

page 265 } I hereby certify that the answers given to the foregoing questions are true and correct to the best of my knowledge and belief.

James C. Caywood

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

G. Edward Koch
Notary Public

My commission expires:
May 1, 1969

page 266 } CROSS-EXAMINATION

By Mr. Shannon:

Q. Mr. Caywood, I note, in your statement of qualifications, you indicate that you were engineer in charge of maintenance of the B & O Railroad between 1957 page 267 } and 1961. Was that the period just prior to the C & O's acquisition and control of the B & O, which I believe took place sometime in February, 1963?

A. Yes, sir, that is the period when I was engineer of maintenance of the Eastern Region, I believe, of the Baltimore & Ohio; that is correct.

Q. Did you continue in that position, after the C & O acquired stock control of the B & O?

A. In June of 1960, I was appointed assistant chief engineer System Construction and Maintenance of the Baltimore & Ohio. In October of 1961, I was appointed chief engineer Construction and Maintenance for the Baltimore & Ohio.

Q. Since leaving the railroad industry and becoming an official, I believe, of DeLeuw, Cather and Company?

A. That is correct.

Q. Have you been engaged in making regular appraisals of railroad property throughout the United States?

A. I have been engaged in making appraisals of railroad properties in various parts of the country. I have done appraisal work in connection with the Washington Terminal properties, and the Baltimore & Ohio properties, that were involved in the Rapid Transit program that I page 268 } am connected with in Washington. I directed the activities relating to the evaluation of the

assets of the Delaware & Hudson Railway, in the States of Pennsylvania, New York, and New Jersey, I believe.

Q. Specifically, what was the purpose of that appraisal of the Delaware & Hudson properties?

A. Well, Mr. James E. Carr asked me to appraise the roadway assets of that corporation, and I don't believe he ever precisely told me what purpose he wanted those appraisals made for.

Q. You don't know, then, whether it was in connection with the finance document 21510, which is reported in 330 ICC, at page 78?

A. No, sir, I have no knowledge of this.

Q. Are you familiar with this proceeding, Mr. Caywood?

A. No, sir, I am not.

Q. You are not familiar with it?

A. No, sir.

Q. Have you ever made an appraisal of a line of railroad for *ad valorem* taxation for a state taxation authority, besides this particular one?

A. No, sir, I have not.

Q. This is your first one?

page 269 } A. Yes, sir.

Q. Have you ever made an appraisal of railroad track and road property, to be used by a railroad in connection with a case such as this, where the railroads are contesting the appraisal made of properties by State officials?

A. In my capacity, various capacities with the railroad company, I was quite often called upon by the Taxation Department, Real Estate Department, and various departments of the railroad to give them valuations of sections of the railroad, and I am sure many of these were in connection with tax cases. But I cannot be precisely specific about any particular case.

Q. You weren't given any specific instructions, I mean, as to the nature of the use?

A. I don't recall.

Q. And that was when you were with the B & O, wasn't it, Mr. Caywood?

A. Yes, sir, this is correct.

Q. Now, you indicated in your testimony that you were instructed to determine for appraisal purposes the fair market value of N & W's road and track structures in Virginia, I believe. What was the criteria used by you in arriving at your statement of fair market value?

page 270 } A. Well, we were told to—instructed by letter from Mr. James E. Carr, vice-president of Taxation of the N & W, that this property was to be appraised, and a fair market value set, exclusive of any franchise value or any going concern value, just the mere, bare bones of the property were to be ascertained and appraised.

Q. Well, then, were you given any instructions as to the effect of the fair market value, the price that the property would bring when it is offered for sale by one who desires but not obligated to sell it, and is bought by one who is under no necessity of having it?

A. I received a letter from Mr. Carr, dated May 20, I believe, sir, in which that statement is made precisely.

Q. Is that Exhibit 1-JAC?

A. That is May 29, yes, sir.

Q. And they were your instructions?

A. Yes, sir, this is correct.

Q. To your knowledge, Mr. Caywood, are the road and its track structures of the N & W up for sale at this time?

A. No, sir, they are not, to my knowledge.

Q. Have they ever been up for sale in the last five years?

A. Not to my knowledge.

Q. To your knowledge, is it N & W's plan to page 271 } liquidate and go out of business in Virginia?

A. I haven't been told so.

Q. And isn't it true, Mr. Caywood, that the N & W is on the threshhold of a great merger with the C & O?

A. So I read in the papers, yes, sir.

Q. And that merger, I believe, has been at least tentatively approved by an examiner and recommendation to the Commission; is that right? Examiner of the ICC?

A. So I read in the *Washington Post,* yes, sir.

Q. Continuing now, on page 7 of your testimony, Mr. Caywood, you state, and I quote, "We were instructed that only the bare bones of the property should be included in the appraisal." Were these instructions set out in James E. Carr's letter to which you have just referred, which is identified as Exhibit 1-JAC?

A. These are the only instructions that were received, yes, sir.

Q. What is your understanding of the term "bare bones"?

A. Well, my understanding of the term "bare bones," is simply what is this property worth, if you do not have a right or privilege to operate it as a going concern?

Q. Were you given any instructions as to the meaning of "bare bones"?

page 272 } A. No, I don't recall receiving that. This was my interpretation of "bare bones." I don't see where the property would be worth anything, without a right to operate it, other than liquidate it by salvage value.

Q. So that phase of the appraisal was pretty much left up to your professional judgment, was it not?

A. That is correct, yes, sir.

Q. Further, on page 7, you indicated that you were orally requested to examine and determine the condition of the property expressed as a percentage of new, were you not?

A. Yes, sir. Mr. Dan Kiley, assistant vice-president of Taxation, discussed this with me, and asked me to make this valuation.

Q. I see. Mr. Caywood, what is your understanding of original cost of a line of railroad?

A. Well, this would be the cost at which it was originally constructed, would be my understanding.

Q. You have had quite a bit of experience in railroad operations, railroad construction of projects, have you not?

A. Yes, sir.

Q. In making your estimation, and in making studies of railroad construction projects and all, aren't page 273 } you required, as a maintenance official, to base such estimates on the ICC's Uniform System of Accounts?

A. The guidelines used, yes, sir, are the ICC Uniform System of Accounts.

Q. If your railroad, for example, or you were with the B & O, just for a hypothetical example, if you all filed to construct a line of railroad, you are required to file an application and return questionnaire with the Interstate Commerce Commission, were you not?

A. This is correct.

Q. An innate part of your duties was to supply the data, the engineering data, that normally accompanies the return?

A. This is correct.

Q. And, in supplying that data, you are required, are you not, to give a statement of the estimated cost of construction by primary ICC property accounts?

A. This is correct. The estimates were all set up on the basis of the ICC accounts.

Q. So, to that extent, you do have knowledge, were required to have knowledge, of ICC Uniform System of Accounts for Railroads?

A. Oh, I have knowledge of them, yes, sir.

Q. What is your understanding of the term
page 274 } "original cost" of the line now in place?

A. Well, I am not clear as to what—my understanding would be that the original cost of line now in place would be its initial construction cost.

Q. In other words, you wouldn't take into account any additional betterments that came along? I do not want to confuse you with ICC accounting at this point. Your understanding of the original cost of line down in place is the initial investment of cost setup in the primary property accounts?

A. Well, plus betterments. I'm sorry. If you are talking as of the present date, it would include betterments, since the original.

Q. What about renewals?

A. No.

Q. You wouldn't include any renewals?

A. No.

Q. Such as a tie renewal?

A. No.

Q. Or rail that had been renewed?

A. No. The only difference, in the weight of rail would be capitalized; if you lay heavier rail in place of lighter rail.

Q. I am not trying to confuse you with capi-
page 275 } talization, now, Mr. Caywood. I am just talking about where you say replace a 132-pound rail with a 132-pound rail. For instance, maybe you put the 132-pound rail in, in 1946; and then, in 1956, you replaced that with a 132-pound rail. You wouldn't disturb your primary rail property account there, would you?

A. No, sir.

By Chairman Catterall:

Q. You would keep the cost of the original rail and not the cost of the rail now in place?

A. That is correct.

By Mr. Shannon:

Q. Mr. Caywood, normally, how is the railroad's maintenance budget determined?

A. Well, there are many ways that this is determined. The most reasonable and sensible way is on service life and need basis. This is an idealistic situation. Unfortunately, it is not always carried out. But I think most intelligent and diligent maintenance-of-way officers attempt to persuade their managements in this direction.

James A. Caywood

Q. But that is not the normal way it is done, is it?

A. Well, you would have to define "normal."

page 276 } Q. Let me put it this way. Let me restate the question, in this manner: Normally, don't you determine or estimate your expected operating revenues per year? And isn't a portion of that assigned to the engineer in charge of the maintenance, for maintenance of way?

A. Well, sometimes this is done over the protest of the maintenance-of-way officer, but it is done in that manner, in some instances.

Q. So, actually, a poor railroad would defer a lot of maintenance; is that correct? That is, a railroad that had a low earnings and heavy expenses, and didn't have a high net income?

A. Well,—

Q. Would be more prone to; is that right?

A. It might be.

Q. How was it done on the B & O?

A. We had some deferred maintenance.

Q. Is my understanding correct, that your assignment was to determine the fair market value of N & W's road and track property, based on the bare bones concept? That was the first phase of your assignment, was it not?

A. That is correct, sir.

Q. And the second was to determine the condition of the property, expressed as a percentage of new?

page 277 } A. That is correct, yes, sir.

Q. In carrying out your assignment, I believe you stated in your testimony that your field work commenced on June 3, 1968, and was completed on October 10, 1968; is that correct?

A. Yes, sir, that is correct.

Q. If my arithmetic is correct, that would be approximately, what, 129 days?

A. No, sir, not 129 days; it would be around 51 days, wouldn't it?

Q. Well, I made a hasty calculation. It doesn't make a great deal of difference.

A. Well, you are right; but I am thinking about the track portion with the structures used, yes, sir. You are probably right.

Q. Give or take a day, it doesn't make any difference.

A. I will take your word for it.

Q. Did you work on Saturdays and Sundays?

A. No, sir. These were five-day weeks.

James A. Caywood

Q. How many people assisted you in making the inspection?

A. We had a total of seven people, in addition to myself, that performed this field appraisal work.

page 278 } Q. How many hours a day did your people work?

A. Well, they are very hard-working, honest people; they all worked eight hours, at least, because we paid them for this much; and I checked them frequently, to determine this; and how much they worked on their own, beyond that, I don't know; but I do know that they did a lot of work at night, in reducing field notes, and summarizing data.

Q. The data that they developed during inspection during daylight hours?

A. Yes, sir; were reduced from field notes.

Q. Did you, personally, inspect all of N & W's railroad and track properties in Virginia?

A. I didn't personally inspect all of it, no, sir.

Q. Actually, how many days did you devote to the inspection of this property, Mr. Caywood?

A. I spent about a grand total of three and a half days on various portions of the line, verifying the methods that the people were using in the field to obtain the information, and seeing that they were going about this work correctly.

Q. But, actually, most of the physical inspection was done by your *subordinants?*

A. This is correct, sir.

page 279 } Q. On page 9 of your testimony, you state that over 3,000 man-hours were devoted to this project. As I understand your testimony, you don't mean to testify that 3,000 man-hours were actually spent inspecting N & W's road and track properties in Virginia, do you?

A. Yes, this is the time that was spent in inspection, and preparing for inspection. There were a lot of searches.

Q. And night work?

A. And night.

Q. And office work?

A. No, no, this was the hours paid for. There were more hours than that spent.

By Commissioner Hooker:

Q. No night work?

A. No, sir.

James A. Caywood

By Mr. Shannon:

Q. How did you go about making the inspection, Mr. Caywood?

A. Our inspectors used high rail vehicles to go over the road. They did a lot of walking, too.

Q. On page 10 of your testimony, you say you determined the average fair market value per mile in a single track, I believe you said, $13,962?

page 280 } A. Yes, sir.

Q. Double track, $28,914?

A. Yes, sir.

Q. Triple track, $36,096; and yard and siding, $9,778; is that correct?

A. That is correct, yes, sir.

Q. Don't you really mean the net salvage value per mile for each of these classifications of track?

A. This would be the value of these tracks, after cost of removal, yes sir.

By Chairman Catterall:

Q. I didn't hear the end of that answer.

A. It would be the value of the tracks, after cost of removal, yes, sir.

Q. You mean the salvage?

A. Salvage value.

By Mr. Shannon:

Q. Maybe I can clarify it by asking this question: By "net salvage value," do you mean the value of the materials which would be recovered from the road and track structures, if the line were to be taken up, after deducting the cost of recovering such material?

A. This is correct, sir.

Q. How many ties are used in a mile of main-

page 281 } line railroad track?

A. Well, this varies, depending upon the spacing.

Q. Let's take—excuse me.

A. Go right ahead.

Q. No, I want you to finish your answer.

A. This varies between sidetracks and main tracks. It depends upon the standards of the railroad, itself. It may vary between 2,000 and 3,200.

Q. Let's take a good railroad, like the N & W. And I say that in all sincerity; it's a very fine railroad. Take the

N & W mainline, between, say Roanoke and Norfolk. What would be the number of ties in a mile of mainline?

A. In that particular territory—this is just from a recollection—I believe they have about 24 ties to the rail in that territory.

Q. 24 to what?

A. To a 39-foot rail.

Q. How many would that be a mile? I will have to rely on your—

A. That would be about 3200, I believe, if my arithmetic is correct.

Q. You have got your slide rule there, it will save me a lot of trouble.

A. It would be about 32—yes, 3240, something

page 282 } like that.

Q. What is the present cost of a crosstie, Mr. Caywood?

A. Well, that varies, depending upon locality, and specie of tie. A main track tie, No. 4 and 5 tie, would probably be in the range of $5.00, $5.50.

By Chairman Catterall:

Q. $5.50 installed, or just by the tie?

A. Just the tie.

Q. Just to purchase it?

A. Yes, sir.

By Mr. Shannon:

Q. Of course, under ICC accounting, when you refer to "ties," I think it was account 8, let me get my book.

A. Account 8.

Q. Account 8. That only includes the cost of the tie; it doesn't include anything for cost of labor installing it; is that right?

A. That is correct.

By Commissioner Hooker:

Q. Does it include the cost of loading the tie on the car, and then unloading it when it gets to the place of destination?

A. No, sir, the cost of distributing material

page 283 } is in another account.

By Mr. Shannon:

Q. What account would that be in, Mr. Caywood?

A. Track laying and surfacing, account 12.
Q. That is your labor?
A. Yes, sir.
Q. How many tons of rail are laid in a mile, say, of 132-pound-weight track?
A. I have got to get my slide rule out again. But it's somewhere in the neighborhood of 220 tons.
Q. I acknowledge Mr. Caywood as an expert, or I wouldn't ask him these questions if he wasn't an expert. I know him, and know how well—

Mr. Riely: Its 132 times 1760, whatever that may be. I don't think it really takes expertise.

By Mr. Shannon:
Q. What is the present cost per ton of 132-pound rail, Mr. Caywood?
A. Well, the cost of rail is the same, whether it's—
Q. 132, it doesn't make any difference?
A. The current price is somewhere around $125 a ton, net ton, that is.
Q. By "net," in railroad parlance, I guess you
page 284 } mean a ton of 2,000 pounds?
A. Yes, sir.
Q. $125?
A. That, I believe, is the current price. That is just the rail, itself, now, without fittings.
Q. What about re-lay; what would be the cost of that?
A. Well, we—
Q. On today's prices?
A. Re-lay rail can be $78, $78.50.
Q. Isn't it a little higher than that now?
A. It varies sometimes from day to day, depending upon what the supply-and-demand situation is. I don't know what the price is today.

By Chairman Catterall:
Q. What is re-lay rail?
A. It would be rail, sir, that is suitable for reapplication in track.
Q. Used rail?
A. Used rail, yes, sir.
Q. Like used automobile?
A. Yes, sir.

James A. Caywood

By Mr. Shannon:

page 285 } Q. What would it cost, at today's prices, approximately, to construct, say, a mile of railroad on N & W's line, between, say, Crewe and Norfolk? You are familiar with the approximate location of Crewe, are you not?

A. Approximate location. I don't have figures right now on that. Are you talking about from scratch?

Q. Just a mainline.

A. To grade it?

Q. To grade it and ballast in, and ties and rails.

A. I don't have any figure handy. It would cost a considerable sum of money.

Q. Could you draw on your experience to give an approximation?

A. It would take me sometime to figure this up.

Q. But it would cost considerably more than, say, a hundred thousand dollars, would it not?

A. I would say so.

Q. And would it cost more, say, to construct a mile of railroad, say, between Bluefield and Roanoke, in the mountains, than it would down in the Tidewater region?

A. It probably would. The grading cost would probably be higher in that area.

Q. Grading would make a *different* in construction cost?

page 286 } A. Grading, in the initial cost, is a consideration, yes, sir, initial construction of the railroad.

Q. How about engineering, isn't that a cost that you have to consider in constructing a line of railroad?

A. Oh, yes, sir. The plans have to be made, and surveys have to be made.

Q. And then, bridges, trestles, culverts, that is an item which must be considered, is it not, in constructing a line?

A. Yes, sir.

Q. And tunnels?

A. Yes, sir.

Q. Mr. Caywood, what is the normal life of a treated crosstie?

A. Well, again, sir, this varies widely, depending upon the curvature, grade of the track, tonnage over the line, the specie of the wood, the type of treatment of the wood, the ratio of coal tar to creosote. Many things enter into this. This is an extreme variable.

Q. If I said the ICC says it's at least forty years, would you accept that as reasonable?

James A. Caywood

A. No, sir.

Q. You wouldn't.

A. This would depend greatly upon the location and the tonnage and the alignment, grades, species of

page 287 } wood.

Q. Let me ask you—excuse me, go ahead.

A. Well, those are the factors.

Q. Let me ask you this: Isn't it true today, that there is less fouling of ties, less damage to ties, today, than, say, there was back during the day when we had the steam engines?

A. Well, I don't know. A lot of this depends upon the traffic over the line. A diesel engine probably gives you less impact than the steam engines did; but other conditions might over ride this.

Q. Then are you saying that the counterbalance impacts of steam locomotives on track structure was eliminated with the advent of the diesel?

A. Yes, but other things came into play, too. You have more nosing and wheel slipping, and things of this nature, in connection with a diesel; and when you get your rail burned from a diesel operation, your impacts might become much greater than they were with steam engines.

Q. Did the steam engine—didn't the diesel, rather, eliminate the fire and the water damage to ties, fouling of ballast by the head end and firebox centers?

A. Well, I had many a section of track set on fire from hot-boxes, and they still exist.

Q. Where was that, on the B & O?

page 288 } A. Yes, sir. I had a bridge burn down at Harper's Ferry, one time.

Q. But, as a general proposition, you wouldn't get the fire damage to ties from a diesel that you would from the old steam engine; isn't that a fact?

A. No, I don't agree with you on that. Our incidence of right of way fires increased on the Baltimore & Ohio, after the advent of the diesels over the steam, so something caused this, and it had to be the diesels.

Q. Could it be partially due to the fact that you had considerable deferred maintenance and right of way wasn't maintained in as good condition on the B & O as, say, it would be on the C & O or the N & W?

A. Well, sir, are you saying it is easier to set an old tie on fire than it is a new one?

Q. I am saying, if you let the weeds grow up in your right of way or track, you have more of a *hazzard.*

James A. Caywood

A. We did have some pride on the B & O, and we did try to keep the weeds down.

Q. How about improvement in the design of tie plates, tie pads; hasn't that led to prolong the lives of ties, to a significant extent?

A. Wider, high-eccentricity tie plates at specific locations help. They are not widely used. They are used
page 289 } in specific locations. Tie pads are used in very minor usage of tie pads on railroads. They are used in some special applications.

Q. Haven't you also brought about a reduction in the number of derailments through the prohibition of cast-iron wheels and waste-pack car journals, which has extended tie life?

A. Well, I never heard this. In fact, the ICC and the Bureau of Safety are making quite a bit to do nowadays about the increase in derailments.

Q. Did you find, on the Norfolk & Western, there were many derailments, during your inspection?

A. I never investigated this, sir.

Q. Did you see any evidence of it from the track structure?

A. There is evidence that they have had derailments in some of the locations, yes, sir.

Q. In the past years?

A. How recently it occurred, I never investigated that; but there are evidence that accidents had occurred, and ties were damaged in locations.

Q. Do you know Mr. Hilitz of the Delaware & Hudson?

A. Yes, sir, I do.

Q. How do you regard him, as a maintenance-
page 290 } of-way man?

A. Well, Mr. Hilitz, I presume, is a very fine maintenance-of-way man. I never examined his maintenance practices. I have seen the results, in appraising the Delaware & Hudson. He was president of that road, and they have a high degree of maintenance up there, very high standard of maintenance, far over and above the N & W.

Q. Yes. And I have in my hand, I have been reading here, as I have been talking to you, Mr. Caywood, the ICC's report in the N & W inclusion case, which involved the Delaware & Hudson and the Erie-Lackawanna, in which the Interstate Commerce Commission said the average life, whatever it may be, is greater than forty years, and that was based largely on Mr. Hilitz' testimony.

James A. Caywood

A. Well, sir, I have an exhibit, Area Exhibit 16, that I think the highest life shown, and that is on tangent track with very little tonnage, is forty-two years. This ranges on down to twenty years for a tangent track, carrying about 5 million gross tons of traffic. It would be about forty-two years. That is on tangent track. Tangent track, carrying 50 million gross tons, would be thirty years' life.

On a 6-degree curve, estimated tie life would be, well, it's about fifteen years, on a 6-degree curve, carrying 50 million gross tons.

page 291 } Q. Mr. Caywood, then, would it be reasonable to conclude that maintenance-of-way engineers on railroads differ as to the tie life, average tie life?

A. Well, I think they have to differ. They have different conditions to put up with. They may buy five species of wood, because they live in different parts of the country; they get their materials from different sources, they have different treatment processes, many factors, that would make this vary, yes, sir.

Q. Would you, from your observation, say that the N & W put a pretty good quality tie in its railroad?

A. The N&W uses mixed hardwood ties, which is a very normal mixture of ties. It's not the best. Ordinarily, the best tie is recognized to be a white oak tie.

Q. Generally speaking, where are they used?

A. What do you mean, sir?

Q. In what section of the country, generally?

A. Where they are obtainable. I am sure that the N&W could purchase this type of tie, if they wanted to, but they probably would have to pay a premium, and they just don't desire to do this.

Q. Do you usually get your ties from a source that is closest available? Is that right?

page 292 } A. Yes, but you can specify what you want.

Q. And N&W ties are all treated now; isn't that right?

A. Yes, sir.

Q. In referring to your Exhibit 6-JAC?

A. Yes, sir.

Q. In arriving at your estimate of the fair market value of N&W's line of railroad in Virginia, you take into consideration only ties, rails, and other track materials, do you not?

A. This is correct, sir.

James A. Caywood

Q. Isn't it a fact that in constructing a line of railroad substantially more than ties, rails and other track materials are required?

A. In construction. But bear in mind, sir, that this wasn't the purpose of our endeavor here, to develop what it would cost to construct that railroad; we were asked to make an evaluation on the fair market value, based on no going-concern value, franchise value.

Q. Let me ask you this: Does a line of railroad, excluding assuming that you would have a line of railroad without any operation over it, but you have it available, say, for sale, wouldn't a line of railroad already in place be more valuable than the components that go into that

page 293 } line?

A. You mean if they were assembled?

Q. Yes, assembled. Assembled, versus torn down.

A. It would cost something to reassemble it, yes, sir.

Q. Have you ever determined the value of a going line of railroad, on the basis of the salvage or scrap value of ties, rails, and other track materials, before?

A. In my capacity as chief engineer of the Baltimore & Ohio, we determined the value of lines, based on liquidation value that we disposed of.

Q. You did that, for abandonment purposes?

A. Yes, sir.

Q. Were you going to file a Section 118 application, Interstate Commerce Commission, for abandonment, you do it in that way?

A. Yes, sir.

Q. So you have done it, in that connection, where you are going to take up, or liquidate?

A. Yes, sir.

Q. Do you know whether the ICC accepts the type of appraisal that you have made there, as indicative of the value of a line of railroad?

A. Well, I have no knowledge of what the ICC accepts or rejects. We simply made an appraisal of the fair

page 294 } market value of this property, without considering any going-concern value, franchise value.

Q. Mr. Caywood, on page 13 of your testimony, you state that you didn't determine any value for ICC account 1, Engineering; since it can't be sold. I believe you say you concluded it had no market value; is that correct?

A. That is correct, sir.

Q. And I believe you reached the same conclusion with

respect to grading, tunnels, subways, bridges, trestles, and culverts?

A. This is correct, sir.

Q. Which, under your "bare bones" concept, would have only zero value; is that correct?

A. Yes, sir. It's not "my" bare bones. Under a bare-bones concept, this would be so, yes, sir.

By Chairman Catterall:

Q. It all comes back to scrap value?

A. Yes, sir, it comes back, net value after cost of removal.

Q. If I built a railroad from here to New York and had no franchise, but had good ties and rails and ballast and bridges and tunnels, no trains running over it, I had no franchise; but I had it all laid out, and then I offered to sell it at auction, to anybody who could get a fran-
page 295 } chise, then, a going concern is what they earn from operating a railroad, is it not?

A. Well, a going concern would have that value, plus, I presume, good will, and—

Q. Depending upon the earnings?

A. Yes, sir.

Q. When the Seaboard was in receivership for so long, the going-concern value was not very good, was it?

A. I wouldn't imagine it was. I have no specific knowledge of that.

Q. Would you reckon anybody would buy my hypothetical railroad that I just built for you?

A. For salvage value, they probably would. If they were unable to get a franchise, I know of no other—

Q. But the bare bones would be there; and then, if they could run trains over it, they would make enough to pay the gross receipts tax.

A. Sir, unless I misunderstand, you would then be privileged to run these trains without a franchise.

Q. Oh, heavens, no. I am just trying to figure out how you approach the bare bones. You say you approach it by imagining a railroad with no trains running over it; and I am trying to ask you to imagine a beautifully-constructed railroad, with no trains running over it is now offered for sale
page 296 } to somebody who might wish to, and be legally competent to run it.

A. Well, in the absence of a franchise, again, I would only say that it would be worth the salvage value.

Q. You don't think somebody who got the franchise would

pay what I spent to build that, in order to take it over?

A. In the absence of a franchise, I couldn't imagine that they would, no, sir; or the assurance of a franchise.

Q. If my railroad ran into the City of Washington, D. C.—I am trying to get your idea of what are the bare bones, as distinguished from the earnings. Good will means earnings, does it not?

A. Yes. I realize what you are after, sir; but, again, I cannot establish any value, other than salvage value, in the absence of a franchise or going-concern value.

Q. See, we have a separate tax on the going-concern value, and on the bare bones.

A. Yes, sir.

Q. And the statute defines what goes into the bare bones, as including cuts, fills, and tunnels.

A. As I would see it, sir, the price, the healthy price of some two-million-odd dollars N&W pays annually page 297 } for their franchise, as I heard this morning in testimony, would seem to take care of their obligations in regard to what going-concern value they have there.

Chairman Catterall: That takes care of what they earn from running a train. I am getting awfully close to a legal argument, and I will stop.

By Mr. Shannon:

Q. Maybe I will ask him a couple of questions on franchise.

Mr. Caywood, with your experience on the railroad, you just testified that you were familiar with filing abandonment applications, and I take it you have had familiarity with construction applications, too, to the ICC?

A. Not with the application, itself; in the portions that I have dealt with.

Q. Now, your department would deal with the engineering data?

A. Yes, sir.

Q. Let's see, you have to give a profile. I believe the line that is to be constructed, you have to set up, by primary property accounts, the cost of constructing the mainline, as well as the cost of constructing side tracks, and so forth; is that correct?

A. That is correct.

page 298 } Q. And all of that is included in the return of the questionnaire?

A. Yes, sir.

Q. To get a franchise, for instance, if the Norfolk & Western should want to build an extension of its line into Virginia, how would they go about it? Do you know?

A. I have no idea.

Q. Isn't it a fact that from what you just said about the return questionnaire, that they would have to file an application with the Interstate Commerce Commission under Section 118?

A. I don't know. I only know what I had to do in supplying information. Now, what went beyond that—

Q. And you do not know what they paid for that, if anything?

A. No, sir, I have no idea.

Q. So you really don't know how a railroad goes about acquiring what you call a franchise?

A. No, sir.

Q. And what is normally referred to as a certificate of public convenience and necessity, authorizing an extension?

A. No, sir. All I am saying, sir, is, in the absence of a right to operate this railroad, that it has no value other than the bare bones and salvage. This is all

page 299 } I can say. I am not an expert, as far as franchises are concerned.

Mr. Riely: May it please the Commission, I hate to interrupt, but it seems to me we have spent fifteen minutes on this subject.

Chairman Catterall: I guess we had better recess for five minutes.

(Recess)

By Mr. Shannon:

Q. Mr. Caywood, what is the highest and best use the Norfolk & Western derives from its track and track properties in Virginia?

A. Well, the highest and best use would be as an operating railroad.

Q. On page 26 of your testimony, you stated that you have determined that the fair market value of ties on the Norfolk & Western line in Virginia is $3,488,878; is that correct?

A. That is correct.

James A. Caywood

Q. Do you have any idea how many ties or how much the N&W spent on ties, to put in its line in Virginia, since 1958?

A. No, sir, I am not familiar with those
page 300 } figures.

Q. You never made any check of that?

A. Not that, no, sir.

Q. Is there any rule of thumb to guide you by as to the number of mainline—I say the number of cross-ties replaced annually, in a first-rate railroad?

A. There is no rule of thumb that I know of, no, sir.

Q. If I were to tell you that, according to the Norfolk & Western's Annual Operating Reports filed with this Commission, they show that the N&W spent about $9,438,000—let me correct that—$3,773,113 in ties, since 1958, would you say that is reasonable?

A. I would have no basis for saying that is reasonable at all, but—

Q. Would you have any basis for saying it is unreasonable?

A. No, sir, I wouldn't.

Mr. Riely: May it please the Commission, it has no relation to the direct testimony. I don't think he has any basis for testifying at all.

Mr. Shannon: It has a very definite basis to his direct testimony. He's coming up and estimating what the cost of ties is, in the N&W system in Virginia.

page 301 } Mr. Riely: He has not said one thing about cost of ties.

Mr. Shannon: He's come up with the value of ties, scrap value.

Mr. Riely: There is a difference.

Mr. Shannon: Scrap value. Thank you for correcting me.

Mr. Riely: What he's being asked about is cost, if Your Honors please.

Mr. Shannon: We will cover that with another witness.

By Mr. Shannon:

Q. Mr. Caywood, what is the average life cycle of rail used in the Norfolk & Western line?

A. We did not make a determination of this in our evaluation as to the average life cycle. There was an outfall as a result of our evaluation, which seems to indicate that there is about a forty-one-year life. This was purely an outfall of our evaluation. Again, our assignment was to determine

the bare bones value of this property.

Q. Isn't it a fact that rail has several life cycles, in other words, you could put new rail in a mainline, and then, it wears down to a certain point, and you may then re-lay that, say, in the Shenandoah Division?

page 302 } A. Sir, I would like to show you how rail does. If I could have some of my material there, I could show you how this rail varies in wear. These (exhibiting) are actual sections of rail, taken out of tracks of the Norfolk & Western Railroad. This is 131-pound rail that was removed from the New River District at milepost 335. Now, let me show you what—here is the new section of that rail.

Q. Mr. Shannon: Your Honor, I don't know how you could get these into the record as exhibits.

Mr. Riely: I would like to move that they be admitted as exhibits, if Your Honors please.

Chairman Catterall: The witness testified some rails wear more than others.

Mr. Riely: This is what he is showing, in response to Mr. Shannon's question, and I ask that they be received as exhibits.

Mr. Shannon: That is not in response to my question. My question was not the degree of wear. I asked him if it wasn't different life cycles in rail, and I haven't gotten an answer yet.

Mr. Riely: I ask that they be received. If not, I will put them in on redirect.

Mr. Shannon: I object, because, this is in no way responsive to my question. I simply, merely asked what

page 303 } the average life cycle of rail is, and I think Mr. Caywood—

Chairman Catterall: Of course, some wear faster than others, and it all depends upon what runs over them. But I don't see how the particular cross-sections add anything to his oral statement.

Mr. Shannon: I agree, Your Honors. I don't want to put them in.

Mr. Riely: I do want to put them in.

Chairman Catterall: Let's not put them in.

Mr. Riely: I will offer them later.

Mr. Shannon: Will you have cross-sections for each counsel?

Mr. Riely: No, sir. They will be offered as an exhibit.

Chairman Catterall: You are not going to bring in a diesel locomotive and steam locomotive?

Mr. Riely: No, sir.

Chairman Catterall: I don't see any need to clutter up the record with these exhibits.

By Mr. Shannon:

Q. Would you answer my question on the average life cycle of rails?

A. Well, the rails, the life cycle of rails, varies
page 304 } again, as the tonnage, curvature, and grades over which the trains operate, the track structures.

Q. Isn't it a fact, Mr. Caywood, that you take a new rail out that was laid initially in the line, and you can re-lay that, say, in a line that has less traffic?

A. This is quite often done, yes, sir.

Q. And then you can even get a third life cycle out of it by, say, taking it out of a line of the Shenandoah Division and putting it in some mountain line where you have one or two trains a week?

A. To a very much lesser degree, you might be able to do this. You always have to downgrade this rail, according to tonnage, if you put it in a lesser-tonnage line. You also have to take a lot of other things into consideration, in doing this. You have to be very careful. The older a rail gets, defects that are not visible, such as internal defects, traverse defects, horizontal and vertical split heads that develop through fatigue, and through metallurgy, if you have a bad history of rail in a mainline, increasing failures of this type, which you have to be cautious of; and oftentimes, you will have to abandon that stretch of rail, as a safety measure.

Q. Then, sometimes, you could go and take this re-laid rail, this twice re-laid rail, and you could end up in
page 305 } a side track somewhere, where it is used rarely; isn't that right?

A. This is often done, yes, sir.

Q. You get the maximum use out of your rails?

A. You certainly attempt to.

Q. That is good maintenance practice?

A. This is good maintenance practice.

Q. On page 28, you state that the mean weight of rail used at Norfolk & Western's side tracks and yards in Virginia were estimated at 119 pounds.

A. This is correct, sir.

James A. Caywood

Q. How did you go about making that estimate?

A. Well, we took from the N&W records the weights of rail and they reported this to the State Commission, incidentally, the mileage by weights of each type; and we used that mileage in arriving at an average of—actually, it was 118.87 pounds per yard.

Q. Did you observe any heavier weight rail in any of the side tracks or yard tracks?

A. Yes, it varies. This is correct.

Q. This is the average?

A. Average, yes, sir.

Q. Then you wouldn't have any idea how much the N&W has spent, say, in the last ten years for rail laid in

page 306 } its running yard tracks in Virginia, would you?

A. No, sir.

Q. Mr. Caywood, what is included in other track material, that you referred to here?

A. Well, other track material includes the tie plate, the angle bars, the bolts, the spikes, the anti-creepers, the switch stands, switch points, derails. The ICC accounts have them all listed. I have gone over the principal ones, I think. I may have omitted something.

Q. How are these track materials purchased, and other track materials?

A. Well, they are purchased in different ways. Frogs are purchased by units, switch points by units, tie plates by the ton, angle bars by the ton, bolts by the keg. This varies.

Q. And they appear in the ICC primary account 10, don't they? I believe it is 10. Let me check it. I do not want the record to show—account 10, other track material.

A. Yes, sir.

Q. So that account would only include the cost of those items of property, no labor?

A. That is correct.

Q. When a branch line is abandoned, isn't it

page 307 } usual practice in railroad operations for the company to store the materials and supplies recovered from the abandonment, so that they could be used for re-lay purposes, in other parts of the system?

A. It might be done that way, or sometimes, they are disposed of completely.

Q. Normally, what quantity would you store? About the quantity that you would use in a year?

A. I know of no normal measure of this, sir. If you had

a need for the rail fittings that came out of that line, you might store them and use them. Most railroads, if the material is fit material, you probably would transfer it immediately to another site, and use it.

Q. Aren't these materials that are taken up from a branch line and stored, for use elsewhere, are they carried in ICC primary account 712? Or do you know?

A. I am not familiar as to just what account they are carried in. There is an account, but I am not sure.

Q. There is an ICC account?

A. There is an account; but I am not sure what it is.

Q. Mr. Caywood, as an experienced and professional maintenance-of-way engineer, in your opinion, do you feel that the Norfolk & Western would be willing to sell
page 308 } its track properties in Virginia for $33,248,754?

A. In the absence of a going-concern value, I don't know what else they could do with it.

By Chairman Catterall:

Q. Let me try once more, about this bare bones business. The witness has reached the salvage value as the bare-bones value, because, as I understand you, sir, you assume that the last train has run over the Norfolk & Western, and that there will never be another one. Would your method of evaluation be different, if you had been employed to value the same property the day before the first train ran over the track, same property? In either case, they never earned a nickel?

A. If I had knowledge that the right to operate was not going to be included in the sale, I could do nothing more—

Q. I am not talking about a sale; I am talking about the Norfolk & Western that has got a franchise from the State, and issued their stocks and bonds, and have laid the rails; and they are about to cut the ribbon for the first train to go over the rails; the same rails, same structure, but if you are looking at it before the first train ran over the rails, would your method of valuation be different from what
page 309 } it has been?

A. Well, if I understand you correctly and fully, sir, yes, I would look at it as a going concern. Other items—

Q. No, no, they haven't turned a wheel; they haven't earned anything, no income, no gross receipts, no nothing.

A. Only if I knew that there was going to be a successful or going operation carried on. Otherwise, I would appraise it the same way.

Q. They wouldn't have built it, if they didn't have the right to run over it. That is the assumption.

A. This is a logical assumption to make, yes, sir.

Q. Standing at the promontory point, and watching the golden spike go in. You then appraise it differently from what you would have, if they had started taking up the rails?

A. Oh, I certainly would, if that situation—

Q. I think that throws some light on your mental process.

A. Yes, sir.

By Mr. Shannon:

Q. Let's talk about signal equipment, Mr. Caywood. How many miles of centralized traffic control system does the N&W have in operation in Virginia?

page 310 } A. I don't have a precise figure, but the centralized traffic control approximates 700 miles in Virginia.

Q. What does a mile of CTC cost, installed?

A. I am not current on the cost of that, sir.

Q. Don't have any idea?

A. No, sir, I don't; not current.

Q. What was the figure that was available to you, that you last recall?

A. Well, the last figure that I recall, we put in about a hundred miles of CTC on the Akron-Chicago Division, at a cost of about $2,500,000.

Q. That was about how many miles?

A. A hundred miles.

Q. And two and a half million?

A. Yes, sir.

Q. And that was the Akron-Chicago Division of what line?

A. Baltimore & Ohio.

Q. Not the N&W?

A. No, sir.

Q. When was that?

A. That was in 1962, or—3.

Q. What highway protective grade devices do railroads, such as N&W, have?

page 311 } A. You are quite aware that they don't own all of these facilities; they are owned by the State, and other people, a lot of these.

Q. The cost of it, I think this Commission is aware of that, because they are the ones that determine which percentage would be borne by each.

A. Yes, sir.

Q. As a maintenance-of-way engineer, would you have direct responsibility for supervision over signals and interlockers and maintenance of signal interlocking equipment?

A. I would have the general responsibility. This is, of course, an area where your own expertise is needed.

Q. Normally, in railroad operations, doesn't this type of equipment come under the direct supervision of your superintendent of signals and communications?

A. This is correct, sir; yes, sir.

Q. And he would be in charge of maintaining those?

A. This is correct. But he would only report for administrative purposes to the chief engineer.

Q. Then you, as maintenance-of-way engineer, would have only a general familiarity with this type of thing?

page 312 } A. Well, sir, in our appraisal of the N&W facilities, we used two people of the type that you are speaking of: One, from the Pennsylvania Railroad, Frank Chattin, who was a permanent member, of DeLeuw, Cather & Company, and has been for quite some time; and Mr. Harold Hudson, of the Southern Railway, formerly chief engineer of signals for the Southern, did this work, and made this appraisal.

Q. They reported it to you?

A. This is correct.

Q. You relied on them?

A. Yes, sir, because, again, this takes the expertise of these people, to know what that is.

Q. Now, you stated, on page 86, that you determined that a considerable portion of standard items of equipment and material would have no market value on account of the deterioration. The question is this: Do you mean to say that this equipment is not being utilized by the N&W?

A. Well, no. It is old, and its useful life is diminishing, is the intent of that statement.

Q. Is this equipment, then, being used and actually serving the purpose for which it is intended?

A. It is functioning, but it is reaching its limit of reliable function.

page 313 } Q. But it is being utilized?

A. At the present time, yes.

Q. In train operations?

A. Yes.

Q. Mr. Caywood, from your inspection of the N&W's line, did you find it to be a well-maintained line of railroad, by ordinary acceptable standards?

A. I would say that the N&W Railroad is maintained to the standards that are necessary to operate it safely, as a major carrier.

Q. That is the stock answer that the railroads usually give in their returns to a questionnaire, isn't it?

A. I cannot answer that, sir. I never made that stock answer.

Q. How would you compare it, say, Mr. Caywood, with the Baltimore & Ohio, as, say, the period before February, 1963? Would you say that N&W is a better-maintained railroad?

A. No, sir, I would not. I was somewhat surprised when I came on the N&W property. Everybody says that the B & O is poor now, couldn't make the grade; but I can actually say that our tie conditions were better, our rail conditions were probably on a par, our ballast conditions were probably as good; and this would be my—

Q. That is not what they told the ICC in
page 314-315 } the B & O—C & O control case, wasn't it?

A. In what, the C & O, or B & O?

Q. I don't know. I will have to let you answer that.

Mr. Riely: It seems we get back to those legal questions, if Your Honors please.

Mr. Shannon: No; this is a factual question.

By Mr. Shannon:

Q. I want to read to you and see if you agree with this, see if the ICC is wrong here. They said: "Because of a number of substandard locations on B & O's line, funds that would ordinarily have been used to maintain its entire right of way were diverted for repair and maintenance work at the most crucial points. As a result of this policy, B & O has been forced to neglect its normal overall maintenance program."

It goes on to say, "thus making it impossible to concentrate on plant improvements."

Do you agree with that?

A. I do not totally agree with that statement. I am not familiar at all as to who made it or why it was made. I just have my own opinion.

Q. I would show you the report here.

A. Well, I will take your word.

page 316 } Q. I will show you that was made in the B&O—C&O control case.

A. But you asked me the comparison between B&O and N&W, and I told you.

Q. So it really depends on whether it is B&O and C&O, so far as state of maintenance?

A. I don't know, no. I made that statement in my own professional opinion as to what the comparable conditions were.

Q. In your appraisal of bare-bones value, did you include anything for overhead, general overheads?

A. No, sir.

Q. Your value, your appraisal, is based solely on what you concluded to be the value of the ties, the rails, and other track materials; is that correct?

A. This is correct.

Q. And that was on the salvage, the net salvage value?

A. This is correct, sir.

By Chairman Catterall:

Q. You gave no value at all for ballast, I assume?

A. No, sir, we could find no—in the absence of any going-concern value, we could find no market or use for this ballast.

page 317 } By Commissioner Hooker:

Q. Just a bowl with no wheat in it?

A. That is correct.

By Mr. Shannon:

Q. Mr. Caywood, in recent years, have notable achievements been made in techniques of joining and laying of rails, renewal of crossties, and servicing tracks?

A. Yes, sir, a great deal of mechanized equipment has been developed in the past ten or fifteen years, that have enabled the railroads to hold their costs down in this area. This, principally, has resulted in the fact that while the labor costs have been spiraling, as well as the material costs, they have been able, through reductions in labor, to get reasonable amounts of material in the track, which has been the salvation.

Q. These factors that I just enumerated, they are what you might call the backbone of good track maintenance; is that right?

A. So far as I know, it's part of it, yes, sir.

Mr. Shannon: I have nothing further, thank you, Mr. Caywood.

The Witness: Thank you, sir.

page 318 } By Mr. Epps:

Q. What is your definition of "line"?

A. Well, that would be a piece of line extending from one terminus to another terminus.

Q. I am speaking, I think, of an engineering term. Using the engineering term, "line."

A. Pardon me, sir?

Q. I am going to ask you about your surface, next. You know the term "line"?

A. Yes, sir.

Q. In connection with lines—

A. Yes, sir.

Q. —as an engineer, would you tell us what line is?

A. Line is the smoothness or the alignment which the rails follow, the curvature, tangent. This would be related to the regularity of this.

Q. Regularity of curves on tangents?

A. Yes, sir.

Q. Is that correct?

A. Yes, sir.

Q. What is "surface"?

A. Surface would be the unevenness vertical, vertically.

Q. Or evenness, as the case may be?

page 319 } A. Or evenness.

Q. Did you give any value, in your appraisal of the Norfolk & Western Railroad, for line and surface?

A. No, sir, we did not; because, in the absence of any going-concern value, this would not be a factor.

Q. Did you give any in-place value as to anything at the N&W Railroad, in your appraisal?

A. No in-place value.

Q. No in-place. As a matter of fact, you got a negative value, because you had to pull it out of place?

A. That is correct; yes, sir.

Q. In the hypothetical question, which Judge Catterall gave to you, you said that you didn't know anybody would have a franchise to buy it, and have to buy it, and so forth. Suppose the government bought it for your high-speed project that you have been working on, the government could buy it and operate it; is that right?

A. I presume they could. I don't know whether they would have to have a franchise or not.

Q. I believe they can do it. Let's assume they could. Let's

assume that they did, and you were valuing it for the seller to the government, and the government was going to buy it and run the high-speed road. Would you come
page 320 } up with a different value from the value which you filed here?

A. If I valued it as a going or operable property, yes, sir, I would.

Q. I don't want to get you and me in trouble. I do not want to get over the line, where it is a going concern, but I want to get you to say it is a goable concern. How about that, maybe tomorrow or the day the government takes it over, it will start operating?

A. You would have to define "goable," for me.

Q. Well, it's in place, it will bear railroads, it will—locomotives will pass over it, those locomotives can draw cars, it's ready to go, but it hasn't gone. All right, thank you. That helps us.

Now, let me ask you this: Where are you staying, here in Richmond?

A. I am staying at the John Marshall.

Q. John Marshall Hotel?

A. Yes, sir.

Q. And—

Mr. Riely: May I inquire to the relevance of that question?

Mr. Epps: If you will be so kind as to wait, you will hear.

Chairman Catterall: I didn't even hear it.

page 321 } Mr. Epps: I asked him where was he staying here, and he said he was staying at the John Marshall Hotel.

Mr. Riely: Do you want to know what he had for breakfast?

By Mr. Epps:

Q. If you had to value that property, at what use would you value it?

A. Well, if the franchise, prior to operating it, were going to remain there, I would value it as a hotel.

Q. Highest and best use, you would find as a hotel?

A. Yes, sir.

Q. And you wouldn't value it for salvage, as long as it was in place and usable as a hotel?

A. With the privilege to continue to operate it.

Q. Well, let's assume it's no longer the John Marshall Ho-

tel; let's say the management has sold it with no more going concern, there is no more value, and another corporation has bought it as Franklin Hotel, wouldn't it still have in-place use, the highest and best use, which would be as a hotel?

A. If they were going to operate it as a hotel with the privilege to do it, it would be.

page 322 } Chairman Catterall: You don't have to have a privilege to operate a hotel. Why don't you use the Hotel Richmond, that was bought by the State?

Mr. Epps: I might have, if I had thought of it.

By Mr. Epps:

Q. I believe you arrived at the value of the signals of this road, of $1,600,000; is that correct?

A. That is correct.

Q. What was the original cost of those signals?

A. I am not aware of that.

Q. It would be more than that, wouldn't it?

A. Yes, sir.

Q. Several times more?

A. I don't know how many times. I have no knowledge.

Q. Maybe ten?

A. No, sir; I would have no knowledge at all how many times.

By Chairman Catterall:

Q. How would you find any value at all? I thought, in answer to Mr. Epps, you said it was a negative value.

A. Not in signals, no.

page 323 } Q. No, sir, I mean in the whole thing.

A. Oh, no, sir.

Chairman Catterall: What was that negative value?

Mr. Epps: He said from the in-place value, there was a negative value, by reason of the fact that you had to pull it up before you could sell it; and he agreed with that.

Chairman Catterall: But not zero; merely a subtracted value?

The Witness: You subtracted the cost of taking it up.

Mr. Epps: Yes, sir. I did not mean to mislead you.

By Mr. Epps:

Q. Isn't it true, Mr. Caywood, that in following what you

thought were your instructions, you were not to put any in-place value on the road?

A. No, I was merely told to make a bare-bones appraisal, without considering the franchise or the privilege to operate it.

Q. Or the value of the property in place?

A. I don't quite follow you there.

Q. Well, you know what property is, in place,
page 324 } and you have talked about "line," and "surface," and you know what they are; and the Norfolk & Western track properties are a railroad in place, tunnels and bridges and trestles, all hooked up, over which locomotives can run and operate; and that is what we mean by "in place."

Now, I am asking you if you put an in-place value on; and you said no. And I am asking you if, when you didn't do that, you were following your instructions?

A. Well, in the absence of any going concern value, the line and surface would be worthless, it would be valueless.

Q. In the absence of a going-concern value?

A. Prior to operating.

Mr. Epps: It's a legal conclusion.

By Chairman Catterall:

Q. The question is whether you were following instructions, or whether you were doing it under your own initiative.

A. Well, the instructions were what were contained in Mr. Carr's letter, and I was following my own initiative, from there on out.

Q. In other words, it was your interpretation of the instructions, and not a specific instruction from the person who employed you?

A. This is correct, yes, sir.

page 325 } Mr. Epps: Your witness.

REDIRECT EXAMINATION

By Mr. Riely:

Q. Continuing this last thought, Mr. Caywood, you valued the Norfolk & Western track in place, as it was, did you not?

A. Oh, yes. It was intact and operating, when we valued it; yes, sir.

James A. Caywood

Q. And the fact that it was in place when you valued it, from the point of view of no going concern, no one who could run a railroad, it was a detriment, rather than an asset, wasn't it?

A. This is correct.

Q. If the Norfolk & Western, for example, should be sold tomorrow to the government, to be run as a railroad, it would be sold with going-concern value, would it not?

A. I am sure it would, yes, sir.

Q. It would have going-concern value, when it was sold?

A. Yes, sir.

Q. One further question. You said that there is a fallout or hangout, or something, to your study.

A. Outfall.

page 326 } Q. Outfall. You got a forty-one-year life for rail of the Norfolk & Western; is that correct?

A. This is correct.

Q. Was that from new to re-lay, or was that from new to scrap?

A. Total life.

Q. Total life?

A. Yes.

Q. Total life for forty-one years?

A. Yes, sir. This is an average, now, sir.

Mr. Riely: I have no further questions.

Mr. Shannon: You may stand aside, sir.

The Witness: Thank you, sir.

(Witness stood aside.)

Mr. Riely: Mr. Tipton has gone. I think we had better adjourn.

Chairman Catterall: We will then adjourn until ten o'clock tomorrow morning.

(At 3:40 p. m., an adjournment was taken to tomorrow, April 16, 1969, at 10:00 a. m.)

page 327 }

* * * * *

Richmond, Virginia

Wednesday, April 16, 1969

The above-entitled matter came on for further hearing, pursuant to recess, at 10:00 o'clock, a.m. before the State Corporation Commission, Ralph T. Catterall, Chairman, presiding.

PRESENT:

Honorable Ralph T. Catterall, Chairman

Honorable H. Lester Hooker, Member

* * * * *

page 328 } Mr. Riely: May it please The Commission, Mr. Shannon and Mr. Epps and I have talked about future program and subject to the approval of The Commission, I believe we have agreed on this:

Today, we will have Messrs. Tipton, Kiley, Johnson and Butler for cross examination—they are the company witnesses.

If we have to, we will go over tomorrow. We don't think we will have to. I hope The Commission will be happy to agree with me that tomorrow may be an open date.

On Friday, we will have Dr. Foster, Mr. Johnson and Mr. Garrett. Dr. Foster is a witness for Mr. Epps and Mr. Johnson and Mr. Garrett are Mr. Shannon's witnesses.

On Monday, we will have Mr. Dunn in the morning and Mr. Howland in the afternoon.

On Tuesday, we will have Mr. Priest as the first witness, followed by Mr. McCarthy; and we will begin then on Mr. Younger.

I anticipate Mr. Younger's cross examination may be quite extensive.

On Wednesday, we will interrupt Mr. Younger to begin with Mr. Koncel and we will complete Mr. Younger on Wednesday.

page 329 } At that time, we shall ask The Commission to adjourn the case for rebuttal testimony, and having looked through that large black book, the first dates that we can find that are agreeable to all of the parties and the witnesses are Monday, June 30 and Tuesday, July 1. I ask The Commission to reserve those two dates. I believe that we may be able to dispose of the matter in one day but cer-

tainly we will be able to dispose of it in two. I hope that batting order, if I may call it that, is agreeable to The Commission.

Commissioner Catterall: So we will put it down on June 30.

Commissioner Hooker: What day of the week is that?

Mr. Riely: Monday and Tuesday.

Commissioner Hooker: Don't you think you had better reserve more than two days?

Mr. Riely: I don't think so.

Mr. Shannon: How many rebuttal witnesses do you have?

Mr. Riely: I don't have the slightest idea.

Mr. Shannon: I think, Judge Hooker, it might be good to put an extra day in there.

Mr. Riely: Let's put Wednesday down—that is free now—and that will reserve it.

page 330 } Commissioner Hooker: If you don't, something may come up.

Mr. Riely: That's all the preliminary matters I have.

If no other counsel has preliminary matters, I am ready to call Mr. Tipton.

Come around, please, Mr. Tipton.

Whereupon, RUSSELL D. TIPTON, was called as a witness on behalf of the applicant, and having previously been duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

By Mr. Riely:

Q. Mr. Tipton, your name is Russell D. Tipton?

A. Yes, sir.

Q. And you are the Russell Tipton whose prepared testimony, consisting of 16 pages and one exhibit, numbered Exhibit 1-RDT were filed originally in this case, is that correct?

A. That is correct.

Q. Thereafter, I believe there was filed supplemental testimony consisting of 7 pages and Exhibit 2-RDT, is that correct?

page 331 } A. That's correct.

Q. Are the answers given in that testimony correct, to the best of your knowledge and belief, Mr. Tipton?

A. Yes, they are.

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* * * * *

TESTIMONY OF RUSSELL D. TIPTON ON DIRECT EXAMINATION

Q. State your name and address.

A. Russell D. Tipton, 550 Broad Street, Newark, New Jersey.

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

A. I am presently a partner in Haskins & Sells, an international public accounting firm.

Q. How long have you been in the accounting profession and what positions have you held?

A. I have been in the accounting profession since graduating from Ohio State University in 1936. In that year I joined the staff of Haskins & Sells and I was admitted to partnership in 1952. I was a partner in the New York
page 333 } office until 1964 when I became managing partner of the Newark office. I have been a certified public accountant in the State of New York since 1939 and am also a certified public accountant in five other states. I am a member of the American Institute of Certified Public Accountants, the American Accounting Association and the National Association of Accountants. I have served on several committees of the New Jersey and New York State CPA Societies and was elected a trustee of the New Jersey CPA Society in 1967.

Q. Do you have particular experience with railroad accounting?

A. My special professional interest has been in the transportation industry, especially railroads. I have been chairman of the Committee of the American Institute of Certified Public Accountants that fosters cooperation with the Interstate Commerce Commission. Among the technical papers of which I am author are "Audits of Motor Carriers" published in 1961 and "Internal Control in Railroad Accounting" which appeared in the 77th Report of the Railway Accounting Officers in 1963.

Q. What is your connection with this proceeding?

A. Norfolk and Western consulted me as to the extent to which physical deterioration and wear and tear
page 334 } are reflected in depreciation deductions and ex-

penses generally, and particularly in the case of the railroad track accounts which I understand are the subject of this proceeding.

Q. Will you state generally the purpose of depreciation deductions in accounting practice?

A. Depreciation accounting is a system of accounting which is designed to distribute the cost or other basic value of assets over their estimated useful life.

Q. Does depreciation accounting recognize the decline in value of assets?

A. The primary purpose of depreciation is the distribution of an asset's cost over its useful life. The role of depreciation in measuring the decline in value of an asset because of physical deterioration and wear and tear is secondary. Generally speaking, however, depreciation accounting, at the same time it recognizes the distribution of cost so that such cost may be offset against income produced by the asset, will also reflect the decline in value of an asset resulting from physical deterioration and wear and tear on the asset.

Q. Does the amount of accounting depreciation which has accumulated on an asset up to a given time en-
page 335 } able an accountant to estimate the amount by which an asset has declined in value?

A. In the absence of unusual factors such as extraordinarily high salvage or the use of accelerated methods of computing depreciation which may tend to distort the extent to which depreciation measures the decline in value, the accumulated depreciation on an asset will provide a reasonably accurate idea of remaining value. It is also helpful, in addition to looking to depreciation accounting to refer to other means of valuation. An accountant can, however, by analyzing the amount of depreciation which has accumulated on an asset or group of assets, estimate with reasonable accuracy the extent to which a decline in value has occurred.

Q. How is the depreciation which has accumulated for certain assets recorded?

A. Usually the accumulated depreciation deductions on an asset or on a group of assets in a single account are recorded in a depreciation reserve account or an accumulated depreciation account. The amount of such reserve or accumulated depreciation account at any given time will thus show the extent to which depreciation has accumulated with respect to the asset or assets in the account to which the particular re-
serve is related. For example, if the investment
page 336 } in an asset is $100 and the reserve for deprecia-

tion has accumulated to $70, the asset is 70% depreciated, or stated differently, the net depreciated investment in the asset is 30% of the original investment.

Q. Can you summarize the means by which the accounting records of a company normally reflect the decline in value of assets?

A. Accounting depreciation, recognizing the decline in value of an asset or group of assets resulting from physical deterioration and wear and tear, is accumulated in a reserve account. The total reserve for depreciation which has accumulated shows the approximate extent to which the value of the asset with which the reserve is associated has declined. If the amount accumulated in the reserve is subtracted from the amount in the asset account, the approximate net depreciated value of the asset results.

Q. Do large industries normally use a separate account for each individual asset?

A. No. The normal procedure for a large corporation is to record assets in group accounts. Such accounts will include all assets of a particular kind and a single depreciation deduction will be computed for all the assets in that

page 337 } so-called group or mass account. Frequently, such group accounts are continued for a long period of years during which time new assets are purchased regularly and added to the account and assets are retired from the account when they reach the end of their useful lives.

Q. Is it possible for an accountant to make general predictions concerning the size of a reserve for depreciation in the case of such a group or mass account?

A. Where such a group or mass account is a mature account, that is where it has been in existence with assets being added and retired at approximately the same annual rate and depreciation deductions being taken over a period of years composing more than one full life cycle, the reserve on such an account will be within a certain accepted percentage range in its relationship to the asset account.

Q. About what percent will the reserve for depreciation or accumulated depreciation normally be of the asset account in the case of such a mature group account?

A. The reserve will normally be around 50% of the asset account. Stated differently, a mature group account will normally be around 50% depreciated at any given time, assuming that there is no marked pattern of growth in the

page 338 } account. By that, I mean assuming that there

has been no consistent pattern of expansion in the amount of assets in the account.

Q. Assuming then that no growth pattern exists for a mature group account, the account at any given stage will be about 50% depreciated?

A. Yes, within a few percentage points that will be true for any mature group account.

Q. Now let's look at the railroad track accounts which are the subject of this proceeding. How are assets in the track accounts recorded in the books of account of railroads?

A. Railroads maintain group or mass asset accounts for the elements of their track structure divided by account numbers according to Interstate Commerce Commission account classifications. Thus, Account 1 records the investment in Engineering; Account 5, the investment in Tunnels and Subways; Account 6, the investment in Bridges, Trestles and Culverts; Account 8, the investment in Ties; Account 9, the investment in Rail; Account 10, the investment in Other Track Material; Account 11, the investment in Ballast; Account 12, the investment in Track Laying and Surfacing; and Account 13, the investment in Fences, Snowsheds and Signs.

page 339 } Q. Have these accounts been consistently maintained by the railroads?

A. The assets in railroad track accounts have been recorded in the prescribed account classifications since 1916 under the uniform accounting rules of the Interstate Commerce Commission.

Q. Under what method of accounting for *deprecation* are Accounts 8, 9, 10, 11 and 12 of the railroad track accounts depreciated?

A. These accounts, which include the investment in ties, rail, other track material, ballast and track laying and surfacing, are depreciated by use of the retirement-replacement method of accounting. This method of depreciation is somewhat different in its operation from the more common straight-line or ratable methods of depreciation. It is almost universally used by railroads, however, for computing the depreciation on the track accounts mentioned.

Q. Will you explain the operation of retirement-replacement accounting for depreciation?

A. Yes, and in doing so I will refer to a recent ruling of the Internal Revenue Service which explains in detail the operation of this method which is also used by

page 340 } railroads in computing their depreciation deductions for track accounts.

Russell D. Tipton

[Counsel will introduce Exhibit 1-RDT.]

In this method the cost of each new asset put into use is capitalized in the accounts. When an asset is replaced by another asset of like kind and quality, as where 80 lb. rail is replaced with 80 lb. rail, the capital account is not disturbed but instead the cost of the replacement, less salvage, is charged as an expense. When an asset of the track structure is replaced and a betterment is involved, for example, where 80 lb. rail is replaced with 100 lb. rail, the cost of the 20 lb. betterment portion is capitalized and added to the asset account and the replacement portion is charged as an expense. When an asset is retired without replacement, the asset account is reduced by the capitalized book cost of the asset retired less salvage and that amount is charged to expense.

Q. Will you summarize the elements which are charged to expense under the retirement-replacement method of accounting for depreciation?

A. There are three parts to the total annual charge to expense. First, the cost of replacements where no betterment of the asset is involved. Second, the cost of the non-betterment portion where there is a replacement involving a
page 341 } betterment. Third, the capitalized cost of assets which are retired without replacement. These three elements make up the annual charge to expense under retirement-replacement accounting and that charge is the equivalent of straight-line depreciation on the assets which are covered by the retirement-replacement method.

Q. Is a reserve for depreciation maintained for assets depreciated under the retirement-replacement method?

A. No, since under retirement-replacement accounting the cost of replacements is charged directly to expense as explained above, no reserve for depreciation is maintained. The balance in accounts depreciated under this method is about the same as the asset balance reduced by accumulated depreciation in a similar acccount under a straight-line method.

Q. How, then, is it possible to determine the accumulated reserve for depreciation for accounts depreciated by this method?

A. Although no reserve exists in the normal operation of the method, it is possible to develop a reserve by going back a full life cycle for assets in the track accounts and constructing the reserve as it would have existed if main-
page 342 } tained. Similarly, the balance in the asset accounts can be reconstructed to show what it

would presently be if ratable depreciation accounting had been followed. After reconstructing the asset accounts and their applicable reserves, the net of the two items would be the amount which now appears as the ICC account balance of each track account.

Q. Have you had any experience in developing a reserve for railroad track accounts which have been depreciated under this method?

A. Yes. My accounting firm was retained by the Association of American Railroads and the United States Treasury Department to review a study of the retirement-replacement method of depreciation followed by the railroad industry.

Q. What was the purpose of that study?

A. The purpose of the study was to determine that the retirement-replacement method of accounting generally used by the Class I railroads for ICC Accounts 8 through 12 has, over a life cycle for the assets in such accounts, yielded a reasonable cumulative depreciation allowance for the exhaustion, wear and tear of the components of the track structure of the Class I railroads as of December 31, 1963.

page 343 } Q. Did the calculation of the cumulative amounts of depreciation charged by railroads under this method of accounting for depreciation enable you to determine what percentage the depreciation which had been claimed up to the study date was to the investment in the assets?

A. Yes, as part of the study, the relationship of the reconstructed reserve to the assets in the accounts was measured. This reserve ratio was computed in order to show that the accumulated depreciation charged over a life cycle had been within a reasonably acceptable range.

Q. What relationship would you normally expect to find with respect to the track accounts and the reconstructed reserve for depreciation?

A. As an accounting matter, you would normally expect to find that the reserve for depreciation on such accounts would be approximately 50% of the investment in the asset accounts. As I stated earlier, it is a general rule that mature group accounts would have accumulated a reserve for depreciation sustained of approximately 50%. The railroad track accounts are examples of mature group accounts and thus about a 50% reserve would be expected. This would mean that the balance shown in the books for these accounts, since that is a net balance after the reserve for depreciation has been deducted, would reflect depreciation on the assets of about 50%.

Russell D. Tipton

page 344 } Q. What did the study of the track accounts for the Class I railroads in the United States actually determine with respect to the reserve for depreciation on such accounts?

A. That study showed that the depreciation deductions which have been claimed on the assets in the track accounts have accumulated to an amount which is within a normal range of variation from 50% of the investment in the assets.

Q. Did the study show any marked difference in retirement-replacement method of depreciation deductions on these accounts from what would have been claimed had a straight-line depreciation method been used?

A. The retirement-replacement deductions for depreciation have been somewhat less over a life cycle than the depreciation deductions would have been under a straight-line method, but the total depreciation accumulated is reasonably close to the normal 50% which would be expected to have accumulated on a mature group asset account.

Q. What relationship do the track account balances shown by the Class I railroads have to the original investment in those accounts?

A. Such balances are approximately equal to net balances after the total investment has been reduced by
page 345 } the above-mentioned depreciation reserve of about 50%. The balances shown in ICC Accounts 8 through 12 thus are net depreciated balances after depreciation representing physical wear and tear of approximately 50% has been deducted.

Q. Can you summarize your conclusions as to the extent to which the railroad track accounts reflect depreciation?

A. Based on results of the aforementioned study, railroad track accounts reflect about 50% depreciation. The net balances shown in such accounts represent the original cost of the assets which are recorded in the accounts reduced by accumulated depreciation of approximately 50%. It is fair to state, therefore, based on the study of Class I railroads, that the railroad track accounts reflect recognized depreciation of about 50% of their original costs.

Q. Mr. Tipton, based on your experience, would you say accumulated depreciation of 20% of the original cost for the railroad track accounts is too low—that is, that such percentage of accumulated depreciation is significantly less than has been realized on the assets in those accounts?

A. Unquestionably, a reserve for depreciation
page 346 } or an accumulated depreciation percentage of

20% is far too low for the railroad track accounts. The study which my accounting firm reviewed showed that depreciation of approximately 50% is what has actually been reflected to recognize physical wear and tear and obsolescence. Furthermore, for mature accounts without a significant growth rate—and the railroad track accounts are such accounts—a depreciation accumulation (within a normal range of 50%) is normal, proper and about what accounting theory would lead one to expect. A depreciation accumulation of 20% would be expected only in accounts which are either not mature or which are experiencing rapid growth, and railroad track accounts do not have either of these characteristics.

Q. As an accounting matter, what amount of depreciation would you say should be applied to accurately reflect current condition if the railroad track accounts were restated to their original cost?

A. Based both on accounting theory and the actual analysis of the track accounts for the larger U. S. railroads reviewed by my firm, the original cost of these accounts should be reduced by about 50% to recognize the depreciation which has been realized.

page 347 } Q. Thank you, Mr. Tipton.
A. Thank you.

page 348 } I hereby certify that the answers given to the foregoing questions are true and correct to *to* the best of my knowledge and belief.

Russell D. Tipton

Subscribed and sworn to before me this 6th day of March, 1969.

Helen D. Schulz

Notary Public

Helen D. Schulz
Notary Public of New Jersey
My Commission Expires Sept. 23, 1973

page 349 } ADDITIONAL TESTIMONY OF
RUSSELL D. TIPTON ON
DIRECT EXAMINATION

Q. Did you prepare a letter dated April 7, 1969, which

your firm sent to Mr. Melvin J. Strouse, Director of State and Local Taxes for Norfolk and Western?

A. Yes.

[Counsel will introduce Exhibit 2-RDT.]

Q. Do the schedules numbered 1 and 2 which were attached to that letter relate to Schedules 1 and 2 which were attached to your letter of January 9, 1968, to Mr. Strouse which has been introduced as Exhibit 5?

A. Yes. These Schedules numbered 1 and 2 which show respectively the book balance in Accounts 1, 5, 6, 8, 9, 10, 11, 12 and 13, and the original cost for those accounts for the State of Virginia have been amended to reflect accounting information now available which was not available to my firm at the earlier date when the schedules were submitted.

Q. What change is reflected in Schedule 1?

A. Schedule 1, which shows the book balance—State of Virginia as of December 31, 1966, has been revised to show a total depreciated book balance of $100,502,313 instead of $100,314,246 as originally shown. This figure also conforms to the up-to-date book Schedule 611—"Road and Equipment Property Within the State" which H. J. Brinner, Comptroller of the Norfolk and Western, submitted to Mr. Lee B. Younger by letter dated March 12, 1969.

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Q. Did your review of the information from which Schedule 1 was compiled show that that Schedule is accurate?

A. Yes. My review disclosed no inaccuracies in that schedule.

Q. Turning to Schedule 2, have the amounts in this schedule changed from those shown on the original Schedule 2 submitted with your letter of January 9, 1968?

A. Yes. The total depreciated original cost for Accounts 1, 5, 6, 8, 9, 10, 11, 12 and 13 shown on the revised Schedule 2 is $92,702,077 compared with $87,787,207 shown on the original Schedule 2 or a difference of slightly less than $5,000,000. The revised Schedule 2 is based on the most current accounting information available to Norfolk and Western and, like Schedule 1, reflects data not available at the time the original Schedule 1 was prepared.

Q. Have you reviewed the accounting information which was used in preparation of the revised Schedule 2?

A. Yes. I reviewed the information used in the prepara-

tion of this schedule including the computation of original cost of the assets now in the track structure and the depreciation accrued on its *assts,* and have found that the figures shown on that Schedule are correct.

page 351 } Q. Based on your examination of the information on which this Schedule was based then, do you find that the cost of the assets now in the track structure of the Norfolk and Western, determined under the basis used in making the AAR depreciation study, after a reasonable allowance for depreciation, is $92.7 million?

A. That is correct.

Q. Now, Mr. Tipton, let's discuss the changes which have been made in the revised Schedules 1 and 2. First, let's look at Schedule 1. The depreciated book balance stated on this schedule shows, as you stated earlier, an increase of about $188,000 in the total depreciated book balance of over $100 million. To what is this small change attributable?

A. This change is primarily attributable to accounting performed by the Norfolk and Western Accounting Department subsequent to the time the original Schedule 1 was prepared. Sometimes the final accounting on railroad projects is delayed because of the rather complex requirements of the Interstate Commerce Commission for accounting records and the changes made in the revised Schedule 1 are mostly attributable to this fact.

Q. Now, Mr. Tipton, let's look at Schedule 2. This schedule shows Original Cost—State of Virginia for cer-

page 352 } tain ICC property accounts of N&W and the Depreciated Original Cost column total has increased about $4.9 million over that shown in the first Schedule 2. So that we may understand this change, will you first tell us how this depreciated original cost was computed?

A. The original cost of the assets now in the track structure was computed by starting with the investment shown for Accounts 8 through 12 in the so-called Engineering Report which was prepared by the Interstate Commerce Commission to show assets held as of 1916, stated in 1910-1914 values. To this beginning figure for assets held in 1916 were added the net changes resulting from additions and retirements since the date of the Engineering Report. These changes were restated to the same 1910-1914 values as used in the Engineering Report by using price indices prepared by the ICC. The total of these two figures—the intital balances plus changes through 1966—produced the total investment in track assets as of the end of 1966 stated in 1910-

1914 values in conformity to ICC practices. Since it is obviously necessary to increase these values to recognize the inflation which has occurred in the cost of track assets to produce accurate cost figures for the track accounts as of the date they were actually acquired, the investment figures for each account were increased by using ICC index figures to show a restated value as of the year the average asset in each account was added to the track structure. The lives for each account used to determine the average date of acquisition in making the trending calculation were determined according to the study of the track assets prepared by the Association of American Railroads and revised by my accounting firm. After being increased by these trending percentages, the balance in each account accurately reflects the actual cost of assets presently in the railroad track structures. To these figures for Accounts 8 through 12 were added the book figures for Accounts 5, 6, and 13 and a figure for Account 1 (Engineering) attributable to the track accounts. The latter accounts are stated at actual costs and do not require the above described trending computation.

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Q. What was the original cost of the assets determined in the revised schedule?

A. The original cost of the track accounts plus Accounts 1, 5, 6, and 13 was determined to be about $188 million. From this depreciation sustained on the assets of $95.3 million has been deducted, resulting in a depreciated original cost for these assets of $92.7 million.

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Q. By how much does this exceed the depreciated original cost determined in the original Schedule 2 calculation?

A. As I stated above, by somewhat less than $5 million.

Q. To what is this difference attributable?

A. The difference is made up of several factors. First, the beginning figure—that is, the original Engineering Report investment as of 1916 was subject to an error in the original computation caused by a mistake in trending the ICC Engineering Report figures back to 1910-1914 values. This error in the original cost has been corrected.

Q. What other changes have been made?

A. The second change in the two schedules was made in the net changes calculation and results primarily from accounting performed subsequent to the preparation of the original Schedule 2. This is the same type of change to which I earlier referred in the case of Schedule 1 and is reflected in net additions to the accounts made up to the end of 1966.

Russell D. Tipton

Q. Is there a third change?

A. The final trended balances for the accounts shown in the original schedule had been reduced to give effect
page 355 } to certain Interstate Commerce Commission accounting exceptions. These ICC exceptions are based on the manner in which certain accounting records are maintained and result in a reduction in the net investment figures shown on the books. Since the calculation of Schedule 2 went back to actual balances based on the Engineering Report and actual net changes, it is not necessary to make the ICC exceptions adjustment and it should not have been subtracted from the balances so computed. The ICC exceptions are simply irrelevant to this proceeding. The revised statement corrects the Schedule simply by not making the adjustment.

Q. Have you reviewed all of the changes made in the revised Schedule 2?

A. Yes. My accounting firm has examined the computations as well as the theory on which the revised schedule has been made and in our opinion it fairly presents the information it purports to show.

page 356 } A. Yes, they are.

Mr. Riely: I submit Mr. Tipton for cross examination.

Mr. Epps: Thank you, sir.

CROSS EXAMINATION

By Mr. Epps:

Q. In your testimony in chief you speak, I think, of retirement-replacement accounting?

A. Yes.

Q. I believe that you are familiar with it because you tell us about it and that is what I want to ask you about for openers, please, sir.

The Interstate Commerce Commission, I believe, calls it betterment accounting in its docket on this and if sometimes I may say "betterment," sometimes I will try to use your terms, but we mean the same thing if that is all right, sir?

A. Yes.

Q. Now, are you familiar with the docket in the ICC that I am talking about, ICC Docket No. 32153, titled,
page 357 } Betterment and Depreciation Accounting for the Railroads? It is reported in 309 ICC 289.

A. I am familiar with it. I did not attend the hearing, but I am familiar with it.

Q. Did Haskins & Sells take any position or part in that case?

A. No, sir; they did not.

Commissioner Catterall: Would you talk a little bit louder, sir?

By Mr. Epps:

Q. I am asking you the questions, and I certainly want to hear them, but it is also important for both of us that these gentlemen hear them, so I don't mind if you give me the side of your face.

I should like to refer to a few—well, to summarize, let's summarize that hearing, if you don't mind, and see if we can agree what it is. Then I would like to see if you subscribe to some of the, what I think are the findings or positions in that case, and then I would like to apply it to the case we are talking about today.

As I understand that decision, there was an effort made on the part of a few railroads and one of the big ten accounting firms, to have the Interstate Commerce Com-
page 358 } mission change from Betterment Accounting or Retirement-Replacement Accounting, to the so-called General Accounting Principles or Present-Day Depreciation Accounting. Do you agree that that is what that was?

A. I agree.

Q. And the majority of the railroads in the American Association were on the side of retaining the present and then-existing Betterment Accounting or Retirement-Replacement Accounting, is that correct?

A. Yes.

Q. Norfolk and Western was not one of the railroads who moved for the change? As far as we know, it was one in the association that wanted to keep what we have—as far as we know?

A. I do not know to the contrary.

Q. The parties who were moving are listed as—Norfolk and Western is not one of them—can we agree on that?

A. We can agree on that.

Q. Now, in its opinion, cleaving to the old and refusing to step off into Depreciation Accounting, on page 291 the commission says, in stating the position of the railroads:

"The railroads," and I am quoting, "assert that
page 359 } expenses incurred to keep the track in condition
for safe operation are maintenance expenses in every sense of the word and should be so treated. Also, that Depreciation Accounting cannot be properly employed because there is no depreciation of the track structure as a whole."

You subscribe to that?

A. I am not sure of the context in which that is being stated.

Q. I don't want to state it out of context. I gave you the whole opinion. This is on the third page of the opinion and it is page 291. I have marked them with double lines on the left margin, what I want. I certainly don't want to quote it out of context.

Do you want to see this, Mr. Riely?

Mr. Riely: If you have an extra copy.

Mr. Epps: Do you have a copy?

Mr. Riely: I don't think I have a copy.

Mr. Shannon: Mr. Johnson's Exhibit 3, our Mr. Johnson.

Mr. Riely: Your Mr. Johnson's Exhibit 3.

The Witness: In response to your question, no, I do not subscribe to the statement that there is no depreciation as a whole.

page 360 } By Mr. Epps:
Q. All right, sir.

I refer you again to the next page, 292, again stating the position of the railroads—that is through the Association in that case—and quote you this, and then I will let you read it because I don't want you to think I am giving it to you out of context:

"...but the railroads assert that such techniques are not applicable," such techniques, talking about Depreciation Accounting—"the railroads assert that such 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."

I want to ask you if you subscribe to that, but I want you to see it in the opinion so you will know the context of it.

A. I do not subscribe to that statement.

Q. All right, sir.

What about on the same page, "Unlike a car, building or

locomotive, the useful life of the composite track structure is semi-permanent in the sense that when properly maintained, the end of its life span is unforeseeable."

Do you subscribe to that?

page 361 } Commissioner Catterall: Page 292?

The Witness: I would agree with the statement that the end of the life span is unforeseeable within a reasonable period of years.

By Mr. Epps:

Q. I hope, maybe, we can get to an agreement.

The next point I want to ask you about is this:

"A specific depreciation reserve for the whole track structure as such, in anticipation of obsolescence or permanent discontinuance for other causes in the remote future of transportation by rail, in order to provide for losses from such a happening would be highly speculative."

Mr. Riely: What page are you reading from?

Mr. Epps: Still 292.

Commissioner Catterall: Next to last.

Mr. Epps: Last complete paragraph on that page.

Would you like me to read that again?

The Witness: No. The question of useful life or obsolescence is not a certainty in depreciation for any asset, whether it be railroad or otherwise. It is a subjective reasoning.

By Mr. Epps:

page 362 } Q. Well, the statement which I just read to you, of course, follows the one about the life span being unforeseeable. Then it talks about a depreciation reserve only for remote causes which the Commission determines speculative.

I wondered whether you would agree with that?

A. I would substitute the word "subjective" for "speculative."

Q. You and I can agree if we change one word. That is pretty good.

Thank you.

Now, I would like you to look at two more in this general nature, then I want to ask you about what I think is a resulting comment about depreciation.

The two statements that I have now, the first one is the

longest, I will ask you to bear with me. Then—

Mr. Riely: If you have a copy, why don't you give it to him so he can read it along with you? Wouldn't that be sensible?

Mr. Shannon: I will let him have my copy.

Mr. Epps: If Mr. Shannon—

Mr. Riely: I will be grateful for that. I think it is easier for the witness.

Mr. Epps: 294, page 294.

By Mr. Epps:

page 363 } Q. On that page, there is a quotation which begins, "Concerning the constant year-by-year cost of track maintenance, the railroads have made the following significant explanation." Then it is the quotation from the railroads' explanation that I want to go into with you.

"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 for 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."

Do you subscribe to that position taken by the

page 364 } railroads in that case?

A. This is referring to physical deterioration, I believe.

Q. Yes, sir.

A. Which is more of an engineering concept than an accounting concept.

Q. I would agree with that, but you are familiar with the difference between observed depreciation and book depreciation, and this is what we are talking about here, or a portion of what we are talking about here.

A. Yes. That's correct, sir.

Q. So, with that qualification, you would subscribe to this statement?

A. Well, again I think I have to qualify the accounting terminology here. This says there can be no deterioration of the structure. I do not subscribe to that concept.

Q. You think that is a little too broad?

A. Yes, sir.

Q. All right, sir.

The general thought behind that, your qualification, the general thought behind the position of the railroads you agree with?

A. Yes.

page 365 } Q. Then, continuing—and this is the last sentence until we get to the depreciation—

"In fact, it can be demonstrated that a track which has been in service for a number of years is actually 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."

Would you subscribe to that?

A. I don't feel that I would be qualified to. I could express a personal opinion but again this is an engineering concept.

Q. I will accept your explanation on that. Thank you.

Now, I think you said this, or something like this, in your direct testimony, but would you turn to page 295 of that same case that Mr. Shannon has lent you and under the tables I should like to ask you if you subscribe to the sentence in the middle of that paragraph which reads:

"This pattern of track maintenance, therefore, is reasonably comparable with the pattern which might be expected from the use of conventional depreciation accounting techniques."

A. Yes, I subscribe to that.

page 366 } Q. I believe on pages 10 and 11 you make a statement that is somewhat similar to that, do you not?

A. That is correct.

Q. And in your exhibit which is the Internal Revenue Exhibit, there is a statement in there to the effect that what results from this Betterment Accounting or Retirement-Replacement, as you term it, is in effect an adjusted basis?

A. Yes.

Q. Now, would you say, therefore, that you and I are, for the purposes of this discussion, can agree that it is your position that Betterment Accounting has depreciation built into it, if you will?

A. Yes, sir; I would subscribe to that.

Q. Now, your direct testimony explains what this is. Do you want your case back? It explains the operation of this Betterment Accounting. I do not intend to go over it except if you need to do so to make my questions clear. But am I correct in believing that when a replacement is in effect, everything is charged to expense, a true replacement?

A. Under Betterment Accounting?

Q. Yes.

A. Yes.

Q. Now, let's take it, it is not a replacement, it is a betterment. You charge the increment of the better-
page 367 } ment, the physical increment, is that correct?
A. That is correct.

Q. And the labor is charged to expense?

A. Yes.

Q. And that portion underneath the increment is allocated to what is already on the books so the asset that was already on the books, is that correct—

A. The betterment or increment, if I understand your question, is the part that is added to the asset on the books.

Q. The rest of it is equivalent to, if that is a good term, what is already on the books?

A. I see. Yes, yes.

Q. Now, would you tell us the difference between an addition on the one hand and a betterment on the other hand?

A. An addition would be something added to the account that was not there before, such as a new spur, a new sidetrack, a branch line.

Q. Right. Thank you.

And in that case, do you put on the books not only the cost of the account—let's say it is rails—but also the labor?

A. Yes, sir.

Q. So that an addition has two elements: the
page 368 } material and the labor—but the betterment, the
only thing that is added to the books is the betterment itself?

A. Yes, sir.

Q. All right, sir.

Commissioner Catterall: Before you leave that, what do you add to the books? If a rail cost $100, that cost, $100, was installed in 1910 and was replaced in 1967 with an identical rail.

The Witness: If it is an identical rail, Your Honor, there would be nothing added to the asset account. It would be expense. But if you were replacing 80-pound rail with 100-pound rail, then you would capitalize 20 pounds.

Commissioner Catterall: In other words, the 1910 rail replaced by identical rail would cost the railroad four times as much, but it would be carried on the books at the cost of the 1910 rail?

The Witness: Yes.

Commissioner Catterall: But if they put a rail that weighed 20 pounds more, what would go on the books?

The Witness: The cost of 20 pounds at today's installation price.

Commissioner Catterall: But not the cost of 120 pounds?

The Witness: No.

page 369 } Commissioner Catterall: In other words, you leave, you change the book value of the rail unless you have a new rail that weighs 20 pounds more and then you would add one-fifth of the cost of the new rail to the book value of that rail?

The Witness: That is correct.

Commissioner Catterall: That is the railroad method, but not what ordinary accounting would do?

The Witness: This is not what is described as addition and retirement accounting or the accounting normally followed by industry and other utilities.

Commissioner Catterall: Thank you, sir. I think it is clear.

By Mr. Epps:

Q. Now, before we leave your testimony in chief, I would like to see if we can agree on another matter.

On page four you indicate that an accountant can, however, by analyzing the amount of depreciation which has accumulated on an asset of or group of assets, estimate with reasonable accuracy the extent to which a decline in value has occurred.

page 370 } mate by depreciation the accumulated reserve

What I want to ask you about is that portion of your statement that says that the accountant can esti-

with reasonable accuracy, the extent to which a decline in value has occurred.

Would you be willing to say that you can make a better appraisal as to the amount of decline in cost based on a life cycle?

A. Well, I believe I also testified that depreciation accounting is normally designed to spread the cost of the asset over its life.

Q. That is the reason I am suggesting that maybe we ought to talk about cost and not value when we are talking about depreciation reserve.

A. Well, the spreading of the cost is a primary purpose.

Q. Yes, sir.

A. Of depreciation accounting.

On the other hand, in the absence of unusual factors, such as high salvage, inflation, style changes, obsolescence, the book depreciation does tend to equal the decline of value. In other words, if you bought a typewriter with a normal five-year life, at the end of two years it would be roughly 40 percent depreciated.

Q. But it would not hold in a period of rapidly
page 371 } rising prices?

A. No sir.

Q. We have just, and are experiencing such a period—you would agree with that?

A. The inflation of the past several years has been at a higher rate than in prior years.

Q. And we had it still in prior years?

A. Yes.

Commissioner Catterall: On your railroad accounting and your typewriter example, if I follow you, if the railroad had a 1910 typewriter that cost $100 and in 1967 replaced that typewriter with an identical typewriter that cost $500, you would still carry it at $100 on the books?

The Witness: No, the replacement accounting in the railroads only applies to the track accounts.

Commissioner Catterall: You say if you applied the same rule to typewriters, that would be the same?

The Witness: If you applied the same rule, yes.

By Mr. Epps:

Q. Now, I would like to refer, if you please, sir, to your additional testimony which was filed here yesterday, and I hope you have your work papers which your counsel furnished to counsel for the counties, cities and towns.

A. Yes, sir.

page 372 } Q. I believe that one of the matters made clear in the additional testimony is that somebody made a $10 million error, is that right?

A. No, I wouldn't say it in that way, Mr. Epps.

Q. Well, all right, sir. Somebody made an error?

A. No, the letter specifically refers to updating the previous schedule with more recent information.

Q. Let's look at page six. The difference is made up of several factors. First, the biginning figure—that is, the original engineering report, investment as of 1960 was subject to error in the original computation caused by a mistake in trending the ICC Engineering Report. We did have an error. Maybe I overstated it when I called it a $10 million error.

A. That was an error, yes, sir. Misunderstanding, rather.

Q. So, the difference between what came in, in January, from Haskins & Sells and what came in, in July, and what we now have by your additional testimony in your schedule two for original cost or original cost trended is $10 million, the difference between $177 million and $187 million in round figures?

A. That is correct.

page 373 } Q. And do you know that the $177 million figure is the figure which the Commission used as its step off?

A. I am not familiar with what the Commission used.

Q. I just want to point out that that is right at the crux of the matter we are talking about here today, one seven seven-one eight seven.

Also, I believe, that your account completely omits grading, is that correct?

A. That is correct.

Q. Who told you to omit grading?

A. We were not told to omit anything. We were asked to review a schedule that had been prepared as a response to a request from Mr. Younger, and as we stated in our first letter, we reviewed the validity of the method being followed and tested the mathematical computation and the preparation of the schedule.

Q. Then you checked what they asked you to check, is what I suppose I am getting at. Nobody asked you to check grading, and hence you didn't check it, is that right?

A. We understood that the information on the schedule was what Mr. Younger had requested.

Q. And you didn't check grading?

A. No, sir.

page 374 } Q. Now, I think we have agreed that a betterment doesn't have any labor charge, and I think we have agreed that in effect this betterment accounting has depreciation built in.

With those two concepts in mind, I would like to go to your work papers, to your schedule two.

Mr. Epps: Now, may it please The Court, in order that The Court can follow this, I was furnished with one copy of this on request—

Mr. Riely: I have another copy and left it at home.

Mr. Epps: That was very foresighted of you.

Mr. Riely: Foresighted of me, but I will go home and get it.

We will listen carefully.

Mr. Epps: I just wondered if we might have, somebody might have, it. We could let The Commission use it.

Mr. Riely: I don't even have a copy to look at myself.

Mr. Carter: Use my copy.

Mr. Epps: You haven't got it. They didn't send you a copy.

Mr. Carter: I have schedule two but I don't have the worksheet.

page 375 } Mr. Epps: We will do the best we can.

Commissioner Catterall: We will listen carefully.

Mr. Epps: Then we would like to make some arrangements to get it duplicated.

You can come and look over my shoulder if you would like to.

By Mr. Epps:

Q. Before we get into the schedules, and from a general approach to schedule two which is called Original Cost, State of Virginia, in the left-hand column on your schedule two—

A. Yes.

Q. By "schedule two," I mean the revised schedule two, December 31, 1966.

A. Yes.

Q. Originally filed at $177 million in January of '68, and then refigured and filed at $187-odd million—am I correct in saying that this was arrived at by taking original book balances of the component railroads involved back in the

1916 report and in 1910-'14 dollars, was that one of the steps that you did?

A. The original engineering inventory at that date, yes.

Q. On the books?

page 376 } A. No, it was not.

Q. Engineering inventory?

A. Right.

Q. Right. In 1910 dollars.

A. 1910 to '14 base dollars, yes.

Q. Then you took your betterments and additions over the years, is that correct?

A. No, sir. The mechanics involved here, we took the additions and retirements each year, prepared by the Engineering Department, to update the physical inventory. This is not the accounting that is on the books. In other words, it is not betterment accounting.

Q. You took the engineering report each time?

A. Which show the actual property added and the actual property retired.

Q. Well, if it is a betterment, it shows the costs, only the cost, of the betterment, is that it?

A. No, sir; it shows the total cost of what was added to the property.

Q. With labor?

A. With labor.

Q. And this is true, and in addition to?

page 377 } A. Yes.

Q. Now, is that true in your column, in the beginning balances, too?

A. Well, the beginning balance in 1916 was computed by the Interstate Commerce Commission on a uniform basis for all railroads.

Q. Right. It is not a book balance?

A. No, sir.

Q. All right, sir.

Now, if we will take this, take these ICC—I want to go now to schedule two of schedule two, if you don't mind. And this is a schedule, is it not, that contains the accounts in the left-hand column, one, five, six, eight, nine, ten, eleven, twelve and thirteen?

A. That is correct.

Q. And then your columns number one contain for the accounts five, nine, ten, eleven, twelve the so-called betterment accounting accounts?

A. I am sorry; I believe you meant account eight rather than five, eight, nine, ten.

Q. Did I say five?

A. It looks like a five on there.

Q. I must ask you to answer the questions I
page 378 } mean and not the ones I say.

Commissioner Catterall: Has this been filed as an exhibit?

Mr. Epps: No, sir, but we intend to file it. We asked for the work papers, sir, in preparation of our cross examination and sometime later, last week, or I don't say late or early, but I can't tell you when it came, but Mr. Pasco sent me last week one copy of his work papers which Mr. Tipton used in preparing his—

Commissioner Catterall: You have the copy?

Mr. Epps: I have one copy.

Commissioner Catterall: Here is a copy here.

Mr. Epps: Mr. Shannon just brought it. He got it somewhere.

Mr. Pasco: You all copied it after you got it.

Mr. Epps: I went to Mr. Younger but we have not had time to make exhibits for everybody.

Commissioner Catterall: It will go in as Exhibit 17 as soon as you are finished with it.

(The document referred to was marked Tipton Exhibit 17 and received in evidence.)

page 379 } By Mr. Epps:

Q. Now, column one is the engineering reports, beginning engineering report that you are now talking about, from the basic engineering report?

A. Yes, sir.

Q. Column two is net changes from ICC?

A. BV, Bureau of Valuation.

Q. Bureau of Valuation, 588, since 6-3-16 restated in 1910-14 values, is that correct?

A. Yes, sir.

Q. If I understand that correctly, what you did was to take these 588s which were the engineering inventories that you described to me, and found out that the dates in which these additions were made, and took them back to 1910-'14 dollars, is that correct?

A. That is right.

Q. By a divisor that the ICC furnishes?

A. Yes, their index.

Q. So, when you had this column one and column two in 1910-'14 dollars you came, you added them for column three?

A. Yes.

Q. And then you brought them back forward again, is that right?

page 380 } A. That is correct.

Q. But you didn't bring them to 1967, did you?

A. No, sir.

Q. You brought them to a period of dates chosen by one-half of the studied life cycles, is that correct?

A. Right.

Q. So that column four is the average life cycle you used, half of which you would deduct from the current date to figure the year whose multiplier you used, is that correct?

A. That's correct.

Q. And five is the multiplier for the particular year that you chose?

A. That is correct.

Q. And then six is the trended value in the case of account eight to 1950 of the ties?

A. Yes.

Q. In the case of rails, to 1947, of the rails?

A. Yes, sir.

Q. In the case of account ten, other track material, to 1954?

A. Yes, sir.

Q. And in the case of ballast to 1939?

page 381 } A. Yes, sir.

Q. And in the case of track laying and surfacing, to 1948?

A. Yes, sir.

Q. The multiplier for ballast for 1939 was 141, is that correct?

A. That's correct.

Q. As a matter of interest, what is the 66 multiplier on that item?

A. The multiplier for ballast in 1966 is 362.

Q. Versus 141. Would you give us the other 66 multipliers?

A. For ties, 419.

Q. Wait a minute now; would you go a little slowly.

The one we had was account eleven, 141 versus—

A. 362.

Q. 362.

All right, sir. Where are you going? To ties?
A. Number eight, ties, 419.
Q. 419 versus 291?
A. 291.
Q. Rails?
A. Rails, 423 versus 212.
page 382 } Q. Versus 212. All right.
Ten.
A. Other track material, 482.
Q. 482?
A. Versus 353.
Q. Versus 353.
A. For number 12, 430 versus 363.
Q. All right, sir.
Now—

Mr. Shannon: Would you repeat the last one?
Mr. Epps: 363 versus 430.
Mr. Shannon: You were using region five, Mr. Tipton?
The Witness: Yes, sir.
Mr. Epps: That was '66. Were you using '66 as a base?
The Witness: 1966.
Mr. Shannon: What is your figure?
The Witness: For 12, 430.
Mr. Shannon: Yes, I see.

By Mr. Epps:
Q. Do they contain '67 multipliers, too?
A. No, sir.
page 383 } Q. You don't have the '67?
A. I do not have.
Q. I thought I picked the lastest one you have.
I was correct, that is the lastest one?
A. That is the lastest one.
Q. Now, in going back to column two, you speak of additions. You said, as I understand it, that that is a net addition?
A. Yes, sir.
Q. And we agreed earlier that there is a difference between an addition and a betterment, and my question to you is: Does that indicate that there are no betterments in column two?
A. A betterment would be included in column two. In other words, if we replaced 80-pound rail with 100-pound rail, column two would take out the original 80-pound rail at its

engineering value and put in the new 100-pound rail at the cost of year installed.

Q. Plus labor?

A. Yes.

Q. So, that your term, additions—I don't want to be talking about apples and in the categories or oranges—so, when you are talking about additions under column

page 384 } two, you are talking about a wide set of things that are added to the railroad and which is greater than and more all-embracing than the term, addition, used in the narrower sense of betterment accounting, is that correct?

A. That is correct.

Q. Now, the engineering reports and the figures on those, on the form, Bureau of Valuation, 588, have nothing to do with any difference of accounting? They are just estimates of current, they are just current costs, is that correct?

A. The 588s prepared each year for changes in the property account are based on the additions at actual current cost.

Q. The 588s, after they get to the ICC, do they go into the property accounts of the railroad at the ICC?

A. The Interstate Commerce Commission have both a Bureau of Valuation and a Bureau of Accounts. The 588s go to the Bureau of Valuation to update the engineering inventory of the railroad it is not an accounting set of records.

Q. So that these records don't go into the accounting section and be added to eight, nine, ten, eleven, twelve?

A. No, sir.

Q. But they go to another place called

page 385 } the Bureau of Valuation?

A. That is correct.

I might add that the accounting of the Commission has been changed since 1964 so that both records are handled on the same basis. But prior to '64, which is the bulk of the period here, there were two separate sets of records.

Q. Now, Mr. Tipton, let's assume that instead of using multipliers from 1939 to 1954, you had used 1966 multipliers. To what extent would your updated historical or original cost have been increased?

A. I wouldn't know the answer to that because we didn't make the computation. We weren't trying to do that. We were not looking for reproduction cost new or present-day value. This schedule was designed to compute the original cost of the property in service today.

Q. But that property, or its equivalent, is still in service, is that correct?

A. Which property now?

Q. The same property you are talking about, the property that you used the multipliers on and came up with 39 or 49 or 50 or 54, as the case may be—that property to which you applied multipliers back yonder, a generation ago, in some cases that property is still, that property or

page 386 } *or* its equivalent is still in the system and in use?

A. Yes.

Q. I submit to you that that is what the multipliers are for, to bring them up to today's date?

Mr. Riely: Is that a question, if it please The Commission?

Mr. Epps: Yes.

The Witness: Well, to answer that as a question, if I have—let's take ties as an example—ties have a 32-year life, and in a property that is 100 years old, these have been replaced many times. So that each year, on an average basis, I replace one-thirty second of the ties in the railroad. That means that today, as of 1966, I would have in the tie account one-thirty second of the ties which would have been put in 32 years ago, in 1934. Another one-thirty second of those ties would have been put in in 1935, and so on down through the list, so that the actual cost in 1966 of the ties in place include those put in in 1934, '35, '36, '37. The average cost of the ties put in over the 30 years was selected as the mid-point so that that multiplier is too high for the ties that were put in, in 1934 to 1950; and it is too low for the ties put in from 1950 to 1966.

But as a mathematical model to arrive at the

page 387 } average—

Q. This does not, I believe, take into account a rapidly rising price curve? It assumes a straight line? It does not take into account the acceleration in the price rise, is that not correct?

A. It takes a mid-point as a mathematical concept. A review of the price indices do show that the amount of inflation over the first half of the year is not much different than that over the last half.

Commissioner Catterall: Your figures show some increase in cost since 1928, I take it?

The Witness: Yes, sir.

Commissioner Catterall: What was the percentage of that increase?

The Witness: If we took ties as an example—

Commissioner Catterall: I mean the whole thing.

The Witness: The indices are quoted separately for each element.

Commissioner Catterall: You can't answer that question, I take it, from the papers you have got?

The Witness: No, sir.

Mr. Epps: I don't believe there is anything in this exhibit that could answer that. We will have it for you

page 388 } from another witness.

Commissioner Catterall: Right.

By Mr. Epps:

Q. If we wanted to determine 1966 values, we would use the 1966 multiplier?

A. Yes, sir.

Q. Right.

Now, would you look at your account eight in column six which is $6,857,799.

Mr. Riely: What column?

The Witness: Column three.

Mr. Epps: I told him to use the ones I meant, Mr. Riely. Column three.

Mr. Riely: Beg your pardon for the interruption.

Mr. Epps: No, I thank you. Column three.

By Mr. Epps:

Q. That is the figure against which you used your multipliers, is it not?

A. Yes, sir.

Q. Now, would you take, instead of the 1950 multiplier, would you take a pencil and use the 1966 multiplier and tell us how much difference that would make in

page 389 } tracks?

Mr. Riely: I object to that, if Your Honor please. That is purely a mathematical matter. This witness did not testify as to the 1966 multipliers. It can be determined by simply looking at the exhibit. It is far beyond the scope of his direct examination.

Mr. Epps: May it please The Court, he just got through

saying you would get 1966 values by using the 1966 multipliers. I just wanted to illustrate by one calculation. I think it is perfectly appropriate.

Commissioner Catterall: We have an expert witness who knows these things.

Mr. Riely: He doesn't know the answer; he does.

Mr. Epps; I am certain—

Commissioner Catterall: When he gets his pencil out, he will know the answer.

Mr. Riely: I can do it, too.

Has anybody got a computer?

Mr. Pasco: Not responsive to his question.

Commissioner Hooker: Do you have a tablet?

Mr. Riely: It is 419 times $6,857,799—is that not correct?

The Witness: Yes, sir.

Mr. Riely: Let's do that.

page 390 } Mr. Epps: Let's wait until you get to redirect. Would you go ahead with the calculation?

Mr. Riely: Can we send out and get a computer?

What is the answer, Mr. Tipton?

Mr. Epps: Wait a minute. I will ask him.

Mr. Riely: I thought you had already asked him.

Mr. Epps: Do you have your answer now?

The Witness: Subject to re-audit, the answer I get is $28,734,177.81.

Mr. Epps: Right.

That would be versus your column six this time, Mr. Riely.

Mr. Riely: Thank you.

Mr. Epps: $19,956,195, is that correct?

The Witness: That's correct.

By Mr. Epps:

Q. And if you made the same calculation on the '56 multipliers to get '66 costs all the way down, you would have a similar calculation and a reasonably similar increase? sometimes greater, sometimes less?

A. Yes, sir.

Q. All right.

Now, if the 588s contain the complete additions, page 391 } including what you and I have in other context called additions and betterment, what would have been the result if you took all of the dollars and all of the 588s and added them to your column one and came up to date? Do you know the answer to that?

A. No, sir.

Q. Would this be another way to get it, what we are talking about?

A. I don't believe so because in dealing with these accounts, to arrive at the units in place, it is necessary to convert the dollars into 588s which do not have units here. In order to apply the multiplier, you need to know that we are working with the same dollars.

Q. So what I have, the method I have suggested to you, then, mixes 1932 dollars and 1929 dollars and that would be an unfortunate scramble?

A. Yes, sir.

Q. I think I asked you, but I want to make sure, did I ask you about overhead?

A. I don't believe so.

Q. Does your account have anything for overhead?

A. The number one account, engineering, is an overhead account.

page 392 } Q. What about general overhead?

A. There would be no general overhead in the usual meaning of the word.

Q. No interest during construction?

A. No, sir.

Q. Now, I think I am through with that, sir. I would like to go back just to summarize and touch on your testimony in chief for a moment.

You speak of a study in which a life cycle could be historically resuscitated and that you can have an experimental or a form or model, I think is the word, have a model series of depreciation accounting for a certain element—say, track, or say, rails, or any one of them that you want to take—if you get *you* life cycle; and contrast this with betterment accounting. In other words, you can contrast the depreciation concept with the betterment concept and see where you come out, and you discuss this in your testimony, is that correct?

A. Yes, sir..

Q. Now, you don't say so in so many words; you didn't actually do this for the Norfolk and Western, did you?

A. This study was for the Association of American Railroads and the United States Treasury.

page 393 } Q. But you are not saying in your testimony that you did it for the Norfolk and Western in this case?

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A. Well, the concepts developed in that study were applied to this.

Q. I understand. But I am correct in interpreting your testimony as a concept merely and not that you did it for the Norfolk and Western to make it applicable to this case?

A. That is correct.

Mr. Epps: I have no further questions. Mr. Shannon may have cross examination.

Commissioner Catterall: Do you want to ask any questions?

Mr. Shannon: I have one question.

By Mr. Shannon:

Q. Mr. Tipton, referring to page 10 of your testimony, you used the sentence—you say, starting at the top, "These three elements make up the annual charge to expense under Retirement-Replacement Accounting and that charge is the equivalent of straight line depreciation of the assets which are covered by Retirement-Replacement method."

You don't mean to say, to testify, do you, that Retirement-Replacement Accounting—that Betterment-Replacement to use the correct terminology, that Betterment-Replacement Accounting is equivalent to straight-line depreciation accounting, do you?

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A. In its effect on the income statement, yes; that is what I mean.

Q. Has the Interstate Commerce Commission ever issued a formal ruling holding that Retirement-Betterment—correction, Betterment-Replacement Accounting is the equivalent of straight-line depreciation accounting?

A. I know of no pronouncement by the Interstate Commerce Commission on that subject.

Mr. Shannon: That's all I have.

Commissioner Catterall: What do you mean by the use of the word "equivalent"? Is it the same dollar for dollar or that it corresponds to in the procedure?

The Witness: The dollar effect on the net income statement over a life cycle period comes out to approximately the same answer.

Commissioner Catterall: Same number of dollars?

The Witness: Same number of dollars.

Commissioner Catterall: Any redirect?

Mr. Epps: Before you go on, may I get *may* exhibits straight right now?

page 395 } Mr. Riely: Seventeen is in.

Mr. Epps: You have a copy?

The Clerk: Yes.

Mr. Epps: We can furnish copies to The Court, or will you?

Mr. Riely: If The Court would like to have them.

Commissioner Catterall: We have to have them eventually.

(Discussion off the record)

Commissioner Catterall: We will decide later.

Mr. Epps: If I have an obligation, I want to fulfill it.

Commissioner Catterall: Exhibit 17.

Mr. Riely: If I don't have an obligation, I want to deduct it.

REDIRECT EXAMINATION

By Mr. Riely:

Q. Mr. Tipton, carrying out further Judge Catterall's last question, if you turn to schedule one—that is, the book balance of the account show there, December 31, 1966, is it not?

A. Yes, sir.

Q. —and that follows the Retirement-Replace-

page 396 } ment Accounting method for accounting through 13, is that correct?

A. That is correct.

Q. And in your opinion, that net figure of $100 million is, in essence, a depreciated filing? It is after the deduction of depreciation or its equivalent?

A. It works out to about the equivalent amount, yes, sir.

Q. Now, Mr. Epps suggested and made you do a lot of multiplication about applying 1966 multipliers to the figures shown in column three of schedule two, appended to schedule two of Exhibit 17. If you used 1966 multipliers, would you get an original cost of the property?

A. No, sir; you would not get.

Q. What would you get?

A. You would get the cost to replace today.

Q. A reproduction cost, is that correct?

A. Yes, sir.

Q. Now, Mr. Younger had requested the original cost of the property in those accounts, had he not?

A. That is our understanding, for the reason to prepare schedule two.

Q. So, the use of the 1966 multipliers would have been erroneous in preparing a reply to Mr. Younger's
page 397 } request, is that not correct?

A. That is correct.

Q. Mr. Epps asked you about a sentence in this ICC docket 32513 which, it was stated, that the end of the life span of track is unforeseeable. Does that mean that the end of a life span of a particular length of rail is unforeseeable?

A. I interpret that as meaning the life span of the entire railroad. There is no doubt that an individual component part, whether it be a tie or piece of rail, has an identifiable life span.

Q. That would be true of tie, you say?

A. Yes.

Q. And a rail?

A. And a rail.

Q. And ballast?

A. Yes.

Q. And OTM, other track material?

A. Yes.

Q. That they do have a foreseeable life?

A. Right.

Q. If you were using a ratable depreciation, nothing, on the books, you would have to determine lives and
page 398 } depreciate accordingly, am I not correct?

A. That is correct.

Mr. Riely: I have no further questions.

Mr. Shannon: I have one question to clarify the one question you asked.

RECROSS EXAMINATION

By Mr. Shannon:

Q. Mr. Younger asked for the original cost of the line in place today, did he not?

A. I do not know the specific words of Mr. Younger's request, but I was informed that he asked whether the railroads could compute what the original cost of the property being used today was.

Mr. Riely: Do you know whether Mr. Younger's request was oral or written?

The Witness: No, sir; I do not.
Mr. Shannon: That's all I have.
Mr. Riely: That's all. I think I can state properly I don't think there is any disagreement that Mr. Younger's request was oral.
Mr. Shannon: That's correct.
Mr. Epps: Yes.
Mr. Riely: Was not written—so we don't have
page 399 } his exact words written for posterity.
Commissioner Catterall: You may recall him.
Mr. Riely: I propose to do so.
Thank you, Mr. Tipton.

(Witness excused.)

page 400 } Mr. Riely: I believe Mr. Kiley—
Mr. Shannon: Let's take Mr. Johnson next.
Mr. Kiley is all right.
Mr. Riely: Mr. Kiley, will you come around, please?

Whereupon DANIEL L. KILEY, a witness on behalf of the applicant, having previously been duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

By Mr. Riely:
Q. Mr. Kiley, you are Daniel L. Kiley?
A. Yes, sir.
Q. And you prepared the testimony consiting of ten pages, plus the affidavit, that was submitted originally in this case, did you not?
A. Yes, I did, sir.
Q. Have you ever testified before this commission before?
A. Yes, I have, sir.
page 401 } Q. And if I were to ask you the questions on those ten pages, you would give those answers or approximations of them?
A. Yes, sir.
Q. And those answers are in your belief true and correct?
A. I wish to make one small arithmetic change on page five.
Q. Page five. Would you state what it is, sir?

Mr. Riely: Your Honor, it is in the black book.

The Witness: Six lines from the bottom there is percentum of 40.8. It should be—

By Mr. Riely:
Q. 40.8 should be 55 percent?
A. Right; and on line six, on the second line, 60 percent should be 45.
Q. What page is that?
A. On page six, sir.
Q. Page six, second line, the 60 percent should be 45 percent?
A. Yes, sir.

Commissioner Catterall: I missed the first two.

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* * * * *

TESTIMONY OF DANIEL L. KILEY
ON DIRECT EXAMINATION

Q. State your name and address.
A. Daniel L. Kiley, 8 North Jefferson Street, Roanoke, Virginia.
Q. Where are you employed and what is your present position?
A. I am presently Assistant Vice President-Taxation, Norfolk and Western Railway Company.
Q. Describe your education and experience.
A. I received my education in accounting and taxation at the College of William and Mary at Norfolk. Prior to joining Norfolk and Western, I was employed by the Virginian Railway on the staff of the Comptroller in various accounting positions, including Tax Accountant and Assistant to Comptroller. In both of those positions I was responsible to the Comptroller for Federal income tax matters. In 1959 when the Virginian Railway was merged into the Norfolk and Western, I was appointed Assistant to the Comptroller of Norfolk and Western. The duties of that position were related to income taxes. In 1964 I was appointed Director of Income Tax Administration for Norfolk and Western and in 1968 I became Assistant Vice President-Taxation. In this position I have responsibility for the administration and planning of all Federal and state tax matters.

page 403 }

Daniel L. Kiley

Q. Mr. Kiley, are you familiar with the depreciation recorded for accounting purposes on the railroad track accounts which are the subject of this proceeding?

A. Yes. Since such depreciation is a deduction for Federal income tax purposes as well as for state income tax purposes, I am familiar with depreciation expenses for the track accounts, including those accounts under the retirement-replacement method. I am also familiar with the

page 404 } Interstate Commerce Commission accounts numbered 1, 5, 6, 8, 9, 10, 11, 12 and 13 in which are recorded the book balances for engineering; tunnels and subways; bridges, trestles and culverts; ties; rails; other track material; ballast; track laying and surfacing; and fences, snowsheds and signs. These are the assets with which this proceeding is concerned.

Q. Will you explain your understanding of the purpose of depreciation deductions in accounting?

A. Recognition of depreciation by means of deductions or charges to expense is intended to spread the cost or other investment over the useful life of the asset and to reflect, in a systematic manner over that useful life, the decline in value which results from physical deterioration and wear and tear.

Q. Is this the purpose of the depreciation which is reflected for track accounts of Norfolk and Western?

A. Yes. Depreciation for the track accounts has the same purpose as depreciation for any other assets—

page 405 } that is, to recover cost and reflect decline in value. As Mr. Tipton has indicated, the method by which depreciation is calculated for the track accounts is somewhat different from the typical straight-line or ratable method of depreciation. Retirement-replacement method deductions for the track accounts, however, do reflect the decline in value of the assets in such accounts resulting from deterioration and wear and tear. The charges to depreciation for Norfolk and Western perform this function.

Q. Are all of the assets involved in this proceeding recorded in accounts depreciated under the retirement-replacement method?

A. No. About half of Account 5, Tunnels and Subways, and all of Accounts 8 through 12 which represent Ties, Rails, Other Track Material, Ballast and Track Laying and Surfacing, are depreciated under the retirement-replacement method. Account 6, Bridges, Trestles and Culverts, and Account 13, Fences, Snowsheds and Signs, are also involved in

this proceeding and these accounts are depreciated in full by the use of a ratable method of depreciation. Account 5, Tunnels and Subways, is depreciated ratably in
page 406 } part, that is, to the extent of that portion of the amounts in this account relating to depreciable assets. This is a little complicated, but let me give you an example. A tunnel lining is depreciated ratably, but the cost of the tunnel bore is not. Of the approximately $10,800,000 in this account, about $5,600,000 is depreciated ratably and the remainder is depreciated on the retirement-replacement method. Account 1, Engineering, is depreciated ratably only in part, that is, to the extent that the amounts in this account relate to property that is otherwise depreciated ratably.

Q. How does the amount of the reserves, taken cumulatively, compare with the investment in these accounts?

A. At December 31, 1966, the depreciation reserves for Accounts 6 and 13 and that portion of Account 5 that is ratably depreciated were 55% of the investment in these accounts. In addition, I should point out that, except in the case of selected bridges, ratable depreciation on these accounts has been accrued only beginning in 1942 and, of course, much of the investment in these accounts was made well before 1942.

page 407 } Q. Does this mean that the depreciated condition of these accounts was less than 45%?

A. That is correct.

Q. Now let's look at the accounts depreciated by the retirement-replacement method—that is, Account 8, Ties; Account 9, Rails; Account 10, Other Track Material; Account 11, Ballast; and Account 12, Track Laying and Surfacing. Is the depreciation which has accumulated in the past for these track account assets of Norfolk and Western recorded in an account set up for that purpose?

A. No. As Mr. Tipton has indicated, the retirement-replacement method does not provide a reserve for depreciation or any other means of recording the depreciation deductions which have been sustained. Rather, becaue of the way this method of depreciation operates, the balances of the various track accounts of Norfolk and Western are not balances, showing, in effect, the investment in track account assets after the depreciation which has been sustained on such assets has been deducted.

Q. Mr. Tipton indicated in his testimony that he had reviewed a study of the track accounts for all Class I railroads operating in the United States, and that

page 408 } this study developed the extent to which depreciation had been sustained on the track accounts of those railroads. Have you made a comparable study for Norfolk and Western?

A. Yes. Under my supervision a study has been made of the track accounts of Norfolk and Western. The purpose of this study was to develop, based on the retirement-replacement deductions, the amount of depreciation which has been reflected over a full life cycle for the assets, and thus to develop a reserve showing the depreciation which has been sustained.

Q. What relationship between the investment in track accounts and the accumulated depreciation sustained on those accounts was shown by your study?

A. The study showed that depreciation had been sustained on track accounts in the amount of about 50% of the investment of those accounts, subject to a variation well within a normal range.

Q. In other words the track accounts of Norfolk and Western are approximately 50% depreciated?

A. That is what the study showed. About 50% of the investment in the track account assets has been recovered in depreciation and accordingly, about a 50% de-
page 409 } cline in value recognized.

Q. Was the result of your study of the extent to which depreciation has been reflected in line with accounting theory?

A. Yes. As Mr. Tipton has indicated, an accountant would normally expect to find that the reserve for accumulated depreciation on a mature account would be about 50% of the investment in that account, within a normal limit of variation. Railroad track accounts in general and Norfolk and Western's track accounts in particular are mature group accounts as to which no substantial growth has been experienced. As such, they should have accumulated, according to accounting theory, about 50% depreciation and the study which I directed confirmed that expectation.

Q. Is the amount of depreciation which has accumulated under the retirement-replacement method of depreciation markedly different from what would have accumulated under a ratable method of depreciation?

A. No. The study of Norfolk and Western track accounts showed very little difference in the depreciation expenses reflected under the retirement-replacement method and the depreciation which would have been reflected if
page 410 } a ratable method had been used.

Daniel L. Kiley

Q. Will you summarize the extent to which Norfolk and Western track accounts reflect depreciation?

A. Based on the study which has been performed under my supervision, the track accounts of Norfolk and Western are net depreciated balances showing the original cost of the assets in each account after a reduction for accumulated depreciation sustained of about 50%, reflecting physical deterioration and wear and tear.

Q. Based on your experience with the accounts of Norfolk and Western, would you expect accumulated depreciation of 20% for the Norfolk and Western track accounts to be significantly less than has actually been realized on the track account assets?

A. Yes. I agree with Mr. Tipton that depreciation of 20% could be expected only in immature accounts or accounts which are experiencing rapid growth. In common with most railroads, Norfolk and Western's track accounts do not have either of those characteristics. Accordingly, a reserve for depreciation of 20% would be far too low for the Norfolk and Western track accounts. The depreciation which has actually been sustained of about 50%, as shown
page 411 } in my study of depreciation on Norfolk and Western, is a much more normal and reasonable reflection of depreciation sustained. A 50% depreciation factor has thus been confirmed by that study. Not only would a 20% depreciation reserve be too low as a matter of accounting theory, it is too low as a matter of the actual depreciation sustained. If the Norfolk and Western track accounts were restated to the original cost, that original cost should be reduced by approximately 50% in order accurately to recognize the depreciation which has occurred.

Q. Thank you, Mr. Kiley.

A. Thank you.

page 412 } I hereby certify that the answers given to the foregoing questions are true and correct to the best of my knowledge and belief.

D. L. Kiley

Subscribed and sworn to before me this 8th day of March, 1969.

Hazel Brown
Notary Public

My Commission expires:
July 15, 1969
I was commissioned Hazel A. Tinsley

page 413 } Mr. Riely: I will get it for you, sir.
40.8 should be 55.

Mr. Kiley is tendered for cross examination.

CROSS EXAMINATION

By Mr. Shannon:

Q. Mr. Kiley, I note that you are currently Assistant Vice-President of Taxation, Norfolk and Western, is that correct?

A. Yes.

Q. In your capacity as Assistant Vice-President, Taxation, I take it you have be familiar with the ICC Uniform System of Accounts for Railroads?

A. I am.

Q. Under the ICC Uniform System of Accounts for Railroads, is it not true that maintenance costs are charged to operating expenses for years the maintenance was incurred and, consequently, results in railroads paying less Federal income tax?

A. Well, I won't answer, yes, but that doesn't motivate a charge for expense.

Q. What I am getting to, when you charge your expenses against, your maintenance expenses against operating costs, then the greater operating expenses, the less that you would affect your—

page 414 } A. That's correct, sir.

Q. Does the ICC Uniform System of Accounts for Railroads recognize straight-line depreciation for accounts, one, three, five, six, eight, nine, ten, eleven, twelve and thirteen?

A. Form A.

Form A, on page 224, you will note that there is depreciation under the straight-line method computed on account one, engineering.

Q. Mr. Kiley, may I ask you, maybe Mr. Riely wants to come around and look over your shoulder, what is the annual composite rate for engineering?

A. .90.

Q. Nine tenths of one percent?

A. That's correct.

Q. What is your rate of depreciation on grading?

A. For ICC purposes, it is .13.

Q. Is that thirteen hundredths of one percent?

A. Yes.

Q. What about account five?

A. .79.

Q. Tunnels and subways. There again it is less than one percent—.79?

page 415 } A. Yes.

Q. Bridges, trestles and culverts?

A. 1.45.

Q. Fences, snow sheds, signs?

A. 3.97.

Q. I note there that you have nothing included for accounts six, eight, nine, ten, eleven and twelve—is that right?

A. You have account six; that is 1.45.

Q. Six. Excluding six, it would be eight?

A. Eight through twelve.

Q. That's right. And they are generally what are regarded as your track accounts?

A. That's correct, sir.

Q. There is no depreciation allowed for the track accounts?

A. Under the ICC accounting methods, there is no depreciation recorded in the accounts.

Q. There would be no reserve setup in your accounts under ICC accounting for these same track accounts?

A. That's correct, for ICC accounts.

Q. Yes, Mr. Kiley. I don't know whether I asked you or not, but did I ask you to read into the record

page 416 } what the depreciation for account six, bridges, trestles and culverts is?

A. 1.45.

Q. Five, account five, was tunnels and subways. Did you give that figure?

A. Yes; .79.

Q. Yes, sir.

Now, Mr. Kiley, let's turn to page four of your statement. Toward the top you say, "Retirement-Replacement method deductions for track accounts, however, do reflect the decline in value of the assets in such accounts resulting from deterioration and wear and tear."

How is this reflected?

A. Well now, at this point we have got to come back from ICC accounting to a realization that in computing Federal income taxes, that this is one of the areas where ICC and tax accounting differ. For Federal income tax purposes, the allowance made under the retirement-replacement method of accounting for ICC purposes is an allowance for depreciation and so held by our courts.

Daniel L. Kiley

Q. For Internal Revenue Purposes?
A. That's correct.
Q. But Interstate Commerce Commission, they
page 417 } don't go along with that?
A. I don't know that they have ever taken a position one way or the other.
Q. They don't allow it?
A. I didn't say that. They could allow it under a different name.
Q. Under a different name. But you just testified, I believe, that on track accounts they don't permit you to set up a reserve?
A. I agree that they are not ratably depreciated; rather, they are depreciated under the retirement-replacement method of depreciation.
Q. You, in effect, take your depreciation as you go along each year by charging to operating expenses the amount that you expend for track, road maintenance?
A. That is too broad. We don't do that at all. What takes the nature of depreciation is only the cost of replacements under the retirement-replacement method, but not repairs.
Q. When you say replacements, you mean renewals, in railroad parlance?
A. Renewals.
Q. Then, as Mr. Tipton indicated here, better-
page 418 } ment or an improvement would be capitalized and charged to a particular property account?
A. To the extent the betterment is capitalized.
Q. To the extent. Thank you.
Were you with the Old Virginian Railway?
A. Yes, I was.
Q. Were you with them in 1957?
A. Yes, I was.
Q. Now, I am going to ask you the same question Mr. Epps asked Mr. Tipton here. Are you familiar with the ICC docket 32153, the Report of the Commission in the proceedings styled, entitled, Uniform System of Accounts for Railroad Companies, Betterment and Depreciation Accounting?
A. No, sir; I was not in any way involved with that with the Virginian.
Q. Do you know about it?
A. I know of it, but I am not sure I have ever read it all the way through.
Q. You have seen it?
A. I know it exists.

Daniel L. Kiley

Q. Then you would say, you are familiar with the Commission's ruling in that case, you would have to be, would you not?

page 419 } A. No, I am not, really. Like I say, I haven't read it. I know it is an exhibit in this case. I was not involved in it from 1957. My duties were solely Federal income tax matters.

Q. You heard Mr. Tipton, I believe? He agreed that in that proceeding the railroads urged the retention of the so-called Betterment-Replacement Accounting?

A. Yes, sir.

Q. Now, is it not true, Mr. Kiley, that track property is made up of hundreds of thousands of lengths of steel rails, millions of crossties, and additional millions of items of fastening and other track materials as well as great quantities—

A. There is—

Commissioner Catterall: We will recess for ten minutes.

(Short recess)

Mr. Riely: If it please The Commission, if I may interrupt just one second, Mr. Strouse is unable to be here on the 30th of June, the 1st or 2nd of July. He is very necessary to me and I wonder if I could put it up to 8, 9, 10 of July which seem to be vacant on the docket.

Commissioner Catterall: That is going to take

page 420 } up an awful lot of work on our docket.

Mr. Riely: I would like to cancel the three.

Commissioner Catterall: You want to cancel the three you already have?

Mr. Riely: June 30, the 1st and 2nd of July.

Commissioner Hooker: You are getting mighty close to August.

Commissioner Catterall: You want to cancel on July 1?

Mr. Riely: The 30th, day before.

Commissioner Catterall: July 8, 9 and 10.

Mr. Riely: Yes, sir.

Commissioner Catterall: 10:00 a.m., 13629, railroad tax case.

Mr. Riely: Thank you, sir.

Commissioner Catterall: Why don't you go over to September and be done with it?

Mr. Epps: It will be surrebuttal then.

Commissioner Catterall Now, if you will put that back.
Mr. Shannon: I have a question, please. Did you answer it, Mr. Kiley?

(The Reporter read the question referred to.)

page 421 } Mr. Shannon:—ballast and grading.

By Mr. Shannon:
Q. Is that a fact, Mr. Kiley?
A. I think they are substantial numbers.

Commissioner Catterall: Very moderate answer.
The Witness: I haven't counted them.
Mr. Epps: Services outside Virginia.

By Mr. Shannon:
Q. You agree that the parts and track structure are analogous to windows and floors of a building, the parts of a house?

Commissioner Catterall: He is trying to figure out what the trap is.
Mr. Shannon: No trap, Your Honor. I put up a simple illustration.
Commissioner Catterall: That is what scared him.
The Witness: The answer is going to be, yes, if you are talking about the capital nature of assets.
Getting back into repairs and replacements—

By Mr. Shannon:
Q. I am just talking in general about contents.
A. No, I don't think we can be that general. An item is either a capital item or a repair item, depending
page 422 } on what particular work you did on the structure. I think you have to know more about what it is, that you extend the life of the property by making this repair that made it a capital improvement—could be capitalized rather than expensed under your example. It is difficult to answer a question that general.

Commissioner Catterall: More like the floors of a house, really.
The Witness: If it is a floor, you capitalize it.
Commissioner Catterall: Beams to hold up the floors and the ceilings. That is better than doors and windows.

Mr. Shannon: That's right. I will accept that.

By Mr. Shannon:

Q. Well, now, Mr. Kiley, would you agree that the track structure of a railroad is of a semi-permanent nature, to the extent that it is properly maintained?

A. No, sir; I would not.

Q. You would not? You don't agree with the ICC, then, and ICC docket 32153?

A. Because I am not familiar with it.

Q. You don't agree, then, with the concept of Betterment-Replacement Accounting, then?

A. I agree with the theory of depreciation com-
page 423 } puted under the Retirement-Replacement Method.

Q. Wasn't that the theory, wasn't that the basis for the ICC upholding Betterment-Replacement Accounting, the fact that they said, relying on what the railroads presented to them—

Mr. Riely: Mr. Kiley has testified he is not familiar with that. I don't think he can be asked what the ICC said. I object to the question.

Commissioner Catterall: A witness can always set off cross examination by saying, I don't know. It is one of the greatest weapons that every witness has. The other one is: I can't remember.

By Mr. Shannon:

Q. Mr. Kiley, let's go on then to your direct statement. Let us look at page six. Page four, I beg your pardon.

Now, you state at the bottom of page four in response to the question: Are all of the assets involved in this proceeding recorded in accounts depreciated under Retirement-Replacement Accounting—you use the word, depreciated?

A. Yes, sir.

Q. In giving your answer, did you mean to indicate track accounts are actually depreciated as such under ICC account-
ing methods?

page 424 } A. No, sir; not under ICC accounting methods.

Q. But in framing this answer, you had in mind, did you not, Federal income tax purposes?

A. Also I acknowledged it is recognized by the railroad industry as being a method of depreciation of track structure.

Q. But it is not recognized by the Interstate Commerce Commission?

Daniel L. Kiley

A. I don't know that the Interstate Commerce Commission has ever recognized this or not recognized it.

Q. You do know, do you not, that there is no depreciation reserve set up for your primary track accounts?

A. Yes, I do.

Q. And that the ICC does not allow depreciation for the so-called non-depreciable accounts which would be your track accounts, be ties?

A. Here we are getting into a field that has to be distinguished from ICC accounting and the use of this word, non-depreciable. The ICC is recognizing that these are not ratably depreciated.

Q. When you say, ratably depreciated, you mean they are not depreciated over a period of years, is that right?

page 425 } A. No, they are not depreciated by computing a depreciation rate applied against the capitalized cost to give you annual deduction. Rather, we are computing the depreciation on the track, under the Retirement-Replacement Method which I believe Mr. Tipton put a description in, in his exhibit.

Q. Let me ask you another question here. Turn to your schedule two 11-B again. I have one more question on this that I would like to develop with you.

That is fences, snow sheds and signs, account 13. I believe it is on line eight there.

A. Yes, sir.

Q. What is the rate of depreciation?

A. 3.97.

Q. Now, you show the balance at the beginning of the year, in fact—correct me if I am mis-stating it—$2,453,881, do you not?

A. Yes, sir.

Q. Now, what do you show in your reserve account for that, which would be the next page, 211-D, depreciation reserve?

A. $2,478,692.

Q. Am I correct, aren't fences, snow sheds and signs fully depreciated?

page 426 } A. For corporate purposes, yes.

Q. So that is the reason you didn't make any charge to reserve in column C of line eight, page 226, schedule 211-D of your 1967 Annual Report to the Commission?

A. That is the reason it wasn't recorded in the corporate accounts.

Q. Are they still in use on the railroad?

A. Yes.

Q. Even though they have been fully depreciated?

A. For corporate purposes, not Federal income tax purposes.

Q. For corporate purposes they have been fully depreciated?

A. That's right. I should make it clear in answering that, that we use different rates, different methods for Federal income taxes than we do for corporate. In fact, every bit of this corporate depreciation is excluded from tax depreciation substituted under the use of methods allowed for corporate taxes, Federal income taxes.

Q. Mr. Kiley, you indicated earlier here, I think, when I asked you about this ICC docket 32153, you said you didn't read it all, if my information is correct?

A. That's correct.

page 427 } Q. But you have read part of it?

A. I glanced at for awhile in this room yesterday. I notice it was attached to—

Q. So you are familiar with it, then?

Mr. Riely: That is a question, Mr. Kiley, which I think deserves an answer.

Mr. Shannon: I understood, as we get into this, he didn't know anything about it. That is the reason I put it down, but he has read part of it.

Mr. Riely: He said he glanced at it. He doesn't admit he read it.

Mr. Shannon: I think his answer was, he didn't read it all.

Mr. Riely: If Mr. Shannon proposes to ask him questions about it, I think I will interpose my objection right now.

Mr. Shannon: You don't have to make it. I am not going to ask him any questions. I am ahead of you, Mr. Riely.

By Mr. Shannon:

Q. Mr. Kiley, on page five of your statement, you refer, down at the bottom, you said, "I should point out that, except in the case of selected bridges, ratable depreciation on these accounts has been accrued only beginning

page 428 } in 1942." What is significant about the date, 1942 there?

A. Well, this again is distinguished between depreciation recorded in corporate accounts and that allowed for tax purposes.

Q. May I stop you and ask you, do you keep two sets of books?

A. Certainly.

Q. One for Federal income tax and one for ICC, is that right?

A. That's correct. And let me asnwer why. As I mentioned before, the ICC does not recognize the use of anything but striaght-line methods. For computing Federal income tax purposes, it is our job to hold that tax to a minimum and naturally we use methods other than recognized—

Q. You are answering about '42, what happened in 1942?

A. In 1942 the Interstate Commerce Commission commence depreciation on the books of these accounts

Q. When you say "these accounts," do you mean accounts one, three and five in part, as you said there?

A. Six, thirteen and part of five.

Q. Yes, and two and a half, seven and thirteen. Are they involved?

A. I suppose they were.

page 429 } Q. Then do I understand from what you have said here that the ICC made it mandatory, effective 1942—I think it was actually around what, the first part of 1943, wasn't it?

A. Yes.

Q. —they made it mandatory for railroads to charge to operating expense these depreciable accounts that you have just mentioned?

A. That's correct.

Q. Prior to that time, it was optional, was it not, or do you know?

A. I really don't know.

Q. But in this 1943 or 1942 order that the ICC entered requiring mandatory accounting for these particular accounts, they did not involve track accounts?

A. That order did not involve track accounts.

Q. Mr. Kiley, you indicate on the bottom of page six that Mr. Tipton had made a study which you refer to and then you go ahead and on top of page seven said, you may have had a comparable study for the Norfolk and Western?

A. Yes, that's correct.

Q. When did you make this study?

A. In 1966, I believe.

page 430 } Q. Mr. Kiley, has the Norfolk and Western undergone rather rapid growth in the last ten years?

A. Growth measured in which way?

Q. Growth, expansion of railroad through mergers approved, acquisitions?

A. Yes.

Q. In 1959, I believe, the Norfolk and Western acquired the Virginian; that is how you came with Norfolk and Western?

A. That's correct.

Q. Then, I believe, it was in 1964 they merged with the Nickel Plate and have a lease arrangement with the Wabash?

A. That's correct.

Q. And were there other railroads that were added into the system or taken in—Pittsburgh and West Virginia?

A. It was leased, the assets of Pittsburgh and West Virginia were leased.

Q. Leased. Wasn't there a connecting line up in Pennsylvania, up in Ohio?

A. We purchased the so-called Sandusky line from the Pennsylvania Railroad.

Q. So you have had a rapid growth in that respect during the past ten years?

A. Well, yes, there has been, Norfolk and Western has expanded through acquisition of other companies or by leases.

Q. Mr. Kiley, is it not a fact that the Better-
page 431 } ment-Replacement Accounting as now in effect,
pursuant on to the ICC Uniform System of Accounts for Railroads, gives railroad management a nice tool by which it can influence earnings by adjusting maintenance expenses in any given year?

A. I have nothing to do with the determination of how much money is spent in the budget. I am not the proper person to ask that.

Q. You do know if maintenance expenses go up, your operating expenses go up, you pay less taxes?

A. I can conclude that if the flow of cash depleted, that a prudent management will withdraw from making expenditures, whether it be for track or acquisition of cars.

Q. Defer purchases until they got the money?

A. They would postpone the acquisition of freight train cars.

Commissioner Catterall: We have these constitutional questions coming here.

Mr. Shannon: I may have one or two more questions; I think Mr. Carter, Mr. Epps may have something here.

Commissioner Catterall: We will recess until 1:30.

(The noon recess was taken at 12:00 o'clock.)

Daniel L. Kiley

page 432 } AFTERNOON SESSION

Whereupon DANIEL L. KILEY resumed the stand and testified further as follows:

CROSS EXAMINATION

(Resumed)

By Mr. Shannon:

Q. Mr, Kiley, when you were with the Virginian, I believe you stated in your qualifications that you were Assistant Controller, is that true?

A. That's right.

Q. What were your duties as Assistant Controller?

A. Handled Federal income tax matters.

Q. That was your sole responsibility?

A. Yes.

Mr. Shannon: No more questions.

Commissioner Catterall: Any more questions?

Mr. Carter: I would like to ask you two or three.

By Mr. Carter:

Q. As I understand it, study was made, and I believe Mr. Tipton's firm made it, of all the Class I railroads in the United States as to depreciation?

A. Yes, sir.

page 433 } Q. They came up with a formula of about 50 percent, as I remember. Then you say that you made a study in about 1966?

A. Yes, sir.

Q. Now, in your statement on page, I believe it is on, page seven of your testimony, you say that 50 percent of investment in these accounts, or those accounts, are subject to variation well within a normal range.

I am not an accountant, of course, and I don't know much about the railroad, but what is a normal, within a normal range? What did you mean by that?

A. We are talking about 50 being the absolute, and within normal ranges, I would think, lower 40 to high of 60.

Q. To a high of 60?

A. Yes, sir.

Q. Then it could have been as high as 60?

A. What I say is that if everything had been perfect in re-

serve, you would look for 50 percent—that is your rates, your estimate, salvages computed right, your retirements are made reasonably as you are expecting to be, the computation, reasonable, that you would look for 50 percent reserve on that account. I say that within variations it could be to a low of 40 or high of 60. It wouldn't be too far out of

page 434 } line with normal.

Q. Anywhere between 40 and 60 would be in line?

A. I think it would be within the range an accountant would look for in testing the appropriateness of accumulated reserve.

Q. When you made this reserve, as I understand it, it was subsequent to the study made by Mr. Tipton's firm for the American Railroad Association?

A. Made roughly at the same time.

Q. When it was determined that 50 percent was the mean all over the United States, is that right?

A. It was made at about the same time.

Q. It must have been made before Mr. Tipton because you say on page eight of your testimony that the 50 percent that you found, 50 percent depreciation, the study to which I directed myself confirmed that expectation.

In other words, you say that it confirmed the expectation of the 50 percent because that had been determined as the, during the study by the, of all the Class I railroads in the United States, by Mr. Tipton's firm.

A. No, sir; I have to rely on memory as to where this thing fell, exactly. But the purpose of the study was to give the tax people of the American Railroads an oppor-

page 435 } tunity to see whether they really should stay on the Retirement-Replacement Method for tax purposes, whether it was giving the railroads something equal to what they would get under the other method.

Several roads, including Norfolk and Western, made studies, not in the depth Mr. Tipton's study is, to see whether we had been receiving more or less than we would receive under ratable method, straight-line method.

Q. You say that, you still say that, as such they should have accumulated to about 50 percent, according to the study which you directed, to confirm that expectation.

Well, now, when you made this study, you expected it to come out like it did? In other words, did you have a goal of 50 percent and then you made the study in order to reach the goal, is what I am trying to say?

A. We certainly did not. We were looking for one thing and one thing only: to see whether the railroad industry should continue, for the computation of Federal income taxes, remain on the Retirement-Replacement Method, or should we seek a change in our accounting methods for tax purposes to some other method.

Q. What do you mean by, then, that the study confirmed that expectation? What expectation? If it wasn't

page 436 } due to the fact that you had set a goal of the 50 percent and you were trying—that was your expectation?

A. No, sir; going back just a little bit further, the Internal Revenue Service had raised the point that the railroads were receiving maybe more, mabye less, but they were not satisfied that we had been getting more than we would under the ratable method. They had studies, all of these studies were devoted to satisfying the Treasury Department, the Internal Revenue Service, that this method did give the equivalent of a straight-line method of depreciation.

Q. Well, the Federal Government wouldn't have the study if they thought they were getting their just share of the tax, would they?

A. Well, as I said, they were under some people in the Internal Revenue Service, people were under the illusion that the railroads were getting more than—

Q. I thought maybe they were afraid you were getting too much.

A. That is what I say.

Q. The government wasn't afraid they were getting too much tax? They were afraid of getting too little?

A. That is correct.

Q. As a layman, I would like to know a little

page 437 } bit about this tunnel business that you have in your testimony—I believe it is probably on page five.

You say that you depreciate ratably at the total cost of the tunnel, $10,800,000, and you depreciate ratably the $5,600,000?

A. Yes, sir.

Q. Of course, you—what do you do with the balance?

A. Well, now, the ten-million-eight that is referred to on page five is total investment in the tunnel costs.

Q. All right.

A. Including both the cost of driving the hole and the cost of man-made improvements to the inside of that hole. For

the purpose of the tunnel bore itself, no life can be determined, so we can't put a ratable method for that particular part. We are on the Retirement Method which give the reduction at the time of retirement.

Q. Which part, the part of the bore?

A. The bore.

In addition to that, there are certain man-made improvements there like linings.

Q. I understand.

A. Concrete, timber, and so forth, which can be depreciated over a life for those components that are subject

page 438 } to measurement.

Q. I understand that is where you have plaster and brick and everything. I understand that—they have a given life—I understand that. Just like a track, tie, or anything else. But what do you do about the bore is what interested me as a layman.

A. The bore is under the retirement portion of the Retirement-Replacement Method of depreciation.

Q. How many years is retirement-replacement? Does that bore change any? What changes the bore?

A. I can't tell you from an engineer's point of view what happens to the bore, but as far as the computation of allowance of depreciation on the bore, we would receive it only at the time we retire it. It is under that Retirement-Replacement Method, but wholly under the retirement because we have to wait for that deduction from the date it is installed to some date when it is retired.

Q. What tickled my imagination was how long it would take a bore to completely wear out.

A. Well, Mr. Carter, if we can do that, we would put a life on it and ratably depreciate it.

Mr. Riely: I will have a few.

page 439 } REDIRECT EXAMINATION

By Mr. Riely:

Q. The bore is on the Retirement-Replacement Method?

A. Retirement-Replacement but as a factual matter, it is subject only to the retirement portion of it.

Q. So you get no benefit from that until the bore is in fact retired?

A. That's correct, sir.

Q. And now, I believe you testified that certain of these accounts were not depreciated before 1942, is that correct?

Daniel L. Kiley

A. For ICC purposes.
Q. For ICC purposes?
A. That's correct.
Q. They were depreciated for IRS purposes?
A. Some were.
Q. Some were?
A. Yes. Selected items were depreciated prior to 1942 for both ICC and tax purposes but they were selected.
Q. Selected?
A. On the Old Virginian Railway, it went to total ratable depreciation on all of its bridges in 1928.

Q. So, it has varied, perhaps, from railroad to
page 440 } railroad?
A. Yes.

Q. Now, the ICC rates for depreciation, are they the same as you used for Federal income tax purposes?
A. No, sir.
Q. The Federal income rates are generally higher or lower?
A. Higher.
Q. Higher.
Now, it is true that maintenance is an item of expense that is charged against, or that is deducted from operating revenues to determine that railway operating income, is that not correct?
A. Repairs are deductible as expenses.
Q. They are deductible for determining net income for Federal income tax purposes?
A. Yes.
Q. How about depreciation expense?
A. Just likewise deductible.
Q. For tax purposes?
A. Yes.
Q. That is deductible for accounting purposes?

A. For determining corporate net income.
page 441 } Q. So, both of them are treated exactly alike in determining net railway operating income and determining net income to Federal income tax purposes?
A. That's correct.

Mr. Riely: I have no further questions of Mr. Kiley.
Commissioner Catterall: You may stand aside, sir.

(Witness steps down.)

page 442 } Whereupon EDWARD Q. JOHNSON, a witness on behalf of the applicant, having previously been duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

By Mr. Riely:

Q. Your name is Edward Q. Johnson?

A. Correct.

Q. You have submitted prepared testimony in this case, originally presented, seven pages in length?

A. I have.

Q. And you are the Chief Engineer of the Norfolk and Western Railway?

A. I am.

Q. And if I asked you the questions contained in those pages, you would give the same answers?

A. I would.

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* * * * *

TESTIMONY OF EDWARD Q. JOHNSON
ON DIRECT EXAMINATION

Q. Please state your name and address.

A. E. Q. Johnson, Roanoke, Virginia.

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

A. I am Chief Engineer of Norfolk and Western Railway Company.

Q. Will you please state your educational and professional experience?

A. I received a Bachelor of Science in Transportation Engineering from the University of Michigan in 1938. During the period 1938-1949 I held various engineering positions with the Chicago, Rock Island and Pacific; Chi-
page 444 } cago, Burlington and Quincy; Wabash; Ann Arbor; and Florida East Coast Railroads. During the period 1949-1955, I was a division engineer for the Wabash. During the period 1955-1957 I was general manager of the Des Moines Union Railroad. During the period 1957-1964 I held, in order, the positions of construction engineer, manager of operations, research and chief engineer of the

Wabash Railroad. In 1964 I became Chief Engineer of Norfolk and Western.

I am a Director and officer of the American Railway Engineering Association and a member of the Roadmasters and Maintenance of Way Association.

Q. What are your duties as Chief Engineer?

A. I am responsible for maintenance and construction of road property on the Norfolk and Western Railway and its various subsidiaries.

Q. Then one of your responsibilities is the maintenance of the Norfolk and Western's lines of railroad in the State of Virginia?

A. Yes.

Q. What are the goals and objectives of the Norfolk and Western's roadway maintenance programs, as you see them?

page 445 } A. Our goal could be best summarized by the word "efficiency." We try to do the best possible maintenance job at the lowest possible cost.

Q. Is there an overall condition in which you aim to keep the property maintained?

A. Yes, in line with our efficiency goal, we generally strive to keep the property maintained in about a 50% condition, or, stated another way, so that the track structure as a whole at any given time has about half its useful life remaining.

Q. Why would a 50% condition represent maximum efficiency?

A. If we replace any element of the track structure before its useful life is at an end, we have lost efficiency because we are not getting maximum use from our investment. However, if we leave property in service beyond the time when it performs its particular function, we risk an even greater loss of efficiency because of the possibility of causing wrecks or slowing down traffic. Consequently, under optimum conditions, we replace elements of the track structure just as they end their useful lives. Since the maintenance of a line of

page 446 } railroad is a fairly even continuing process of replacing old with new, at any given time the track structure will contain some new material and some material that is worn out, and the major portion of the property will be of an age and condition that would fall between these two extremes. On the whole, to the extent we can meet our efficiency goal, the average condition of all the elements of property in the track structure will approximate 50%.

Edward Q. Johnson

Q. I take it that this efficiency goal of 50% condition cannot always be met?

A. No, but the variances often balance out. For instance, in some of our renewal programs, we find it more efficient to remove whole sections of material when the major part of the property is worn out, even though there is some property in the section which still has some remaining life. All other factors being equal, this procedure would yield an overall condition percent somewhat higher than 50% since the new or 100% material going into the line would exceed the worn out or zero percent material coming out.

However, as a matter of fact, rail, ties and other items of the track structure often stay in the line beyond the time when their useful lives have expired. Every rail-
page 447 } road makes numerous "emergency" repairs on a daily basis. There is no way to foretell with complete accuracy when any single item will fail, and it is impossible to replace every single worn out element of the track structure as soon as it reaches a zero percent condition. Some items, such as a broken section of rail, must be replaced immediately, but others, such as a worn out tie, can be left in place temporarily as long as other surrounding ties are performing their function.

Q. Mr. Johnson, you stated that the maintenance of the track structure is a fairly even, continuing process. This does not mean that you remove all the various track structure components at the same time, does it?

A. No. Each element of the track structure and track appurtenances is covered by a separate program of maintenance. Nor do all classes of track require equal maintenance. Heavy tonnage main tracks need more attention than light tonnage tracks or branch lines or yard tracks. By even maintenance I mean that once a line of railroad has been in existence for some time, it is in a constant state of being renewed. It is not economically feasible to renew the entire road at once, and we try, depending on budget limitations, to renew various sections and vari-
page 448 } ous elements of the track structure each year. Over a period of time, a fairly even cycle of maintenance develops.

Of course, all the maintenance-of-way work is not on such a "program" basis. As I indicated earlier, we must constantly inspect the track structure for material which wears out sooner than expected, or material damaged in an accident, or material which has latent defects. When we find such nonserviceable property, we replace it.

Edward Q. Johnson

Q. Mr. Johnson, do you have any criticism of the DeLeuw, Cather appraisal, as testified to by Mr. Caywood?

A. No.

Q. In view of your knowledge of the condition of Norfolk and Western's track structure in Virginia, does a 48% condition seem reasonable and accurate?

A. It does.

Q. Mr. Johnson, has the Norfolk and Western "plant" in Virginia undergone any material growth in size since 1926?

A. No. In 1926, Norfolk and Western and the Virginian Railway, a predecessor, operated 2,856 miles of track in Virginia. At present we operate 2,894 miles of track

page 449 } in Virginia.

Q. Thank you, Mr. Johnson.

A. Thank you.

page 450 } I hereby certify that the answers given to the foregoing questions are true and correct to the best of my knowledge and belief.

E. Q. Johnson

Subscribed and sworn to before me this 6th day of March, 1969.

Hazel T. Brown
Notary Public

(I was commissioned Hazel A. Tinsley)
My commission expires 7-15-69

page 451 } Mr. Riely: May it please The Commission, I offer the testimony of Mr. Johnson, and Mr. Johnson is tendered for cross examination.

CROSS EXAMINATION

By Mr. Shannon:

Q. As Chief Engineer of the Norfolk and Western Railway, you are the officer responsible for the maintenance, the well-being of the track and track structures, the railroad generally, is that correct?

A. That's correct.

Q. Mr. Johnson, how is your maintenance budget determined on the Norfolk and Western?

A. We start on our maintenance budget along about in September of the year, when we request each of our engineers to

have his maintenance forces review the territory under their supervision. We prepare an estimate of the requirements for the crossties, rail, ballast, and all other items of maintenance expense which they forward to my office.

My office then combines these so we get a system figure in which the Assistant Chief Engineer of Maintenance and myself review.

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We make alterations to it as we feel necessary, based on our knowledge and condition of the properties, and we then submit this estimate to our management through our Budget and Planning Department.

At that time, the comparable estimates are received from other departments, revenue estimates are prepared, and a look is taken at where this winds up with net. Maybe it is satisfactory, maybe it isn't.

Obviously, management has certain goals to meet, and profit-wise, and we then sit down and review these and sometimes we find that adjustments are necessary. If they are necessary, we sometimes have to make them.

Q. Mr. Johnson, on the Norfolk and Western, then, is your maintenance budget related to anticipated or expected earnings?

A. No, it is related first and primarily to anticipated requirements. Then it is tempered by the requirements of earnings.

Q. Now, generally, how much is allocated annually to the Norfolk and Western for maintenance?

A. That varies. In 1968, we spent approximately $60 million in maintenance. We anticipated in 1969 spending approximately $66 million. It varies.

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Q. Is that pretty well allocated uniformally throughout the system?

A. Not necessarily. Again it is allocated on the basis of requirements and many of our programs are cycle programs so that it would not be necessarily allocated uniformally by each mile throughout the system.

Q. Yes. Well now, Mr. Johnson, what percentage of your system is in Virginia as of today?

A. Approximately?

Q. Approximately. Does 20 percent sound reasonable?

A. Slightly under 20 percent. I am guessing.

Q. Mr. Johnson, is it not a fact that historically maintenance in the railroad industry followed the trends of total operating revenues and expenses?

A. I think there is a relationship between maintenance

expenditures and operating revenues. After all, we are in business to make a profit. We have to. In good times we spend a little more than we do in poor times, obviously.

Q. Mr. Johnson, in determining or performing track road maintenance on the Norfolk and Western, isn't your goal actually to keep the Norfolk and Western line maintained to

page 454 } the standard necessary to accommodate the volume of your present traffic as well as the volume of traffic that you expect or anticipate to develop?

A. Our aim, as you stated, is to maintain the road property consistent with requirements of traffic at the lowest possible cost.

Q. And is it not a fact that maintenance in this day and time, good maintenance, is necessary in order to keep the railroad competitive?

A. Well, I think that falls in line—when I said, consistent with the requirements of traffic, tonnage, speeds, that sort of thing.

Q. By "competitive" you mean competitive not only with other railroads but with motor carriers, all modes of transportation that can haul the same traffic that the Norfolk and Western can haul?

A. Yes, sir.

Q. Do you have many derailments on the Norfolk and Western line in Virginia?

A. No, I don't think we have many derailments.

Q. What was the last major derailment you had in Virginia?

A. You mean from any cause?

Q. Say, from defective track, defective track condition.

page 455 } A. Offhand, I don't recall when the last derailment we had, major derailment due to defective track conditions, was.

Q. That brings me to the next question: There are numerous causes that can precipitate a derailment—defective car as well as defective track, isn't that correct?

A. That's correct, or it could be human failure, too.

Q. And when you know of a defective track condition which might contribute to a derailment, what do you do?

A. We repair it.

Q. You repair it.

What precautions do you take to warn trains when there is a defective track condition until you get it repaired?

A. Well, it depends on the nature of the defective condition.

If it is such that it is not possible to pass trains, we stop traffic. It may be, the nature of the defect would be such that trains could move over it at reduced speeds, so we do put a "reduced speed" over this particular section of track.

Q. Is that what is commonly called a "slow order" in railroad parlance?

A. Yes, sir.

page 456 } Q. Now, as Chief Engineer of Norfolk and Western, I am sure you keep an almost daily vigil, personally and through your subordinates, as to track conditions that exist on the lines, isn't that correct?

A. I have 13,000 miles of track. It is impossible for me as an individual to keep a daily vigil on the whole system of track, but through my office and the organization we have, we have people on the track daily, some Saturdays and Sundays, perhaps.

Q. You have a number of subordinates who report to you when a condition that arises that requires some major attention—of course, that would be reported to you, would it not?

A. If it is something that requires attention, they have authority to go ahead and take care of it themselves before they report it to me.

Q. But you certainly want to know about it?

A. Yes, sir.

Q. How many slow orders are there outstanding as of today in Virginia?

A. I couldn't tell you how many there are today. I haven't seen today's slow order list.

Q. How about yesterday?

A. I haven't seen that.

page 457 } Q. When is the last slow order list you saw?

A. Probably last Friday.

Q. How many slow orders were there then in Virginia?

A. It would probably be three or four, perhaps.

Q. Do you have any idea as to why, what precipitated the issuance of those slow orders?

A. Well, I am sure we had one where we had a tie gang renewing ties on the Norfolk Division during the working hours to protect the work, the men working.

We, I am sure we had one in another tie gang renewing ties. I am sure we had one at another location where we were renewing rail.

Q. It was to protect your section gangs that were performing ordinary track maintenance, is that right?

A. That's correct.

Edward Q. Johnson

Q. Now, do you have a significant amount of deferred maintenance on the Norfolk and Western line in Virginia?

A. No, I don't think we do.

Q. Then would you say that to make your goal, to maintain your railroad to standard proficiency that you described in your testimony, that you, your maintenance program in Virginia, is a fairly uniform program throughout the system in Virginia?

page 458 } A. I am not sure what you mean by "throughout the system in Virginia."

Q. I mean, let me put it this way: is it not a fact that your railroad is pretty well uniformally maintained in Virginia to an efficient standard?

A. Well, each class of line, depending the tonnage and the speed, would have a different level of standard of maintenance, but within that category I think our maintenance is farily uniform.

Q. Mr. Johnson, what is the maximum speed limit of trains on your main lines, say, between Roanoke and Norfolk?

A. Seventy miles an hour.

Q. Is that passenger train speed limit?

A. Yes, sir.

Q. What is your maximum freight train limit on that line?

A. I believe it is 60 miles an hour.

Q. How about on the Shenondoah Division?

A. Sixty miles an hour on the Shenondoah Division.

Q. You have no passengers on the Shenondoah Division?

A. We have no passengers.

Q. When you replace a piece of rail on a main line track, what do you normally do with the rail taken out

page 459 } of the main track, assuming it is not a broken or defective rail? I know that you discard, scrap those. A rail worn probably to the point where you no longer consider it desirable to keep it in the main line but—

A. Are you speaking of an individual rail?

Q. Yes, individual rail that is taken up.

A. I don't know why an individual rail would be taken out unless it were broken—

Q. You are putting down—

A. —or worn out.

Q. You are putting down a welded rail.

A. But not in individual rails.

Q. I understand that. I want to talk a little bit about that later. But when you put out welded rail, you take up the old jointed rail, isn't that right?

Edward Q. Johnson

A. That's correct.

Q. What would you normally do with that rail that is taken out of the main line?

A. Well, we would first classify the rail and the portion of it which would undoubtedly be scrap, scrap that portion of it; the balance of it we would, first we might be using it for repair purposes on an individual rail basis, such as replace-

page 460 } repair purposes on an individual rail basis, such as replacement of Sperry car rails, or we might be taking the rail and cropping it and welding it, and relaying it in other lines; or we might be laying it jointed in other lines of lesser traffic.

Q. Well, couldn't and wouldn't you, insofar as possible, endeavor to use it in the line having a less, lower traffic density than the main line?

A. Yes, if the rail still had service life in it, we certainly would.

Q. Then is it not a fact, Mr. Johnson, that rail taken out of the main line has utility for use somewhere else in the system, assuming, of course, it is not broken or defective?

A. Well, in normal programs it is. It is conceivable and it does happen on certain territories where there is a great amount of curvature and sharp curvature that the rail that went in, in the initial instance, might not have enough service life left in it for reuse. In other words, it would be completely worn out from the curve standpoint.

Q. Now, what do you ordinarily do with rail, ties and other track material removed from an abandoned branch line?

A. Well, to the extent that the materials are reuseable, we use them.

Q. In other words, you store them for use else-

page 461 } where?

A. Well, we generally, we would like to distribute them for use elsewhere rather than putting them in storage and build up material counts.

Q. Then, as I understand your answer, you were able to utilize this material elsewhere on the railroad as the need arises?

A. To the extent we have a balance.

Q. I believe I asked you maximum speed limits. What is it on the Bristol Division, Mr. Johnson? I don't believe I asked that one. Maybe I don't describe the line right, between Roanoke and Bristol. What do you call that?

A. I am not sure what it is, to be quite honest. Various

speeds all over 14 states, I don't really remember for sure on each line.

Q. You don't have an operating timetable with you?

A. No, I don't.

Commissioner Catterall: What is the maximum length of a freight train?

The Witness: Oh, that could vary considerably from probably 20 cars to 250 cars.

Commissioner Catterall: You could run 250-car trains?

page 462 } The Witness: Yes, sir. We can run longer—it is possible—but it is not economical.

Commissioner Catterall: That would be over a mile long, wouldn't it?

The Witness: It certainly would.

Commissioner Catterall: Two miles?

The Witness: Well, depends what kind of cars they are. If they are coal cars, the average of 50 foot, 50 times 250, it is several miles long.

Commissioner Catterall: Several miles.

By Mr. Shannon:

Q. Is it not a fact, Mr. Johnson, that a line of railroad over which passenger service is performed must be maintained to a higher standard than one over which only freight trains operate?

A. Well, it must be, line and surface must be maintained to higher standard. It doesn't necessarily mean that the ties, tie condition, rail, rail condition, other track material, ballast, have to be maintained to a higher standard. Primarily, line and surface only.

Q. Is the line and service maintained to a higher degree in order to provide a smoother ride for passengers, is that it?

page 463 } A. Well, essentially, yes, because they are operating at higher speeds and any irregularity is felt more at higher speeds than it is at the slower freight train speed.

Q. What about your curvature? Would that be affected by passenger operations?

A. The amount of elevation?

Q. Yes.

A. Yes.

Q. Now, Mr. Johnson, let us turn to page five of your testimony, please, sir. Toward the bottom of the page you state that:

"Heavy tonnage main tracks need more attention than light *tonage* main tracks or branch line or yard tracks."

Isn't that a fact?

A. That's correct.

Q. Now, what do you mean by, "heavy tonnage main tracks"?

A. Well, our heavy tonnage lines are all over 40 million gross tons per mile per year.

Q. Would you explain that a little for the record here? I am afraid it might not be clear.

A. Well, that is the total tonnage of equipment, locomotives, contents, in tons that are moved over the railroad per year. That is our heaviest traffic lines. We consider heaviest traffic 40 million, or in excess.

page 464 } Q. May I interrupt you, sir? Where would those lines be in Virginia? Between Bluefield and Norfolk?

A. Yes, between Norfolk and Bluefield.

Q. Continue the answer. I didn't mean to—

A. Then we have a number of classifications of tracks which we use as guides in attempting to establish levels of standards of maintenance. We break it down below 25 to 40, general classification. That is another area that we set as somewhat of a standard. And we break it on down to lines that maybe carry less than a million, branch lines which might carry less than a million tons a year.

So it is all, requirements of maintenance are all relative to the *tonage.*

Q. That's right. That leads me to my next question:

The weight of the train certainly has a direct bearing on the maintenance performed on the line?

A. That's right.

Q. Is that right?

A. That's right.

Q. What is the average weight of coal trains moving coal to Norfolk for export?

A. I don't know.

Q. You don't know?

page 465 } A. I have never figured it out.

Q. What would be the normal consist of a coal train, number of cars?

A. I am not sure; I don't know what the normal consist is.

Q. Do you know what the weight of a large capacity car of coal would be?

A. Well, the largest cars would be 100 ton. I think our average would around 70 tons per car.

Edward Q. Johnson

Q. But your largest would be 200 thousand, is that just—is that the pay load?

A. It is gross weight.

Q. Gross weight.

A. I am not sure. Wait a minute. I would have to look at the specifications on the cars. I am not sure whether that is gross or net.

Q. Well then, is it not a fact that coal trains are substantially heavier than a manifest train? I mean, regular boxcar freight, in railroad parlance, is that not what you call a manifest train?

A. Right.

Q. Isn't it a fact that coal trains run substantially heavier than manifest?

page 466 } A. On a car-by-car basis, you mean?

Q. Yes.

A. Yes.

Q. Now, I believe you said that the largest capacity car that you are operating is the 100 ton hopper?

A. That's right.

Q. Mr. Johnson, is it not true that railroads today are operating heavier and larger capacity equipment than they were, say, 30-40 years ago?

A. That's correct.

Q. That is considerably heavier, is it not?

A. Well, we do handle, we do handle loads under special conditions, special movements, special equipment, special cars, that are in excess of a million pounds.

Q. Now, your bridges, of course, would have to be, and your structures would have to be designed to accommodate those heavy loads, would they not?

A. That's correct.

Q. Would they not?

A. Yes.

Q. Mr. Johnson, are you familiar with the Norfolk and Western Blacksburg Branch?

page 467 } A. Just—I am familiar with it, yes, not in detail.

Q. Where is it located?

A. It is located west of Roanoke, Missouri.

Q. Roanoke, Missouri?

A. Roanoke, Virginia in Christiansburg, formally connected to Blacksburg.

Q. You believe that is in Montgomery County, isn't it?

A. A portion of it.

Edward Q. Johnson

Q. That is my next question: Wasn't a portion of this line abandoned in 1966 pursuant to authority granted by the Interstate Commerce Commission?

A. Yes, it was.

Q. And Finance Docket 22902?

A. A portion of it was. I don't recall the mileage.

Q. Now, are you familiar with the ICC Uniform System of Accounts for Railroads so far as they pertain to the duties and functions performed by the Chief Engineer's Office?

A. Yes, I am.

Q. And are you familiar with account 267?

A. Yes, I am.

Q. And what is that?

A. That is, 267 is—I don't know whether it is labor affecting retirements or—

page 468 } Q. 267?

A. That is the retirement losses involved.

Q. That's right. The retirement of non-depreciable road property, isn't it?

A. Right.

Commissioner Catterall: Like a tunnel? You mean like a tunnel?

The Witness: No.

Mr. Shannon: Like a line of railroad, the non-depreciable.

The Witness: A piece of track.

Mr. Riely: Like the bore of a tunnel?

Commissioner Catterall: You are saying, non-depreciable part of the track?

The Witness: The track itself is non-depreciable.

Mr. Shannon: That's right. The ties and the rails.

Commissioner Catterall: You are back on ICC accounting and not the Internal Revenue accounting?

Mr. Shannon: That is what we are talking about.

Commissioner Catterall: It makes a big difference who you are talking to.

By Mr. Shannon:

Q. Mr. Johnson, when a line is abandoned, don't you charge to this account—that is, 267—the service value

page 469 } and, I believe, they define service value as the ledger value less the value of salvage?

A. Yes.

Q. —of the non-depreciable road property retired?

A. That is my understanding.

Edward Q. Johnson

Q. And is it also your understanding that you charge the salvage, the net salvage that is retired, you put that in account 712?

A. As I recall, that is materials, supplies.

Q. Materials, supplies; that's correct; that's right, sir.

Mr. Johnson, are you familiar with the—let me get it; I don't want to miscall it, mislabel it here—

Your Honor, I apologize, my desk looks like Fibber McGhee's closet.

Commissioner Catterall: I have seen worse desks.

By Mr. Shannon:

Q. Are you familiar, Mr. Johnson, with the supplemental report of the Interstate Commerce Commission in Finance Docket 21510, Norfolk and Western Railway Company and New York, Chicago, St. Louis Railroad Company, merger decided in June 9, 1967. I will let you look at it and see.

A. I am acquainted with it but not familiar
page 470 } with it in detail.

Q. Did your office do any work, lend any assistance, in preparation of information that went into that?

A. Yes, sir.

Q. It did?

A. Yes, sir.

Q. In this proceeding, Mr. Johnson, wasn't the Norfolk and Western seeking to show need for greater maintenance on the Erie, Lackawanna, and the Boston & Maine systems by formulating service lives based on time periods, on crossties, based on time and wear for rails?

A. Yes; in connection with that case we prepared some estimates of the extent of deferred maintenance on these properties and in so doing we had to make some assumptions as to life of materials, which assumptions were generally, we thought, on the conservative side, and not necessarily what we really thought service life was.

Q. Didn't the ICC reject those, that contention?

A. No, I don't recall that they rejected it.

Q. I show you page 811—

Mr. Riely: May I see it?

Mr. Shannon: Just a minute. Come right around.

Everything I have underlined, I don't think
page 471 } there are any trade secrets on there.

I don't like to make you read in public, Mr.

Johnson, but could you read this paragraph right here for me, please?

The Witness: "Norfolk and Western seeks to show a need for greater maintenance on the Erie, Lackawanna, and the Boston & Maine systems by formulating service lives based on time periods (for crossties), or based on time and wear (for rails)."

By Mr. Shannon:

Q. Continue.

A. "Yet, Norfolk and Western President expressly disavowed formulas that would tend to show a particular road was deferring maintenance, apparently recognizing that maintenance in the railroad industry has historically followed the trends of total operating revenues and expenses."

Q. Then they go on in that case, do they not, to cite the Uniform System of Accounts for Railroad Companies, 309 ICC 289 which they state that they rejected depreciation accounting techniques for track structures—isn't that right—agreeing with the American Railroads, including the Norfolk and Western?

A. That is what it says here.

Q. That is what it says, does it not?

page 472 } Mr. Shannon: Your Honor, I would like to submit this as an exhibit in the record.

Commissioner Catterall: Exhibit 18.

(The document referred to was marked Johnson Exhibit 18 and received.)

Mr. Shannon: Mr. Riely, I am sorry it is the only copy I have got.

Mr. Riely: I will get one; thank you, sir.

By Mr. Shannon:

Q. On Norfolk and Western, have you ever been forced to neglect your normal, overall maintenance program for lack of maintenance funds?

A. I have never found the case when I really needed something that I couldn't get it.

Commissioner Catterall: That is a good budget.

Mr. Shannon: An honest witness, Your Honor.

Edward Q. Johnson

By Mr. Shannon:

Q. Are you familiar with the state of maintenance of the road and track properties of other nearby railroads?

A. Quite a few.

Q. C&O?

A. Yes, sir.

page 473 } Q. B&O?

A. Small portions of B&O. I am not familiar about that.

Q. Has your familiarization with the B&O just come about since your tie-in with the C&O in this pending merger proceeding?

A. No, I have had occasion to ride over portions of the B&O in past years.

Q. Then, Mr. Johnson, from the testimony you have just given, am I correct in assuming that in your opinion Norfolk and Western line of railroad is a better maintained line of railroad than, say, the B&O?

A. Well, I am not so sure I can really answer that because I don't know the overall state of maintenance on the B&O.

Q. From what you have seen of the B&O?

A. From what I have seen in past several years, I think our overall state of maintenance is better than the B&O.

Q. Would you agree with the statement that this Norfolk and Western is "the finest coal transportation machine in the world"?

A. I wouldn't take exceptions to that, no, sir.

page 474 } Q. I didn't think you would, Mr. Johnson.

Mr. Johnson, I would like to talk a little, briefly, with you about this line, that 8.4 mile line I believe you have under construction up near, oh, up in Richlands—is that where it is, somewhere up there?

A. I assume you are referring to the extension of our Big Creek Branch which originates at Richlands.

Q. Beg pardon?

Commissioner Hooker: I thought it was Buchanan.

The Witness: It is connecting up the Big Creek Branch and going over into Buchanan fields to bring coal out.

By Mr. Shannon:

Q. Is it not a fact that in recent years the Norfolk and Western has improved its methods of track construction?

A. I think so, yes, sir.

Q. Now, this Big Creek Branch, when was this project started? When was it started, approximately?

Edward Q. Johnson

A. Approximately a year and a half ago.

Q. And when do you expect it to be completed?

A. We expect to run our first trains in May, although all the work will not be completed at that time.

Q. In May, '69?

A. Yes, sir.

page 475 } Q. Is it not a fact that this undertaking included, oh, some 2,400,000 cubic yards of grading, construction of a 3100-foot long tunnel, and a rather large steel viaduct?

A. That's correct.

Q. And haven't the track construction techniques employed by the Norfolk and Western in building this line enabled it to speed the work and have it performed more efficiently?

A. No; the track building techniques on this particular job were not designed to speed construction because of the quantity of the grading involved and the nature of the tunnel. Track building speed was not needed on this particular job. It was our goal to build the line, have the track completed, at the time the tunnel would be completed with a minimum manpower.

Q. In other words, no use to have a track down until you have the viaduct and tunnel completed?

A. That's right.

Q. Are you using welded rail on this line?

A. Yes, sir, on all except sharp curves.

Q. What is the length of continuous strip of welded rail?

A. We will weld them to any length you want. Generally—

page 476 } Q. Ordinarily, what is it?

A. Approximately 1400 feet long.

Q. Fourteen hundred feet. What are the advantages of welded rail, Mr. Johnson?

A. Elimination of joints and the maintenance problems attendant to joints.

Q. Wouldn't that reduce track wear?

A. No, no. It doesn't necessarily reduce track wear at all.

Q. It reduces wear, where it would ordinarily, the rails would be jointed together?

A. It eliminates joint maintenance.

Q. Is that a rather expensive phase or feature of maintaining a railroad, joint maintenance?

A. Depending on the track involved.

Q. Now, in building this line, are you using pre-plated ties?

Edward Q. Johnson

A. We are.

Q. Would you explain briefly for the record what a preplated tie is?

A. That is merely attaching the plate, the tie plate, to the tie before it is shipped to the job rather than shipping it in two pieces.

page 477 } Q. Cuts down the work at the job site because somebody doesn't have to put the—

A. Somebody has to do it at a non-job site.

Q. What type of machine do you use to set the rail on the ties?

A. Are you referring to this particular job?

Q. I am referring to this particular job.

A. In this case, we were using a speed swing.

Q. That, I take it, is some sort of a rubber-tired crane adaptable for use on a track construction, is that right?

A. Yes.

Q. Following the placing of the long rails, do you use automatic tie spiker?

A. We do.

Q. How many spikes will this drive at a time?

A. Four.

Q. Aren't you using automatic tie tampers to bring the track into proper alignment?

A. Yes, this is commonly done; yes, sir.

Q. How about ballast regulator?

A. Yes, commonly done. Everybody does that.

page 478 } Q. Now, Mr. Johnson, what is it costing per mile to construct—give me a ballpark figure. I know you can't give me the exact figure, but approximately what is the cost per mile of constructing this line of railroad we are talking about here between, I believe you called it, the Big Creek Branch?

A. I don't have the estimates with me. It is a little hard to recall. They were made several years ago. But this probably is the most expensive line the Norfolk and Western has ever constructed because it is in the most mountainous territory you could possibly find.

Q. Is that due to heavy grading expenditures?

A. Due to heavy grading expenditures, due to the heavy bridge costs, due to the construction of a major tunnel.

Q. Do you have any idea what the per-mile cost is, ballpark?

A. Not offhand, no. It is several hundreds of thousands of dollars a mile, I am sure.

Edward Q. Johnson

Q. I believe—I will ask counsel—did you all furnish, did you furnish me, the return questionnaire in connection with the construction of this line? If not, I would like to have a copy of it, if I may, just to put in the record.

Mr. Good: I don't know whether we did or not.
page 479 } Mr. Shannon: May I ask Mr.—
The Witness: Maybe I can answer your question. The line is 8.4 miles long and the cost, as I recall is $5.6 million, in that vicinity, to the best of my memory.

By Mr. Shannon:
Q. Mr. Johnson, do you agree with this statement:
The realization of an immediate saving by reduced maintenance expenditures may result in a much greater loss over a longer period of time?
A. Well, I would say it might be possible.
Q. I show you this statement. Who is that attributed to?
A. That's my statement.
Q. Your statement.

Commissioner Catterall: Is it true or might be true?
Mr. Shannon: I understand you, it is your answer, it is true or might be?
The Witness: No, I say it might be possible.

By Mr. Shannon:
Q. Now, is it a fact, Mr. Johnson, that today you must design, construct, maintain tracks and structures at a level at which they may be planned and may be used in the future?
page 480 } A. That's correct.

Mr. Riely: Why don't we put the article in evidence?
Mr. Shannon: I haven't got but one more.
Commissioner Catterall: You want to ask if everything is true?
Mr. Shannon: I haven't got but—
Mr. Riely: Ask him if what he said in the article is true.
Mr. Shannon: I will be glad to put it in but—
Commissioner Catterall: Ask him one more question.
Mr. Shannon: I would like to examine the witness myself.
Commissioner Catterall: One more question.

Edward Q. Johnson

By Mr. Shannon:

Q. Is it not a fact that a line with inadequate structures and clearances represents profits that can't be realized?

A. That's true.

Mr. Shannon: That's all I have got, Mr. Johnson. Thank you very much.

Commissioner Catterall: Any other questions of this witness?

page 481 } Mr. Epps: I would like to go back to the first part of your testimony, pages three and four.

By Mr. Epps:

Q. On page three, you make a statement that maximum efficiency, you aim at 50 percent condition, and if it exceeds the useful life, then a 50 factor enters and railroad can be unsafe. Is that your testimony—or let me put it another way: that you balance condition with safety?

A. No, I don't think that is what I said.

Q. All right, sir.

Commissioner Catterall: You are saying that this railroad is today half as good as new.

The Witness: What I have said is that in my experience of maintaining the railroad and trying to get the maximum life out of materials consistent with safe operating conditions, consistent with the speed we have to run the trains and the tonnage we are running, that we have reached a point where, when you sit back and look at it, appears to be at about a 50 percent condition.

Commissioner Catterall: It is half as good as new?

The Witness: Yes, sir.

Commissioner Catterall: If it got to be 25 percent as good as new, would you still run trains on it?

page 482 } The Witness: I think that would depend on what was 25 percent, what element of the track it was, what the speeds were, what the tonnages were. I would say under certain circumstances it might be possible, even, to run trains at 25 percent condition but not at 70 miles per hour.

Commissioner Catterall: Suppose it was 10 percent?

The Witness: If it was, the rail was there, it was only every other tie, but yet the rail was still holding together, might be.

Commissioner Catterall: You would still run it as long as the rails were running together?

The Witness: Maybe at two miles an hour.
Mr. Epps: Thank you, sir.
Commissioner Hooker: Off the record.

(Discussion off the record)

By Mr. Epps:

Q. Well, on page three, does that summarize your testimony, by the third answer on that page? If we replace an element of the track structure before its useful life is at an end, then we have lost efficiency because we are not getting the maximum use from the investment. You recall that answer?

A. Yes.

page 483 } Q. However, this is the other side of it: If we leave property in service beyond the time when it performs its particular function, we risk an even greater loss of efficiency because of the possibility of causing wrecks or slowing down traffic?

A. Yes.

Q. I equated that to safety. But you say, as I understand it, that you shoot at 50 percent, but if you replace too soon, you are not efficient. If you wait too long, you cause a wreck; perhaps you run a risk of causing a wreck?

A. That's correct.

Q. Is that correct?

A. That's correct. What I said was, in the overall.

Q. Overall?

A. Overall property.

Q. Then you continue, as you now have indicated from the next page, that as a matter of fact rails and ties stay beyond their useful life, is that correct?

A. At times, yes.

Q. In other words, you do not replace a tie, you do not mark a tie and say, it has to come up in 32 years or 40 years. You test those ties and wait, and when do you

page 484 } replace a tie, when it fails?

A. Generally, we try and not replace a tie until it no longer serves its function of bearing and holding gauge.

Q. Now, I take it that if you have too many ties of that nature in one section of track, then you could come to the situation where you run the greater risk of having a wreck, is that correct?

A. That's right. Under those conditions, if there are three, we might replace two.

Edward Q. Johnson

Q. And leave one?

A. Could be, depending on the *charcter* of the line and the track and the *tonage.*

Q. So, while you say that tie, that third tie you leave in, having replaced two, in that circumstance the third still is performing a function?

A. Not necessarily. Just because it is there doesn't mean it is performing a function.

Q. It is filling up some space?

A. Filling the space serves no purpose in tying the track together.

Q. You haven't replaced it, so to that extent it saves you the expense of a replacement at that time, correct?

A. Well, yes, that's true, but of course I might
page 485 } have not replaced that tie waiting until I get
into my cycle maintenance or my cycle program where I can bring in equipment and replace a lot of ties economically.

Q. So you have a reason for leaving it there which is an economic reason?

A. That's right. There is an area there in which you have to operate.

Q. So we can agree, can't we, that it still has some use to the railroad?

A. Not if this tie is not serving a bearing or to hold the rails to guage; just because it is there serves no purpose, serves no function.

Q. But you have not replaced it?

A. I have not replaced it.

Q. You would have to spend money to replace it?

A. The question was, does the tie serve any purpose. I say, no.

Q. In the narrow sense, perhaps your answer is true, but wouldn't you go along with me that in the broad sense it is saving you money economically?

A. Well, in the broad sense I have deferred the replacement of that tie until next year or the year after when I could
come in and do it at half the labor cost it might
page 486 } take me to do it now.

Q. These three ties that you and I were talking about that failed and that you needed to replace two of them, leaving one failed tie in, in the hypothetical case, the failure is not determined by the life cycle of that tie, but from physical tests and inspections?

A. From physical inspection.

Edward Q. Johnson

Q. And is not based on a life cycle?
A. Well, if you mean because it has been "X" period of years, it no longer serves its function, no.
Q. You don't say, I have to get 32 years out of this tie?
A. No.
Q. You could have 40 or 50 or you could have 20 and it still might fail?
A. Or ten.
Q. And it still might fail?
A. Yes.
Q. If you have enough failures on a given section, you need to replace it?
A. Yes.
Q. But if you don't have a whole lot of failures in a given section, you can leave it in there and do so?
page 487 } A. Depending again on the extent, the requirements of the track.
Q. Now, do you ever retamp an old tie and respike it and rework the ballast along with a new tie?
A. Oh, yes, periodically.
Q. This is a tie that is taken out, or is it in place that you do it?
A. This is an existing tie in place where we retamp and connect with a smoothing or resurfacing program.
Q. And extend the life of the tie by doing this?
A. No, that doesn't extend the life of the tie; just improves the line and surface.

Mr. Epps: Improves its use.
No further questions.
Commissioner Catterall: Have you any questions?
Mr. Riely: Yes.
Commissioner Catterall: How many?
Mr. Riely: Six or seven.
Commissioner Catterall: We will recess for five minutes.

(Short recess)

Commissioner Catterall: You have five questions of this witness?
page 488 } Mr. Riely: Your Honor, perhaps you count them; I am not sure I will. I have a couple of silly little questions to begin with, but just to clear things up—

Edward Q. Johnson

REDIRECT EXAMINATION

By Mr. Riely:

Q. You referred to Sperry car rail. I am not sure the judges know exactly what *the* means, and perhaps you would explain it.

A. In our rail testing program, we operate rail detection equipment owned and operated by Sperry Equipment Company. These are devices for testing rails to locate internal defects and under present-day conditions of tonnage and unit weights, heavy axle loads, we find it necessary to operate these Sperry cars several times a year and they are finding more and more defects. As defects are found, we have to replace the rails.

Q. Are these the defects that are not obvious?

A. These are internal defects that can't be seen by visual inspection.

Commissioner Catterall: Nothing but fatigue factors?

The Witness: They are more than that; they are internal, crystalline, little crystalline point will be in the inside. It will grow with the transverse defect. It could be,
page 489 } transverse defects in a Shelly rail.

By Mr. Riely:

Q. What is a Shelly rail?

A. Well, that is a type of defect that is common to heavy tonnage railroads, particularly on curves, and generally on the guage corner of the high side of the curve. These are where internal defects develop as a result of high wheel loadings.

Q. These machines operate through electronic equipment?

A. That's correct.

Commissioner Catterall: You don't use track walkers anymore that you used to 50 years ago?

The Witness: Track walkers couldn't detect these kinds of defects.

Commissioner Catterall: You still use track walkers?

The Witness: In a few locations in the mountains.

By Mr. Riely:

Q. You mentioned elevation on curves. What does that mean?

A. Well, on curves, the outside rail is elevated above the

lower rail so that to overcome the centrifugal force of equipment rounding the curve—

page 490 } Q. Now, when Mr. Shannon was questioning you about the Blacksburg Branch, you referred to account 712, isn't that correct?

A. That is 712, material and supplies account to which the material salvaged from the retirement would be charged.

Q. Is that the gross value of the material?

A. That would be the gross value of the material, not including the labor to recover it.

Q. The labor to recover it is charged?

A. Would be charged to account 270.

Q. But 270, not to 712.

Now, welded rail, does welded rail create obsolescence in any portion of the track structure?

A. Well, yes. It would make obsolete the joint fastenings under jointed rail. I am speaking about the angle bars, the track bolts. We annually have to scrap thousands of dollars worth of angle bars and bolts because we have no further use for them and there is no market for them.

Q. One other matter:

Judge Catterall referred to long trains and you referred to *tonage* as a factor in maintenance, is that cor-

page 491 } rect?

A. That's correct.

Q. What is the significance? Do the long trains make a difference in maintenance?

A. No, the length of the train itself has no significance itself at all in maintenance. You could take one car, if you run it up and down the track a million times, you would get just as much *tonage* as you might have in ten trains.

Q. The *tonage,* not the length of the trains?

A. That's correct.

Q. Now, Judge Catterall also talked to you about running trains over track that was in ten percent condition.

Would it be theoretically possible to run train over track that was in one percent condition?

A. I say it was highly improbable.

Q. Would it be theoretically possible?

A. Well, if you had perhaps very small unit of track such as maybe six inches whose condition was one percent, yes. If you are talking about a line of road at one percent, I would say it would be highly improbable that you could get over it at any speed with any kind of equipment.

Edward Q. Johnson

Commissioner Catterall: When did you last ride over the Washington and Old Dominion?

The Witness: Never have.

page 492 } Commissioner Catterall: Never ran that risk.

Mr. Riely: I have no further questions.

Mr. Shannon: I have one noncontroversial question I would like to ask Mr. Johnson.

Commissioner Catterall: Gratefully received.

Mr. Carter: I would like to hear that.

RECROSS EXAMINATION

By Mr. Shannon:

Q. How many miles of welded rail do you have on the Norfolk and Western in Virginia, Mr. Johnson?

A. I have never added it up in Virginia.

Q. Could you give me a ballpark figure?

A. I can tell you on the system.

Q. How many on the system?

A. About 800 miles.

Q. About 800 miles.

Mr. Riely: We will be glad to supply the Virginia figure as soon as we can determine it.

Mr. Shannon: That's all right. I was curious.

Commissioner Catterall: You may stand aside, Mr. Johnson.

(Witness steps down.)

Mr. Riely: Is it my understanding that you

page 493 } gentlemen did not want Mr. Butler?

Mr. Shannon: I have no desire to cross examine Mr. Butler, no.

Commissioner Catterall: Why do you call them interveners? They are defendants.

Mr. Shannon: Defendants, I beg your pardon.

Mr. Epps: No.

Mr. Riely: Then, I expect, Your Honor, Mr. Butler's testimony is received without cross examination. Mr. Mewhinney, and Mr. Kelly.

I think we have reached the end of our rope today and I believe that the understanding is that we would adjourn until Friday morning.

Commissioner Catterall: Leave everything in *statu quo* here, just leave everything where it is.

Mr. Riely: On Friday morning, we will have Dr. Foster, Mr. Johnson and Mr. Garrett.

Mr. Shannon: Your Honor, I am going to have Mr. Garrett and Mr. Johnson available. I believe they will be here; afternoon is perfectly acceptable.

Mr. Pasco: Foster in the morning.

Mr. Shannon: I assume Dr. Foster will be here.

page 494 } Commissioner Catterall: This case will be continued until 10:00 a.m. on Friday.

(Whereupon, the hearing in the above-entitled matter was recessed until 10:00 a.m. Friday April 16, 1969.)

CERTIFICATE OF REPORTER

I, Gilbert Halasz, do hereby certify that I took the stenographic notes of the foregoing testimony and had the same reduced to typewriting under my supervision; that the foregoing is a true record of the testimony given by said witnesses; that I am neither related to nor employed by any of the parties to the action in which this testimony was taken; and further that I am not a relative or employee of any attorney or counsel employed by the parties hereto, nor financially interested in the action.

Gilbert Halasz

page 495 }

* * * * *

Richmond, Virginia
April 18, 1969

Before: HONORABLE RALPH T. CATTERALL,
Commissioner
HONORABLE H. LESTER HOOKER,
Commissioner

* * * * *

page 496 } (April 18, 1969) (Friday at 10 o'clock)

PROCEEDINGS

Mr. Shannon: Your Honors, may it please the Commission, at this time I would like to formally submit the testimony contained in this red binder which has been distributed to all parties and all counsel of record here.

The testimony of the Commission's witnesses, Mr. Boyd E. Garrett, Mr. Edward P. Johnson, and Mr. Lee B. Younger. With the submission of this testimony for the record I would like to make an opening statement concerning the position of the Commission staff in this, if I may.

Commissioner Catterall: You may.

Mr. Shannon: Section 176 of the Constitution of Virginia requires the State Corporation Commission each year to ascertain and assess the value of roadbed and other real estate, rolling stock and all personal property (except the franchise and non-taxable shares of stock issued by other corporations,) of each railroad corporation in the State.

Section 169 of the Constitution provides for the assessment of property at its fair market value.

Section 58-522 of the Code of Virginia implements the requirements of Section 176 of the Constitution providing for the valuation for assessment of real estate and
page 497 } tangible personal property of public service corporations by this Commission.

Section 58-515 of the Code further provides for local levies at local rates on the real estate and tangible personal property of every railway situated in such locality.

Section 58-532 of the Virginia Code requires the Commission in making its assessment of railroad property to find for each railroad, for its main line or lines and for each branch line in the State the average value per mile of its track, track appurtenances and track structures including cuts, fills, excavations, ballast, bridges, trestles and tunnels.

Section 58-524 of the Code requires each railroad to report, among other things, the fair cash value of its trackage and all signals including track and crossing signals.

Section 58-512.1 of the Virginia Code, which was adopted in 1966, provides that any increase in the assessed valuation of any public service corporations property shall be made by application of the local assessment ratio prevailing in such taxing district for other real estate as determined by the most recently published findings of the Department of Taxation.

Thus, the increased assessment in Norfolk and Western's roadway and track properties which are in issue in this proceeding are already on the true local assessment ratio prevailing in such taxing districts since 1926, a
page 498 } period of over 42 years, there has been no increase in the reported fair market and assessed values of the roadway and track properties of the Norfolk and Western and other railroads operating in Virginia despite the fact that other taxpayers have experienced and are

continuing to experience increases in the assessment of their property and despite the fact that the 1967 road and track costs have increased by approximately 235 per cent above those of 1926.

It is significant to point out at this time, as will be borne out by the evidence, that since 1926 Norfolk and Western has spent approximately 227 million dollars on road and track maintenance alone in Virginia, all of which was charged to operating expenses and consequently resulted in the railway company's paying less Federal income taxes.

Ties, the average cost of which was $1.60 in 1926, are being replaced today with ties, the average cost of which is over $5.11. Rail, which cost an average of $38.65 per ton in 1928 was being replaced with rail, the average cost of which was $107.74 in 1967.

Under the Interstate Commerce Commission's uniform system of accounts for railroads, which the rail carriers are required to follow, the increased values of ties, rails and other track material used in renewal of road and track
page 499 } structures are not capitalized on the company's books but are charged to operating expenses.

This system of accounting, which is known as betterment and replacement accounting, when challenged in 1957 in a proceeding before the Interstate Commerce Commission in Docket No. 32153 was vigorously supported by the A.A.R. in behalf of most of the nation's railroads, including the Norfolk and Western and other Virginia railroads.

In urging retention of the existing accounting rules permitting renewals of track property, etc., to be charged to operating expense. In the year such renewals are made, it is particularly interesting to note in this proceeding what the railroads told the Interstate Commerce Commission concerning their constant year-by-year costs of track maintenance.

On page 294 of the Commission's report in Finance Docket 32153, 309 I.C.C. 289, a copy of which is identified in this record as Exhibit E.P.J. 3 the railroad stated as follows: I am quoting from the decision.

"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,
page 500 } 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."

Notwithstanding this statement by the railroads to the Interstate Commerce Commission and notwithstanding the fact that the values of the railroad's track properties in Virginia have not been increased in 42 years, during which period wage, material, and other costs have more than doubled, applicant now urges this Commission to find for tax purposes that its track and track structures are in a substantially depreciated condition having only net salvage or scrap value.

It is urged by the Commission's Division of Public Utilities Taxation that applicant's position is untenable, unrealistic, and completely ignores the economic facts of life since 1926, as will be demonstrated by the evidence adduced here today in behalf of the Commission staff and the defendants, which shows that by every reasonable and relevant valuation factor considered in arriving at fair market

page 501 } value of applicant's property here at issue the Commission's assessment of N&W's roadway and track property is just, fair, reasonable, and long overdue.

Mr. Epps: May it please the Commission, at this point I tender on behalf of the defendants the Virginia Counties and Cities canned testimony which has been prepared and served on counsel. Copies are in the hands of the clerk and the Commission.

Because of the introduction of additional testimony on the part of Mr. Tipton, an expert for the applicants, I now tender certain additional testimony of Maurice J. McCarthy. I have given copies of this to counsel. I now tender four copies of this.

Commissioner Catterall: That will be added to it.

Mr. Epps: Yes, sir.

With the explanation that during the course of the day there may be a second or third sheet which will have some, perhaps, calculation which based upon the exigencies of time we wanted to get in to say what he is going to say anyway. If it gets here we will tell you as soon as we get to it.

Commissioner Catterall: All right.

Mr. Epps: Now, just a word about the position of the defendants.

As has been indicated by Mr. Shannon, if the

page 502 } applicant is successful it is these defendants who will be required to disgorge the funds which they have already gotten and spent. The Virginia Cities and Counties have received, under our statutes, have received the assessments and have budgeted them or are now budget-

ing them and should applicant be successful it would, the refund, of course, will come from the counties, cities and towns whom we represent, Mr. Carter and I represent here today.

Needless to say this is a hardship that is hard for them to face.

These are the localities which are served by this railroad and, of course, from which they get these revenues.

We expect our testimony to be aimed at and to demonstrate the reasonableness of the assessment of the Division of Public Utilities Taxation.

We think if we demonstrate that the assessment now, the matter of how it is arrived at, is reasonable under the circumstances we, as the municipalities and counties perform our function to show that the assessment is reasonable and there should be no change in it on behalf of the Commission.

Now, pursuant to agreement with counsel and somewhat out of order it is agreed that instead of hearing the Commission's witnesses at this time they have asked us to, or we have agreed to have Dr. Foster present, and hearing no objection I will call Dr. Foster around and identify him and present him for cross-examination.

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Dr. J. Rhoads Foster.

His evidence is in and filed as a portion of the blue book.

Commissioner Catterall: That was sworn to when it was filed?

Mr. Epps: It was sworn to.

Doctor, these gentlemen accept your written oath and we won't have to administer further oath.

DR. J. RHOADS FOSTER was called as a witness and testified as follows:

DIRECT EXAMINATION

By Mr. Epps:

Q. You are, I believe, Dr. J. Rhoads Foster?

A. I am.

Q. And your residence?

A. My business address is 1101 17th Street N. W., Washington, D. C.

Q. You are the J. Rhoads Foster who has prepared testimony that has been already filed in this proceeding?

A. I am.

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* * * * *

TESTIMONY OF J. RHOADS FOSTER ON DIRECT EXAMINATION

Q. Will you state your name and address.

A. J. Rhoads Foster. My business address is 1101-17th Street, Northwest, Washington, D. C. 20036.

Q. What is your profession?

A. I am an economist and president of Foster Associates, Inc., a consulting firm.

Q. What, briefly, has been your formal education?

A. I studied at the University of Missouri, Columbia University and New York University. In 1933 I received from the University of Missouri the degree of Doctor of Philosophy in political economy with specialization in the relation of government to business.

Q. What has been your employment other than in a consulting capacity?

page 505 } A. My first employment was in 1933 by Consolidated Edison Company, then New York Edison Company. In that employment I was special assistant and assistant to the rate engineer.

From 1937 to 1942, I was economist to the Board of Public Utility Commissioners of the State of New Jersey. I was also director of special investigations for that commission, in charge of rate, financial, and accounting proceedings. I prepared studies of reasonableness of earnings and of rate levels for electric, gas, telephone, water, and other utilities in New Jersey, and advised the Commission with respect to matters of legislation, regulatory policies and practices, and personnel standards and practices. I have been an independent consultant since 1942.

Q. In general, what has been your experience as an independent consultant?

A. I have been employed by public agencies and numerous private enterprises as an independent consultant to make studies and prepare reports with respect to a wide variety of subjects, including proposed legislation, property values, cost of capital, and fair rate of return, principles and methods of regulation, and problems of finance, taxation, pricing, and marketing.

I have given evidence on one or more occasions before the

page 506 } Federal Power Commission, the Federal Communications Commission, the Securities and Exchange Commission, the Civil Aeronautics Board, the Excess Profits Tax Council, the Board of Tax Appeals, Department of Taxation of Ohio, the regulatory commissions of the States of Arkansas, California, Florida, Georgia, Illinois, Indiana, Kentucky, Maine, Maryland, Massachusetts, Michigan, New Jersey, New York, North Carolina, Ohio, Oregon, Pennsylvania, Tennessee, Washington, and Wisconsin, the regulatory commissions of the Dominion of Canada and the Province of Alberta, and the Committee on Ways and Means of the U. S. House of Representatives.

Q. By what types of private enterprises have you been employed in a consulting capacity?

A. Gas companies, including producers, transporters, distributors, and integrated companies, combination electric and gas companies, electric companies, telephone companies, airline companies, motor carrier and street railway companies, and railroad and shipping companies.

Q. Have you been employed by trade associations to make studies or to present evidence with respect to matters of industry-wide interest?

A. Yes.

Q. Will you identify these associations?

A. Independent Natural Gas Association of America, Mid-Continent Oil & Gas Association, Edison Electric Institute, National Association of Electric Companies, and United States Independent Telephone Association.

page 507 } Q. What has been your employment in a consulting capacity by governmental agencies?

A. My first employment as a consultant was by the Federal Communications Commission, in 1937-1938. I was employed from time to time by the State of New Jersey and by the Board of Public Utility Commissioners of New Jersey in proceedings to advise, prepare reports, and give evidence with respect to methods of regulation, property values, capital structures, cost of capital, and reasonableness of earnings of electric, gas, and telephone utilities under the jurisdiction of that Commission.

Foster Associates has been employed in recent years by numerous governmental agencies, including the Bureau of Land Management, U. S. Department of Interior, the Agency for International Development, the Federal Government of Canada, the International Bank for Reconstruction and Development, the President's Commission on Postal Organization, and numerous state and municipal authorities.

Dr. J. Rhoads Foster

Q. I will now inquire more specifically concerning the professional areas with which you have acquired experience and conversancy. Have you been employed as a consulting economist in connection with valuations of corporate properties?

A. Yes. Much of my professional work over thirty years has been concerned with capitalization rates and market values of stocks and debt securities, representing
page 508 } corporate property.

Foster Associates prepared under my direction a report on the value of the railroad property of the Pennsylvania Railroad Company for the purpose of *ad valorem* taxation in Ohio. In this connection I submitted evidence before the Board of Tax Appeals.

I prepared reports to management and gave evidence before the Securities and Exchange Commission, with respect to plans of reorganization and the standards of fairness under Section 11 of the Holding Company Act, on behalf of Long Island Lighting Company and Kings County Lighting Company.

Also before that Commission, I gave evidence with respect to financing standards, on behalf of Utah Power and Light Company.

I was employed as a consultant by the Board of Public Utility Commissions to advise with respect to refinancing of Jersey Central Power and Light Company.

Such recapitalization proceedings involve determination of the value of the corporate entity and the value of the shares equitably distributable to stockholders and classes of outstanding debt. It may be noted also that appraisal of outstanding stock and debt and estimation of capitalization rates is required by the cost of capital method of determining a fair rate of return in utility rate cases. I have been engaged in approximately 50 such proceedings before regulatory agencies. Foster Associates also has made appraisals of utility properties in eminent domain proceed-
page 509 } ings.

I am a member of the New York Society of Security Analysts and of other professional societies, and past chairman of the Committee on Corporate Finance, National Association of Railroad and Utilities Commissioners.

My writings include articles on asset costs and values and on depreciation. I taught the course, Principles and Valuation, in the Graduate School of Business Administration,

New York University. The reports of the Committee on Corporate Finance, written during my tenure as chairman, are published in the NARUC Proceedings.

Q. What has been your experience with earnings regulation of public utilities or other industries?

A. Much of my professional work has concerned the development of methods and techniques of earnings regulation of different industries. For some 15 years, my activities have been directed in large part to the problems inherent in the undertaking by the Federal Power Commission to establish an appropriate and effective method of gas producer price regulation under the Natural Gas Act. I was employed earlier as a consultant by the New Jersey Commission in connection with its adoption of a method of earnings regulation, called the "New Jersey Plan." Illustrative of this experience with different industries, I gave evidence on two occasions with respect to method of earnings regulation of the airline industry. The first concerned the airmail subsidy problem, and the second, in the General Passenger Fare Investigation, concerned method of regulating earnings from commercial traffic.

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I have prepared reports and submitted opinion testimony regarding fair rates of return to public utility and transportation companies in numerous proceedings before regulatory agencies. The most recent such appearance was on behalf of United States Independent Telephone Association in Docket No. 16258 before the Federal Communications Commission (the second general investigation of American Telephone and Telegraph Company), and on behalf of telephone companies before the regulatory commissions of California, Florida, Maryland and New York.

Q. What has been your experience with accountancy and taxation?

A. I am co-author of Foster and Rodey, *Public Utility Accounting,* published by Prentice-Hall in 1951. So far as I am aware, this is the only textbook on the subject. Its use was in courses in universities and in staff training programs of public utilities and accounting firms. I supervised for two years the Accounting Department of the Public Utilities Commission of New Jersey. I am author of numerous reports and articles on accountancy, taxation and related subjects.

I was employed by the Edison Electric Institute and the National Association of Electric Companies to make studies of the character and effects of federal taxation of electric utilities. I presented evidence with respect to the

page 511 } economics of taxation before the Ways and Means Committee of the U. S. House of Representatives on two occasions, in 1947 and 1950.

Q. What, generally, has been your teaching experience?

A. I have taught in several schools, including New York University, from 1935 to 1952. At New York University, I taught in the Department of Public Utilities and the Department of Real Estate of the School of Commerce, Accounts, and Finance, in the Graduate School of Business Administration, and in the Graduate Division of the School of Law. I taught courses in public utility economics, regulatory policies and practices, principles of valuation, pricing and marketing utility services, administrative procedure, and public utility law, and the graduate seminar in public utilities.

Q. What have you been asked to do in connection with this proceeding?

A. You asked me to read the testimony of Mr. James A. Caywood, Mr. Edward F. Koncel, and others as submitted by them on direct examination, and to form an opinion regarding the validity of the value concepts which guided their appraisals of the railroad property of the N&W Railway Company. Your request was for a critique and statement of relevant and guiding valuation principles, not for an application of these principles or quantitative estimates of the fair market value of properties of the Norfolk & Western Railway Company in Virginia.

page 512 } Q. The constitution of Virginia requires that, except as otherwise provided, all assessments of real estate and tangible personal property shall be at their fair market value. In making his appraisal of roadway items, Mr. Caywood was guided by instructions contained in a letter from Mr. James E. Carr, Vice President—Taxation and Real Estate, Norfolk & Western Railway Company. This letter, identified as Exhibit 1-JAC, reads in part as follows:

"Fair market value is defined as the price which the property will bring when it is offered for sale by one who desires, but is not obliged, to sell it, and is bought by one who is under no necessity of having it."

In your opinion as an economist, is that a correct or acceptable definition of fair market value?

A. I think that definition, as I understand it intended meaning, of fair market value is correct and acceptable for the purpose of general property taxation.

Dr. J. Rhoads Foster

I construe the language used by Mr. Carr to mean that the value being sought is not measured by either the price which would be realized at a forced sale, unfair because the seller is under pressure to sell, or by a holdup price, unfair because the buyer has no alternative and must have the property. The definition assumes that the owners of the property have ample opportunity to obtain the best offer and that bidders have ample opportunity to become informed regarding characteristics of the property and to evaluate comparatively alternative investment opportunities.

page 513 } This concept of fair market value is reasonably consistent with the competitive market price standard, even though applied to a specialized property which is not for sale. Fair market value is the present worth of the existing property in its highest and best use. This is generally the use for which the property was designed and constructed. However, value of a property may be greater in an alternative use, as when the property in its intended use is no longer capable of earning a return or disassembled items of the property have a greater value in some other use.

Stated in other words, fair market value is the price which the present owners would pay if they were to buy the property in competition with other well-informed prospective owners, but does not include any special value to the owner in the sense of a subjective or sentimental value. A value to the owner which reflects a favorable attitude toward property which would not be possessed by other owners is not relevant for valuation of an income-producing property such as a railroad.

Q. What is the distinction, if any, between fair market value and value for the purpose of utility rate regulation?

A. "Fair value" in utility rate regulation is a type of rate base determined by reference to cost evidence, not by reference to market value. Used as the rate base, "fair value" becomes a determinant of permissible rates and earnings and thus a determinant of the market value

page 514 } of the utility property. Thus, market value of a utility or railroad property is an end result of the regulatory process, a product of the kind of rate base, the rate of return allowed and of the other factors which determine the earning capacity of the property in the market served. Market value 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. Rate regulation looks to cost evi-

dence, 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.

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. Regulation limits earnings and may eliminate monopoly profits, but does not invalidate the principle that the market value of a going concern depends upon the returns expected by investors and upon the rate at which the expected future returns are capitalized or discounted in the market.

Q. Mr. Koncel says at page 5 of his direct examination that the unit method is the best way to determine the full fair market value of a railroad's operating property. Are you of the same opinion?

page 515 } A. Yes. The value of a railway property such as that of the Norfolk & Western Railway Company is dependent upon the way in which its component parts, including its road property, its rolling stock and its intangible assets, are physically and functionally integrated as an operating entity capable of supplying transportation services and generating income for creditors and owners. Therefore, a railroad is best valued as a unit to the extent the property is functionally a single entity. The value of a railroad as an operating entity includes the value of its operating privileges or franchise. In the case of an integrated railroad system located in more than one state, the entire fair market value must be apportioned or assigned to each taxing jurisdiction by procedures such as those employed by Mr. Koncel.

Q. Recognizing that Virginia does not use the unit method, and that the State Corporation Commission assesses the value of the Railroad property, not including the franchise, for the purpose of general property taxation, do you agree with Mr. Koncel that total fair market value is the same regardless of differences in method of assessment?

A. Yes. The fair market value of a property does not depend upon choice of appraisal methods. Although the unit method is better, it is possible to reach an equivalent and equally reasonable result by use of other appraisal methods, generally of the kind which have been used by the State Corporation Commission.

page 516 } Q. Mr. Caywood testified as follows at pages 6-7 of his direct examination:

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"We were instructed that the value so determined should be the fair market value of the property, exclusive of any franchise value. We were instructed that the franchise value includes the value of the charter or the privilege of doing business, that is, the value of the privilege of serving the particular community being served, the value of being first in possession in 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. We were instructed that only the 'bare bones' of the property should be included in the appraisal."

In carrying out his assignment, Mr. Caywood reached the following conclusions regarding the fair market value of roadway components.

The value of engineering, grading, tunnels, subways and bridges, tressels and culverts is zero for the reason that "while these items may have 'going concern' value to an operating railroad, they have no market value exclusive of franchise value."

The fair market value of ties, if marketable, is the price to be expected from a broker in used ties, less the estimated cost of removing and recovering the ties. All ties given a condition rating of 70 percent and a portion of the ties rated at 60-70 percent of new condition were considered by Mr. Caywood to be marketable.

page 517 } The fair market value of rail and other track materials is the estimated price at which these components could be resold for reuse or as scrap, less the cost of recovery.

The market value of railroad ballast and of fences, snow-sheds and signs is zero, either because these items have no alternative use or because the cost of recovery would be in excess of their value as scrap.

In your opinion, are Mr. Caywood's conclusions valid in terms of the fair market value standard and in relation to his instructions?

A. I think his conclusions are wholly invalid in relation to the fair market value standard. Since I would give the language you have quoted a meaning quite different from what appears to have been Mr. Caywood's understanding, I cannot say that his instructions were necessarily wrong. Multiple conceptual questions are presented, such as the following. What is the nature of the franchise value which is

to be excluded in estimating fair market value of a roadway property? What is the meaning of the term "bare bones" of the property? Is the total market value of a railroad property, such as that of the Norfolk & Western, less the amounts for which items of tangible property might be sold for an alternative use or as scrap, the correct measure of franchise value? Stating essentially the same question in different words, are the prices at which items of railway page 518 } property might be sold as scrap or used materials, if dismantled, a correct measure of the fair market value of the roadway property?

Q. What is the nature of franchise value?

A. A franchise is a special privilege granted by the state which gives a railroad or public utility access to markets and reduces what would be otherwise its exposure to competition. Therefore, franchise value or going concern value is the difference between the total value of an enterprise and the value which would exist under competitive conditions in the case of unregulated enterprises. The franchise owner is raised above exposure to direct competition and may thereby realize profits in excess of what would be obtained if he were fully exposed. It follows that the value of a franchise of a railroad or public utility enterprise depends upon its ability to realize profits in excess of a fair return on its investment in tangible assets, that is, earnings which are in excess of the competitive standard and which might be taken away by regulation.

Q. What is the distinction between franchise value and going concern value?

A. I would make no distinction for the purpose of this proceeding. I think franchise value should be viewed as including the value of the charter or the privilege of serving the communities being served, the good will page 519 } inherent in the established business, and the other values which are comprehended in the concept of going concern value.

Q. In terms of this definition, what is the source of franchise or going concern value in the case of railroad properties?

A. Norfolk & Western, other railroads and public utilities are regulated enterprises. Their earnings are controlled on the basis of the cost standards generally applied by regulatory agencies in the United States. Under this regulatory standard, it is capitalizable expenditures, not value, which is the measure of the rate base and the determinant of allowable earnings. The franchise is generally reflected in the rate

base at the amounts actually paid to public authorities who granted the franchise privilege. I know of no instance within the last quarter of a century where elements of going concern value in excess of actual or estimated costs of overheads or other intangible assets were allowed as rate base components. Since earnings are determined by reference to past or current cost of used and useful property, the primary source of franchise value is expenditure made for organization and other overheads, including operating privileges. The rate base treatment is in this respect consistent with the provisions of applicable Systems of Accounts.

page 520 } This generalization is subject to a qualification which has particular significance for railroads. Individual railroads compete for traffic with each other and with alternative modes of transportation. Therefore, in fixing freight rates, the Interstate Commerce Commission tends to apply a modified cost standard which looks to the composite revenue requirements of railroads on a group basis. As a consequence of differences in character of markets served and the use of a group method instead of the individual company return on rate base method, the rate of return earned on book capital varies widely among railroads. If earnings are less than the current cost of the capital committed to tangible assets, there exists no value in excess of the value of the total property over the value of the tangible property. Value depends upon whatever is in fact the income-producing capacity of the property. In the case of a profitable railroad, the total market value of the property may be considerably in excess of the value of the tangible property, a difference sometimes called "corporate excess".

Q. What comment do you have with reference to the instruction that only the "bare bones" of the property should be included in the appraisal?

A. Mr. Caywood apparently construed that instruction to mean that the track property should be valued as though disassembled, using as the measure of value the

page 521 } prices at which the disassembled items of property might be sold as scrap or for alternative uses. I have never previously heard that meaning given to the term "bare bones". It was a familiar term in connection with estimates of cost of reproduction new, but meant the cost of a property assembled, installed, and in operating condition but before addition of intangible components of a rate base. In the present context, it should be construed to mean value of the tangible property not including franchise

value and, therefore, contributes nothing to an understanding of the problem.

Q. Are there other reasons why the franchise value of a railroad property, such as that of the Norfolk & Western, should not be defined as total fair market value less the amounts for which ties, rails and other items of tangible property might be sold as salvage or for secondhand use?

A. Yes. The value of all the functionally integrated assets of a going business entity, whether tangible or intangible, is rooted in prospective earning power. The Norfolk & Western is a successful going concern. It is one of the most profitable major railroads in the United States. The tangible and intangible properties are functionally integrated. At page 16 of his direct examination, Mr. Koncel makes the point that "without a franchise to operate a railroad, the market value of this property would be its liquidating or salvage value."

page 522 } I agree that this would be so, unless the railroad were permitted to operate without a franchise. But is is equally true that without the tangible property as well as upon the posession of a franchise would have little or no value. The capacity of the railroad to supply transportation services depends upon the tangible property as well as upon the possession of a franchise. Valuation of tangibles and intangibles should be on a consistent basis. It is not consistent to value the intangibles on the basis of the assumption that the enterprise is a going concern and the tangibles on the basis of the assumption that it is in process of liquidation. It is no more logical to say that the fair market value of tangible property is measured by prices which would be paid for salvage than to say that the fair market value of the franchise is the price at which it could be sold for some alternative use if the railroad were no longer a going concern.

Q. What are the circumstances where the market value of secondhand materials and scrap may be the measure of fair market value?

A. Market value of items of railroad property, disassembled and offered for alternative uses, measure fair market value only when the existing business has lost all capacity to provide the intended transportation services,

page 523 } and is no longer a going concern. In this circumstance, scrap and salvage value is a floor for the reason that the items of property have a greater value in an alternative use or as scrap than as component parts of a physically and functionally integrated railway system.

Dr. J. Rhoads Foster

The general principle is that the value of any business property is the discounted present worth of the income expected by owners and creditors. An exception to this principle is when a railroad or other enterprise ceases to be a going business, so that maximum values are preserved by liquidation. Only in this circumstance is the fair market value of the property determined, not by prospective earnings, but by the prices at which the disassembled items of property can be sold as salvage or for some alternative use.

Q. In reaching a conclusion as to fair market value, exclusive of franchise value, Mr. Koncel used a zero factor for capitalized income. He reduced by 50 percent the value indicated by stock and bond prices as allocated to Virginia. He then added this figure to an estimate of depreciated cost of N & W equipment allocated to Virginia plus 50 percent of the total investment of the N & W in Virginia road property. He then divided the product by three to arrive at an estimate of fair market value exclusive of franchise value. In your opinion, is this a valid formula?

page 524 } A. No. The formula ignores fundamental principles of enterprise valuation. The market value of a going concern, particularly when its property is of a specialized nature, depends entirely upon prospective earnings. Earnings and market value are dependent upon the whole of the physically and functionally integrated property, including both the tangible and the intangible assets. Therefore, it is wrong to assign the total value to the franchise when capitalized income is taken as the measure of total value.

Mr. Koncel then used an estimate of the market value of the stock and debt of the Norfolk & Western as a measure of fair market value on the unitary basis, and attributed at least 50 percent of this total to franchise value. But the prices at which the outstanding stocks and debt of the Norfolk & Western are traded in the securities markets are merely evidence of the same market value of the total property which is sought by capitalization of income. As Mr. Koncel said at one point in his testimony, the fair market value of property does not depend upon what method of estimation is used. The value reasonably attributable to the franchise is no more or less when the value of the total property is estimated by reference to stock and debt prices then when it is estimated by reference to income.

I know of no foundation for an assumption that 50 percent of market value is reasonably attributable to franchise value,

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page 525 } regardless of whether the value estimate is for the total property of the N & W or is based on appraisal of property located in or assigned to Virginia.

Q. If the value of the property of the Norfolk & Western is rooted in prospective earning power and arises out of the way in which the items of property have been put together, physically and functionally, as means of providing transportation services worth more than their cost, how is it possible for the Virginia Corporation Commission to determine the fair market value of the tangible property without first determining the value of the integrated property as an entity?

A. I think it is correct, as Mr. Koncel said, that the unit method is the best way to determine full fair market value.

I agree also with Mr. Koncel's statement that "cost by itself is a very unreliable indicator of value" and must be used with considerable care.

Cost evidence, whether book cost, original cost, or cost of reproduction, is often meaningless as a measure of market value. Book or original cost less depreciation frequently is far above the values indicated by more reliable approaches when a railroad property has partially lost its capacity to provide transportation services and generate income, due to growing competition from alternative modes of transportation or other causes. On the other hand, net book or original cost may understate value in the case of

page 526 } railroads which have not suffered the same degree of obsolescence in the values of their properties.

Where earnings have some reasonable relationship with cost, original and current cost less depreciation are useful aids to judgment in estimating market value. This method is, of course, used by the State Corporation Commission for the reason that Virginia has not adopted the unit method.

A general principle of valuation is that cost incurred to construct and acquire property under competitive market conditions may be acceptable or even the best evidence of the value of a property at the time the cost was incurred.

Q. Are you saying that it is the current cost, not the original cost of providing a given productive capacity, which is the better evidence of value?

A. Yes, but only in the case of a property which has not lost its service-giving capacity as a result of competition, technological changes or other causes of obsolescence.

Q. Please explain.

Dr. J. Rhoads Foster

A. Cost of replacing tangible property less accrued depreciation is useful evidence of its present value since that cost would be incurred by any other enterprise undertaking to supply the given transportation services. Fair market value may be in excess of replacement cost less
page 527 } depreciation because, if the tangible property were to be destroyed, the time required for replacement would involve serious business disruptions and losses. The price which a prospective buyer would willingly pay for an assembled tangible plant, exclusive of monopoly value, is in excess of the current cost of building a new plant with equivalent capacity to provide transportation services. Therefore, assuming a requisite earning capacity, an assembled operating property may have a franchise or going concern value in excess of the cost which would be incurred to replace the tangible properties.

Similarly, the costs which would be incurred in replacing the franchise, that is, the privilege of serving the communities being served, is useful evidence of franchise value. But the value of franchise privileges may reflect a capacity to generate income, arising out of protection from competition or out of going concern value, substantially in excess of franchise cost.

It follows that each of the component parts of a total property may be worth at least the amounts which it would cost to reproduce or replace the property. The value of such a successful, going concern, as an economic whole, may be in excess of the sum of the parts, each valued independently.

Q. Why is not original cost equally useful evi-
page 528 } dence of market value in the case of an enterprise having value as a going concern?

A. Before original or book cost can be of real assistance in determining present fair value of a property, it is necessary to have some knowledge of how price levels have changed since the dates of acquisition or construction of the property. To illustrate, the ICC Index of Railroad Construction Cost was in 1966 about 290 percent of the average 1935-1939 level. As the general rule, the divergence between original cost and value increases with the passage of time, due to technological developments and changes in unit costs of labor and materials.

Q. Are you suggesting cost of reproduction less depreciation as a formula for determining present market value of the tangible property?

A. No. I am not suggesting that cost of reproduction should be used as an exclusive formula in any circumstance.

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I think the Commission should consider all relevant and available evidence in estimating market value of properties under its jurisdiction. A letter written by former Commissioner Epes, dated September 17, 1927, and identified as an exhibit in this proceeding, states that the Commission then

page 529 } looked to all available evidence and used an estimate of reproduction new cost less depreciation as a maximum limit for the 100 percent of actual value to which it related its assessments, but not as a formula or measure of value.

Conventional appraisal procedures frequently value tangible assets on the basis of evidence of cost less depreciation. But cost is not value and cannot be used as a formula to measure value. The conventional procedures look to cost as evidence of value, but hold that the value of tangible property, exclusive of franchise value, is not in excess of estimated cost of reproduction new less depreciation.

Q. Turning now to depreciation, will you please define this concept?

A. Depreciation in its economic sense means a loss of value from any cause. Thus, a loss of value as applied to the productive assets of a going concern means a decline in the present worth in monetary terms of the expected future productivity of the property. Highly specialized and quite different meanings have been acquired, however, by the word "depreciation" in connection with the recognition, for different purposes, of the phenomenon of loss of value. One such meaning is in accounting, where the purpose is an appropriate amortization of original cost by assignment against revenues over the estimated useful life of the property. The

page 530 } result of this procedure, which is required by the Systems of Account promulgated for public utilities by the State Corporation Commission and for railroads by the Interstate Commerce Commission, is a conventionally acceptable determination of income. However, "depreciation" is defined in terms of cost, not value. Asset cost less an accounting reserve for cost amortization is only by coincidence a measure of property value.

Q. What is the significance of this distinction between depreciation and cost amortization for the purpose of property valuation?

A. If the estimate of fair market value for the purpose of general property taxation is to be consistent with the market value concept, the measurement of both cost and accrued depreciation should be reasonably consistent with that standard.

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I may illustrate this point by reference to certain testimony of Mr. Tipton. He states, correctly, that: "The primary purpose of depreciation (accounting) is the distribution of an asset cost over its useful life." However, he goes on to assert that, in the absence of unusual factors, "The accumulated depreciation on an asset will provide a reasonably accurate idea of remaining value." It appears that Mr. Tipton is here using the term "value" as an accounting concept, not in its economic meaning or with a meaning consistent with the concept of market value. The
page 531 } other factors are not unusual or exceptional.
Other information required to permit an estimate of market value includes the change in unit cost of labor and materials since the time when the expenditures being amortized were incurred, the changes in the character and quality, of the market served, technological developments, and other factors which bear on the present value of the property as determined by its capacity to provide transportation services and the prospective returns on the capital being employed.

Q. Mr. Tipton, a partner in Haskins and Sells, testified that the railroad track accounts of Norfolk & Western "are depreciated by use of the retirement-replacement method of accounting". Under this method no reserve for depreciation is maintained. When an asset is retired and replaced by another asset of like kind and quality, the cost of the replacement, less salvage, is charged directly to expense and the asset account left unchanged. When a component of the track structure is replaced and a betterment is involved, as when 80-pound rail is replaced by 100-pound rail, the cost of the 20-pound betterment portion is added to the asset account and the cost of the replacement portion is charged as an expense. The cost of each new asset put into use is capitalized in the accounts. When an asset is retired without replacement, the asset account is reduced by the
page 532 } capitalized book cost of the asset retired, less
salvage, and that amount is charged to expense.

Assuming this to be a correct description of the accounting procedure which has been followed by Norfolk & Western with respect to track accounts, what is the effect on the meaning or usefulness of book cost as evidence of current market value of the property?

A. Since charges are made directly to expense accounts to reflect replacements, no book reserve is maintained for accrued depreciation. Recognition must of course be given

to the fact of depreciation is using cost as the evidence of value.

Moreover, the book cost is a historical cost which is below the original cost of the property now in service for the reason that cost of replacement by another asset of like kind and quality has been charged to expense over a long period of rising prices.

Q. Is it correct that, in the case of a group or mass account for which asset costs are added and retired at about the same annual rate over a period of years comprising at least a full turnover cycle, a reserve reflecting straight line cost amortization over the estimated useful life of the property will approximate 50 percent of the asset cost being amortized?

page 533 } A. If the conditions are strictly as stated in your question, an affirmative answer is required almost as a truism.

However, two qualifications are relevant. The first is in the context of cost amortization. When unit costs of input resources are rising over the life cycle of such an asset account, unless the rising costs are offset by more efficient utilization of labor and materials in the construction process, the dollar amounts of additions must be in excess of the subtractions from the account if the real productive capacity of the property is to remain unimpaired. The ratio of the reserve to unamortized asset cost will be below 50 percent even though there is no real growth of the property. Of course, the ratio of amortized to unamortized cost will be less than 50 percent if the real investment is growing.

The second qualification concerns depreciation in the sense of loss of value as distinguished from amortized cost. As I already have said, it is the value concept rather than the accounting concept which is relevant to an estimate of the market value of the property. It is significant that the railroads have contended that a track structure must be maintained "in at least as good operating condition as when it was constructed" so that: "The day it goes out of service it must be in just as good operating condition as the day it was first put into service, except, of course,

page 534 } to the extent that changing conditions of use may permit a changing standard of safe operation." This contention was in support of replacement accounting for track property as contrasted with a proposed change-over to depreciation accounting procedures. *Uniform System of Accounts for Railroad Companies, Betterment and*

Depreciation Accounting, Report of the Interstate Commerce Commission, December 18, 1959. I have no opinion regarding the depreciation which has in fact accrued in the track structures of Norfolk & Western. It is obvious, however, that amortized original cost, whether hypothetical or as reflected on the books, is not a reliable measure of whatever may be the loss in the value of the property.

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

J. Rhoads Foster

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

Leda K. Terrill
Notary Public

My commission expires: Sept. 14, 1971.

page 535 } Q. And you are now here for cross-examination?

A. I am.

CROSS-EXAMINATION

By Mr. Riely:

Q. Dr. Foster, I have been impressed indeed by your wide experience as outlined in the statement of qualifications. I note for example that your firm prepared under your direction a report on the value of railroad property of the Pennsylvania Railroad Company for the *ad valorem* tax in Ohio, is that correct?

A. That is correct.

Q. About when was that report prepared?

A. Approximately two years ago.

Q. I have a copy here dated May 1967. Would that be about the right time?

A. As I recall, yes, sir.

Q. Now, in what other property tax cases relating to railroad companies have you participated, Dr. Foster?

A. None.

Q. How about your firm? Has it participated in any others to your knowledge?

A. No. It has not.

Q. It has not?

page 536 } A. It has not.

Q. Do you know Dr. Paul J. Garfield?

A. I do.

Q. Is he connected with your firm?

A. I answered erroneously. It is correct that he has participated in other cases, one or two. I am not sure I can identify them.

Q. Did he not participate in the Seaboard Coast Line case in Tallahassee on behalf of your firm?

A. That is correct.

Q. But the Ohio case, and this one, are the only ones in which you yourself have participated?

A. That is correct.

Q. Now, Dr. Foster, turning to your prepared testimony on page 23. Would you like a copy of it, sir?

A. I have a copy. Thank you.

Q. Towards the top of the page you state, "Where earnings have some reasonable relationship with costs original and current costs less depreciation are useful aids to judgment in estimating market value." Would you explain what you mean by "reasonable relationship with costs?"

A. Yes.

page 537 } At the time of the incurrence of the cost of productive property in general the capital expenditure has a maximum meaning and usefulness as evidence of value. That relationship changes over time for a multiplicity of reasons and in general original expenditure to the construction of the productive assets tends to lose its usefulness as a measure of value with the passage of time.

Whether or not either original costs or a reproductive or replacement cost retains usefulness and significance as a measure of present value depends upon many conditions and circumstances.

Q. Well, as I understand your last answer, Dr. Foster, it is normal for a businessman to invest in a capital asset at a time when he anticipates the receipt of a reasonable return from that investment, is that correct?

A. Normally a businessman does not make capital expenditures unless they expect revenue receipts to provide for the operating expenses incidental to that aspect of the business. Provides for the recovery of the capital and provides that a return on the capital which is equal to at least the cost of the capital being committed, however that cost may be measured.

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Q. But over a period of time the relationship between the investment and the return or earnings, or what
page 538 } you will, may change so the relationship is no longer a reasonable one, is that correct?

A. It does not follow that the relationship becomes necessarily unreasonable.

Q. But it is possible?

A. Yes, sir, it may be so.

Q. Now, could you outline to me your concept of the limits of a reasonable relationship between earnings and cost?

A. The reference to earnings is, of course, a shorthand statement for present market value. Present market value is dependent upon or is a function of prospective earnings.

If the business is one whcih serves a declining market the property tends to become obsolete due to that change in the character of the market and that loss of value in an economic sense is a primary cost of a departure of market value from cost, either original or current cost. Conversely, of course, the market may be maintained or even grow, an enterprise may be relatively profitable and successful so that the value of the business may be greater than original cost or even greater than what would be the cost of replacing the tangible property.

Q. I quite understand that, Doctor. Yet what I am trying to find out is the measure of the reasonableness
page 539 } of the relationship. Would you state that that had a percentage relationship to the investment in some way, either measured at the time of the investment or at the time of consideration?

A. The direct measure of the value of any business property is a present worth or present market value which is a reflection of and is determined by the discounting of anticipated returns on the property. That is to say the returns which are in prospect, the basis of informed judgment reflecting past trends and considerations, discounted or capitalized at a rate which is consistent with what would currently be the cost of the required amount of capital.

Commissioner Catterall: What do you understand by the word "reasonable" in Mr. Riely's question? Of course we fix reasonable rates because of the utilities, they can't charge what they please, but as I understand businessmen make as much money as they can. How does the word "reasonable" apply?

The Witness: In the case of a public utility rates are

fixed not on the basis of the present worth of the property, but on the basis of the evidence of the cost of the property. To use present worth or present value as a utility rate base would be inappropriate because of circulature. You would be, by that procedure, using a value of the prop-
page 540 } erty which is dependent upon the earnings which you allow as a measure of earnings of what you ought to allow and therefore it is inappropriate.

Commissioner Catterall: Mr. Riely's question was not directed to reasonableness of utility earnings but reasonableness of earnings.

The Witness: Yes, sir.

Commissioner Catterall: Not utility earnings but earnings. Is there any criteria for saying it is unreasonable for a man to make as much money as he can?

The Witness: No, I did not mean to so imply. And for the purpose of taxation the question of whether the earnings of the railroad are or are not reasonable doesn't enter into it. The value of the property depends upon what are in fact the earnings.

Commissioner Catterall: That is right confusing. That is what confused me.

The Witness: I am sorry.

By Mr. Riely:

Q. But understanding that it depends upon what the earnings are in fact it is true that cost is useful only when earnings show a reasonable relationship to cost. Now, you have made, I believe, no detailed study of the Norfolk
page 541 } and Western for the purposes of this case, have you?

A. I have not.

Q. But you did make a detailed study of the Pennsylvania two years ago?

A. Yes.

Q. Now, would one per cent return of relationship of earnings to cost be a reasonable relationship in connection with the Pennsylvania?

A. In connection with a railroad, the Pennsylvania or any other, which is incapable of earning a fair return on book investment or cost, whether that be one per cent or two per cent, that cost becomes not helpful, not significant evidence. It is appropriate for the taxing authority to look to the cost. If the cost is among the kind of evidence which are relevant but having looked at it in that circumstance it would have, I

think to be concluded, that cost is not a useful measure of present value. On the other hand in the case of a different railroad having a different earning capacity the fair value may be at least equal to or in excess of that cost, whereas in the case of the Pennsylvania, which was earning only 1.6 per cent on book equity it becomes immediately obvious that the property would not be replaced because the existing property has a diminished earning capacity.

page 542 } Q. But what in the case of the Pennsylvania would you have considered to be a reasonable range, either as a figure or within limits?

A. I am sorry. I do not know what you mean by "range" or "reasonable range."

Q. What would you have considered to be a reasonable relationship of earnings to cost in the case of the Pennsylvania? And I ask you to state that either as a per cent or as a range of per cent point.

A. I do not have in mind the precise results reached in the Pennsylvania. I do recall it was my conclusion that the current market value of that property was only a fraction of the original cost, book cost or cost of reproduction. I do recall cost was in the range of, I believe, two to three billion dollars or more and concluded that the values—

Q. Would you have reached the same conclusion if the Pennsylvania had been earning six per cent on its original cost in the State of Ohio?

A. The Pennsylvania does not earn on original cost in a single state or in any—

Q. But you could compute it on an allocated basis, could you not?

page 543 } Mr. Epps: I think we should let him finish one answer before we start another question, Mr. Riely.

Mr. Riely: I thought he was through.

Mr. Epps: He was in mid sentence.

The Witness: I think we understand each other.

An estimate of return on property located in a single state or fragmented tracks of the total property is a product of arbitrary allocation. There is only one logical economically valid approach to the valuation of a property and that is to look to the property in its entirety.

Q. Well, in other words you cannot give me a definition of

what you mean as a reasonable relationship in a per cent basis when you made this sentence on page 23?

A. I think the answer, sir, that it is a matter of degree as the evidence shows that cost, whether original or current, has some close relationship in terms of it being more or less similar to what is indicated as value, but other evidence then, of course, the cost is more meaningful.

If one must find that cost is on a fraction, or conversely that value is on a fraction of the cost then, of course, cost cannot be used as a formula when one is seeking value.

Q. Do I now understand you to say that if the result of your computation of value by the capitalization
page 544 } of prospective earnings is near or approximates cost cost is useful, but if it is not near or near cost that cost is not useful?

A. That is essentially correct. Cost is not a determinant of value. Cost is not value. It is only the present worth of prospective returns which is the measure of value. If the taxing authority is going to use cost as the measure in the sense of a formula it acquires usefulness under certain condition and lacks usefulness under others.

Q. Acquires usefulness when it approximates value computed on the basis of the capitalization of prospective earnings?

A. When it approximates the in fact value resting on the statement that I have just made that cost is not value.

Q. Well now, let's pass to page 15 of your testimony, Dr. Foster. I note that you say on that page, "It follows that the value," it is about halfway down the page, "It follows that the value of a franchise of a railroad or public utility enterprise depends upon its ability to realize profits in excess of a fair return on its investment and tangible assets. That is, earnings which are in excess of the competitive standard and which might be taken away by regulation."

Does the Norfolk and Western, in your opinion,
page 545 } realize profits in excess of a fair return on its investment on tangible assets?

A. I have not made that statement.

Q. What would be a fair return for the Norfolk and Western?

A. I have not made that study, either.

Q. If the Norfolk and Western in fact earns more than a fair rate of return you would admit that is franchise value in the Norfolk and Western under your definition, would you not?

A. I would.

Q. But it is your view, Dr. Foster, that cost, either original cost or reproduction cost, is useful only as an aid in judgment, is that not correct?

A. Correct.

Q. And is not to be taken as an evidence of value in itself, is that correct?

A. It is evidence of value but is not to be taken as a measure of that.

Q. And it can only be used in fact when the railroad is earning a fair rate of return, is that correct?

A. It is a measure of value only when earnings are such that the value is at least equal to the cost.

page 546 } Q. Thus the use of cost as evidence of value would be limited to relatively few railroads in the United States, wouldn't it, Dr. Foster?

A. No. We are playing with words, now. The word "evidence" in this case. If I were a taxing commissioner I would want to be informed as to the cost.

Q. But you would consider it of material weight only in the case of relatively few railroads in the United States, would you not?

A. Correct.

Commissioner Catterall: Seaboard Airline Railroad was in a receivership and they went for about 20 years and can hardly pay the interest on the receiver's certificates. During that period would you say that their property should not be taxed at all, have no value?

The Witness: If the basis of taxation is market value, and if that basis is made the measure, in fact the measure of the tax, then it seems to me that the value is greatly diminished, but there is always the prospect of improvement in the recovery, and until a railroad actually is in liquidation I would not say that there should be no taxation.

Commissioner Catterall: It was in receivership, though.

The Witness: Yes, but not liquidation.

page 547 } Commissioner Catterall: And of course we collected on its gross receipts and the franchise tax although, according to your view, there would be no value whatever in the franchise value, in the franchise. Your definition of franchise value is what it is worth in excess of a reasonable rate of return.

The Witness: It is to be understood that the answers that I have given to you and in the direct presentation is a reflec-

tion of the application of the economic concept of value and that for administrative reasons there may be impractical variations of literal application of that.

Commissioner Catterall: And in Seaboard case the variation would be 1000 per cent.

The Witness: Maybe, yes.

Mr. Riely: Are you through?

Commissioner Catterall: Through.

By Mr. Riely:

Q. Now, Dr. Foster, I ask you to look on page 651 of the transcript in the Ohio case, Pennsylvania Railroad Company against Porterfield, and Mr. Epps has a copy there, unfortunately I only have two copies.

Mr. Epps: I will look over the witness' shoul-
page 548 } der but won't prompt him.

Mr. Riely: I will tell you one thing, Mr. Epps, with the high regard I have for you, I don't think you could prompt Dr. Foster.

Mr. Epps: I would not attempt to aspire to that.

By Mr. Riely:

Q. Now, you say on that page, do you not, "The historical or book reproduction of property used in the Pennsylvania Railroad operation, the operation of unit of which we are speaking, is wholly irrelevant to and meaningless for purposes of estimating value." Is that not correct?

A. You have read correctly.

Q. And, well, you meant it when you said it?

A. I meant it when I said it and I mean it now in the sense that it should be put aside and not given weight.

Q. Well, would you think the same thing about the Norfolk and Western in this case?

A. No, I would not say the same thing.

Q. Why not?

A. Because compared with the Norfolk and Western is a successful allowable profitable railroad.

Q. Do you know the rate of return of the Norfolk and Western for 1968 or '67 or '66?

page 549 } A. I looked to the report sufficiently to have a general impression although I made no close study.

Q. Well, do you consider then the Norfolk and Western's earnings a fair rate of return on its investment?

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A. According to my notes the rate of return earned by Norfolk and Western on its equity capital was in the range of 8.0 to 9.8 per cent for the years 1959 through 1966 and was dropped to 7.2 per cent in 1967.

Q. That is taken from railway and net operating revenues?

A. Net operating railway revenues less fixed charges and including rents and various categories of interest charges.

Q. And does not include, of course, any non-operating rent?

A. No.

Q. Do you consider that a fair rate of return for the Norfolk and Western?

A. I have not made a precise study as to what is a fair rate of return for the Norfolk and Western. I am unable to answer your question as certainly reference to '67 where it dropped to 7.2 per cent it would, on the face of it, be very doubtful that is adequate.

page 550 } Q. Of course in those circumstances earnings wouldn't bear a reasonable relationship with cost, would they?

A. The earnings which are relevant in estimating market value are not the earnings of any one year.

Q. What period do you use?

A. That is in itself a matter of judgment.

Q. What would you use in case of the Norfolk and Western?

A. Norfolk and Western earnings have been sufficiently stable over a long period of time. The problem is far less difficult than it would be in the case of most railroads.

Q. Did you give me a period?

A. No. I don't know. Actually since over a period of ten years the variation in the rate of return in the rate of return to which we referred has been from 7.9 to 9.2 per cent and since over that period the tendency was toward a rising rather than a fluctuating or declining rate of return I would look to the entire period. I would look to a longer period, but not say five years or three years as a matter of a formula.

Q. It would rest on judgment?

A. Yes, estimates of value are always dependent upon judgment.

page 551 } Q. Now, the standard in Ohio was fair market value too, was it not?

A. Yes.

Q. And wouldn't you agree with me that cost, whether reasonable cost or reproduction cost, cannot properly be used as the sole basis for the valuation of railroad property for *ad valorem* tax purposes?

A. I do agree with that statement.

Mr. Epps: Are you through with the other?

Mr. Riely: I am coming back to that. You might as well leave it there.

Mr. Epps: I understand.

By Mr. Riely:

Q. The case in which you testified in Ohio, I believe, has gone to the Supreme Court of Ohio, has it not?

A. I believe it has gone to the Supreme Court and the Supreme Court has issued an opinion.

Q. And is not that the opinion or copy of the opinion which I have handed you?

A. It would appear so.

Q. This is the case of the *Pennsylvania Railroad Company* against *Porterfield* decided by the Supreme Court of Ohio, December 31, 1968, and reported in 16 Ohio State page 552 } 136, 243 Northeast 2d at page 87.

Would you turn to page 90 of that opinion, please, Dr. Foster, where the Court says, "We conclude that a decision determining the valuation for Ohio tax purposes of a railroad is unlawful by the method used to determine that valuation, does not purport to consider the value of any of the railroad's property except by reference to its cost when acquired at various times over a long period of years and where such decision gives no consideration to the earnings of the railroad, and where such decision gives no consideration to the market value of the debt of and ownership interests in the railroad." You would conclude that is a proper economic standard?

Mr. Epps: I think as a matter of foundation we ought to find out whether the witness is familiar with the opinion before we cross-examine on the various points of it.

Commissioner Catterall: Well, the opinion speaks for itself.

Mr. Epps: Yes, sir.

I don't know whether he has read the whole opinion.

Mr. Riely: This is from the question I asked him and I want to ask him whether he agrees with that page 553 } conclusion as a matter of economic principle.

Mr. Epps: Could we find out whether he is familiar with the opinion before we get into this?

Commissioner Catterall: No. This witness doesn't need that kind of protection.

Mr. Epps: All right, sir.

The Witness: I am sorry. May I ask your name?

Mr. Riely: Riely. I beg your pardon, Doctor.

The Witness: Mr. Riely, any response that I would make to your question would either have to be very general or with specific reference to the circumstances which were reflected in the issues being here considered.

Now, what the Court says is related directly and is dependent, in form, is dependent upon the taxing procedure of the Commission. I can answer you affirmatively, but I am making the point that the answer is inaccurate or misleading in part for that reason.

By Mr. Riely:

Q. I don't want to try to make you mislead me or me mislead you, Doctor, but your answer is generally in the affirmative, generally with qualifications which we won't go into?

A. I think so.

page 554 } Q. I think it would be nice if we had this as an exhibit.

Commissioner Catterall: As an exhibit?

Mr. Riely: Yes, sir.

Commissioner Catterall: As evidence of foreign law? You can call it an exhibit if you want. What is the number?

The Clerk: 19.

Commissioner Catterall: Exhibit 19.

(The document referred to was received into evidence as Exhibit No. 19.)

Commissioner Catterall: Who were you employed by in the Pennsylvania case?

The Witness: By the Pennsylvania Railroad.

Commissioner Catterall: You were employed to make the value as low as possible?

The Witness: No, sir.

By Mr. Riely:

Q. Dr. Foster, I wouldn't answer that question if I were you, on my constitutional rights.

Commissioner Catterall: The employers hoped you would make it as low as it could be made, not that you were employed to do that?

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page 555 } The Witness: I am willing to attribute such hopes and expectations.

By Mr. Riely:

Q. Dr. Foster, I hand you a copy of Exhibit L.B.Y.-2, which has been tendered by Mr. Younger, in this case, or at least ask Mr. Epps to hand you a copy and ask you if you would examine it briefly.

A. Yes, sir.

Q. Now, Mr. Younger on page 28 of his prepared testimony says the following about this exhibit. "The original cost totalling $177,800,335 was accepted as filed to which the 80 per cent 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, this 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 tracks, siding and yard track to arrive at the fair cash value or full value per mile for 1968 for the various track classifications."

page 556 } In your opinion, Dr. Foster, is this method of valuing Norfolk and Western track at 80 per cent original cost a proper method to determine valuation of tax structures for *ad valorem* tax purposes?

A. I am not in a position to answer that question. The answer to that question depends upon more knowledge than I have of accrued depreciation and other relevant consideration.

Q. If you were asked to value track of Norfolk and Western for tax purposes the track in Virginia, and were given only the original cost of such track would you make a proper valuation?

A. Are you suggesting that, or does your question mean could I make a proper valuation having no knowledge of any facts or circumstances other than the original cost?

Q. That is correct, sir.

A. Obviously I could not.

Q. What additional information would you need?

A. I would need a galaxy of information and facts relevant to the physical condition of the railroad, the indication of obsolescence, the decline of the value of the railroad.

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Q. Excuse me, the third one I didn't hear, Doctor.

page 557 } A. I would want to know not only the original cost but I would want to know something of the depreciation factors. We all know what are the causes of depreciation. One must or should make inquiry as to the degree in which those causes have developed in the particular situation. One would need to be, or should be, informed as to the rise in the unit cost of labor and materials going into such a program. One would, or should be, informed as to the change in the character of the market and factors bearing on the value of the property.

Q. Would you need to know the earnings of the property?

A. Yes. I had in mind referring to factors bearing on the change of the market.

Q. So you refer to physical condition, obsolescence, unit cost and factors that apply to the change in the character of the market, is that the main categories that you consider?

The Witness: Could the reporter please read that?

Mr. Epps: Your answer or the question?

The Witness: Well, the preceding answer and Mr. Riely's question.

(The reporter read as follows:

"Would you need to know the earnings of the property?

"Answer: Yes. I had in mind referring to fac-

page 558 } tors bearing on the change of the character of the market.

"Question: So you refer to physical condition, obsolescence, unit cost, and factors that apply to the change in the character of the market, is that the main categories that you consider?"

The Witness: I think the statement "categories" is perhaps somewhat incomplete. We are here, I think, assuming that the purpose is to estimate the fair market value of the property. The original cost is evidence, cost of reproduction or replacement is evidence. The condition of the property in a physical sense is evidence. Accrued depreciation in the economic sense is relevant in evidence.

Of course, accrued depreciation in the economic sense is not unrelated to the evidences of present value derived by reference to market prices, stock and bonds of the company or by

reference to its experienced earnings. By reference to all those changing factors which bear on the probability of future earnings and continued care of the company as a successful viable company or otherwise.

Q. So if you determined to capitalize dollar value, excuse me, of the fair market value of the company or—
page 559 } strike that question.
If you determine a value for the company based on capitalized earnings that would take into account the changing character of the market and obsolescence, would it not?

A. Yes. It would do so insofar as that changing character of the market has already been reflected in or had its impact on earnings.

Q. Now, Dr. Foster, on page 11 of your testimony you state it is basic on the other hand, excuse me, I beg your pardon, let me give you a chance to get there.

About the middle of the page.

"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." That is what you say, is it not?

A. Yes, sir.

Q. And I note that you use the word "solely." Do you mean prospective earnings are the only important factor to be considered?

A. No. What I am saying is market value is the present worth of what buyers and sellers believe to be
page 560 } dividends or returns, which is a prospect. However, dividends of cost and other evidence are relevant to an estimate of present worth.

Q. Prospective earnings are the only test, but there are a number of different ways in which you can estimate prospective earnings. Would that be proper?

A. I think that is a good statement. No.

Q. "Ways" was the word that bothered me.

A. Different kinds of evidence which are relevant by way of a component of the analytical process.

Q. Prospective earnings is still the clue?

A. Prospective earnings are the determinants of present worth. A principle which is so well established in economic and financial literature that perhaps it cannot be questioned. But there are, of course, uncertainties in estimation pro-

cesses, and for that reason, in particular, other bases of estimation or kinds of evidence are useful.

Q. Well, Doctor, if there were a railroad which had no prospective earnings would its value be zero?

A. If your question is to be taken literally.

Q. Yes, sir.

A. That there is no prospective earnings at any time in the future then the considered judgment of those

page 561 } who would have an opinion as to market value then the railroad in fact has no value. And in fact would be liquidated although the process of liquidation might be prolonged.

Now, I want to qualify what I have said because when I say would have no value I mean no value as a reflection of earning capacity. There is, of course, the residual value of the items of property in some alternatives.

Q. What alternative uses would there be for a large quantity of track property, Doctor?

A. The alternative uses are, of course, somewhat limited if you are assuming all railroads to lose their capacity to provide service and generate income. In that circumstance perhaps the rails and the ties and other physical units would have no market whatever and so might the abandonment, might be placed, the property would not be disassembled. That, of course, perhaps was not your assumption.

Q. You go a little too far. I am talking about one railroad and not the entire railroad system.

A. So that the alternative uses, secondhand use of property by other railroads desiring the same kind of unit of property are, in the case of land, of the use for some other residential business purposes.

Q. That is really what we talk about as sal-

page 562 } vage as far as the track is concerned, isn't it?

A. Perhaps the distinction between the sale of property available for a similar use on a secondhand basis and a sale as scrap is useful, but the two kinds of alternatives I think can be combined to describe the word "salvage."

Q. Now, Doctor, I want you to go back to Ohio with me for a minute, if you will. If you will turn to page—

Mr. Epps: The big record?

Mr. Riely: Yes, please.

Page 581.

I would like to ask about a couple of paragraphs there in the middle of that page.

Dr. J. Rhoads Foster

"A property," you said," which we call a business property, a property whose function is to provide a service and make an income is necessarily to be valued as a going concern. The value of such a property depends wholly upon its capacity to produce an income. There are certain qualifications to that broad statement in that under certain circumstances a property may cease to be a going concern so that its value would then depend upon the salvage value of the assets. In other words the price at which they might be sold as salvage. Subject to that qualification a business property, value of business property, is dependent
page 563 } upon its capacity to produce an income for the owner of the property."

Now, you said that in Ohio, did you not?

A. You read the record correctly.

Q. And the only practicable alternative for track property to use as railroad is salvage, would you agree with that?

A. Salvage value in the sense in which we have defined.

Q. Yes, sir.

Now, would you turn to 664 of that transcript at about two-thirds of the way down the page. You said, I believe, "I did say that the value of the going concern depends upon its capacity to produce income. If there is a prospect that it will cease to be a going concern, or if its value as a going concern is less than what would be its salvage value, then what may be realized through disposing of the assets for some alternative use does become an appropriate measure of the value of the property."

Aren't you saying, Dr. Foster, that the going concern of a value of railroad property is the difference between its value as a going concern and its salvage value?

A. That is not what I am saying. When I used the language which you have read it would not have occurred
page 564 } to me that anyone would construe that language as you have now.

Q. So there is a difference in your mind between the value of a railroad property as a going concern and its going concern value?

A. I was using the expression value as a going concern to mean status as a viable property capable of producing income.

Q. Is that an answer to my question?

A. I *tended* it to be.

Dr. J. Rhoads Foster

Q. May I ask the question again?
A. Yes, sir.
Q. You, in your opinion, there is a difference between the value of a railroad property as a going concern and its going concern value?
A. Well, there is if you give to the words "going concern value" a meaning such as meaning to which I have attributed those words and testimony in this case.
Q. Which case, the Pennsylvania case or the Ohio case?
A. No, the Virginia case.
Q. The Virginia case?
A. Yes, sir.
Q. What is the difference?
page 565 } A. Well, I touched a moment ago on the meaning which I was attributing to the terms. I will spell that out. In the Ohio case we were dealing with the problem of valuation on a unit basis.

Commissioner Catterall: You mean the whole railroad?
The Witness: The entire railroad without any separation between value, tangible property, and to franchise value or a value in excess of or to be distinguished from the value of the tangible property. In that context I made the statements to which you have referred making the point, which I believe to be a correct one, that when an enterprise ceases to be a going concern in the sense that it ceases to be a viable productive successful enterprise and enters a liquidating stage then the value as salvage sets the floor. In this proceeding in Virginia we have a different set of circumstances.
The valuation for the purpose of the property tax is not on a unit basis. There is for the purpose of taxation, the separation between value of the tangible property and the value of the franchise. So that the word "going concern value" as distinguished from values of going concern has a significance and meaning here for this purpose which I think is appropriately to be distinguished from the
page 566 } meaning which I was using, the other phrase in Ohio.

Q. Dr. Foster, on page 22 of your testimony you state, and I quote, "I agree also with Mr. Koncel's statement that cost by itself is a very unreliable indicator of value and must be used with considerable care." That was your statement, was it not?
A. Yes, sir.

Dr. J. Rhoads Foster

Q. Would you now turn to page 26, about a third of the way down the page. You say, "But cost is not value and cannot be used as a formula to measure value." Is that correct?

A. Yes, sir.

Q. Now, if the Commission in this case in fact used cost as a sole basis for the assessment of the track of the Norfolk and Western it was in error in your opinion, wasn't it?

A. I have not so stated and I would not so state. If the Commission satisfied itself that cost is an appropriate measure of fair market value and in doing so it must look, I think, to all the factors which are relevant, then it is not following a procedure that is erroneous or which yields an inequitable or unfair result.

Q. But if it did not look at other factors, if it did not look at capitalization of earnings or stock value and

page 567 } debt value would it be in error?

A. Might or might not.

Q. Under what?

A. Speaking generally if a taxing authority looks only to cost and closes its eyes to all other kinds of evidence it would reach fair market value only by coincidence.

Q. Now, I believe you would consider it appropriate to take into account obsolescence in making a valuation in which cost is given weight?

A. Obsolescence is a cause of loss of value and therefore my definition is relevant, yes.

Q. I believe you stated you were not familiar with Dr. Garfield's testimony in the Seaboard?

A. No, I am not.

Q. You have not looked at that.

You don't know whether he allowed any factor for obsolescence?

A. I have not even discussed it with him.

Q. What did you mean on page 23 when you said, "That cost is an evidence of the value only in the case of a property which has not lost its service giving capacity as a result of competition, technological changes, or other causes of obsolescence?" What do you mean by that sentence?

page 568 } A. It should be noted as a preface to my response the question referred to current cost and not to original cost. It is a general principle that cost which would be incurred currently in a measure of value in the case of a property which has a full service giving capacity and has not lost value as a consequence of competition, technological change or other causes of loss of value.

Dr. J. Rhoads Foster

Q. Could you make a determination, Dr. Foster, of whether a particular railroad has lost its service giving capacity as a result of the items that you mentioned?

A. I think so. I undertook to do so in the case in Pennsylvania. I could make—

Q. But you have had this recorded cost, did you not? You reviewed it but you did not use it as a factor in reaching your conclusion?

A. And in that case I found that the railroad had lost service giving capacity as a result of the competition and obsolescence and so on.

Q. Did you reach a particular percentage in that case, do you recall?

A. Well, is it correct that this is the same question you asked earlier in relationship between the conclusion as to fair market value and to cost? If so, I have to give

page 569 } the same answer.

Q. No, it is not the same question, Doctor, though you may consider it a related question.

You stated that you made a determination in the Pennsylvania case of the loss of service giving capacity. I asked you whether you reached that in the terms of a per cent of current cost or on original cost, or any other cost?

A. Not directly in that form, however, in the economic sense loss of value which is depreciation in the economic sense is a result of loss of service giving capacity and therefore is the ratio which is the same as the relationship between present value and cost.

Q. Well, did you reach in the Pennsylvania case any per cent condition or per cent depreciation for the property to be allowed either to current cost or original cost?

A. No, because having put cost aside it was unnecessary for me to do so.

Q. Now, could you make the determination of the loss of service giving capacity by reference to cost only?

A. No.

Q. Now, I believe you mentioned competition. Has not the competitive situation with regard to transportation changed greatly since 1926?

page 570 } A. Very greatly.

Q. There have been trucks, airplanes, pipelines, electric wires, all of those things provide competition for the railroads, do they not?

A. There has been a rising tide of competition from alternative modes of transportation.

Dr. J. Rhoads Foster

Q. Now, on page 23, toward the bottom of the page, "Cost of replacing tangible property." You say, "Less accrued depreciation is useful evidence of its present value."

Is it not true, Dr. Foster, that the cost of replacing the Norfolk and Western is something quite different from the cost of its reproduction?

A. Yes.

Commissioner Catterall: I don't quite understand the difference.

By Mr. Riely:

Q. Would you explain it to His Honor?

The Witness: Well, Commissioner, it is a technical difference. Cost of reproduction is a term used to mean the cost of replacing the property with identical facilities. The property in its present location with its present design, without change from the physical character of the property, it is very seldom that in fact an old property would be replaced by new property of precisely the same design using the same kind of equipment.

page 571

Commissioner Catterall: I see. That would never happen. So I didn't think that was a possible meaning.

The Witness: Well, that is the meaning. For example, in older literature in utility regulations. But I used the term "replacement cost" to take account of the fact that the current cost would be the cost, or should be the cost of the kind of property which would be constructed today.

Commissioner Catterall: Well, that would be much more expensive than the reproduction cost?

The Witness: No.

Commissioner Catterall: You would have air conditioning and all sorts of things.

The Witness: Oh, yes, in degree that is true.

Commissioner Catterall: I mean—

The Witness: Excuse me.

Commissioner Catterall: Replacing, you mean putting in service a new plant?

The Witness: A plant capable of providing the same service that the present plant is capable of.

Commissioner Catterall: By reproduction you mean rebuilding the same old mid-Victorian plant?

page 572

The Witness: Right.

Commissioner Catterall: I see. I should think

replacement would necessarily be much more expensive and much more efficient.

The Witness: It is true you would install air conditioning, for example, and perhaps that improves the quality of the service. On the other hand you would redesign. You would use modern up-to-date arrangements, perhaps in a different location. And that would perhaps more than offset other considerations.

By Mr. Riely:

Q. I think His Honor is in fact erroneous. I hate to say that on the record, but normally replacement cost would be less than reproduction costs, isn't that true?

A. I am not sure, Mr. Riely. The concept is so difficult to measure a practice that we look to experience cost, original cost, or replacement cost as evidence. I understand the difficulties attempting to measure cost of assessment of total property or by measuring value in reference to segment of the total property and by reference to cost. But it has to be done that way. It would be administratively infeasible to try to apply a replacement cost concept. It is far too difficult.

page 573 } Q. Well, you are a businessman, Doctor, as well as being an economist. Would you replace the Pennsylvania Railroad in Ohio today if it didn't exist?

A. With the answer I have just given you assumed what earlier I referred to as a property which is fully going concern quite correct. In the case of the property that has much accrued obsolescence, such as the Pennsylvania, the existing trackage would not then construct, much of it would not be replaced. So for that reason replacement cost would be much less than cost of reproduction.

Commissioner Catterall: You replaced only part and it would be less than reproducing all?

The Witness: And Mr. Riely is pointing out when there is a great deal of obsolescence you would actually not replace all but replace only part.

By Mr. Riely:

Q. For example, you know that in 1959, I believe, the Virginian was merged with the Norfolk and Western. You would not replace both the Norfolk and Western and Virginian if you were starting off to build your ideal railroad throughout the Commonwealth, would you, Dr. Foster?

Dr. J. Rhoads Foster

A. I expect you are right, but I am assuming that there is a parallelism or overlap of function. I don't
page 574 } know enough to say.

Q. In fact from an economic point of view if you were replacing a railroad you would build only lines on which you could reasonably expect to make a profit, wouldn't you?

A. There may be other constraining factors such as regulatory requirements.

Q. Disregarding these gentlemen before me.

A. If you could disregard them and disregard public relation considerations and rest your decision entirely upon what is relevant to profit motive, the answer is "yes."

Q. Aren't there lines on the Norfolk and Western on which a fair rate of return is not derived?

A. I don't know. I would not be surprised, however.

Q. Now, Doctor, what has been the effect of inflation on the railroad?

A. The first effect of inflation is to increase the unit cost of the materials and supplies and all input resources. Since inflation has been experienced during the same time interval that due to competition there was decline in the quality of the markets, the combination of the two for the railroad industry generally has resulted or did result in a reduction in earning capacity and experienced rate return.

Q. So the effect of inflation on the railroad
page 575 } industry was somewhat different from its effect on industry in general, was it not?

A. Competitive industry in general can adjust itself to the inflation because as the cost of input resources rise so may the cost of market price of products being sold.

In the case of the railroads, as I have just said, of the market, precluded the upward adjustment in rates which would maintain a better rate of return.

Q. And I believe you have said this on pages 953 and 954 of the Ohio record which I ask you to turn to beginning at line 20.

"With inflation there is a decline in the general purchasing power of money and unless the effect of inflation is offset by other factors any business suffers from it. But inflation has a particularly severe impact on the railroads because of the large amount of capital employed and the relative stability. In other words they don't grow in terms of volume of business as does many other businesses." The reporter was bad there, Doctor.

Dr. J. Rhoads Foster

A. Not the reporter. Well, perhaps the reporter would have been presumptuous to have corrected the errors in my extemporaneous speech.

page 576 } Q. Would you agree with the statement you made there? You would agree today, wouldn't you?

A. Yes, sir.

Q. Then might it not be correct that the value of a rail road property would not increase as fast in an inflationary period as the value of other businesses?

A. Your statement would be correct under the market conditions or under conditions of market trends which we have experienced in the past. It doesn't necessarily follow it would be true under all conditions because if the railroads have been or were capable of earning a fair return the accommodation to inflation would then be dependent upon regulatory powers.

Q. But is it not true in any inflationary period the fair market value of a railway property might actually decline from what it was at the beginning of the period?

A. Well, it might. We should, of course, keep in mind that it is the limitation of market rather than inflation as such which is the real factor here.

Commissioner Catterall: Hasn't the railroad freight rates gone up four per cent every year?

The Witness: Railroad freight rates have gone up with considerable frequency. Sometimes more than four per cent. But my remarks with respect to the importance of the market

page 577 } is still relevant because ton miles have declined either absolutely or relative to total interstate or intercity ton miles. And to the I.C.C. and necessarily the railroads have had been concerned with the increase in freight rates was not diminishing the volume of business flowing more to competing modes of transportation.

Mr. Riely: Is Your Honor finished?

Commissioner Catterall: Oh, yes.

By Mr. Riely:

Q. Now, going back to where we were, Doctor, if it is true that the value of a railroad property would probably not increase at the same rate as the cost of goods and services of inflationary periods would not it be unfair to use

reproduction cost new as the value of the railroad property in an inflationary period?

A. Because by definition that, if that were true the particular railroad cost of reproduction might and probably would tend to represent an overstatement of value.

Q. Now, Doctor, if you would turn to pages 10 and 11.

I judge that from your testimony on pages 10 and the bottom of page 10 and the top of page 11, or all of page 11, that you consider that the determination of value for rate regulation purposes, and the determinance of fair market value involved different considerations, is that cor-
page 578 } rect?

A. That is correct. I so stated, I believe, in response to a question from the Bench.

Q. You said on page 11, I believe, that rate regulation looks to cost evidence either original cost or some current cost, is that not correct?

A. Yes.

Q. And valuation on the other hand, you say, depends solely upon prospective earnings, is that not correct? I am trying to be exact.

A. Your choice of words makes the question, I think, a bit inexact.

Q. I apologize, Doctor.

A. Value depends upon prospective earnings. Valuation, which is the word you used, is a process for estimation and, as I have said, I believe, that one should look to all kinds of evidence that may be useful.

Q. Now, see if I can say it exactly by saying in valuation for tax purposes you attempt to reach value through use of, primarily, through the use of the determination of prospective earnings. I don't seem to be able to state it correctly, Doctor.

A. You try to reach value, Mr. Riely, and value being the present worth of prospective earnings, commonly
page 579 } the best evidence of value is capitalized earnings.

There may be circumstances where some other evidence might be better.

Q. 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?

A. 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.

Q. All right, Doctor.

Now, I guess I will have to go back to Ohio again with you. Would you mind turning to page 589 of the Ohio transcript?

There you state beginning near the top of the page three steps, sir, are involved in applying the capitalized income method. "First it is necessary to determine the amount of the income from the railway unit. In other words to determine the amount of income which is to be capitalized. The second step is to estimate appropriate capitalization rate. Of course final as the third step, to make the applications to determine value of the property."

You agree this is the proper way to go about
page 580 } determining value by capitalization income?

A. Yes, these are the steps which are inherent in that approach.

Q. Now, Doctor, as the first step, the determination of the amount of income from the railway unit. The starting point customarily is net railway operating income, is it not?

A. Yes.

Q. But in many cases it is appropriate to make adjustments to the ten railway operating income as reported by the carrier, is it not?

A. That may be.

Q. And I believe you have already testified that it is not your custom to use net railway operating income as adjusted for a single year?

A. Yes.

Q. And in the Pennsylvania case I believe that you selected a five-year period, is that not correct?

A. I believe I made computations or looked at data for five years and also for other time periods.

Q. Now, the second step is the appropriate capitalization rate. First let's talk about equity.

In the Ohio case you found that 12.5 was an appropriate
capitalization rate for the equity of the Penn-
page 581 } sylvania, did you not?

That appears on page 634 of the transcript, I believe, before you.

A. Yes. It is stated on page 634 that having reached with respect to equity capitalization rate a conclusion that 11.5 per cent is appropriate for railroads superior investment quality. I then moved to 12 and a half per cent to reflect the relatively inferior basic quality of the Pennsylvania.

Q. What would you think appropriate capitalization rate for capital of the Norfolk and Western to be?

A. Any answer that I could give you would have to be strictly within the context of the situation which existed at the time I made the Pennsylvania study. I have made no study since then. As of that time in terms of my conclusion as of that time the 11.5 per cent or some general similar rate would have been my conclusion.

Commissioner Catterall: What was the Pennsylvania debt ratio at that time?

The Witness: I will have to look it up.

Commissioner Catterall: If you don't know the debt ratio your other figure loses significance.

The Witness: I am certain I took the debt ratio into account at that time.

page 582 } Commissioner Catterall: Never mind. We are getting a little far afield.

By Mr. Riely:

Q. Doctor, Mr. Epps has over his right shoulder a copy of a document that I believe that you will identify as your appraisal report of the Pennsylvania and Ohio, would you not, or one of the two volumes? The other one is here, if you would like both.

Commissioner Catterall: Suppose we recess for ten minutes so everybody can relax.

(A recess was taken at 11:30 to reconvene at 11:40.)

By Mr. Riely:

Q. Doctor, when we took the recess I believe you had handed you that volume of your appraisal report of the Pennsylvania and Ohio case. I asked you to read the footnote into the record that appears on page 117.

A. Yes, Mr. Riely.

Q. Would you read it, or maybe I can read it.

A. I am sorry. I didn't understand you wanted me to read aloud.

Q. Yes, I would like to have that in the record.

A. "The Norfolk and Western is the most

page 583 } stable and has the best growth record." I perhaps should explain this means as among major railroads in the United States. "The typical annual growth

rate was 6.4 per cent for earnings and 5.5 per cent for dividends. Dividend yield averaged about 6.0 per cent. Assuming that investors projected that growth rate into the long-term future the capitalization rate for this company is in the neighborhood of 11.5 to 12.5."

Q. Thank you, Doctor.

That, of course, is capitalization rate on the equity?

A. It is capitalization rate on the equity portion subject to the assumption which is stated in the sentence I read.

Q. Yes.

Now, for the Pennsylvania you determined that the appropriate capitalization rate for the debt portion of the capital structure was five per cent in the Ohio case, did you not?

A. I do not remember. It is in the exhibit and it will show, but I have not reviewed that study.

Q. I understand that.

Would you look on page 165 of that report, that little table, I believe there, shows it?

page 584 } A. Yes, sir. And it is correct that I used 5.0 per cent for the debt portion.

Q. Now, have you made a determination of the appropriate capitalization rate for the debt portion of the Norfolk and Western?

A. I have not.

Q. Do you consider it to be less or more than the rate for the Pennsylvania?

A. I believe I should answer that although I have made no study my general knowledge would indicate that although Norfolk and Western is a railroad of better quality investment, quality than the Pennsylvania, the rise in level interest rates since 1965 would indicate that the debt portion would be capitalized in the case of Norfolk and Wesern at a rate higher than 5.0 per cent.

Q. Now, Dr. Foster, on page 165 of which you are looking you conclude, I believe, in that case that the composite capitalization rate for Pennsylvania should be rounded to 10 per cent, is that correct?

A. Yes, sir.

Q. Could you give me the appropriate composite capitalization rate for the Norfolk and Western?

A. Not without making further studies.

page 585 } Q. Do you anticipate it would be higher or lower than the Pennsylvania?

A. Without looking to the capital structure, making more

specific studies with respect to the rate appropriate for both the debt and the common stock, I would not wish to estimate.

Q. Now, may I have the report back?

I simply want to determine, simply to understand your methods, Doctor, how you credit the composite rate. As I understand it you determined the division of income between debt and equity of the 12 railroads that you considered over 15 years as representing the normal capital structure which would be established by buyers of the Pennsylvania Railroad property. Income absorbed by the debt requirements of such a capitalization was 16.8 per cent of income available for fixed charges and 83.2 per cent was available to the common equity. You then proceeded to create the composite of the applicable capitalization rates on the basis of those per cents. Was that the way that you did it?

A. I believe you correctly stated the procedure. Actually, of course, consistent with what we have said about the meaning of book cost under diverse circumstances in estimating value one is capitalizing income and the income

page 586 } flow being two streams, one for the debt and one for the equity. One is in effect capitalizing those two income streams separately and combining the result.

Q. Yes.

Now, well, you referred to 12 railroads in this study. Was the Norfolk and Western one of those 12?

A. Yes.

Q. Doctor, only a few more questions.

I pass now to a different subject. At the bottom of page 12 of your prepared testimony, would you refer to that please?

A. Yes, sir.

Commissioner Catterall: Those per cents that you have just been discussing with Mr. Riely are, I assume, purchases of original cost and not reproduction cost?

The Witness: The percentage I discussed with Mr. Riely in response to his most recent questions did not concern any kind of cost but were rather the rates at which investors would value the prospective income. This is wholly independent of cost. It is a separate and additional approach to the question of value.

Commissioner Catterall: Well, there is then, of the amount of money put into the company by the bond

page 587 } holders and stockholders.

The Witness: The price of course starts with the amount of money put in.

Dr. J. Rhoads Foster

Commissioner Catterall: You are trying to get at, you mentioned certain percentages and I am curious to know what they are percentages of.

The Witness: They are the per cent rates at which investors would capitalize earnings or prospective earnings.

Let me express it this way. At a 10 per cent rate—

Commissioner Catterall: Ten per cent of what?

The Witness: Capitalization rate.

Commissioner Catterall: Ten per cent of the money put in?

The Witness: No, it is a capitalization rate rather than a per cent of. Let me express it this way. Capitalization rate of 10 per cent means that each dollar of income is worth 10 times the income. The result is derived by dividing income by the rate rather than conversely. In other words it means that investors in the market would pay $100 for the prospective return of $10. If the capitalization rate were, say, six per cent it would mean that they would pay
page 588 } $166 for $10 of income.

Commissioner Catterall: Well, I thought you were telling Mr. Riely what they were actually getting, but you were telling him what they would like to get.

The Witness: Their valuation of what they are actually getting. What they think is the worth of what they are getting.

Commissioner Catterall: I thought you said they were actually getting so much on debt and so much on equity that they were actually receiving the amounts you mentioned on the debt and on the equity.

The Witness: They are actually receiving on the debt. Let's use debt to illustrate the point and assume there is a million dollars of debt and the contract rate is four per cent. So they are receiving $40,000 as that stream of income worth. If it is capitalized at five per cent, and Mr. Riely brought out that the five per cent is what I found to be appropriate in the case of the Pennsylvania, it means that $40,000 income is not worth the million dollars but somewhat less. And in this instance $40,000 capitalized or discounted at five per cent instead of the coupon rate of four per cent would mean that the bonds would sell for $800,000 instead of the million.

page 589 } Commissioner Catterall: If they were actually receiving four per cent of a million dollars it would mean that they had put a million dollars into the company's coffer.

The Witness: The people who originally bought the bonds

put the million in and they received four percent of their investment.

Commissioner Catterall: And if a million dollars was spent on the plant then they would be receiving four per cent of the cost of the plant.

The Witness: Yes, sir.

Commissioner Catterall: All right.

If they sell the bond in the present market they couldn't get more than $800,000 and the new buyer would get five per cent. If they bought United States Government bonds five years it would be worth 75 per cent what they paid for it, net.

The Witness: That illustrates the point, yes, sir.

By Mr. Riely:

Q. Let me now just continue along this line for one minute because we used several different percentages. I think you have explained to His Honor the five per cent capitalization on debt and the 12.5 per cent capitalization rate
page 590 } on equity performs the same function?

A. Yes, sir.

Q. But I don't want His Honor to be confused about the 16.8 per cent and the 83.2 per cent. That was determined, and perhaps I am taking unfair advantage of you.

A. I am confused now.

Commissioner Catterall: We are all confused on that. What we would like to do now, just for fun, is what is the actual debt ratio of that company you are speaking of?

Mr. Riely: The Pennsylvania?

Commissioner Catterall: Yes.

Mr. Riely: May I finish one question?

Commissioner Catterall: Finish it, yes.

The Witness: Then if you will get that appendix.

By Mr. Riely:

Q. I think if you read to His Honor those two sentences it will explain the 16.8 and the 83.2.

Commissioner Catterall: I ought not to have asked that question. Does this have some bearing on what we are considering here?

Mr. Riely: Yes, sir.

Commissioner Catterall: What is the bearing?
page 591 } Mr. Riely: Very definitely.

Dr. J. Rhoads Foster

Commissioner Catterall: Tell me what it is.

Mr. Riely: Bearing on how one determines a proper capitalization of earnings of the Norfolk and Western for the purposes of reaching a value.

Commissioner Catterall: In that connection you would be reaching the value of the total plant as a going concern.

Mr. Riely: Yes, sir.

Commissioner Catterall: It would include a going concern value and good will and not reproduction?

Mr. Riely: Not reproduction.

Commissioner Catterall: Good will and all of these things.

Mr. Riely: Yes, sir.

Commissioner Catterall: Which comes under the gross receipts taxed. You are performing a different function in Ohio from what he is.

The Witness: It should be kept in mind, Mr. Commissioner, whenever there is reference to the Pennsylvania analysis, or what was done in that proceeding, it was within the context of a unit cost which is—

page 592 } Commissioner Catterall: Which is a very different type of law from what we have in Virginia.

The Witness: It is a very different type, yes, sir.

By Mr. Riely:

Q. Dr. Foster, you took five per cent and 16.8 per cent and 12.5 per cent and 83.2 per cent to come up to composite the capitalization ratio of 9.98, which you ran into 10. How did you derive the 16.8?

Mr. Epps: They are weight factors.

A. They are weight factors. I started, of course, with the fact that in the case of the Pennsylvania the debt is very large.

By Mr. Riely:

Q. Yes.

A. Relative to volume. I can't remember what it was.

Q. We are going to come to that in a moment.

A. Keeping that in mind it was not appropriate to use the Pennsylvania's capital structure because it is unbalanced, undue amount of debt. Therefore I looked to the capital structures of the 12 railroads which I had identified as being the best and most successful railroads in the United States.

Commissioner Catterall: Is that a normal and
page 593 } proper debt ratio?
The Witness: Yes.
Commissioner Catterall: Can you give that figure now?
The Witness: Well, I expressed it in terms, not of debt—of the balance sheet, but rather of the income flow.
Mr. Riely is referring to the fact that I weighted the five per cent by 16.8 and the 83 per cent, I am sorry, the 12.5 by 83 per cent. That means that the debt ratio, whatever it was, let's assume it was 40 per cent, was such that it absorbed 16.8 per cent of the total available income.
Another way of stating the same thing is that 16.8 per cent of the gross income being taken to pay bond interest. The bond interest was being covered about five times over. That was typical. The capital structure of the better railroad. So I took that as the norm.
Going now to the two sentences that you wanted me to read.

By Mr. Riely:
Q. Yes, sir.
A. The division of income between debt and equity of the 12 railroads averaged over 15 years is accepted as representing the normal capital structure which would
page 594 } be established by the buyers of the Pennsylvania Railway property. Income absorbed by debt requirements of such a capitalization is 16.8 per cent of income available for fixed charges. 83.2 per cent is available to the common equity.
Q. And that is the legend on the table that we just outlined?
A. That is correct.
Q. I believe Commissioner Catterall asked you for the actual debt ratio of the Pennsylvania and you stated you could find it?
A. I hope so.

Commissioner Catterall: I don't really insist on that. I think we have gotten off on a side track for the moment.
Mr. Riely: Thank you.

By Mr. Riely:
Q. I think I had just gone to page 11, Doctor, of your prepared testimony.
The last sentence on that page. "Although the unit method

is better it is possible to reach an equivalent and equally reasonable result by use of other appraisal methods generally of the kind which have been used by the State Corporation Commission." The first part of that sen-
page 595 } tence, I believe you mean that no matter what method you use for the valuation of property, if you use it correctly and accurately you reach the fair and proper result which would be in essence the same result.

I am sorry, I am on page 12, Doctor.

A. I was trying to find the passage and at the same time comprehend your question.

Q. I apologize.

In other words, the fair market value of a property does not depend upon choice of appraisal methods?

A. It does not, no.

Q. If you use the method in the proper manner you get the right result?

A. Well, the difficulty with that statement is that it implies the use of a method as a formula. With the reservation that I do not look on any method as being a formula and do not believe that you can depend on the formula to give you a proper result, I accept your statement.

Q. Now, the last phrase.

On page 12. "What other kinds of appraisal methods were used by the State Corporation Commission in making its assessment for 1968 of the Norfolk and Western track properties?" Do you know?

page 596 } A. I did not intend to be that specific. I intended here merely to say that it is possible to reach an equivalent and equally reasonable result by what is referred to generally as the "inventory method" looking to cost.

Q. But you don't know what the Commission did?

A. I do not know specifically what they did.

Q. And so turning to page 23 at the top of the page where earnings have some reasonable relationship with cost, original and current cost less depreciation are useful aids to judgment in estimating market value. This method is, of course, used by the State Corporation Commission for the reason that Virginia has not adopted the unit method."

Again, you don't know really what methods the Commission used, do you?

A. Other than that they are in a category, what I refer to here as "cost methods."

Dr. J. Rhoads Foster

Q. And if you were told that the Commission in its 1968 assessment used merely a reasonable cost less 20 per cent depreciation without regard to earnings and without regard to stock and debt volume would it be your conclusion that a result could be reached that was equivalent and equally reasonable to a determination on the unit method that have been advocated?

A. My conclusion would be either such a result
page 597 } could be reached, but I am strongly of the
opinion that in order to provide increased assurance that the result would be consistent with the concept and standard of fair market value, that there ought to be consideration of other evidence.

Q. And if that result would reach it, if a fair result were reached by considering cost less 20 per cent depreciation only without examining other elements, you said it would be sheer concidence?

A. I assume you are asking a hypothetical question.

Q. Yes.

A. On that basis the answer might be in the affirmative.

Q. Now, on page 19 of your testimony. Now, the sentence beginning in the second line, "But it is equally true that without the tangible property assembled as an operating entity the franchise would have little or no value." Would it not be equally true that with the tangible property assembled as an operating entity the franchise would have substantial value?

A. With the tangible property assembled as an operating entity the franchise may have substantial value.

Mr. Riely: Thank you. I have no further questions, Doctor.

The Witness: Thank you.
page 598 } Commissioner Catterall: Any other questions
of this witness?

Mr. Shannon: I have several questions I would like to ask the Doctor, if I might.

CROSS-EXAMINATION

by Mr. Shannon:

Q. Dr. Foster, on page 21, I believe, correct, page 18.

Mr. Riely: Excuse me.

Mr. Shannon: Page 18.

Dr. J. Rhoads Foster

You referred to the term "bare bones." Let me ask you a hypothetical question.

Suppose you have a line of railroad assembled between, say points A and B and the Golden Spike has been driven but no trains have yet operated over that line. What would be the fair market value or the fair value of the property? Would it be the components of the property or would it be the line assembled?

The Witness: Certainly it would be the line assembled. If your hypothetical question assumes that a valid decision has been made to commit capital to operating property that property must be valued not on disassembled but on the assembled basis. I think your question was what page 599 } would be the value.

By Mr. Shannon:

Q. I don't mean in terms of dollars and cents, of course.

A. I understand. A generalized answer is that the value of such a property is equal to the amount of capital which has just been committed. I gave you that answer because I assumed that the decision to commit the capital is made on the basis of a rational expectation that the character of the market, the revenue, the earnings, makes that commitment of capital appropriate and to a rational, that the decision to commit the capital is rational. That is the general answer. It is, of course, true, that in particular circumstances the expectation of income may be above that level which is merely sufficient to attract the capital. In other words, the expectation of the return may be above the cost of the capital, but if the investment is prudently made it is not likely to be below the cost of the capital.

Q. In this connection is it hope and expectation of prospective earnings something apart and separate from going concern value?

A. In answer on economic grounds, and this recalls a discussion with Mr. Riely, is that since the property page 600 } or the interest price must be a going concern in order to have this expectation of earnings which are currently being valued, the separation is arbitrary. We may, however, reach a different answer in terms of definition of going concern for legal purposes. One or another. And within that framework going concern value is a term attributable to a value which is over and above, or in excess of the cost of the property, referring to your hypothetical situation.

Dr. J. Rhoads Foster

Q. Well, now, continuing with my hypothetical example. Suppose, before the railroad begins operation, instead of assuming the sale of the line, say, to another line, suppose the State, the sovereign, would buy the railroad, and assuming the State, the sovereign, doesn't have to acquire a franchise, because that is inherent, I believe, in the sovereign, what would be the fair value of the railroad?

A. I think we have already indicated the answer in that a fair market value is not dependent upon identity of a purchaser.

Q. So then the same elements of fair value would be present in either situation?

A. Yes, sir.

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

Commissioner Catterall: Any other questions?

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Mr. Epps: I would like to make a few on redirect.

Commissioner Catterall: All right, sir.

REDIRECT EXAMINATION

By Mr. Epps:

Q. You are familiar, I suppose, that we are not valuing the Pennsylvania Railroad today, are you not Dr. Foster?

A. Yes, Mr. Epps.

Q. Now, this Ohio case. We are not valuing anything under the Ohio law today, you would agree with that?

A. I do agree.

Q. Referring to the decision in the Ohio case, to use two points, I have not studied it and I assume you haven't. Do you have a copy of it?

A. I do have a copy.

Q. On page 90 of the decision, following the syllabus two that Mr. Riely quoted, if you will read the rest of that page with me the case says this, does it not? "There is another reason why the decision in the instant case is unlawful. A substantial part of the property of the Pennsylvania Railroad is real property." You are aware, are you not, that the real property in Virginia is assessed separately and is not a part of those proceedings?

page 602 }

A. I have been so informed.

Q. Yes.

Then continuing on the Ohio case, "Section 2, Article 12

of the Ohio Constitution provides in part 'land and improvements shall be taxed by uniform rule according to value.' "

Then Section 5715.01 of the revised Code provides, "So far as pertinent the taxable value of all real propety shall not exceed 50 per cent of true value."

There are no such constitutional or statutory provisions in Virginia applicable to these proceedings that you know about, are there, sir?

A. I know only what I have been told.

Q. Do you know some of the things you are being asked?

A. I am not conversant with either the Constitution or the Code of Virginia.

Q. You would be very much surprised if identical provisions were in the Virginia law to those that I have shown you in the Ohio law?

A. It would be an amazing coincidence.

Q. Thank you, sir. All right, sir.

Mr. Riely inquired at some length as to the
page 603 } effect of inflation on the railroads. In the case of individuals, let's say, J. Rhoads Foster or A. C. Epps the effect of inflation is reflected in income that creates higher taxes on individuals, doesn't it, the same dollars? The same purchasing power from year to year and with a graduated income tax you pay more taxes?

A. Well, if as a result of inflation you are fortunate enough to have increased earnings or salary, salary in my own case, when existing income tax structure results in a larger number of dollars of income of income tax.

Q. Income tax?

A. Yes.

Q. Yes, sir, on the graduated scale?

A. Yes, sir.

Q. Yes, sir.

I was quoting the individual there with the flexible business or adaptable business which you used in your reply to Mr. Riely.

I have no further questions.

Mr. Riely: May I ask Dr. Foster one final question?

Commissioner Catterall: One.

Mr. Riely: I think it will be one this time, too.

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