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## Minnesota Rate Cases

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## The Minnesota Rate Cases \*

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The decision of the United States Supreme Court in the Minnesota Rate Cases,<sup>1</sup> announced on June 9th, 1913, will constitute a most notable precedent. The court holds (1) that the power of a state to fix rates for its internal commerce is subject to no restriction by virtue of the fact that the exercise of such authority may indirectly affect rates established by the carriers for related interstate traffic. On the other hand, the court commits itself to the view (2) that it is competent for Congress, under the commerce clause, to assert authority over state as well as interstate commerce whenever the two are, in its judgment, so interblended that such action is essential to the full and efficacious exercise of the federal authority. It is further held (3) that in determining the sufficiency of rates prescribed by governmental authority for observance by a public utility, the value of the property devoted to the service is to be ascertained with reference to the fair average of the normal market value of property in the vicinity having a similar character. A number of related principles of only less importance than the foregoing are likewise established. In view of the controlling force which the decision will exert, immediately and prospectively, in the delimitation of the relative authority of the State and Federal Governments over commerce and the determination of the legality of charges imposed by governmental authority and challenged as confiscatory, a brief review of its essential features may not be untimely.

The suits which reached a conclusion in this decision were instituted by stockholders of the Northern Pacific Railway Company, the Great Northern Railway Company and the Minneapolis & St. Louis Railroad Company for the purpose of assailing the constitutionality of certain acts of the Minnesota

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\*The decision has not at the date of going to press, been published. The above comments are based upon a copy of the decision furnished by the Clerk of the United States Supreme Court.

<sup>1</sup> Simpson v. Shepard, (June 9, 1913) U. S.

Legislature and orders of the Minnesota Railroad and Warehouse Commission reducing rates for the transportation of freight and passengers between points within the State of Minnesota. The attack was based, 1st upon the contention that the acts and orders in question constituted an unconstitutional interference with interstate commerce and 2nd, upon the claim that they were confiscatory and, therefore, violative of the constitutional prohibition against the taking of property without due process of law. Both contentions were sustained by the United States Circuit Court for the District of Minnesota in a sweeping decision,<sup>2</sup> from which appeals were taken to the United States Supreme Court.

The facts which gave rise to the first and most striking of the carrier's contentions may be briefly outlined. The Minnesota-North Dakota boundary line is flanked on either side by cities which are normally in competition one with another in the receipt and distribution of freight. As the result of this juxtaposition and the inconsiderable differences in distance from St. Paul, Minneapolis and other centers, they are necessarily placed upon a parity by the railway companies in the matter of rates. Duluth, Minnesota, and Superior, Wisconsin, upon the east present an analogous situation. In compliance with acts of the Legislature of Minnesota and administrative orders of the State Railroad and Warehouse Commission, reductions were made in freight rates from St. Paul and Minneapolis to Moorhead, Minnesota, and other points lying adjacent to the westerly boundary of Minnesota, from St. Paul and Minneapolis to Duluth, and from Duluth to the western points previously designated. Simultaneously with this action, identical reductions were made by the carriers in the interstate rates from the same points of origin to the cities lying upon the Dakota side of the boundary line, and to and from Superior, Wisconsin, this course being compelled by the relationship between the several points of origin and destination as outlined. For a brief period following the reduction in the state passenger fares, efforts were made to maintain interstate fares upon the basis theretofore in effect, but for obvious reasons, these efforts

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<sup>2</sup> Shepard v. Northern Pacific Ry. Co., (1911) 184 Fed. 765.

were unavailing and the carriers were soon compelled to reduce interstate fares to the basis of the combinations upon the boundary cities. The lowering of the state rates and fares also made necessary corresponding reductions in rates and fares to and from numerous points in various other states. For the purposes of this commentary, a more extended discussion of the facts involved in these proceedings will not be necessary.

The structure of the opinion is worthy of detailed consideration. After a concise preliminary review of the controlling facts involved in the case, the court analyzes the problems before it and states the issues. Then follows a discussion of the relative authority of the State and Nation over commerce, the well-known principles being reannounced.

The authority of the Nation over interstate commerce is supreme and plenary, and, as to those subjects which require a general system or uniformity of regulation, the power is exclusive.<sup>3</sup>

In matters admitting of diversity of treatment according to the special requirements of local conditions, the states may act directly upon interstate commerce in the absence of inconsistent federal action.<sup>4</sup>

Within the field of exclusive powers, the inaction of Congress evidences an intent that commerce be free and untrammelled;<sup>5</sup> within the field of concurrent powers, the silence of the federal power is indicative of an intent to acquiesce in the

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<sup>3</sup>The Passenger Cases, (1849) 7 How. U. S. 283; *Hale v. De Cuir*, (1877) 95 U. S. 485; *Wabash, Etc. Ry. Co. v. Ill.*, (1886) 118 U. S. 557; *Bowman v. C. & N. W. Ry. Co.*, (1887) 125 U. S. 465; *Schollenberger v. Pa.*, (1897) 171 U. S. 1; *Atlantic Coast Line v. Wharton*, (1907) 207 U. S. 328; *Okla. v. Kansas Natural Gas Co.*, (1911) 221 U. S. 229; *Louisville & Nashville R. Co. v. Cook Brewing Co.*, (1912) 223 U. S. 70.

<sup>4</sup>*Cooley v. Board of Port Wardens*, (1851) 12 How. U. S. 229; *Willson v. Blackbird Creek Marsh Co.*, (1829) 2 Pet. U. S. 245; *Sherlock v. Alling*, (1876) 93 U. S. 99; *Escanaba Bridge Co. v. Chicago* (1882) 170 U. S. 678; *Smith v. Alabama*, (1887) 124 U. S. 465; *Western Union Tel. Co. v. James*, (1896) 162 U. S. 650; *Hennington v. Ga.*, (1896) 163 U. S. 299; *N. Y., N. H. & Hartford R. Co. v. New York*, (1897) 165 U. S. 628; *C., M. & St. P. Ry. Co. v. Solan* (1898) 169 U. S. 133; *M. K. & T. Ry. Co. v. McCann* (1899) 174 U. S. 580; *La. v. Texas*, (1900) 176 U. S. 1; *Mo. Pac. Ry. Co. v. Larabee Mills*, (1909) 211 U. S. 612; *Atlantic Coast Line v. Mazursky*, (1910) 216 U. S. 122.

<sup>5</sup>*Wabash, Etc. Ry. Co. v. Ill.*, *supra*; *Bowman v. C. & N. W. Ry. Co.*, *supra*; *Leisy v. Hardin*, (1890) 135 U. S. 100; *Covington, etc. Bridge Co. v. Kansas*, (1894) 154 U. S. 204; *McNeil v. So. Ry. Co.*, (1906) 202 U. S. 543; *L. & N. Ry. Co. v. Cook Brewing Co.*, *supra*.

exercise of authority over interstate commerce by the state appropriately to its territorial jurisdiction.<sup>6</sup>

The state has exclusive control over its completely internal commerce,<sup>7</sup> subject only to the qualification that the federal power is paramount when interstate and intrastate operations are commingled.<sup>8</sup>

This portion of the opinion is a well nigh perfect exposition of the divided control over commerce. The leading cases are marshalled with consummate skill.<sup>9</sup>

The court then comes directly to the main point in issue and rejects without qualification the contention of the carriers that, while the state ordinarily has power to fix rates for its

<sup>6</sup> *Willson v. Blackbird Creek Marsh Co.*, *supra.*; *Gilman v. Philadelphia*, (1865) 3 Wall. U. S. 713; *Cooley v. Board of Port Wardens*, *supra.*; *Sherlock v. Alling*, *supra.*; *Reid v. Colorado*, (1902) 187 U. S. 138; *Pa. R. Co. v. U. S.*, (1903) 191 U. S. 477.

<sup>7</sup> *Gibbons v. Ogden*, (1824) 9 Wheat. U. S. 1, *Semble*; *C. B. & Q. Co. v. Iowa*, (1876) 94 U. S. 155; *Dow v. Biedelman*, (1888) 125 U. S. 680; *Kidd v. Pearson*, (1888) 128 U. S. 1; *Regan v. Farmers' Loan & Trust Co.*, (1893) 154 U. S. 362; *Regan v. Merc. Trust Co.*, (1894) 154 U. S. 413; *S. L. & S. F. Ry. Co. vs. Gill*, (1894) 156 U. S. 649; *Smyth v. Ames*, (1897) 169 U. S. 466; *Austin v. Tenn.*, (1900) 179 U. S. 343; *Mo. Pac. Ry. Co. v. Kan.*, (1909) 216 U. S. 262.

<sup>8</sup> *St. L. & S. W. Ry. Co. v. Ark.*, (1910) 217 U. S. 136; *B. & O. R. Co. v. Interstate Commerce Commission*, (1910) 221 U. S. 612; *So. Ry. Co. v. U. S.*, (1911) 222 U. S. 20.

<sup>9</sup> If a criticism were ventured, it might be said that the confusion created by prior expressions of the courts in laying down the doctrine of concurrent powers is not entirely removed. It seems unfortunate that the courts have recognized in express terms the right of the state to regulate interstate commerce as such, even though the exercise of the right is limited to matters of local concern and is not permitted to survive conflicting federal action. Upon strict principle, it would seem that the federal power over commerce among the several states and with foreign nations must be held exclusive. If the state, in the exercise of its jurisdiction over matters of domestic concern, expressly reserved to it under the Constitution, takes action which would be appropriate for Congress pursuant to the commercial power, the fact does not warrant the assertion that the state thereby has jurisdiction over interstate commerce. While the authority of the state and nation may be operative upon the same subject matter and with similar effect, the source and nature of the respective powers are entirely distinct. This is recognized inferentially by the court in the following sentence: "Where the subject is peculiarly one of local concern, and from its nature belongs to the class with which the State appropriately deals in making reasonable provisions for local needs, it cannot be regarded as left to the unrestrained will of individuals because Congress has not acted, although it may have such a relation to interstate commerce as to be within the reach of the federal power." This expression should help to remove much of the confusion which has been engendered through inexact treatment of the doctrine of concurrent powers.

domestic commerce, the power cannot be exercised inconsistently with the standard of rates fixed by the carriers for related interstate traffic. In the words of the court:

“To say that this power exists, but that it may be exercised only in prescribing rates that are on an equal or higher basis than those which are fixed by the carrier for interstate transport is to maintain the power in name while denying it in fact. It is to assert that the exercise of the legislative judgment in determining what shall be the carrier’s charge for the intrastate service is itself subject to the carrier’s will. But this state-wide authority controls the carrier and is not controlled by it; and the idea that the power of the State to fix reasonable rates for its internal traffic is limited by the mere action of the carrier in laying an interstate rate to places across the state’s border, is foreign to our jurisprudence.

“If this authority of the state be restricted, it must be by virtue of the paramount power of Congress over interstate commerce and its instruments; and, in view of the nature of the subject, a limitation may not be implied because of a dormant federal power, that is, one which has not been exerted, but can only be found in the actual exercise of federal control in such measure as to exclude this action by the State which otherwise would clearly be within its province.”

The logic of this conclusion is inexorable. It is inconceivable that the state’s authority, in fixing rates for the movement of its domestic traffic, is to be fettered by rates voluntarily established by the carriers for the movement of interstate traffic and the propriety of which has perhaps never been determined by governmental authority. If the contention were admitted, the authority of the state within its own boundaries could readily be rendered impotent by the simple device of linking state with interstate rates. The court’s conclusion is unmistakably supported by numerous prior adjudications of the same high tribunal<sup>10</sup> and identical results have been reached in a large

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<sup>10</sup> *Dow v. Biedelman*, supra.; *Regan v. Merc. Trust Co.*, supra.; *St. L. & S. F. Ry. Co. v. Gill*, supra.; *Smyth v. Ames*, supra.; *Mo. Pac. Ry. Co. v. Kan.*, (1910) 216 U. S. 262.

number of recent cases arising in the federal courts and presenting the same issue.<sup>11</sup>

The court further supports its decision by referring to the first section of the Act to Regulate Commerce<sup>12</sup> which contains an express disclaimer of jurisdiction over state traffic. This circumstance, in the mind of the court, renders it self-evident that Congress has not sought to establish a "unified control over interstate and intrastate rates."

Now follows the most striking portion of the opinion, wherein the court rules that, to insure the fullest exercise of the federal authority, it is competent for Congress under the commerce clause to assume jurisdiction over state as well as interstate rates whenever the two are, in its judgment so inter-related that such action is essential to the maintenance of the federal authority in its full scope. The words of the court are as follows:

"To suppose, however, from a review of these decisions. that the exercise of this acknowledged power of the State may be permitted to create an irreconcilable conflict with the authority of the nation, and that through an equipoise of powers an effective control of interstate commerce is rendered impossible, is to overlook the dominant operation of the Constitution which, creating a Nation, equipped it with an authority, supreme and plenary, to control national commerce and to prevent that control, exercised in the wisdom of Congress, from being obstructed or destroyed by any opposing action. . . . But these considerations are for the practical judgment of Congress in determining the extent of

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<sup>11</sup> *St. L. & S. F. Co. v. Hadley*, (1909) 168 Fed. 317; *O. R. & N. Co. v. Campbell*, (1909) 173 Fed. 957; *Same v. Same*, (1911) 189 Fed. 182; *Southern Pacific Co. v. R. R. Commission of Nev.*, (1911) 184 Fed. 358; *Love v. Railroad Co.*, (1911) 185 Fed. 321; *L. & N. R. Co. v. Siler*, (1911) 186 Fed. 176; *The Ark. Rate Cases*, (1911) 187 Fed. 290; *S. P. Co. v. R. R. Commission of Cal.*, (1912) 193 Fed. 699. In the case last cited rates prescribed by the California Railroad Commission between San Pedro and Los Angeles were attacked upon the ground of interference with interstate commerce. The court refused to sustain the claim, stating its conclusion in the following terms: "While a state may not competently invade the domain of Congress by directly undertaking to regulate interstate commerce, yet, having the undoubted power to regulate its internal commerce, it may, and not infrequently does, adopt measures to that end which may assert a modifying effect upon interstate rates without thereby transcending the rightful limits of its authority."

<sup>12</sup> Act of June 29, 1906, C. 3591, 34 Stat. 584.

the regulation necessary under existing conditions of transportation to conserve and promote the interests of interstate commerce. If the situation has become such, by reason of the interblending of the interstate and intrastate operations of the interstate carriers, that adequate regulation of their intrastate rates cannot be maintained without imposing requirements with respect to their intrastate rates which substantially affect the former, it is for Congress to determine, within the limits of its constitutional authority over interstate commerce and its instruments the measure of the regulation it should supply.<sup>13</sup>

While it may truly be said that this expression can have the force of obiter dictum only, it would be idle to deny its tremendous import when so deliberately announced. We may see this result foreshadowed in the case of *St. Louis and Southwestern Railway Co. v. Arkansas*,<sup>14</sup> where the attempted asser-

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<sup>13</sup>The Circuit Court had laid it down as an established principle that the authority of the state over its internal commerce may not be asserted if interstate commerce is thereby affected. That court said (1911, 184 Fed 765, 772) "on the other hand, the laws of a state or the orders of its commissions relating to its interstate commerce which by their necessary or natural or probable operation have the effect substantially to burden interstate commerce are violative of the commercial clause of the Constitution and void." In support of its position, the court cites a number of decisions of the Supreme Court, *inter alia*, *Henderson v. The Mayor of New York, etc.*, (1875) 92 U. S. 259; *Hall v. de Cuir*, (1877) 95 U. S. 485; *Western Union Telegraph Company v. Pendleton*, (1881) 122 U. S. 374; *Wabash, etc., Ry. Co. v. Illinois*, (1886) 118 U. S. 557; *Bowman v. Chicago and Northwestern Railway Co.*, (1888) 125 U. S. 465; *Houston, etc. Ry. Co. v. Mayes*, (1906) 201 U. S. 321, but it is to be noted that the decisions cited fail to support the principle asserted. In each instance the action of the state was not directed against its domestic commerce, but was operative immediately upon interstate commerce, and was held void because without the field of concurrent powers or because in conflict with asserted federal authority. It is believed that in but a single instance has the Supreme Court stricken down the act of a state operative in terms upon its domestic commerce only upon the ground of repugnancy to the commerce clause, *viz.*, *St. Louis & Southwestern Railway Co. v. Arkansas*, (1910) 217 U. S. 136. In this case the court condemned a reciprocal demurrage statute of the State of Arkansas, operative only upon state traffic, upon the ground that the penalty imposed for failure to furnish cars to the state shippers directly compelled the carrier to discriminate against shippers desiring cars for interstate movement. The case apparently recognized the status of the carrier's equipment as a unit used interchangeably in state and interstate operations and, therefore, exclusively subject to the paramount federal power. Curiously enough, the lower court in the principal case failed to rely upon this decision.

<sup>14</sup> (1910) 217 U. S. 136.

tion of state authority over the instruments of state and interstate traffic was rendered abortive. It is suggested in *Interstate Commerce Commission v. Illinois Central Railway Company et al.*,<sup>15</sup> in which the court sustained the authority of the Interstate Commerce Commission to prescribe rules for the distribution of coal cars among coal producers. It is even more directly anticipated in the case of *Southern Railway Company v. United States*,<sup>16</sup> in which it was held that the Federal Safety Appliance Act applies to cars used interchangeably in moving state and interstate traffic over a railroad constituting a highway of interstate commerce. Beyond all question, these decisions mean that eventually the jurisdiction of the states will be narrowed and the Federal power immensely enhanced.

The court makes it clear that this result is to be reached not because the federal authority may properly be extended to the domestic affairs of the state as such, but because the intermingling of matters which are alike of state and federal concern requires a comprehensive assertion of the federal authority. The court says:

"There is no room in our scheme of government for the assertion of state power in hostility to the authorized exercise of federal power. The authority of Congress extends to every part of interstate commerce, and to every instrumentality or agency by which it is carried on; and the full control by Congress of the subjects committed to its regulation is not to be denied or thwarted by the commingling of interstate and intrastate operations. This is not to say that the Nation may deal with the internal concerns of the State, as such, but that the assertion by Congress of its constitutional power to regulate interstate commerce is not limited by the fact that intrastate transactions may have become so interwoven therewith that the effective government of the former incidentally controls the latter. This conclusion necessarily results from the supremacy of the national power within its appointed sphere."

The judicial statesmanship of the United States Supreme

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<sup>15</sup> (1910) 215 U. S. 452, 474.

<sup>16</sup> ((1911) 222 U. S. 20.

Court could not be evidenced more conclusively than by the words just quoted.

The conclusions thus reached by the court in the principal portion of its opinion would seem to have been inevitable. There cannot exist, in the very nature of our federal scheme of government, any hiatus between the state and the federal jurisdictions. The Interstate Commerce Commission has no authority over state commerce and, consequently, if the right of the state to control its local traffic were denied, a great gulf between the authority of the state and the nation would have been opened and state rates, at least when related to interstate rates, would be immune from governmental interference. There can be no doubt, as the court concedes, that the exercise by the state of its lawful power over domestic affairs may sometimes affect interstate commerce to a substantial degree, but this circumstance cannot serve to invalidate the state's authority. The objection thus presented does not go to the jurisdiction of the state,—it rather addresses itself to the wisdom of the divided control over commerce. The announcement of the court that it is competent for Congress to cast its authority over intrastate commerce when so intermingled with interstate affairs that such action is essential to the effective exercise of the federal authority, represents a larger view of the scope of congressional power under the Constitution than has heretofore been fully recognized. Herein lies the tremendous significance of the decision considered with reference to its ultimate effect.

The concluding portion of the opinion deals with the question of confiscation, and may be very briefly considered.

The court holds at the outset that the value of the outstanding stocks and bonds of the carriers cannot be used as an element in determining the value of operating property or as a basis of rate making, sustaining the conclusion of the lower court in this respect. The court likewise finds no fault with the conclusion of the master, confirmed by the lower court, that rates cannot be fixed with reference to the original investment of the carriers. It is in fact expressly stated that "in ascertaining the present value, we are not limited to the consideration of the amount of the actual investment." The fundamental principle is laid down that in determining the sufficiency of rates prescribed by governmental authority for observance by a public utility, the value of the property devoted to the

service must be ascertained with reference to "the fair average of the normal market value of land in the vicinity having a similar character." The court refuses to allow an increase in value in excess of the increase in neighboring lands of like character devoted to other uses, stating that to permit of such an increase is to sanction results which depend upon mere conjecture.

In accepting present value as the basis with reference to which the sufficiency of rates is to be determined (and by present value is apparently meant the present-day cost of reproduction less depreciation where such deduction is appropriate),<sup>17</sup> the court recognizes the right of the carrier to a return upon the unearned increment in the value of its property<sup>18</sup> and holds at the same time that the original cost of plant is not a certain measure of present worth.

The lower court had accepted values of rights of way and terminal properties largely in excess of the admitted value of adjoining lands of similar character, upon the theory that a special "railway value" was present which could not be found in neighboring areas. The Supreme Court refuses to conceive of a distinctive "railway value," asserting that here again the carriers were entering into the speculative field.

In estimating the present values of railway properties subject to deterioration, proper deductions must be made to take care of depreciation. In so holding, the court follows established precedents, legal as well as economic.

In seeking to apportion the values of property between state and interstate operations (a problem now vexing all railroads and railroad commissions), the gross revenue derived from each source is not an appropriate criterion. Value is not to be measured by gross earnings, and it is obvious that when gross revenues are accepted as the basis for distributing property values between the two divisions of traffic, real value is entirely ignored. In the words of the court:

"The value of the use, as measured by return, cannot be

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<sup>17</sup> *Smyth v. Ames*, supra.; *San Diego Land and Town Co. v. National City*, (1899) 174 U. S. 739; *San Diego Land and Town Co. v. Jasper*, (1902) 189 U. S. 439.

<sup>18</sup> *Willcox v. Consolidated Gas Co.* (1909) 212 U. S. 19.

made the criterion when the return itself is in question. If the return, as formerly allowed, be taken as the basis, then the validity of the State's reduction would have to be tested by the very rates which the State denounced as exorbitant. And, if the return as permitted under the new rates be taken, then the State's action itself reduces the amount of value upon which the fairness of the return is to be computed."

This reasoning is unanswerable. The court takes a sound view of the problem in declaring that, in dividing property values between the different classes of traffic, there should be assigned to each business that proportion of the total value of the property which will correspond to the extent of its employment in that business. While these words may properly give rise to criticism, because they fail to establish a specific standard, it is evident that the court intends to approve a segregation of values in accordance with relative physical user.

The court likewise refuses to approve of the basis accepted by the lower court in apportioning operating expenses between state and interstate traffic.<sup>19</sup> The lower court found that the cost of conducting state traffic amounted to two and one-half times the cost of carrying on interstate operations, basing its conclusion upon expressions of opinion from experienced railway officials. The Supreme Court holds that in accepting this basis, the realm of mere conjecture had again been entered. The court says:

"We are of opinion that on an issue of this character, involving the constitutional validity of state action, general estimates of the sort here submitted, with respect to a subject so intricate and important, should not be accepted as adequate proof to sustain a finding of confiscation."

The court concedes the difficulty of the problem presented, but insists that those who assail the constitutionality of state acts and orders are bound to establish their case.

The court finally reaches the conclusion that because of the deficiency in proof by reason of errors in the methods followed in determining the value of railway properties, in apportioning such values between state and interstate traffic and in segre-

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<sup>19</sup> Chicago, M. & S. P. Ry Co. v. Tompkins (1900) 176 U. S. 167.

gating operating expenses between the two branches of the service, confiscation had not been established in the case of the Northern Pacific and Great Northern Railway companies. As to the Minneapolis and St. Louis Railway Company, it appeared that, notwithstanding the improper bases employed, it was sufficiently clear that the rates fixed would be confiscatory.

Speaking generally of the opinion in so far as the question of confiscation is concerned, it may be said that the decision clears the atmosphere in great measure and that the main principles established will unquestionably find general approval. While many troublesome problems still await settlement, at least it may be said that numerous difficulties, which have thus far interfered with their solution, have been removed.

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