Privy Council Appeal No. 25 of 1922.

The Grand Trunk Railway Company of Canada - - - *Appellants*

v.

The King - - - - - - - - *Respondent*

FROM

THE SPECIAL TRIBUNAL CREATED FOR THE ASCERTAINMENT OF THE VALUE OF THE PREFERENCE AND COMMON STOCKS OF THE GRAND TRUNK RAILWAY COMPANY.

REASONS FOR JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 10TH NOVEMBER, 1922.

Present at the Hearing:

THE LORD CHANCELLOR (VISCOUNT BIRKENHEAD).
VISCOUNT CAVE.
LORD SHAW.
LORD PARMOOR.
LORD CARSON.

[*Delivered by* VISCOUNT BIRKENHEAD.]

This is an appeal by special leave from the award, dated the 7th September, 1921, of a Tribunal of Arbitration created by an agreement, which was confirmed by statute, for the purpose of determining the value of the preference and common stocks of the appellant Company for the purpose of the acquisition of the Grand Trunk Railway System by the Canadian Government.

The appellant Company was founded in 1852 under a Canadian Charter, and was the pioneer of the great railway systems of Canada. It was financed wholly by British capital and the Board of Directors has always met in London. The stock, which is largely held in England, is all fully paid up.

The Company from time to time extended its sphere of operations so that by the date of the agreement in 1920 the Grand Trunk Railway System, which begins at Montreal, consisted of about 4,800 miles of railway, with services to Chicago, New York, Boston, Portland in Maine, New London in Connecticut, and with many places on the Great Lakes. The system also included steamship lines, ferries, bridges, elevators, terminal facilities, hotels, etc., used in conjunction with the railways. These enterprises were either vested in the Company, or in subsidiary companies which the Company controlled either by the direct or indirect ownership of the shares or a majority of them, or by means of leases. The Vermont Central Railway, though controlled and largely owned by the Company, was not a part of the system, but including that railway, some 1,700 miles of the tracks owned or controlled by the Company are in the U.S.A., and about 67 per cent. of the rate receipts are said to be directly or indirectly affected by the rates prevailing in the U.S.A.

In 1904 the Grand Trunk Pacific Railway Company, which was wholly owned by the appellant Company, was formed for the purpose of carrying out an agreement with the Canadian Government, whereby that Government undertook the construction of a railway line called the Transcontinental Line from Quebec to Winnipeg, and the Grand Trunk Pacific Company was to complete the line from Winnipeg to Prince Rupert on the coast of British Columbia. These lines, when completed, were to be operated by the Grand Trunk Pacific. There were also formed two other Companies, the Grand Trunk Pacific Branch Lines Company and the Grand Trunk Pacific Development Company, both of which were to be controlled by the appellant Company, and to be operated so as to conduce to the success of the scheme.

The lines so projected were completed by 1916, but the cost was so great that the Pacific Company refused to operate the Transcontinental line. As it had access to Winnipeg by the Grand Trunk System and the Transcontinental line, the appellant Company was able to operate a through line from Montreal to Prince Rupert. The Grand Trunk Pacific never was able to meet its operating expenses, and, after various sums had been granted by the Canadian Government for its assistance, the dates and amounts of which are not material, that Government was notified early in 1919 that the Pacific Company could no longer operate, and the Grand Trunk Pacific System was taken over by a Government Receiver. Since that date the deficit has increased.

In 1916 a Commission known as the Drayton-Acworth Commission, was appointed by Order in Council to enquire into the whole railway position. It reported in favour of the Government taking over the Grand Trunk System on certain terms, but negotiations along those lines failed.

Subsequently the Grand Trunk Railway Acquisition Act, 1919 (10 Geo. V, c. 17) was passed enabling the Government to negotiate and enter into an agreement to acquire the entire

capital stock (except the 4 per cent. guaranteed stock) of the appellant Company upon terms to be arranged under the agreement.

At that date and at all material times, the stock of the appellant Company amounted to £49,573,492, divided as follows :

	£
4 per cent. guaranteed stock	12,500,000
First preference 5 per cent. stock ..	3,420,000
Second preference 5 per cent. stock ..	2,530,000
Third preference 4 per cent. stock ..	7,168,055
Common stock	23,955,437
	£49,573,492

The outstanding debenture stock amounted to £31,926,125.

Following upon the Act of 1919, an agreement was entered into between H.M., represented by the Minister of Railways and Canals, and the appellant Company acting by virtue of a meeting of shareholders and debenture stockholders held on the 19th February, 1920.

This agreement was, with a slight variation, confirmed by the Act 10 & 11 Geo. V, c. 13. Clause 1 and the First Schedule of the Agreement, as varied by Section 1 of the Act 10 & 11 Geo. V, c. 13, defined the Grand Trunk System. By Clause 2 the Company undertook to use its best endeavours to cause the sale and delivery to the Government of the preference and common stocks then issued and outstanding. These stocks amounted to the nominal value of £37,073,492. By Clause 3 the Government undertook to guarantee the payment of dividends on the guaranteed stock and of interest on the debenture stock, the guarantees to take effect on the appointment of a Committee of Management (provided for by Clause 4), and forthwith on such appointment to be deposited with the High Commissioner for Canada in England. Upon such deposit being made, the voting powers of the holders of guaranteed and debenture stocks were to cease. By Clause 4 a Committee of Management was to be appointed to act until the preference and common stocks were transferred to or vested in the Government, when the Committee was to be discharged. Clauses 6, 7, 8 and 11 are in the following terms :—

> " The value, if any, to the holders thereof, of the preference and common stock shall be determined by a Board of three Arbitrators " :

and then, following upon the provision for appointing these arbitrators—

> " The Board of Arbitrators shall have full power and authority in respect of the control of the arbitration and the proceedings thereof, including the administration of oaths and in respect of the admission of evidence.
>
> " The award shall be made by the arbitrators, or a majority of them, within nine months from the appointment of the arbitrators, or within such further time as the Governor in Council may approve. The unanimous

award of the arbitrators shall be final, but should the award not be unanimous, and should notice of appeal be given by either party to the other within thirty days after the making of the award, an appeal therefrom, upon any question of law, shall lie . . . to the Judicial Committee of the Privy Council, if leave be granted by the said Committee. . . . .

" The value, if any, so determined shall not be greater than an amount on which the annual dividend at 4 per cent. per annum on the aggregate face value of the present guaranteed stock and the new guaranteed stock taken together would be $5,000,000 ; that is, the value, if any, so determined shall not exceed $64,166,666·66. The fixing of this limit shall not be taken by the arbitrators as any admission or indication that the value to be determined is the amount so fixed, or any other amount."

By Clause 12 the Company, upon the final determination of the value of the preference and common stocks, was to create non-voting 4 per cent. capital stock, to be called " new guaranteed stock," to the amount of the value so determined less such deductions as were authorised by the agreement. This stock was to be guaranteed by the Government and distributed among the holders of the preference and common stocks upon the transfer to or vesting in the Government of such stocks, in proportions to be determined by the arbitrators. By Clause 13 the new guaranteed stock was to be issued in exchange for the preference and common stocks. If these stocks or any part should not be transferred, power was given to declare the same to be vested in the Government, and then the new guaranteed stock in respect of such stocks was to be issued to the holders thereof on due application being made. By Clause 19 for the purposes of the valuation, the obligations of the Company as guarantors of any indebtedness of the Grand Trunk Pacific Railway Company, or of the Grand Trunk Pacific Branch Lines Company, or otherwise, and the claims of the Government against either of those Companies or any company forming part of the Grand Trunk Railway System were not to be treated as extinguished or affected by anything in the Act of 1919.

By Clause 20, in the event of the arbitrators considering that the market prices or quotations of the stocks were to be taken into consideration in establishing their value, they were not to take into account the fluctuations, if any, in the market prices or quotations caused by the negotiations or by the passing of the Act of 1919 or the execution of the agreement, but this provision was not to be taken to mean that the market prices or quotations were relevant matters to be inquired into by the arbitrators.

After the arbitration was commenced, provision was made for extending the time for award on certain terms embodied in an agreement dated the 13th May, 1921, and confirmed by the Act 11 & 12, Geo. V, c. 9.

The arbitrators selected for the purpose of the valuation were Sir Walter Cassels, Judge of the Court of Exchequer in Canada, who acted as chairman, Sir Thomas White, who was named by the Canadian Government, and the Hon. William

H. Taft (now Chief Justice of the U.S.A.), who was appointed by the Company.

The arbitrators sat and heard evidence and arguments for over eighty days. A vast amount of evidence was given as to the Company, its history, earnings, speculations and potentialities. During the course of the arbitration certain other evidence as to value of the appellant Company's physical assets was tendered on behalf of the appellant Company and rejected by a majority of the arbitrators for reasons stated in an interlocutory judgment dated the 7th February, 1921, and on the 7th September, 1921, the majority made an award that the stocks in question had no value, for reasons which they gave. The Hon. William H. Taft dissented, and assessed the value of the stocks at $48,000,000. Notice of appeal was given on behalf of the appellant Company on the 1st October, 1921, and on the 22nd December, 1921, by Order in Council, the appellant Company was given leave to appeal from the Award, and from the interlocutory decision of the 7th February, 1921.

The first and principal question to be determined is whether the arbitrators in excluding evidence as to the physical assets of the Company, were wrong in law; and, in considering this point, it is important to bear in mind both the question which the arbitrators had to determine and the principles on which they proceeded. The figure to be fixed by the arbitrators was (in the words of the agreement) the "value, if any, to the holders thereof, of the preference and common stock"; that is to say, of stock which ranked after debenture and guaranteed stock, aggregating £44,426,000, and after the other obligations of the Company. The valuation was necessarily to be made on the footing that the railway was taken over and would be carried on as a going concern; for a break up and sale of the assets was negatived by the statute law of Canada, and would have been contrary to the rights of the holders of prior securities. This being so, the arbitrators had to consider at an early stage of their proceedings upon what basis the valuation was to proceed. They arrived at the unanimous conclusion that the value of the stock was to be ascertained on the basis of the net earning capacity, both actual and potential, which should then be capitalised. This conclusion was expressed by the Chairman (Sir Walter Cassels) on the second day of the proceedings as follows:—

> "The agreement contemplates the continued operation of the railway system. The liabilities of the debenture stocks of the railway and other liabilities of the railway have been assumed. To have a valuation as if the system were disintegrated and broken up is to my mind not permissible. The true method of arriving at the value of the stock is in my judgment to ascertain the earnings of the railway in the past, properly applicable to dividends, and the potentialities of the future."

Mr Taft, the second arbitrator, clearly expressed the same view.

> "The whole stock of the railway (he said) is valuable or otherwise as the ownership and control of the physical property of the railway as

a going concern in the discharge of its public duties will enable it to earn a sufficient amount to pay dividends on the stock. We are, therefore, to capitalise its net earning capacity, present and potential, and fix the value of the stock on that basis."

Sir Thomas White, the third arbitrator, stated the conclusion in the following terms :—

"To determine the question at issue, it is necessary first to consider the subject matter of the arbitration reference. This is, in the language of the statute, 'the value, if any, to the holders thereof, of the preference and common stock' of the Grand Trunk Railway Company as of the date fixed.

"If the system of the Company is to be operated as a going concern, the value of the stock to its shareholders will depend upon the net earnings, present and prospective, of the system. All evidence bearing upon this question is admissible. It is not suggested that the value of the shares should be determined by considering the disintegration of the system, the sale of the assets piecemeal, payment of the debts and distribution of any surplus to shareholders. No such suggestion has been put forward. It is common ground that the property of the system, so long as needed for railway purposes, cannot be disintegrated and sold; the system must be regarded as a going concern. . . .

"The Grand Trunk Railway system is in reality an undertaking having a perpetual franchise. Having such a franchise, and being compelled to operate, the value of its shares must depend upon estimated actual and potential earnings of the system."

The basis of valuation so adopted by the arbitrators (which was certainly not unfavourable to the Company) was accepted by all persons concerned, and was not, and could not be, impeached on the present appeal. It must, therefore, be taken as the governing principle upon which the arbitration was to proceed; and the question is: Whether, having regard to this principle, evidence as to the value of the physical assets was or was not material and admissible?

This expression, "the value of the physical assets," was used in the course of the arguments (both before the arbitrators and before their Lordships) in two different senses, which it is necessary clearly to distinguish. At one time the claim appeared to be that evidence should be admitted of the selling value of the physical assets of the Company, that is to say, of the price at which the tangible assets (land, buildings, rails, rolling stock, terminals, etc.) could be sold: at other times it was contended that the evidence to be admitted was evidence as to what is variously described as the "reproduction" or "reconstruction" or "replacement" value of those assets, by which is meant the cost at which they could have been reproduced at the moment of transfer, subject (apparently) to allowance for depreciation. These two alternative contentions must be dealt with separately.

The contention that evidence of selling value should have been received is, in their Lordships' opinion, contrary to the basis of valuation adopted by the arbitrators, and, indeed, to the whole meaning and effect of the agreement for transfer. The transfer was a transfer of a going concern, which the holders of preference and common stock had no power to sell, either

piecemeal or as a whole. Such a sale was forbidden by the statutes under which the Company was operating; and if an attempt had been made by these stockholders to bring it about, the holders of debenture and guaranteed stock would have been entitled to intervene and forbid it. The question whether a purchaser could be found seems not to have been considered, and it is to be noted that there was no evidence, nor was it even contended, that it would have been more advantageous to the stockholders to disintegrate the system or to sell the assets piecemeal, even if that were lawful. No scheme was ever put forward with a view to any such proposition, nor apparently had the directors even considered such a proposal.

A sale was, therefore, out of the question, and the plain duty of the arbitrators was to value the preference and common stock as stock in a continuing and profit-bearing concern; this being so, it is difficult to see how evidence of selling value could be material. If, indeed, it had been alleged that certain tangible parts of the assets could be sold at a price without producing an equivalent or greater reduction in the value of the undertaking as a whole, different considerations would have arisen: but counsel for the Company, although repeatedly invited by the arbitrators to state whether they put forward such a contention, declined to do so. It should be added that the ruling did not exclude evidence of the selling value of such assets as were not necessarily to be considered as being used by the railway as a going concern, *e.g.*, land grants and coal properties: and there is no doubt, also, that evidence of the cost and physical condition of the rolling stock and other physical assets, and of their suitability for the purposes of the undertaking was admissible. In fact, such evidence was freely admitted. But evidence of selling value stood on a different footing, and was (their Lordships think) rightly excluded. It should be added that this contention, although at times put forward, was never strongly pressed, and was indeed at times disclaimed by counsel who appeared for the Company before the arbitrators, possibly because a valuation on the basis of selling value would have been disastrous for the stockholders, and also that the arbitrators were unanimous in rejecting this contention.

It was upon the alternative form of this contention—viz., that evidence of replacement value should be admitted—that the arbitrators differed in opinion, Mr. Taft holding that such evidence was admissible, and the majority of the Board taking a different view. This contention has now to be dealt with. The relation between cost of reconstruction and profit-earning capacity is not at first sight apparent. The earnings of a railway system will depend mainly upon its location, the traffic available, the soundness and suitability of the line, rolling stock and other assets, and the economy and efficiency of the management. Speaking generally, they are in no way dependent on the question what it would now cost to construct and equip the line. Mr. Taft was of opinion that the evidence was admissible for two reasons.

First, to enable the arbitrators to use the value as a circumstance in judging the future and potential earning capacity. He does not say how this is to be worked out. Assuming, for example, that the arbitrators had found that the line was absolutely insolvent, unable to continue to discharge its obligations or, in fact, to keep open or avoid a receiver, how could the replacement value of the assets add to or detract from the value of the stock ? Assuming, on the other hand, a railway system constructed at a cost which was small in comparison with the returns earned by it as a going concern. Could it be material to show what was the replacement cost as a matter affecting the value of the stock ? Is there, indeed, any way in which such evidence could or should modify or assist the estimate of value, once you have determined upon the principle adopted by the arbitrators ?

But, in the second place, it was also sought to establish a relation between the replacement cost and future earnings by reference to the statute law of the United States.

By the Inter-state Commerce Act, 1920, of the United States (which was passed after the date of the agreement now under consideration), the principle is laid down that the American Inter-state Commerce Commission in fixing the maximum rates to be charged on the United States railway systems shall have regard to the aggregate value of railway property as a whole, or as a whole in such rate groups as the Commission may form, and shall prescribe such rates as may secure a fair return upon such aggregate value. It is argued that the effect of this statute is to make physical value (or replacement cost) a factor in the determination of rates—directly, as to such part of the Grand Trunk system (some 1,700 out of 4,800 miles) as is situate in the United States, and indirectly as to the remainder which is in Canada. The argument is formulated in the powerful dissenting judgment delivered by Mr. Taft.

> " The rule of fair return on necessary value invested is the rule of the Government of the United States, and a considerable part of the lines of the Grand Trunk Railway is within the jurisdiction of that Government. The matter of fixing rates was originally left to the discretion of the Inter-state Commission of the United States with the direction only that the rates fixed should be reasonable. But the result was that the rates fixed by the Commission were not high enough to enable the railways to prosper, and that the system came near to a complete breakdown. Congress, therefore, passed a law which adopted specifically the principle that the public service rendered by railways would be compensated for by rates which shall secure a fair return upon the railway property used in the service of transportation under earnest, efficient and economical management. The Commission is to form railways into groups serving the same zone of territory, and then ascertain the aggregate value of all the railways in the group and fix the rates to secure a fair return on the aggregate. This is to fix the rates according to the average physical value of the existing railways engaged in the service, which is only an alternative method of determining the amount of capital needed to reproduce a railway which could render the service efficiently and economically, assuming that the average value of all railways engaged in the service would be the cost of such a new railway. If it differs from that cost, it must be greater, and so is more liberal to the

railways. My reference to the new Transportation Act of Congress, it is suggested, is without weight, because such groups of railways have not yet been formed by the Commission and may never be. I have no doubt the Commission will proceed to execute the law as directed. Meantime, under the inspiration of the Act, and more certainly to secure a return on the immediate investment, the Commission has increased the traffic and passenger rates most substantially, and, as I understand it, the Canadian Commission has followed suit. It is not the particular method in reaching the actual present investment in railway property as the basis for fixing rates which is important: it is the fact that the principle has been recognised by the statute: and will be followed in the future. This is what makes it proper for us in trying to determine future probable rates to allow evidence of such a factor."

To this reasoning the answer put forward on behalf of the Government of Canada is twofold. First, it is said that even as regards that part of the Grand Trunk system which is situate in the United States, evidence of replacement cost would be no index to the rates which will ultimately be fixed by the Commission. Such evidence would be valueless for that purpose, unless supported by similar evidence as to the value of all the other railways in the United States, or, at least, of all other railways in the same group; and such evidence as to other railways was not tendered, and was probably unobtainable. And, even if this evidence could be obtained, the estimate so reached would not justify the arbitrators in making any assumption as to the valuation which will be adopted by the American Commissioners (who have other factors to take into account), or as to the rates which they will fix. Further, even if the enquiry could have been pushed so far, and some conjecture could have been formed as to the decision which would be reached by the American Commission, this figure would be no real guide to the prospective profits of the lines in the United States which belong to the Grand Trunk system. It is one thing to fix maximum rates; it is another to secure remunerative traffic at those rates, and to draw from maximum rates, themselves conjectural, any inference as to prospective profits would be unsafe and illusory.

Secondly, as regards the lines in Canada which form part of the Grand Trunk system and are of far greater importance, the argument (it was said) has even less value. The principle of the Inter-state Commerce Act has not been adopted in Canada, and there is no reason to assume that it will be there adopted The conjecture—for it is nothing more—that the Board of Railway Commissioners for Canada will, in fixing rates in the future, have regard to the replacement cost of railway property is not supported by any evidence. Even if it were to happen, the above reasoning as to the effect of the principle on the United States would have equal force with regard to Canada. This aspect of the question is thus dealt with in the interlocutory judgment of Sir Thomas White:—

"In Canada traffic rates are under the control of the Board of Railway Commissioners. There is nothing before us to show, nor am I aware, that the Board in fixing rates is obligated to consider the reproduction value of railway property. Nor do I understand that the Board has ever

laid down the principle that such value has any bearing upon the question of Canadian railway rates. Even if, in determining such rates, the Board should decide to have regard to reproduction value of railway property, evidence as to the value of the physical assets of an individual railway undertaking would not be useful for the purpose unless supplemented by evidence of the value of the physical assets of its competitors. It would, in my view, be idle for this Board of Arbitrators to attempt to draw conclusions as to probable future traffic rates in Canada from a consideration of a reproduction valuation of the physical assets of this one railway system.

"Further, I can think of nothing more improbable than that the Board of Railway Commissioners of Canada will, in fixing future rates, regard as a factor to be taken into account the reproduction values of the railway properties, either in whole or by groups, of the Canadian Pacific, the Grand Trunk and the Canadian National Railway systems."

The above reasoning which weighed with the arbitrators in rejecting the evidence tendered, was reinforced in the course of the enquiry by evidence of the results actually obtained during the period for which the American statute had been in operation. It was proved that the Inter-state Commerce Commission, to which was entrusted the duty of putting the Inter-state Commerce Act into operation, had, after much controversy, divided the American railway systems into three groups, had estimated (not on reproduction cost but on book values) the value of the lines in each group, and on that footing had approved certain increased maximum rates. The result of these increases on the operation of the American lines forming part of the Canadian Grand Trunk system during the period from January till April, 1921, was put in evidence, and showed a heavy deficit. The arbitrators had these figures before them when they formed (by a majority) their interlocutory decision to reject the evidence in question.

Upon the whole matter, their Lordships have come to the conclusion that any attempt to estimate future profits by reference to selling value or replacement cost was doomed to failure, and, accordingly, that the arbitrators, to whom the agreement gave wide discretion as to the admission of evidence, were justified in refusing to embark upon an enquiry, which must have occupied many months, and the result of which, when obtained, would have had no legitimate bearing on the question which they had to determine.

The view here adopted involves no criticism of the American cases (referred to by Mr. Taft), in which evidence of value has been accepted; for those decisions were given with reference to a different subject matter, and under a different system of law. The cases cited from the British reports have no bearing on this case.

The second legal objection raised by the appellant Company to the award was founded upon the circumstance that the Chairman, Sir Walter Cassels, in his reasons for the award relied upon certain evidence of Mr. E. J. Chamberlin, the President of the Company, which was given before the Royal Commission of

Railways and Transportation in Canada, and was not repeated or made evidence in this arbitration. This is undoubtedly the fact. But the material facts and figures so deposed to by Mr. Chamberlin are all to be found in correspondence between Mr. Chamberlin and Sir A. Smithers, in a letter of Mr. Kelly, the Vice-President of the Company, and in other documents which were duly made evidence in this arbitration. Sir Thomas White, who made no reference to Mr. Chamberlin's evidence, arrived upon this other material at the same conclusion as that which was reached by the Chairman. In these circumstances, their Lordships have anxiously considered whether they should advise His Majesty to set aside the award on the ground of the Chairman's action. They have arrived at the conclusion that they ought not to take that course. It is plain that, if no reference had been made to Mr. Chamberlin's evidence, the majority of the arbitrators would have arrived at the same conclusion and upon the same materials. If the award were set aside and remitted to the arbitrators on the ground of the reference by the Chairman to that evidence the only result would be to cause great expense and delay to all parties without any reasonable prospect that the arbitrators would arrive at a determination different from that which they have already decided.

It is perhaps hardly necessary to add that their Lordships have neither the right nor the duty to enquire into the merits of the award made by the arbitrators. Under the statute which confirms the agreement, they have only jurisdiction to deal with the points of law raised before them and to determine whether the arbitrators so erred in law that their award should be set aside.

For the reasons above given, their Lordships feel constrained to answer this question in the negative, and they will humbly advise His Majesty that this appeal fails and should be dismissed.

In the Privy Council.

THE GRAND TRUNK RAILWAY COMPANY OF CANADA

v.

THE KING.

DELIVERED BY VISCOUNT BIRKENHEAD.

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