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PUBLIC UTILITIES — RATE-BASE — LATE SUPREME COURT DECISIONS — In fixing the rate-base of a telephone company, the Maryland Public Service Commission translated the agreed 1923 rate-base (with all subsequent additions to plant) to 1933 price levels by means of a composite price index which included both general all-commodity indices, and indices particularly adapted to the telephone business. *Held*, that an order enjoining enforcement of the rates will be affirmed. *West v. Chesapeake & Potomac Telephone Co.*, (U. S. 1935) 55 S. Ct. 894.

Of the utility cases reaching the Supreme Court since 1929, the instant case presents most clearly, perhaps, the issues in regard to the "cost of reproduction" formulæ which must arise in any period of rapid changes in the price level. These issues concern, first, the scope of judicial review of the rates fixed, and second, the proper purpose and basis of any reproduction cost valuation.

The valuation made by the Maryland Commission was one based entirely upon 1923 costs and subsequent historical costs, translated to 1933 figures by means of price indices.[1] The District Court enjoined the enforcement of the rates fixed with reference to such a rate-base upon the ground, among others, that under the circumstances historical cost of the property less the full amount of the depreciation reserve was the proper measure to be applied in determining confiscation, and that the rate-base in this case was less than that figure.[2] The Supreme Court, although criticizing the reasoning of the lower court, affirmed the order, but there was no showing in either court that the rate-base fixed was in fact less than the cost of reproduction less depreciation and plus such

[1] (Md.) 1 P. U. R. (N. S.) 346 (1933).

[2] Chesapeake & Potomac Tel. Co. v. West, (D. C. Md. 1934) 7 F. Supp. 214.

intangible values as going value. The holding of the Supreme Court was that the order of the Commission was supported by insufficient evidence, and was therefore a denial of due process. In discussing the *Los Angeles*[3] and *Dayton*[4] cases, Mr. Justice Roberts said,

> "Nothing said in either of these cases justifies the claim that this court has departed from the principles announced in earlier cases as to the value upon which a utility is entitled to earn a reasonable return or the character of evidence relevant to that issue. It is apparent from what has been said that here the entire method of the commission was erroneous and its use necessarily involved unjust and inaccurate results. In such a case it is not the function of a court, upon a claim of confiscation, to make a new valuation upon some different theory in an effort to sustain a procedure which is fundamentally faulty." [5]

It is upon this question of procedure, primarily, that Justices Stone, Cardozo, and Brandeis dissent from the judgment of the Court.

I.

Admitting for the moment that the order of the administrative tribunal is here supported by insufficient evidence, the question presented would seem to be one of the interpretation of the Maryland Constitution upon the issue of separation of powers, not one of due process and the violation of the Fourteenth Amendment. It is true that when the jurisdiction of the inferior federal courts attaches by reason of the existence of a federal question, that jurisdiction extends to the entire case, with all the issues, federal or non-federal.[6] In the instant case, therefore, since jurisdiction attached by reason of the existence of the federal question of confiscation, the Court could have decided the controversy upon the ground that the order of the Commission was an invalid exercise of legislative power under the terms of the Maryland Constitution. Such a solution of the problem becomes impossible, however, in the future, for, under the terms of the recently enacted Johnson Amendment to the Judiciary Act,[7] all future utility rate cases must be brought in the state courts. As the decision of a state court upon questions of state law is final, future federal review must be confined to the

[3] Los Angeles Gas & Electric Corp. v. R. R. Comm. of Cal., 289 U. S. 287, 53 S. Ct. 637 (1933).

[4] Dayton Power & Light Co. v. Public Util. Comm. of Ohio, 292 U. S. 290, 54 S. Ct. 647 (1934).

[5] (U. S. 1935) 55 S. Ct. 894 at 899.

[6] SCHWEPPE'S SIMKINS' FEDERAL PRACTICE, § 448, p. 385, and § 455, pp. 394-395 (1932), and cases cited.

[7] 28 U. S. C. A., § 41, subd. (1). Approved May 14, 1934.

federal question of confiscation and of due process of law. As the decision in the instant case was put upon the ground of denial of due process, it becomes important to examine the validity of the claim of violation of the Fourteenth Amendment.

Neither the Fifth nor the Fourteenth Amendment forbids governmental action which is not taken in accordance with due process of law; the sole prohibition is of the taking of life, liberty, or property without due process of law. As applied to utility valuation cases, the sole federal question, therefore, becomes one of confiscation.[8] The most recent cases to come before the Court recognize this principle clearly. In the *Los Angeles* case,[9] the test of the Court was clearly one of the results reached by the Commission, and not of the method of valuation applied. The California Railroad Commission fixed the rate-base almost entirely with reference to the historical cost of the property — a method repeatedly condemned by the Court.[10] No attempt was made by the Commission to secure an engineer's appraisal or inventory, nor to apply current unit prices to the accounts embraced in the property. The sole effort made to take account of current price levels appeared in the schedule of "historical cost of reproduction," a translation of historical cost to current price levels through the application of commodity price indices. For these reasons, the minority of the Court declared through Mr. Justice Butler that, "The rates should be set aside because arrived at by arbitrary methods condemned by our decisions." [11] Chief Justice Hughes, however, laid down the rule that,

> "When the legislative method is disclosed, it may have a definite bearing upon the validity of the result reached, but the judicial function does not go beyond the decision of the constitutional question. That question is whether the rates as fixed are confiscatory. And upon that question the complainant has the burden of proof

[8] Louisville v. Cumberland Tel. & Tel. Co., 225 U. S. 430, 32 S. Ct. 741 (1912); San Diego Land & Town Co. v. National City, 174 U. S. 739, 19 S. Ct. 804 (1899); Chicago & G. T. Ry. v. Wellman, 143 U. S. 339, 12 S. Ct. 400 (1892); 2 POND, PUBLIC UTILITIES, 4th ed., 971 ff. (1932). Of course, a finding made without any evidence, or clearly unsupported by evidence, may be so arbitrary as to amount to a deprivation of property without due process. I. C. C. v. Union P. R. R., 222 U. S. 541, 32 S. Ct. 108 (1924); C. M. & St. P. Ry. v. Pub. Util. Com., 274 U. S. 344, 47 S. Ct. 604 (1927); Northern P. R. R. v. Dept. of Pub. Works, 268 U. S. 39, 45 S. Ct. 412 (1924).

[9] Los Angeles Gas & Electric Corp. v. R. R. Comm. of Cal., (Cal.) P. U. R. 1931A 132; injunction denied, (D. C. Cal. 1932) 58 F. (2d) 256, affd. 289 U. S. 287, 53 S. Ct. 637 (1933).

[10] United States v. St. Louis & O'Fallon Ry., 279 U. S. 461, 49 S. Ct. 384 (1929); McCardle v. Indianapolis Water Co., 272 U. S. 400, 47 S. Ct. 144 (1926); Missouri ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm., 262 U. S. 276, 43 S. Ct. 544 (1923).

[11] 289 U. S. 287 at 326, 53 S. Ct. 637 (1933).

and the Court may not interfere with the exercise of the State's authority unless confiscation is clearly established." [12]

Upon these principles, the appellant could not establish confiscation by showing admitted errors in the calculation of overhead costs, nor secure an injunction even though the methods applied by the Commission were utterly condemned by the Court; the burden of proof of confiscation was placed upon the utility, and it was of course impossible for it to show that the historical costs of the period prior to 1930 were so much lower than the costs of reproduction of 1932 as to establish a confiscatory rate-base.

In *Clark's Ferry Bridge Co. v. Public Service Commission*,[13] the fact that the rate-base was fixed at practically historical cost was again insufficient of itself to require an injunction. The argument that reproduction cost must be given a dominant consideration was dismissed with the remark that the appellant's evidence of reproduction cost was unsatisfactory; in common knowledge prices were lower in 1932 than in 1926.

In *Dayton Power & Light Co. v. Public Utilities Commission*,[14] it appeared that the Ohio Commission had fixed the value of the gas lands owned by a subsidiary company at $25 an acre; the Supreme Court of Ohio affirmed the order, but indicated that the land in question could not be valued at more than historical cost. The ruling was upheld by the United States Supreme Court, in an opinion by Mr. Justice Cardozo which characterized the evidence of market value offered by the company's experts as mere opinion evidence disproving the existence of any market, and the evidence of sale prices of adjoining tracts as unsatisfactory. Again, the Court permitted a valuation based largely upon historical cost to stand, and refused to reverse an order solely for failure to consider reproduction cost, or present market value. In the same case, the Court, admitting for the purpose of argument that the rate-base made insufficient allowance for accrued depreciation and delay rentals, required that the appellant show that excessive allowances for other items (amortization of the cost of wells) were insufficient to take care of the error.

In *Lindheimer v. Illinois Bell Telephone Co.*,[15] the Court refused unanimously to enjoin the enforcement of rates, even assuming errors in the valuation of the property, upon the ground that it was not shown that excessive depreciation allowances did not counteract any such possible errors. As Chief Justice Hughes said, "The questionable amounts annually charged to operating expenses for depreciation are large

[12] 289 U. S. 287 at 304-305, 53 S. Ct. 637 (1933).
[13] 291 U. S. 227, 54 S. Ct. 427 (1934).
[14] 292 U. S. 290, 54 S. Ct. 647 (1934).
[15] 292 U. S. 151, 54 S. Ct. 658 (1934).

enough to destroy any basis for holding that it has been convincingly shown that the reduction in income through the rates in suit would produce confiscation." [16]

The most recent decisions of the Court, then, seem to settle the law that the sole federal question in utility valuation cases is one of confiscation of property, and that upon that issue the burden of proof is upon the utility. It is true that "it is not the function of a court, upon a claim of confiscation, to make a new valuation upon some different theory in an effort to sustain a procedure which is fundamentally faulty," but it is equally true that the utility must establish by clear and convincing evidence that the rates will result in a confiscation of property if it is to obtain a standing in a federal court. No such evidence was presented in the instant case. The error of the Commission, as said by Mr. Justice Stone, is at most

> "deemed a denial of due process in the procedural sense. But not even the procedure is condemned because it lacks those essential qualities of fairness and justice which are all the Fourteenth Amendment has hitherto been supposed to exact of bodies exercising judicial or quasi-judicial functions. The Commission has punctiliously adhered to a procedure which acts only after notice and hears before it condemns. . . . The sole transgression, for which its painstaking work is set at naught, is that, in the exercise of the administrative judgment of this body 'informed by experience' and 'appointed by law' to deal with the very problem now presented, . . . it has relied upon a study of the historical cost and ascertained value of appellee's plant in the light of price indices, showing declines in prices, in arriving at the present fair value of the property, a procedure on which this Court has hitherto set the seal of its approval.[17] . . .
>
> "The Commission did not refuse to receive or to consider any of the evidence presented.[18] . . .
>
> "If such an error in the deliberations of a state tribunal is a violation of the Constitution, I should think that every error of a state court would present a federal question reviewable here." [19]

But if, from the standpoint of constitutional law, the decision in the instant case is unfortunate as an undue extension of the concept of due process, it is still more unfortunate from the standpoint of development of public utility regulation. The rising tide of political protest at utility

[16] 292 U. S. 151 at 175, 54 S. Ct. 647 (1934).
[17] (U. S. 1935) 55 S. Ct. 894 at 902.
[18] (U. S. 1935) 55 S. Ct. 894 at 904.
[19] (U. S. 1935) 55 S. Ct. 894 at 907.

rates, no less than the considered opinions of thoughtful legal writers, show the unsatisfactory nature of our present solution of the problem, and the need for a changed method of approach to the question of utility control. The inordinate expense, unconscionable delays, and the dark uncertainty of present rate-making procedure make some change inevitable. The present political drift seems to be towards government ownership of utilities. There are other possible solutions, however; it may be that more satisfactory results would be obtained through placing a greater emphasis upon historical costs in fixing the rate-base,[20] but such a solution seems to be foreclosed by present judicial opinion. It is much more likely that, despite the effect of the decision in the instant case, increasing attention will be given to the use of price indices in an effort to simplify valuation procedure and to take from it many of its more controversial aspects.[21] The probable long-range trend seems to be in the direction of a more accurate distinction between the function of the courts and the function of the administrative tribunals which fix the rates. There is an increasing recognition of the fact that, as a prominent recent commentator has said, no other major industry need be conducted primarily by litigation, in an arena of warfare.[22] If the action of the tribunal be not an unconstitutional exercise of legislative power (a question depending primarily upon the accuracy with which the legislative intent is stated in the enabling act), the attention of the courts should be directed to the question of whether the rates ordered are so high as to mulct the rate-payer, or so low as to confiscate the property of the utility; the area between these two extremes is properly one for the exercise of a legislative discretion.[23] It is too much to ask that our courts be adequately trained, not only as members of the bar, but also as accountants, economists, and engineers, yet expert knowledge in each of these fields is absolutely necessary if a correct decision is to be made upon any of the questions constantly arising in a utility rate case; it would seem, for this reason alone, that greater freedom should be given to the commissions, experienced in the handling of valuation materials.[24]

It is even questionable whether valuation, as now understood, does not play entirely too large a part even in the work of the various commissions. Even though utility products are the products of a mo-

[20] See Customers v. Worcester Electric Light Co., (Mass.) P. U. R. 1927C 705 at 708.

[21] RIGGS, THIRTY-FIVE YEAR DEVELOPMENT IN UTILITY REGULATION, c. 11.

[22] Ransom, "Valuation and Rate Problems," 159 ANNALS 84 (1932).

[23] Beutel, "Due Process in Valuation of Local Utilities," 13 MINN. L. REV. 409 (1929); Beutel, "Valuation as a Requirement of Due Process of Law in Rate Cases," 43 HARV. L. REV. 1249 (1930); Barnes, "Federal Courts and State Regulation of Utility Rates," 43 YALE L. J. 417 (1934).

[24] 40 YALE L. J. 81 (1930).

nopoly, there seems to be no sufficient reason for the sharp distinction made between the problems of marketing utility products, and the marketing of other goods and services; it may be that the presence of monopoly changes some factors in the marketing problem, but the problem itself remains essentially unchanged. The question still remains one of how to secure the most efficient distribution of the product to the consumer at the most economical price. From this standpoint, the important factors to be studied are not valuation and profits, but costs, demand, capitalization, and prices.[25]

It is submitted that such a policy, by which the courts would limit themselves to a consideration of the issue of confiscation, leaving to the commissions the questions of rate-fixing and methods of regulation, is both economically and legally sound. Such a policy, wisely administered, would be just both to the public and to the utilities; it would remove utility affairs from the "arena of warfare" to the conference-room; it would result in more economical administration, would take from the courts such frequent consideration of issues which they are ill-equipped to handle, and yet would protect the utilities from confiscation and the public from unduly high rates.

Such a policy, however, will be impossible of development if the Court adheres to the decision made in the instant case. Furthermore, whatever policy is finally adopted in regard to utility control, it seems evident that there must come a period of experimentation in which new methods of regulation will meet the test of experience. During that period of experimentation, satisfactory results can be obtained only if greater freedom is to be given to the state commissions. The flexibility so secured would make possible the creation in each state of a separate laboratory in which regulatory methods could be tried and permanently adopted or discarded as experience should dictate. Certainly, to give greater freedom to the state commissions must at least result in a diminution of the amount of litigation concerning rates, and bring about a greater degree of cooperation between the public and the utilities.

2.

The second issue involved in the instant case is that of the use of price indices in connection with accurate historical cost data in an effort to lessen the time and expense consumed in fixing the proper utility rate-base. It is to be noted that the present instance is the third time in

[25] Cabot, "Public Utility Rate Regulation," 7 HARV. BUS. REV. 257, 413 (1929); Pegrum, "Legal Versus Economic Principles in Utility Valuation," 6 J. LAND AND P. U. ECONOMICS 127, 235 (1930); Cabot, "Four Fallacious Dogmas of Utility Regulation," 7 P. U. FORT. 719 (1931); Rosenbaum, "Rate Planning — A Departure From Fair Return on Fair Value Methods," 7 UNIV. CINN. L. REV. 1 (1933). But see Ryan, "Public Utility Rate Regulation," 8 HARV. BUS. REV. 193 (1930).

the past twenty years in which the Chesapeake and Potomac Telephone Co. has adjudicated its rates in Commission or Court hearings;[26] twice, rate controversies have resulted in long drawn out hearings in federal court. This experience is not atypical. Professor Riggs, an engineer with wide experience in valuation cases, states,

> "The subject of revaluation of large properties has become a matter of grave concern to officers charged with the management of utilities. Valuation work accurately and carefully done, in sufficient detail to satisfy the requirements of attorneys conducting rate or other cases involving valuation, is costly and time-consuming. . . . To have expended from $50,000 to $500,000 for valuation of utility property within four or five years, and then to face a new valuation to meet the needs of a new case is a serious matter in the case of any company." [27]

This expense is passed on to the rate-payers in the form of an increased allowance for overheads, and an equal expense to the Commission is likewise passed on to the public in the form of increased appropriations for valuation work — or through the failure to hold rate hearings. The consumption of time is equally important; the first order of the Commission in the *Lindheimer* case was issued in 1923, and the hearings preceding that order must have occupied many months. It was not until 1933 that the bill in that case was dismissed. Such a length of time is extraordinary, but few utility valuations, including the length of the commission or court hearings, take less than two or three years. The result is that in a period of depression (even though the utility gives bond to insure refunds to rate-payers) consumers do not receive the benefit of rate-reductions when they are most needed, and in a period of rising prices the utilities cannot receive the needed increase in rates when overheads and other costs are constantly increasing. Nor can it be claimed that the conventional method of evaluation is so accurate in results as to justify a rigid insistence upon its use; indeed, the opinion evidence of expert engineers is frequently little more than dignified guess-work. In one case, expert valuations varied from $670,163 to $1,031,436;[28] in another case, the variation was from $547,488 to $940,988;[29] in *New York Telephone Co. v. Prendergast*,[30] it appeared

[26] The company was involved in rate litigation in 1916, again in 1922-1923, and again 1932-1935.

[27] RIGGS, THIRTY-FIVE YEAR DEVELOPMENT IN UTILITY REGULATION, c. 10, p. 8 (of ms. copy).

[28] Re Marin Municipal Water Dist., (Cal.) P. U. R. 1915C 433, opposite p. 452.

[29] Springfield v. Springfield Gas & Electric Co., (Ill.) P. U. R. 1916C 281 at 307.

[30] (D. C. N. Y. 1929) 36 F. (2d) 54; discussed in the minority report of the Commission on Revision of New York State Public Service Commission Law, 1930, at p. 266, and quoted by Mr. Justice Stone, (U. S. 1935) 55 S. Ct. 894 at 906.

that estimates made by members of the Commission, the Master, the Court, and witnesses for the utility ran from $366,915,493 to $615,000,000. In the same case, the difference in estimates made by two witnesses (both of whom were witnesses for the utility) was $86,246,262.[31]

It was dissatisfaction with the usual methods of valuation for reasons such as these that prompted the Maryland Commission to report that,

> "Both the company and the Commission realized that to attempt to find the present-day fair value of the company's property by the usual method of taking an inventory of all items of property owned by the company, and pricing out those items at present-day prices would not only take at least two years of constant work but would cost the company not less than $300,000 and cost the state a very substantial sum. It was agreed that index numbers should be used in arriving at present-day costs. The Commission's staff carried this index number process through the entire appraisal except in the case of working capital. The company, while it used index numbers, followed a method substantially at variance with the Commission's method." [32]

The basis for the work undertaken was the 1923 fair value, fixed by court order,[33] with all subsequent additions and betterments, as shown on the books of the company. To these figures there was applied a "translator" or average of sixteen recognized price indices as weighted by the Commission. These indices were carefully chosen; five of them were general all-commodity price indices, including the Bureau of Labor Statistics index; the sixth was the index of consumers' general purchasing power issued by the Federal Reserve Bank of New York.

[31] See also Missouri ex rel. Southwestern Bell. Tel. Co. v. Public Serv. Comm., opinion of Mr. Justice Brandeis, 262 U. S. 276 at 299, 43 S. Ct. 544 (1923); and Goddard, "The Evolution and Devolution of Public Utility Law," 32 MICH. L. REV. 577 at 601 (1934).

[32] (Md.) 1 P. U. R. (N. S.) 346 at 351 (1933). The effect of an insistence upon the usual methods of reproduction cost evaluations is stated in BAUER & GOLD, PUBLIC UTILITY VALUATION FOR PURPOSES OF RATE CONTROL (1934), at p. 104:

> "The practical effect [i.e., of the McCardle case], however, was not that sweeping re-valuations were made on the basis of the newer prices, but rather that active effort at rate making largely subsided, because of the grave difficulties of reproduction cost valuations. To a large extent, rates were left undisturbed. When rate inquiries were proposed, companies were mostly able to prevent the proceedings by threat of reproduction cost appraisals. Commissions were reluctant to undertake investigations which would be laborious, expensive and dubious as to outcome. Through the general acceptance of reproduction cost after the Indianapolis case, companies largely succeeded in freeing themselves from rate control, especially where they were satisfied with existing rates."

[33] Chesapeake & Potomac Tel. Co. v. Whitman, (D. C. Md. 1925) 3 F. (2d) 938.

These six indices represented changes in general purchasing power. In recognition of the important part played by construction costs in utility values, five indices of construction costs were included — prepared by trade journals and concerns associated with the construction industry. Additional weight was given to this factor through the inclusion of two indices of building materials, and of a special index of Baltimore labor costs. The two remaining indices represented costs in the telephone industry; one was the Interstate Commerce Commission index of all telephone and telegraph property owned by railroads, and the other was a special index of Western Electric prices for telephone equipment and apparatus.[34]

These indices, when separately applied, resulted in widely varying figures: the lowest value resulting was $24,983,624; the highest, $36,056,408 — 48 per cent higher; the extreme figures stated varied from the final Commission valuation ($32,610,327) by 23 per cent in one direction and 10.6 per cent in the other. The clustering of values, however, is at least as close as is found in many engineers' estimates; eleven of the sixteen indices used gave results between $30,000,000 and $34,600,000. It was manifest, however, that the factors represented in the above indices were entitled to varying weights; the indices used, therefore, were assigned weights of from one to four. The principle, however, upon which the weights were selected and assigned, does not appear in the record. From all that appears, the weighting was a "rule of thumb corrective," which must render the results "all the more dubious and obscure." This objection, found by the Court, might have been overcome had the Commission's record upon the point been more complete. This, however, would seem doubtful; the weight to be assigned to each index used must be a matter of judgment primarily, rather than of mathematics; thus, while such factors as construction costs, or labor costs, can easily be assigned a weight proportionate to their share in the cost of the entire project, it is impossible to decide mathematically the weight to be assigned such a factor as general purchasing power. Yet, as will be shown later, such a factor should be considered.

The most serious objection found with the use made of price indices, however, is the fact that it results in a valuation which is a statement of a "conglomerate mass of dollar value," rather than of the value of so much wire, so many telephone instruments, etc., in terms of present value. Thus, Mr. Justice Roberts points out that,

[34] The Western Electric index was applied only after the elimination of a price rise in 1930 which was found to be artificial and hence inapplicable, since the dealings of the two companies were those of affiliates.

"the company used price relation to obtain the present value of certain property, but separated from other sorts each kind of property so treated. This is comparable to the practice of the Interstate Commerce Commission in translating the value of specific railroad property, e.g., steel rails, by the use of the differential between the per ton price in 1914, the date of original appraisal, and the price prevailing at a later date. Compare St. Louis & O'Fallon R. Co. v. United States, 279 U. S. 461, 486, 487. . . . In this sense the company employed price indices; but it is plain that such a use of relation of values of specific articles as of two given dates is quite distinct from the application of general commodity indices to a conglomerate of assets constituting an utility plant." [35]

A consideration of this objection involves a consideration of the reasons for the insistence upon reproduction cost as the dominant measure of public utility values. It may be that this insistence is founded upon the conception that valuation must be based upon the market price of the identical property to be valued, at the time of valuation. Such a conception is supported by the dictum of Mr. Justice Hughes in the *Minnesota Rate Cases*,[36] that, "The property is held in private ownership and it is that property, and not the original cost of it, of which the owner may not be deprived without due process of law." Again, it is supported by the insistence, in the *McCardle* case,[37] upon the use of spot prices in the calculation of reproduction costs. If, however, this is the basis of the rule, it would seem to be erroneous; this is recognized by Mr. Justice Roberts in his opinion in the instant case:[38] "But it is to be remembered that such a property as that here under consideration is a great integrated aggregate of many and diverse elements; is not primarily intended for sale in the market, but for devotion to the public use now and for the indefinite future; and has, so far as its market value is concerned, no real resemblance to a bushel of wheat or a ton of iron." It is not the market value which is the criterion, but rather a "general decline in values," or a "general rise." The purpose of a reproduction cost valuation, then, is to insure a more or less automatic adjustment of rates to the price level as a whole—to insure to the company and those who have invested in it a return commensurate with increasing costs, and to the consumer a lower rate as the purchasing power of the dollar rises. In his dissenting

[35] (U. S. 1935) 55 S. Ct. 894 at 900. A more detailed account of the method of evaluation employed by the company will be found in the report of the Commission, (Md.) 1 P. U. R. (N. S.) 346 at 354 ff. (1933).

[36] Simpson v. Shepard, 230 U. S. 352 at 454, 33 S. Ct. 729 (1913).

[37] 272 U. S. 400 at 411-412, 418, 47 S. Ct. 144 (1926).

[38] (U. S. 1935) 55 S. Ct. 894 at 898.

opinion in the *O'Fallon* case, Commissioner Woodlock states the case thus:[89]

> "With the majority's main arguments of an economic nature I am in fundamental disagreement. The contention that stability of the investment in railroad property is best attainable by irrevocably linking that investment to the dollar seems to me to be, on its face, quite untenable. The dollar is valuable only because of the commodities that it will buy. Its purchasing power is notoriously characterized by great and continuous instability. The investment theory of value urged by the majority equates railroad property with the dollar. The principle of valuation expressed in the decisions of the Supreme Court equates railroad property with all other forms of property. This is the only real and effective stabilization. For the majority's theory to produce effective stabilization of railroad property it would be necesasry, first, to stabilize the dollar.... Railroad earnings, railroad material, and railroad taxes can not be linked to the dollar; they will change as dollar prices change. It was not a question of railroad property values which brought about the rate changes following 1914 and similar rate adjustments will be necessary when and as similar dollar price changes occur in the future. Real stability in a rate level — which is a dollar relation — can only be achieved through real stabilization of labor and material costs, and for this the dollar must first be stabilized."

If the purpose of the insistence upon reproduction cost is, as contended by Commissioner Woodlock, the "stabilization of the dollar," that is, the determination of changes in the purchasing power of the consumer and of the utility, then changes in the costs of specific items become material only as they affect the value of the capital invested in the property. Thus, when the Court limits the use of price indices to the differential in prices of specific property, carefully segregated, the restriction seems to ignore the primary purpose of a reproduction cost valuation. Further, such a use of price indices offers little means of escape from the difficulties encountered in more orthodox calculations of reproduction cost. It presupposes an elaborate inventory of the property involved — perhaps the most expensive and time-consuming part of the valuation procedure — and the application of a price differential under such circumstances differs little if any from the usual application of current cost estimates.

The third objection found by the Court to the valuation adopted by

[89] Excess Income of St. Louis & O'Fallon Ry., 124 I. C. C. 3 at 64 (1927). See also, Dorety, "The Function of Reproduction Cost in Public Utility Valuation and Rate-Making," 37 HARV. L. REV. 173 (1923).

the Commission is perhaps the easiest hurdle to be taken by any future regulatory body which may wish to apply price indices in the calculation of a utility rate-base. Due to the fact that valuation in the instant case was taken at the lowest prices reached since 1929, it is at the same time the objection upon which the Court laid the greatest emphasis. Since a public utility is not that type of property whose value can be "fairly or accurately reflected by such abrupt alterations in the market," any method is erroneous which is "affected by sudden shifts in the price level." It is only general declines or increases in the price level which are important in valuation, and neither the public nor the utility may claim the advantage of the extremes of those shifts. Thus, in the instant case, even though a "cushion" of $396,000 was included in the rate-base to take care of future price rises, that cushion had already been absorbed at the time of the Supreme Court hearing. Well-founded as the objection is, no reason appears why it could not be met by averaging the price indices used over a longer period of time, thus avoiding the extreme changes apparent upon any inspection of indices.

The question of the possible use of price indices in utility valuation procedure has come before the Supreme Court incidentally on several previous occasions.[40] Indeed, in the *Los Angeles* case, the procedure of the California Commission appears to have been strikingly similar to the procedure of the Maryland Commission in the present case. This is the first time, however, that the question has been brought clearly before the Court for direct decision. Despite every evidence of care in the consideration of the issues presented, it cannot be said that this decision represents the final word of the Court upon the subject. It is suggested that with further study of appropriate indices and of the methods of their application,[41] it may yet be possible to find a more satisfactory method of utility rate-base calculation.

W. J. S. *

[40] United States v. St. Louis & O'Fallon Ry., 279 U. S. 461, 19 S. Ct. 384 (1929); Los Angeles Gas & Electric Corp. v. R. R. Comm. of Cal., 289 U. S. 287, 53 S. Ct. 637 (1933); Clark's Ferry Bridge Co. v. Public Serv. Comm., 291 U. S. 227, 54 S. Ct. 427 (1934). See also Re Barron County Telephone Co., (Wis.) P. U. R. 1933E 403; Re United Rys. Co. of St. Louis, (Mo.) P. U. R. 1928E 419; Chesapeake & Potomac Telephone Co. v. Whitman, (D. C. Md. 1925) 3 F. (2d) 938; United Fuel Gas Co. v. Pub. Serv. Comm. (D. C. W. Va. 1926) 14 F. (2d) 209; Town of Mamaroneck v. New York Interurban Water Co., 126 Misc. 382, 212 N. Y. S. 639 (1925).

[41] See Dawson & Coultrap, "Contracting by Reference to Price Indices," 33 MICH. L. REV: 685 (1935).

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