

# Michigan Law Review

---

Volume 33 | Issue 8

---

1935

## PUBLIC UTILITIES - RATES -VALUE OF THE SERVICE AS BASIS

Follow this and additional works at: <https://repository.law.umich.edu/mlr>



Part of the [Energy and Utilities Law Commons](#), and the [Fourteenth Amendment Commons](#)

---

### Recommended Citation

*PUBLIC UTILITIES - RATES -VALUE OF THE SERVICE AS BASIS*, 33 MICH. L. REV. 1273 (1935).

Available at: <https://repository.law.umich.edu/mlr/vol33/iss8/25>

This Recent Important Decisions is brought to you for free and open access by the Michigan Law Review at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Michigan Law Review by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact [mlaw.repository@umich.edu](mailto:mlaw.repository@umich.edu).

**PUBLIC UTILITIES — RATES — VALUE OF THE SERVICE AS BASIS** — The power company had been serving a sparsely settled rural district in Utah for many years; it had never during its history paid dividends of over 5 per cent, during the last fourteen years it had averaged 3.75 per cent, and during the last five years 2.75 per cent. On the petition of customers who argued that the company should bear part of the burdens of the economic depression, the state utilities commission ordered a ten per cent reduction of all rates on the basis that the charge should not be more than the service was worth. *Held*, while the value of the service is important and should be considered, it is not controlling. The utility's property is still privately owned and as such it cannot be subjected to confiscatory rates without violating the Fourteenth Amendment. If the rates are more than the service is worth, the customers will have to find a substitute. *Telluride Power Co. v. Public Utilities Comm.*, (D. C. Utah 1934) 8 F. Supp. 341.

The rule followed by the commission has from an early date been scrupulously enunciated by the courts in passing on the question of a reasonable rate.<sup>1</sup> So long as this does not seem to conflict with the rule against confiscatory rates, little question is raised; however, when as in the principal case it is believed that the value of the service is less than its cost, at least two sharp questions appear: 1. As a matter of public policy, should the value-of-the-service rule be controlling? 2. As a matter of practicality, can the fair value of the service be intelligently determined? The proponents of the fair-value-of-the-service rule<sup>2</sup> argue on two grounds, namely, that fairness to the public requires that rates be no more or even less than the value of the service to the greater part of its members, and that it does the corporations no good, while harming the public, to raise the rates above the point at which is found the value to the majority of the public, for then the loss of income due to the decrease in users more than offsets the gains in income due to the higher rates.<sup>3</sup> One writer in considering specifically the effect of the depression upon rates reaches a conclusion directly opposite to that of the court in the principal case on the basis that fairness to the public is

<sup>1</sup> “. . . reasonableness relates to both the company and the customer. Rates must be reasonable to both, and if they cannot be to both, they must be to the customer.” *Brunswick & Topsham Water District v. Maine Water Co.*, 99 Me. 371 at 380, 59 Atl. 537 at 540 (1904); *Smyth v. Ames*, 169 U. S. 466, 18 Sup. Ct. 418, 42 L. ed. 819 (1898); *Covington & Lexington Turnpike Co. v. Sandford*, 164 U. S. 578, 17 Sup. Ct. 198, 41 L. ed. 560 (1896); *San Diego Land & Town Co. v. National City*, 174 U. S. 739, 19 Sup. Ct. 804, 43 L. ed. 1154 (1899); *Northern Pac. R. R. v. North Dakota*, 236 U. S. 585, 35 Sup. Ct. 429 (1915); *Darnell v. Edwards*, 244 U. S. 564, 37 Sup. Ct. 701 (1917); *Public Service Gas Co. v. Board of Public Utility Comm'rs*, 84 N. J. L. 463, 87 Atl. 651 (1913); *State Public Utilities Comm. v. Springfield Gas & Electric Co.*, 291 Ill. 209, 125 N. E. 891 (1919); *Hamilton v. Caribou Water, Light & Power Co.*, 121 Me. 422, 117 Atl. 582 (1922). A large collection of further cases is found in POND, PUBLIC UTILITIES, pp. 990-994 (1932).

<sup>2</sup> Lilienthal, “Regulation of Public Utilities During the Depression,” 46 HARV. L. REV. 745 (1933); POND, PUBLIC UTILITIES, p. 989 (1932); NASH, PUBLIC UTILITY RATE STRUCTURES 322 (1933).

<sup>3</sup> *Puget Sound Electric Ry. v. Railroad Comm.*, 65 Wash. 75, 117 Pac. 739 (1911).

paramount to protection of property.<sup>4</sup> The opponents of the rule rely upon the importance of protecting property, point out that value of service varies for each customer, and that as a practical matter the utility will not and cannot operate for long under an unremunerative rate.<sup>5</sup> Those holding this view apparently assume that an increase in rates will necessarily bring adequate returns to the utility. However, even assuming the correctness of the contentions of those upholding the use of the rule, it is nowhere shown how the fair value of the service can in actual practice be intelligently determined.<sup>6</sup> In addition to its varying with each customer so as to necessitate the adoption of some hypothetical average,<sup>7</sup> the value of the service lends itself to no definite standard by which in the general case it may be determined.<sup>8</sup> Therefore, while perhaps theoretically desirable, it is as a matter of fact incapable of itself being used with any degree of precision. The clearly desirable benefits of this consideration, however, are secured, while still protecting the utility from imposition of non-compensatory

<sup>4</sup> "The purchasing power of the dollar having substantially increased since 1929, and the income of consumers having declined drastically, it may well be that 1929 rates are in excess of the value of service under these 1933 conditions."

"it seems reasonable to conclude that where an acute economic emergency exists the customary constitutional principles applicable to the protection of property from confiscation may temporarily be modified or, if the emergency be sufficiently acute, set aside entirely until the emergency period has passed. . . ." Lillenthal, "Regulation of Public Utilities During the Depression," 46 HARV. L. REV. 745 at 762, 774 (1933).

<sup>5</sup> Spurr, "Value of Service' as a Basis for Rate Making," 10 PUB. UTIL. FORT. 363 (1932), criticizing *Re Wisconsin Telephone Co.*, P. U. R. 1932 D 173 at 260 (1932).

<sup>6</sup> "No logical or practical basis for specifically determining the value of the service has so far been developed." Nash, "Utility Rates at the Crossroads," 11 PUB. UTIL. FORT. 79 at 87 (1933).

<sup>7</sup> Spurr, "Value of Service' as a Basis for Rate Making," 10 PUB. UTIL. FORT. 363 at 369 (1932).

<sup>8</sup> The situation involved in securing a power supply for a manufacturing establishment where the cost of the company's setting up its own generating plant can be determined with a sufficient degree of accuracy to possess some meaning, and the competitive situation between the electric and the gas companies in the field of domestic and commercial cooking and heating illustrate the few exceptions to this, but in the field of residential service for lighting and refrigeration, as well as in the cases of the telephone, telegraph, and to some extent the commercial transportation companies, the only alternatives in the usual case are to do without the service or to undertake public operation. This latter has been tried but does not produce the expected results in enough cases to warrant serious general consideration, and many of them, especially the smaller ones, after a few years of operation are bought up by one of the large holding companies. Schmidt, "'Regional' Ownership of Utilities?," 7 PUB. UTIL. FORT. 732 (1931). The federal project in the Tennessee Valley has been referred to as a government yardstick by which to measure the reasonableness of utility rates, but its usefulness as such has been questioned due to the great differences in such items as money rate, control over management, taxation, and methods of accounting required. See, editorial, *ELECTRICAL WORLD*, March 31, 1934, p. 461; editorial, "That Rubber Yard," *New York Times*, Nov. 4, 1934, Sec. 4, p. 4:3; *ELECTRICAL WORLD*, Nov. 10, 1934, p. 844; *ELECTRICAL WORLD*, Nov. 24, 1934, p. 952.

rates, by a method which has no direct reference either to value of service as such, or to investment and value of the property, but which is based wholly upon a study of the market.<sup>9</sup> With lower rates providing increased consumption and a wider distribution, and with a widely and diversely developed market giving to the utility much improved load and diversity factors and therefore lower unit cost, it has been demonstrated that in the long run the utility's interests will be best served by a fully developed market made possible by intelligent rate planning. By co-operating with the state commissions and building up a schedule of rates *as a whole structure*, based upon the demands of the whole market, actual and potential, so as to provide the greatest reasonable profit to the utility, it is argued that both interests would be adequately served.<sup>10</sup> It should be noted, however, that this principle of increasing the profits by lowering the rates according to a "promotional" scale is most appropriate to the electric and gas industries, although to some extent it is applicable to the other utilities as well. It must also be clear that this method of fixing rates is not to function uncontrolled. The commissions should still supervise to prevent any slipping into a "what the traffic will bear" practice, and yet permit the returns always to be above the fair cost of the service. It is submitted, therefore, that the value-of-the-service doctrine as such has no place in the consideration of the fair rate, and that, while it must always be fair to expect a reasonable return over the cost of the service, the interests of both the utility and the public would be furthered better by placing less emphasis upon the value of the service and more upon the determination of a scale of rates which would increase the utility's profits by securing a greater volume of business at less cost per unit.

R. E. W.

<sup>9</sup> By carefully tabulating the rates of the past along with the contemporaneous consumption, a basis can be secured for projecting the corresponding curves for several years into the future, both immediate and remote. At the same time, the corresponding cost curves should be plotted and projected. From these, the rate curves producing the largest revenue consistent with the corresponding costs can be selected, and an intelligent and unified rate structure created. No element of return on investment is included in the compilation of costs. Cabot, "Rate Making and Rate Regulation," 57 A. B. A. REP. 793 (1932). See also NASH, PUBLIC UTILITY RATE STRUCTURES 198-222 (1933), for a well developed technical and detailed description of this same method.

<sup>10</sup> "If the companies would think less about their rights and more about their duties they would serve their own interests better, for it is not so much their legal rights as their customers' requirements that are in question, and it is my rooted conviction that their own interests will be best served by a thoroughly selfless handling of them." Cabot, "Rate Making and Rate Regulation," A. B. A. REP. 793 at 807 (1932).

This same thing is strikingly put by use of a graph in NASH, PUBLIC UTILITY RATE STRUCTURES 174 (1933), in which is illustrated the results of rate reductions under four types of rate structures, the common straight line reduction causing a distinct loss of revenue, while in all three illustrated types of "promotional" structures reductions of as much as 30 per cent in the kilowatt hour rate effected as high as 30 per cent increases in the annual revenue.

"... it makes no difference how high the price of electricity is for the first few kilowatt-hours, the essential thing is that it be low for all additional kilowatt-hours that you may wish to use. And the more you and everyone else pays for the

first few kilowatt-hours the less will be the deficit created which has to be made up in the price charged for these essential additional kilowatt-hours." Ferguson, "Inducement Rates, Key to Progress," 93 *ELECTRICAL WORLD* 435 at 437 (March 2, 1929).