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PUBLIC UTILITIES—RATE BASE—ALLOWANCE FOR DEPRECIATION—Plaintiff toll bridge company appealed from an order of the Pennsylvania Public Service Commission which set a value for rate-making purposes on their bridge property, constructed in 1924-25, identical to the original valuation order of 1926, for the rate-base as of February 2, 1932. The order allowed a depreciation deduction annually which, with 4 per cent simple interest, would amount to enough to replace the bridge at the end of its estimated period of usefulness. The company claimed the order was confiscatory, as based solely on original cost, without taking into account current cost of reproduction; and that interest should not be included in computing the depreciation allowance. *Held*, that the valuation of 1926 was a reasonable one¹ at that time, and, upon the ample showing that costs of construction had declined since 1926, was not confiscatory for 1932; and that it was not confiscatory to consider interest in computing the depreciation allowance. *Clark's Ferry Bridge Co. v. Public Service Commission of Pennsylvania*, 54 Sup. Ct. 427, 78 L. ed. 530 (1934).

After a long period of intensive litigation, during which the utility com-

¹ Plaintiff contended that the value of the physical property was greater than the amount paid the contractor for its construction, plus the value of the land, on the ground that the contractor suffered a heavy loss on the contract. But the evidence showed the loss to have been due to abnormal flood conditions; that under ordinary conditions the contract would have been profitable. The court below allowed an additional amount which it estimated would have been sufficient to avert the loss, if spent in coffer dam construction. The court here thought even that amount not properly included in the valuation for rate purposes; but said that amount would serve to compensate for the amount which the commission deducted for accrued depreciation, if that sum was excessive as alleged. This practice of an appellate court cancelling off possibly too low figures of the valuation on some parts of the property against very liberal ones for other parts was used by this court in *Los Angeles Gas & Electric Corp. v. Railroad Comm.*, 289 U. S. 287, 53 Sup. Ct. 637 (1933), and strongly disapproved of by Mr. Justice Butler in his dissenting opinion.

panies and the commissions neatly exchanged positions,² a series of cases in the early 1920's seemed to establish that cost of reproduction at current prices was the dominant factor to be considered in public utility valuation for rate-making purposes.³ A slight variation was added by the suggestion in some of the decisions that an attempt be made to predict probable reproduction costs for a reasonable period in the future.⁴ Since construction costs began to drop as a result of the depression, there has been wide speculation as to the effect this would have upon public utility rate bases.⁵ Vast sums have been spent on utility properties during the war and post-war years of high prices over the whole public service field, with the possible exception of the street railway companies.⁶ If present-day cost of reproduction were to be the dominant element in the rate base of these properties, many concerns would face valuations for rate purposes far below the amounts actually spent, however prudent their investment.⁷ The principal case, involving a 1932 valuation of property constructed

² Goddard, "The Evolution and Devolution of Public Utility Law," 32 MICH. L. REV. 577 at 591 ff. (1934). See also the other articles cited at p. 603, n. 63, especially Richberg, "The Supreme Court Discusses Value," 37 HARV. L. REV. 289 (1924), and Goddard, "The Evolution of Cost of Reproduction as the Rate Base," 41 HARV. L. REV. 564 (1928).

³ State of Missouri ex rel. Southwestern Bell Tel. Co. v. Missouri Pub. Serv. Comm., 262 U. S. 276, 43 Sup. Ct. 544 (1923); Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm. of West Virginia, 262 U. S. 679, 43 Sup. Ct. 675 (1923); McCordle v. Indianapolis Water Co., 272 U. S. 400, 47 Sup. Ct. 144 (1926). But one of the best known arguments for the prudent investment theory is the minority opinion in the Southwestern Bell case, written by Mr. Justice Brandeis, Mr. Justice Holmes concurring. Further, the case of Georgia Railway & Power Co. v. Railroad Comm., 262 U. S. 625, 43 Sup. Ct. 680 (1923), decided the same day as the Bluefield case, upholds a valuation in which little weight was apparently given to the cost of reproduction at current prices.

⁴ Southwestern Bell Tel. Co. v. Missouri Pub. Serv. Comm., 262 U. S. 276, 43 Sup. Ct. 544 (1923); McCordle v. Indianapolis Water Co., 272 U. S. 400, 47 Sup. Ct. 144 (1926).

⁵ Goddard, "The Evolution and Devolution of Public Utility Law," 32 MICH. L. REV. 577 at 613 (1934). See also Lilienthal, "Regulation of Public Utilities During the Depression," 46 HARV. L. REV. 745 (1933).

⁶ Goldthwaite, "Reproduction Cost and Falling Price Levels," 21 NAT. MUNICIPAL REV. 427 (1932).

⁷ Goldthwaite, "Reproduction Cost and Falling Price Levels," 21 NAT. MUNICIPAL REV. 427 (1932). The construction price index of the Engineering News-Record is cited at length by the article above. On a basis of 100 for 1913 prices, a high of 274 is shown for June 1920, and an average post-war level of 200. As compared with this, the index number for February 1932 was 160, 23 per cent below the average post-war level. Goldthwaite contends, however, that the real drop in cost of construction since 1929 has been much greater than this, especially for utility properties. Such commodities as copper, in various forms, and cast iron pipe, important elements in constructing utility property, show much more of a price decrease. Further, he points out, aggregate labor costs would be considerably lowered by improvements in labor-saving machinery; and in many instances improvement in the utility equipment would mean that smaller, less elaborate plants would be built today to do the work of those now existing if reproduction cost were considered in any

in 1924-25, would have thrown much more light upon the attitude which the courts will take on this point if the contested valuation had been lower than the one set by the commission in 1926, exclusive of accrued depreciation. But the very fact that the commission chose to adhere to the exact valuation made in 1926, defended by a showing that 1932 construction costs were decidedly lower than those of 1926, rather than to adopt a lower sum, is significant; the commission seemed dubious as to whether the courts would uphold such a rate base, although the cost of reproduction theory would plainly seem to call for reduction.⁸ The holding that interest should be included in determining the proper annual allowance for a depreciation reserve, although the court stated no reasons, seems plainly based on the fact that such depreciation reserve for a bridge must of necessity be invested elsewhere, and not returned to the business, as in a more complex property.⁹ The court commented on the disparity between the company estimate of accrued depreciation, and the allowance asked for a depreciation reserve;¹⁰ the latter was more per year than the estimated

realistic sense. The author cites the particular instance of a large plant for the generation of electricity, constructed in 1911. If that same plant were reconstructed today, it would cost more than it did then; but a plant of the same capacity, costing much less to operate, could be constructed at a much lower cost, substituting highly efficient large units for batteries of small ones. The article concludes that current cost of reproduction as a rate base, taking these facts into consideration, would bankrupt even a very conservatively-financed utility company constructed in the post-war era before 1929. It must be pointed out, however, that the courts by cost of reproduction ordinarily mean the cost of reproducing the plant now serving the public, not the services by means of a more modern plant. *McCardle v. Indianapolis Water Co.*, 272 U. S. 400, 47 Sup. Ct. 144 (1926). Further, prices have risen above the 1932 level, and may very probably rise further pursuant to the governmental policy of restoring the 1926 level.

⁸ This seems rather to disprove the argument of the advocates of current cost of reproduction as a rate base, that the high rates the utility will thus be enabled to charge in periods of high prices will be offset by the reductions which they will have to make in periods of lower prices. Dorety, in his article, "The Function of Reproduction Cost in Public Utility Valuation and Rate Making," 37 HARV. L. REV. 173 (1923), argues that utilities would reduce rates by force of circumstances in times of low prices, and that as a result the average level of rates would not be higher on a reproduction cost base than on a prudent investment rate base, while the actual level at any one time would be more commensurate with the ability of the public to pay. The difficulty with the argument, in light of the experience of the past few years, seems to be that the utility rates simply do not come down when other prices fall.

⁹ WHITTEN, VALUATION OF PUBLIC SERVICE CORPORATIONS, Willcox revision, c. 33 (1928). Although it may well be argued that interest should not be included in computing the depreciation reserve for very complex utility properties, in which the reserve is simply put back into the plant, as the author here argues, he concedes that interest should be counted in when there is but a single unit which will be replaced all at once at the conclusion of its usefulness, the depreciation reserve being invested elsewhere in the meantime.

¹⁰ For other cases indicating that past experience, in respect to the actual estimated accrued depreciation, should be looked to in determining whether the allowance for reserve asked is excessive, see *Los Angeles Gas & Electric Corp. v. Railroad Comm.*, 289 U. S. 287, 53 Sup. Ct. 637 (1933); *Smith v. Illinois Bell Tel. Co.*, 282 U. S.

accrued depreciation for the first four and a half years of use of the bridge. Although the sums will not correspond exactly, utility commissions can scarcely regard estimates differing so widely as careful and disinterested ones to which much weight may be accorded.

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133, 51 Sup. Ct. 65 (1930); *Natural Gas Co. of W. Va. v. Pub. Serv. Comm.*, 95 W. Va. 557, 121 S. E. 716 (1924). In the Los Angeles Gas & Electric case, the company's estimate of accrued depreciation on its plant for the period from 1909 to 1930 was \$3,470,326; the *annual* reserve for depreciation asked was \$2,344,744. In the principal case, the company estimated the actual depreciation for the first four and one-half years at \$16,282; and requested an annual allowance for depreciation reserve of \$21,210.