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Public Utility Valuation

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by identifying the elements thereof does not reconcile and explain all the decisions, it is logical and does harmonize more of the decisions than any of the other tests suggested.

J. B. W.

PUBLIC UTILITY VALUATION.—It has been so often remarked that the "valuation" of public utilities is determined by no rule of thumb, that there are no fixed rules or formulas to guide courts or commissions, that determination of value as a rate base is matter of judgment and discretion in each case, *Minnesota Rate Cases*, 230 U. S. 352, 434, that the statement has come to be believed by reason in part of its much repetition. It is usually accepted as axiomatic. The glorious uncertainty resulting from such an admission will continue so long as judgments of one man or set of men differ from those of another. On such an uncertain foundation it is hardly possible that either reason or justice can be attained. Returns in any business enterprise are discovered by methods of accounting, and correct accounting is governed by fixed rules and formulas, not primarily by the judgment and discretion of the accountant. Not that human judgment can ever be eliminated from any question involving human relationships, but that in questions of earnings on investments fixed rules and formulas so far from being eliminated in favor of judgment and discretion should be resorted to as far as possible. Whether a contemplated investment will yield attractive returns is largely to be determined by judgment and discretion, but what an investment has yielded, and even what in future, it will yield under given conditions, is largely matter of accounting, and therefore largely subject to fixed rules and formulas.

It is not strange that in the pioneer valuation case of *Smyth v. Ames* (1898) 169 U. S. 546, the court should have hesitated to lay down fixed rules. The problem was not then understood. But that Justice Harlan's statement in that case should still be quoted as accurate and authoritative in every valuation case, when it is apparent that of the five "matters for consideration" in fixing value there given we now attend at most to no more than two, is not easy to justify. Two of the other three are weighed in guessing at probable earnings under a proposed tariff, but not in fixing the so-called value. That is determined by consideration of actual value, cost-of-reproduction, and various intangibles that had hardly been thought of in 1898. The fifth element, the amount and market value of bonds and stock are rarely accorded any weight whatever. Under recent market quotations the utilities have been as willing to drop that item as they once were insistent that it alone should be considered in determining value.

In 15 MICH. L. REV. 205, and 19 MICH. L. REV. 849, the important developments to the close of 1919 have been traced. Five cases decided in 1923 may be especially noticed as arousing great interest since the former date. The most important of these is the *Southwestern Bell Telephone* case, 262 U. S. 276 (May 21, 1923), reversing the supreme court of Missouri on a judgment affirming an order of the public service commission fixing rates for telephone service. The ground for the reversal was that the commission

undertook to value the property without according any weight to the greatly enhanced costs of material, labor, supplies, etc., at the date of the hearing over those prevailing in 1913, 1914 and 1916. This decision was generally supposed to settle the rule that a valuation must give weight to present cost of reproduction in fixing value. The case is especially interesting because of the able dissenting opinion of Brandeis, J., with whom concurred Mr. Justice Holmes. This dissent pronounced the so-called rule of *Smyth v. Ames* as legally and economically unsound. It is the first clear word from the Supreme Court of the United States for the "prudent investment" theory of valuation. The rule of *Smyth v. Ames* bases results on opinion and judgment, as distinguished from ascertained facts. "To require that reproduction cost at the date of the rate hearing be given weight in fixing the rate base may subject investors to heavy losses when the high war and post-war price levels pass and the price level is again downward," for large investments have been made at high costs. Equally to require the public to pay on a mythical value, high because of present costs, is unjust when the investment was made at low costs.

The Bluefield Water Works and Improvement Co. case, 262 U. S. 679 (June 11, 1923) reversed the decision of the West Virginia supreme court of appeals, thereby following the *Southwestern Bell Telephone Co.* case. It was found that the court "failed to give weight to cost of reproduction less depreciation on the basis of 1920 prices." The commission fixed the value at \$460,000, the company claimed \$900,000. A trifling difference! The court in setting aside the finding of \$460,000 did not say how much the amount should have been increased. The case seems to add nothing to prior decisions.

In this state of the decisions the next case, *Georgia Ry. & Power Co. v. Railroad Com.*, 262 U. S. 625 (June 11, 1923) seems decidedly disconcerting to the adherent of the cost of reproduction theory. The lower court refused to hold that "for rate-making purposes the physical properties of a utility must be valued at the replacement cost, less depreciation". "This," said the Supreme Court, "was clearly correct". The company claimed a value of \$9,500,000. The commission found \$5,200,000. The only evidence that appears of allowance for present replacement cost is in an allowance of \$125,000 to represent appreciation in the value of land owned. The opinion in this case is written by Mr. Justice Brandeis, who so radically dissented in the *Southwestern Bell Telephone Co.* case, but he found that the question on which the court divided in that case was not involved here. Not so Mr. Justice McKenna, dissenting, who could not reconcile the contrariety of decision. Perhaps we are safe in drawing the conclusion from these cases; 1. That present cost of reproduction less depreciation is not alone controlling; 2. That it must be considered, must be given weight. How much weight who can say? At present the weight to be given is subject to the same disconcerting uncertainty that envelopes the whole rule.

The truth of this is strikingly shown in *Waukesha Gas & Electric Co. v. R. Com. of Wis.*, 194 N. W. 846, decided July 14, 1923. After referring

to the three decisions of the United States Supreme Court *supra* the court finds that while it is clear some weight must be given to cost of reproduction at the date of the inquiry, yet no one has pointed out what weight should be accorded that factor. For itself the Wisconsin court concludes "that no great weight is to be attached to cost of reproduction less depreciation under present conditions, and particularly so under the conditions that prevailed in 1921." The court refused to disturb a valuation found by adding to the 1913 fair value the additions at actual cost made by the company since that date. The argument of Rosenberry, J., is well deserving of study. He concludes that the elements to be considered in the order of the weight to which they are entitled are (1) actual cost, when the investment has been prudently made; (2) under normal conditions, cost of reproduction less depreciation, (when conditions are abnormal this should be fourth); (3) going concern value; (4) working capital; (5) other elements in a particular case. Jones, J. dissented.

Contrast with the view of the Wisconsin Court the Virginia Court in *Roanoke Water Works Co. v. Com.* (Sept. 20, 1923) 119 S. E. 268. After referring to the three cases before the United States Supreme Court reviewed *supra*, and evidently agreeing with the dissenting view of McKenna, J., that the last of the three, *Ga. Ry. & Power Co. v. R. Com.*, 262 U. S. 625, cannot be reconciled with the other two, and is therefore wrong, the court disapproves of the effort of the Virginia commission to follow the decision of the court of appeals in the *Petersburg Gas* case, 132 Va. 82 (1922) by adding 20 per cent to the pre-war valuation, and suggests that prices had advanced at the time of the hearing sufficiently to justify adding 70 per cent. This seems to be a wholehearted adoption of cost of reproduction as the basis, and would require the public to pay returns on 70 per cent of the value in 1913 which did not represent the investment of a dollar by the company. The court was equally dissatisfied with the going concern allowance made by the commission, and proposes to almost double it, but without giving any suggestion as to the basis of doing so, or any guide to fixing going concern value in any case.

If further evidence of confusion be needed it may be found in *Columbus Gaslight Co. v. Pub. Serv. Com.* (June 28, 1923) 140 N. E. 538, in which the Indiana court followed the *S. W. Bell Telephone Co.* case and the *Bluefield Waterworks & Imp. Co.* case, and did not refer to the *Georgia Ry. & Power Co.* case, and in *Portsmouth v. Public Utilities Com.* (June 19, 1923) 140 N. E. 604, in which the Ohio court, without referring to any of those decisions of the United States Supreme Court, held that "the rate should give the company a fair and just return on its invested capital and property," and did not refer to cost of reproduction, unless that be included in a later phrase, "based on the value of the property used by it in the public service."

A great number of cases before the commissioners, and many before the courts since the note in 19 MICH. L. REV. 849 might be referred to, but most of them add nothing to previous discussions. It seems still clear that most commissioners would prefer to fix the rate base on the prudent investment,

but the courts with a few exceptions compel them to consider cost of reproduction. As to the weight to be given that element this much only seems clear; not even the courts now permit that to be used as the sole basis of fixing a rate base, and several cases have approved findings in which cost of reproduction under present abnormal conditions has had little part in arriving at the so-called "value."

In concluding, the following out of many cases may be noted: In *Plymouth Electric Light Co. v. State* (N. H. April 3, 1923) 120 Atl. 689, the court approved a *mesne* between the present and pre-war values. It noted that the wide variation in the estimates of the experts led to the "irresistible conclusion that each was not unmindful of his client's interest". The company's experts estimated cost of reproduction, \$49,725, and depreciation \$8,666.50, the town's expert found cost of reproduction \$35,135, depreciation \$11,125. In *Johnson County Gas Co. v. Stafford* (Ky. March 9, 1923) 248 S. W. 515, the court held that in determining what is a reasonable rate for gas there must be provided "a fair return to the investors for their money". "It is universally recognized that the investors in public service corporations are entitled to a fair return upon their money". The company purchased its franchise in 1912. Cost of reproduction was not referred to in the opinion. In *State v. Pub. Serv. Com.* (Mo. May 22, 1923) 252 S. W. 446, the Missouri court cited its own decision in the *Southwestern Bell Telephone Co.* case, 233 S. W. 425, which was reversed by the United States Supreme Court on May 21, 1923, as pointed out *supra*. The Missouri court in stating the rule of valuation to be followed approved the method of *Smyth v. Ames*, 169 U. S. 546, though "doctrinaires may have criticized the basis on which the Smyth-Ames and subsequent cases rest." Whether the valuation arrived at in this case will fare any better at the hands of the United States Supreme Court than the result in the *Southwestern Bell Telephone Co.* case does not yet appear. In *Jacksonville Gas Co. v. Jacksonville* (U. S. Dist. Ct. Jan. 25, 1923) 286 Fed. 404, the court makes this startlingly sweeping statement, "that going concern value cannot be considered as a part of the base for rate making purposes seems to us to be no longer in the realm of disputation", citing *Galveston Electric Co. v. Galveston*, 258 U. S. 388. Glorious if true! It would remove one of the vaguest, most uncertain and elusive elements from this field of uncertainties, but many cases allowing additions for going value seem to deny flatly any such generalization. In *Minneapolis v. Rand* (U. S. Cir. Ct. of Ap. Jan. 8, 1923) 285 Fed. 818, another federal court had no hesitation in adding a little item of \$500,000 for going value, and did not shrink from holding that "the gas company is entitled to the fair value of its property, even though that value has been increased as a result of the war, just as the laborer, the merchant, the manufacturer, the owner of land, and the lender of money may require the prevailing prices for what they furnish". Does not the court make a fatal error in this comparison by failing to note that the earnings of a public utility are subject to public regulation, while the wages of a laborer and the profits of a merchant or manufacturer are not. Cf. *Munn v. Ill.*, 94 U. S. 113, with *Wolff Packing Co. v. Ct. of Ind.*

Rel., 262 U. S. 522 (June 11, 1923). Meantime, under the North Dakota statute, the commission of that state continues to fix value at "such a sum as represents, as nearly as can be ascertained, the money honestly and prudently invested in the property." *Re Western Electric Co.* (March 12, 1923) P. U. R. 1923, C. 820. What will the United States Supreme Court do, if such a case is appealed, with such a valuation under such a statute? As to the English view, see note in 21 MICH. L. REV. 904, to the recent case of *Grand Trunk Ry. v. The King* (1923) A. C. 150.

E. C. G.