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Public Utility Valuation - Going-Concern Value in Rate Making

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PUBLIC UTILITY VALUATION—GOING-CONCERN VALUE IN RATE MAKING.—What is the effect of a city ordinance which proposes to a public utility company the terms on which it may dispose of its product to the users, but which is rejected by the company? As to a company not yet doing business it is clear that the ordinance when rejected becomes a mere legal nullity. It never was more than an offer that might ripen into a binding contract by acceptance. That it is by no means a nullity as to a utility actually operating in the city after the expiration of its franchise and as a mere tenant by sufferance of the streets, is held in *City and County of Denver* v. *Denver Union Water Co.* Supreme Court of the U. S. Nos. 294 and 295, decided March 4, 1918. The city of Denver may well be surprised to learn that by passing an ordinance which the company rejected it was considerably worse off than if it had done nothing. In effect, by passing an ordinance fixing the maximum charges permitted to be made by the company "during the time it shall further act as a water carrier and tenant by sufferance of said streets", the city gave to the plant a value that made the rates illegal and defeated the ordinance. That any unaccepted ordinance should have such an effect is indeed startling, the more so that in this case the city was careful to expressly recite in the preamble that the company had for four years been without a franchise and a mere tenant by sufferance of the streets and that this enactment was made without recognizing the right of the company to occupy the streets or to continue its service.

In *Detroit United Railway* v. *City of Detroit,* 229 U. S., 39, 46, it was held that a street railroad authorized to operate in the streets of a city for a definite time, within a reasonable time after the expiration of such term may be required to remove its tracks and other property from the streets. This of course would apply equally to the mains and other property of a water company after the expiration of its franchise. The city of Denver had the undoubted legal right upon the expiration of the franchise in 1910, or at any time thereafter, upon reasonable notice (90 days in the case of the Detroit United Railway) to require the water company to remove itself and its property from the streets. In such case the property value would be mere junk value, and the rates in the ordinance in question would be a much more favorable option to the company than an order to vacate.

Legally this seems clear, but practically it is very uncertain what are the rights that may be realized. To require this vacation would ruin the company. Equally it would ruin the city. It would require the city three years to install new works, even if not delayed by legal battles and elections. Meantime the city must have water. The city is under no legal obligation to purchase the works even if it has an option to do so. *Denver* v. *New York Trust Co.,* 229 U. S. 123, 142. No more is the company under legal obligation to furnish water. If it does do so it is entitled to a reasonable return on "fair value of the property being used by it for the public convenience". *Smyth* v. *Ames,* 169 U. S. 466. But what is the fair value of a plant that may at any moment be ordered out? Is it junk value? The court holds that the point is not properly raised by the pleadings, the master's report, the exceptions, or the assignments of error, but supposing it were properly raised then by the true intent and meaning of the ordinance (which the company was fighting and had not in any respect accepted) "new rights were conferred upon the company of such a nature that in considering the effect of the provisions limiting rates, the plant must be valued not as junk but as property useful and in use in the public service." This new right the court construes as "the grant of a new franchise of indefinite duration, terminable either by the city or by the company at such time and under such circumstances as may be consistent with the duty that both owe to the inhabitants of Denver". We may agree with the court that to regard the plant as a mere junk heap is "highly penal and destructive in its effect". This perhaps justifies basing rates on the fair value of the plant as in active service. It may be that if its value is to be fixed on the cost-of-production-less-depreciation theory an allowance should be made for that uncertain and highly speculative element, going-concern value. See 15 MICH. L. REV. 205. But that this rejected ordinance should have any such effect or any effect seems wholly unnatural, and contrary to every legal principle. The court seems to have caught at this straw to work out the equitable result of "preserving the substantial rights of both parties". It is extraordinary that an ordinance held to be ineffectual for every purpose for which it was passed becomes effectual for the very purpose for which it expressly states it was not passed. This is indeed a legal boomerang that injures not the opponent and spends all its force on the hurler. Possibly the city of Denver deserved the blow.

The explanation probably is this. The position of the public and the public utility after the expiration of the franchise is a difficult one. The utility has no further right in the streets, the city has no right to use the property, *Detroit United Railway* v. *Detroit*, 229 U. S. 39. But neither can let go the other and the courts naturally look for a settlement to work out substantial justice. This case indicates a strong inclination of the court to hold that so long as the city continues the use the rate should be based on the same valuation (with the exception of a possible allowance for franchise value) that would be the base in fixing rates before the expiration of the franchise. In this division the court catches at this ineffective ordinance as an excuse for avoiding what would otherwise amount to a forfeiture. Whether the same conclusion will be reached in future cases where no such excuse exists remains to be seen.

Three justices are unable to agree to such reasoning. Justice Holmes writing the dissenting opinion admitted that perhaps an instrument could be framed that granted while it said that it did not. He thought the ordinance meant no more than that the company must accept the city's rates or stop. As it could be stopped by the city out and out, it could be stopped unless a certain price was paid. *Ashley* v. *Ryan*, 153 U. S. 436, 443, 444, citing *Paul* v. *Virginia*, 8 Wall. 168. However ruinous it might be to both parties to stop service, the law knows nothing but legal rights, and the relations of these parties after the expiration of the franchise are independent of legal rights. Under the circumstances of the case he thought it hard to see how property could be confiscated by the establishment of almost any rate, and therefore the ordinances can hardly violate the due process clause of the 14th Amendment *Appleton Water Works Co.* v. *Railroad Com.*, 154 Wis. 121.

The case throws no light on the proper theory of valuation of public utilities. All parties accepted the cost-of-reproduction-less-depreciation theory and no issue was made on that. Why going-concern value was fixed at $800,000 instead of $700,000, or $1,500,000, or more or less, is, as nearly always happens in such cases, quite unexplained. *Appleton Water Works Co.* v. *Railroad Com.*, 154 Wis. 121, 148, 15 MICH. L. REV. 205, 218. E. C. G.