Rate Maling: Public Utilities

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erty, or affairs of a like nature and under like circumstances, and failure to do so in negligence, for which pledgee is responsible."

2. "A pledge agreement is to be interpreted and enforced like other contracts, in order to carry out the intent of the parties.

3. "Whether pledgee of interim receipt for bonds was negligent in not procuring delivery of bonds or trustee's certificates where seller of bonds failed before permanent bonds were delivered held for the jury."

EARL J. O'BRIEN

Rate Making: Public Utilities.


The decision of the United States Supreme Court in the now famous O'Fallon Railroad Case¹ has directed the attention of lawyers and the public in general, as investors and consumers, to the state of the law in the field of rate-making for public service companies, and the crux of this interest is an attempt to discover a valid, workable method which may be used to evaluate such companies.

A typical case on this phase of the law is McCardle v. Indianapolis Water Company, supra, in which the Water Company sought an injunction restraining McCardle as a member of the Public Service Commission of Indiana, from enforcing water-rates established by that body, for the reason that such rates did not yield an adequate return on the capital invested. The suit was brought in the Federal District Court of Indiana, resort to the federal court being had on the ground that the rates in question were so inadequate that they resulted in a confiscation of property, "without due process of law," in opposition to the Fourteenth Amendment. The public Service Commission (McCardle et al) in company with the City of Indianapolis, which had intervened, appealed from a decree in favor of the Water Company. The sole question presented for the consideration of the court was the proper method of determining the value of the Water Company's property. The Commission submitted valuations made by its own engineers and the company submitted like reports made by two different firms of valuation engineers, each of these estimates differing by at least $1,000,000 from the others.

The Supreme Court sustained the decree of the District Court but decided the findings below were not as "specific as good practice re-

² 279 U. S. 461.
quired" and rather than remand the case, and thus prolong litigation, it would examine the record and decide the case on its merits.

The principal difficulty confronting the courts today in the field of rate-making is the general disturbance of prices and the change in money values brought about by the World War. In valuing public utilities, one of the main facts to be considered is the relative value of the original cost as compared with the present cost of reproduction. The difference in costs of materials and labor before the war and the post-war costs is so great than valuation on this basis would give a greatly enhanced value to public utilities which would permit excessive rates under the guise of a fair return on the property devoted to public service. Therefore an average of prices during a ten year period was taken, and it was discovered that there was general stability of prices showing a tendency to remain at the high post-war level.

The court set down three main factors which must be considered as essentials of valuation in the present case and these are: (1) the present value of the lands plus the present cost of constructing the plant, less depreciation; (2) the water rights of the company; that is, the value of the privilege of taking water from natural sources owned by the government; and (3) the going value of the utility itself which is intangible and is separate from the physical parts. As to the first of these factors (present cost of reproduction), it is only when prices show a tendency neither upwards nor downwards, and it does not appear probable that there will be a substantial change, that such factor may be arbitrarily applied. In cases where there has been great fluctuation in prices the weight to be given to such costs and figures is to be determined in the light of the facts of the case in hand. Such fluctuation in value may occur in two ways: (1) "where there is no change in the purchasing power of the dollar by reason of various circumstances such as the natural increment of land values in a growing city; and (2) by a decrease in the purchasing power or value of the dollar."

In reaching a proper figure of valuation, the Court kept in mind the necessity of setting a rate which would be practical not only at present but for several years to come.

As a result of these considerations, it was concluded that the value of the Water Company was considerably above the estimates of two of the submitted valuation reports which had been computed on a basis of average prices over a ten year period ending with 1923.

As to the second and third factors, (water-rights and going value) the court held that an allowance equal to 9½ per cent of the value of the physical property of the company was not excessive.

Further, the court held that a return of 7 per cent was quite reasonable and cited cases to show where higher rates had been sustained.
In commenting on this rate the court said, "It is obvious that rates of yield on investments in bonds, plus brokerage, is substantially less than the rate of return required to constitute just compensation for the use of properties in the public service."

It may be noted that Justice Holmes concurred in the result, while Justice Brandeis wrote a dissenting opinion in which Justice Stone joined.

T. W. Hayden